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EDITED TRANSCRIPT

EAT - Q4 2019 Brinker International Inc Earnings Call

EVENT DATE/TIME: AUGUST 13, 2019 / 2:00PM GMT

OVERVIEW:

Co. reported 4Q19 sales of $805m and adjusted EPS of $1.36. Expects FY20 revenue growth to be 9-10% and adjusted EPS to be $4.15-4.35.

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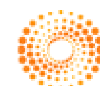

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International earnings conference call. (Operator Instructions) It is now my pleasure to turn the floor over to your host, Mika Ware. Ma'am, the floor is yours.

Mika Ware - *Brinker International, Inc. - VP of Finance & IR*

Thank you, Holly, and good morning, everyone. Welcome to the Earnings Call for Brinker International's Fourth Quarter of Fiscal Year 2019. With me on today's call are Wyman Roberts, Chief Executive Officer and President; and Joe Taylor, Chief Financial Officer. Results for the quarter were released earlier this morning and are available on our website at brinker.com. As is our practice, Wyman and Joe will first make prepared comments related to our operating performance and strategic initiatives. In addition, we will provide guidance for modeling fiscal year 2020 performance. We will then open the call for your questions.

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.

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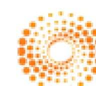

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And of course, on the call, we may refer to certain non-GAAP financial measures that management uses in its review of the business and believes will provide insight into the company's ongoing operations.

And with that said, I will turn the call over to Wyman.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Thanks, Mika. Good morning, everyone, and thanks for joining us as we review our fiscal '19 performance and share how we're going to build on our momentum into fiscal '20.

Brinker delivered a strong quarter and a great year with adjusted earnings at $1.36 for the quarter, up 14%, which took us to $3.93 for the year, up 12%. We drove those results primarily through the strength of Chili's comp sales, which ended the year up 2.3%, 120 basis points beat to the industry, and those sales were driven by comp traffic, up 2.3%, a 380 basis point beat to the industry. During fiscal 19, we achieved or beat the performance that was -- we expected and set the business up for strong future performance.

So we remain committed to our strategy, first, because it continues to drive results; and second, because there's still plenty of upside, which gives us confidence in our ability to continue to take share and grow the business. Now when we laid the strategy out 1.5 years ago, our objectives were threefold: first, strengthen our value proposition; second, improve our operational execution; and third, leverage digital technology to increase convenience for our guests.

In terms of value, we've led the industry for years with 2 for $20, but we needed to refresh that proposition. We wanted a more flexible platform that would work across both dayparts, and we've got that now. 3 for $10 is a compelling offer at both lunch and dinner. It works within our margin structure and resonates to that segment of our guests who are value-driven. It's delivering the right level of performance and preference mixing in the mid-teens. It's now in our base. We've wrapped on it, and we're continuing to hold cost of sales and are now able to grow the check off this base.

From an operations perspective, we narrowed our focus and gave our operators world-class systems to help them execute our brand standards and become best-in-class operators. This one is a slower build as any leadership strategy is, but it's working. We've delivered significant improvement across our guest metrics, and we're encouraged by our operators' continued focus and commitment to our guests.

And now we're leveraging our years of investing in technology to accelerate our share gains. With our industry-leading database, we're increasing the level of personalization used in our digital marketing. We're also using technology to drive financial efficiencies and operational effectiveness, creating better experiences for both guests and team members in our restaurants.

And through our e-commerce platform, guests can order Chili's takeout easier and faster than anyone else in the category. And that technology has supported growth of our takeout business in the solid teens throughout fiscal '19. And we've wrapped on that and we're still driving solid growth, and we expect that trend to continue in this crucial piece of the business. So in 1 fiscal year, we introduced a strong value proposition, drove better operational execution and leveraged technology to deliver a more convenient and personalized experience for our guests.

Looking to fiscal '20, we're building on our strategy by investing in the growth of our business. First, we're investing to grow frequency in the restaurants. With the strength of our value proposition, now we can layer in innovation and marketing support, targeting the value-oriented segment of our guests, which will encourage them to return more often. And with stronger operational execution, our guests are having better experiences and fewer problems, which help us drive frequency as we challenge ourselves to take our guest metrics to new heights.

We are investing in our operators both from a compensation perspective with higher bonuses and better systems, systems like our new training program that are all now -- that are now all-digital and our new forecasting system that helps managers run the kitchen better.

We're also investing to grow our off-premise business. We're using the same e-commerce platform to offer delivery to our guests. Delivery orders integrating to our existing operational system, which provides a seamless experience for our guests and our team members and unlocks the

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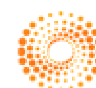

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potential to drive significant growth. We've entered in an exclusive agreement with DoorDash, and we've already seen significant incremental off-premise growth that's accretive to margins. And now we're investing to grow our scale.

We believe in the brand and our ability to run restaurants. So we're looking forward to welcoming 116 additional Chili's locations into our company-owned fleet when we complete the pending acquisition from our biggest domestic franchise partner. We're in the midst of developing plans to invest in these restaurants at an accelerated pace with proven programs that have driven solid performance in our company-owned restaurants.

So fiscal '19 was a great year, and we enter fiscal '20 from a position of strength. We're confident in our ability to deliver double-digit EPS growth again in this very competitive environment. We're excited to share more specifics about our plans and show you examples of what we're planning for fiscal '20 and beyond when we see many of you here in Dallas on Thursday for Investor Day.

I'd like to thank our operators at both brands for their relentless commitment to make every guest feel special. We said when we introduced this strategy, it would be a long build to strengthen the trust and confidence of our guests, and you continue to rise to the challenge every day. I'm proud to be on this team.

And now I'll turn the call over to Joe, who'll give you more clarity on our fourth quarter results, walk you through fiscal '20 guidance and provide some specifics as it relates to the first quarter. So Joe?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Thanks, Wyman, and good morning, everyone. Our fourth quarter ended fiscal year '19 in good form with the company reporting another quarter of top line and EPS growth. Additionally, our restaurant operators did a good job of positively impacting operating margins in areas they control.

Brinker's fourth quarter company sales of $805 million, up 1.7% from prior year, were driven by positive comp sales of Chili's of 1.5%. On a combined basis, Brinker recorded positive comp sales for the quarter of 1.2%, which also represents a successful start to lapping positive comp sales from the same quarter last fiscal year. Our adjusted earnings per share for the quarter increased by 14.3% to $1.36. For the fiscal year, we've reported adjusted earnings per share at the high end of our guidance range of $3.93, a 12.3% increase over the prior year.

As it relates to Chili's quarterly comp sales performance, let me comment on the underlying composition as detailed in our press release. The comp sales for the quarter included a pricing impact of 3.9%. This is a reflection of a year-over-year decrease in our promotional direct marketing activity. The improved performance of our base business allowed us to meaningfully reduce promotional activity and the related comp expense. As we have mentioned before, we account for year-over-year changes in comp expense as an adjustment to price, and in this case, the lower comp expense in the fourth quarter resulted in an increase in net price.

Now the actual menu price increase for the quarter was 3.3%. While in the short run, this is higher than our targeted annual pricing range of 1.5% to 2%, it reflects a year-over-year timing difference as to when we took price as opposed to a change in our pricing strategy. Our annual menu price for fiscal year '19 is right at the top end of our target range, and we expect to maintain annual price increases in the same 1.5% to 2% range as we move forward.

Our restaurant operating margin as a percent of company sales decreased in the quarter to 14.9% due to the impact of the sale-leaseback financing and the adoption of the revenue recognition accounting standard. Excluding the impact of these 2 items, restaurant operating margin would have increased to 16.5% in the fourth quarter. Positive contributions to the brand's operating margins came from sales leverage, our continued shift to more efficient and effective digital marketing, the positive impact of our certified shift leader's program and improved employee health experience. Produce-related commodity inflation, the negative year-over-year mix impact of our 3 for $10 platform and hourly wage rate increases were the primary headwinds to operating margin for the quarter.

Our cash flow for the fourth quarter and the fiscal year remained strong with EBITDA of $110 million and $374 million, respectively. The level of cash generation from our restaurants allowed us to significantly invest back into the business through restaurant development, our ongoing

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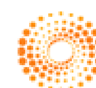

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reimage program and industry-leading technology development. We also maintained a comfortable and stable leverage position with funded debt leverage at 3.25x EBITDA and lease-adjusted leverage at 3.96x EBITDAR at fiscal year-end.

Turning to our outlook for the current fiscal year. Our specific guidance of a number of performance estimates can be found in this morning's press release and on the Investor Relations area of our website, brinker.com. This incorporates our existing view of the casual dining industry, our strategy to drive positive performance at our brands and our cash flow-driven capital allocation programs. As noted in our press release, our guidance incorporates the previously announced acquisition of 116 Chili's restaurants from 1 of our franchise partners. We anticipate closing the acquisition a bit later in this first quarter.

For the fiscal year, we are currently forecasting: comp sales growth of positive 1.75% to positive 2.5%, revenue growth of 9% to 10% driven primarily by the increased capacity from the aforementioned acquisition. We expect our restaurant operating margin for the fiscal year to be in the range of negative 20 basis points to flat. We expect capital expenditures for the year of $140 million to $150 million. We will continue to reimage - our reimage program and expect to complete between 140 and 160 restaurants this fiscal year. Free cash flow is estimated between $160 million and $175 million, returning us to a stronger and more typical level available for capital allocation. Finally, our adjusted earnings per share guidance for fiscal year '20 is a range of $4.15 to $4.35.

Let me wrap up my comments by providing some insight to certain impacts to our anticipated first quarter performance. We are seeing positive comp sales performance in the quarter in a manner that captures market share through comparatively superior traffic performance to our peer group. Assuming the successful closing of the ERJ acquisition, we will start to see favorable year-over-year impact to company sales from the additional capacity, likely contributing incremental capacity in the range of 2% to 3% for the quarter, beyond the revenue growth anticipated from comp sales. Conversely, we will see a reduction in franchise and other revenue as the acquired restaurant shift from generating royalty payments to company sales. We anticipate a year-over-year reduction of 12% to 13% for this quarter.

From an earnings perspective, this is the last quarter that we'll have a year-over-year negative impact from the incremental rent related to the sale-leaseback financing closed last August. As of this month, we are lapping the completion of that transaction, and it is now part of our operating margin base.

For the first time in recent history, we are required by vesting positions of certain senior executives to take the full annual expense of stock-based compensation programs in the first quarter as opposed to over the course of the full year. The year-over-year increase to stock-based compensation expense is approximately $3.5 million. This is purely a timing change as the annual differential for this expense is expected to be flat. Taking all this into consideration, we anticipate our first quarter adjusted earnings per share to be below last year's first quarter in a range of $0.05 to $0.08. Naturally, this is all incorporated into our annual guidance for earnings per share.

Now with my comments complete, we can move to your questions, which will last until the top of the hour. Holly, I will turn it back to you to facilitate.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question is coming from Chris O'Cull.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

I mean the comp guidance for this year implies a pretty healthy improvement from the fourth quarter as you lapped tougher compares. And as we've seen, the segment show some significant softness in recent weeks. So can you speak to maybe the current trend? And what gives you confidence that this performance can be achieved in '20?

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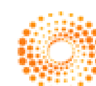

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Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Yes, Chris. Yes, the fourth quarter was a little soft. It was -- it's especially soft early for the category, right? So April was not a great month. And then with the category, we continued to improve as well, continuing to kind of take share and find that differential that we've been kind of running for most of the year as we kind of moved through the course of -- sequential improvement through the quarter was good. And we ended the quarter in really good shape, and we start this quarter in really good shape.

The things that give us confidence that we can continue to see the kind of sales improvements in comps that we guided to are really threefold, and we talked about them. There's -- first, there's still opportunity with us in the strength of our value proposition and the marketing that we can now put into that. The delivery program is kicked off now. It's not in last year's numbers to any great degree. And we're seeing some really good movement off of that program and very excited about how that's working for us, both from a top line perspective but also from an operational perspective. And we turned on all of our restaurants basically overnight and integrated the DoorDash system into our system, and it was seamless. So feeling really good about our potential there. And we've got -- we've just got Phase 1 of that program in gear right now. We've got some very exciting things to continue to push on there.

And then our operators are executing at a level that we haven't ever seen before. Our guest metrics are as high as they've ever been. We ended the fourth quarter with the best guest metrics we've ever achieved at Chili's. And so those things give us confidence that we can continue to move forward, even though there have been some softer pockets here, if you will, in the casual dining space over the last couple of quarters.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

Just as a follow-up, can you give any color as to what you're seeing -- what kind of demand response you're seeing from the delivery initiative?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Go ahead, Joe.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Chris, we're very encouraged by what we're seeing coming out of delivery. Again, we're early on, and we're just about 2 months into the process. It is performing as we expected it to perform. It is delivering the incrementality at very high levels, right in line with what our test shows. It's delivering a better check, and it's delivering a better PPA. One thing is I want to make sure that everybody understands from a profitability standpoint is we're not offering 3 for $10 on the delivery platform right now. So again, that's additive from a check standpoint and helps in that regard.

I think it's clearly a good driver out of the gate. There's been a lot of commentary around the month of July that I've seen out there. July was not a weak month for us when we look at that commentary. And I think delivery was one of the reasons besides the other ones that Wyman has mentioned on coming out of the gate this quarter, right in line with where we expect to be based on the guidance we just provided you.

Operator

Your next question is coming from Will Slabaugh.

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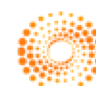

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William Everett Slabaugh - *Stephens Inc., Research Division - MD*

With Stephens. Had a follow-up question on value on your comment, Wyman. When -- you said you feel that you still have a big opportunity with your value platform. Can you talk a little bit more about that, both in terms of how well you would say you're doing today on value versus what you look to do and maybe where that -- what that opportunity might look like?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Well, we know the proposition is extremely powerful, right? So we know that we've got a great proposition, and now our opportunity is twofold. One is to increase awareness. So even though we've been focused this year on keeping our operators' lives simple, so not -- we didn't do an LTO, no promotional activity, no new initiative. We let our operators really run their systems and get much more comfortable at running the day-to-day business, and that paid a lot of dividends for us, both from a guest perspective and from an operations perspective.

What we've got now is the opportunity to take that value message and build on the awareness levels. Even though we've been out there for a year with it, there's still a lot of people that don't know about it. We know that based on our research. And then we also have the opportunity now to add some life to it by some -- by adding some innovation. And we're excited about some of the things that are in test today that could make that platform work even harder for us and continue to build off of the strength of that idea. So there's room to go, and it works within the model that we're now under.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

And Will, 2 data points I'd add to that response, too, is, one, it is an offer that works well, both dining in and to-go. It's helping drive both of those businesses. Again, as we see more and more commentary around the off-premise preferences of our guests, having a value platform that plays well on that side of the equation is playing right into the strengths of where we see the consumer going.

And the other piece of the equation, so we've talked, I mean, obviously, for a long time the industry about casual dining being a lower frequency business. You see higher frequency from our value guest, which makes them a much more valuable guest. When you think about moving that frequency of visits, it's working exactly how we'd like to see that happen.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

And as Joe mentioned, we're not even using it in delivery, and so that's a vehicle that we could play with. But we got levers to pull as it relates to how we -- how do we continue to build on that value proposition, and I think value is going to be important as we look to the future.

William Everett Slabaugh - *Stephens Inc., Research Division - MD*

And a quick follow-up on the guidance, if I could. I know you gave us the restaurant-level margin guide, which looked a little better than what we were expecting. I wondered if you could talk about what type of commodity inflation and maybe what you're thinking on the protein as far as what's incorporated there into the guide.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Sure, Will. Incorporated into that is we do expect a low level -- and again, I think it's a single-digit, let's say, 1% to 3% commodity inflation impact to this year. Obviously, the -- watching a number of things very closely. But we've also taken the steps to make sure we're taking the volatility and protecting the guidance through the contracting side of the equation. We're probably at a -- we are at a more aggressively contracted position. Along those things, as you can contract particularly in the protein space, chicken and pork, in particular, contracted out through the year. Overall,

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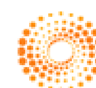

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we're contracted right now for the year at close to -- pushing up close to 70%. You do -- we do expect some produce inflation. That's an area that the industry has kind of dealt with through the last couple of years. That's incorporated into the guidance.

But right now, the markets are not reacting too much out of norm. We got some good news on the corn crop just yesterday. When you look at some of those dynamics, it'll be interesting to see how that plays back through the space. So -- but I think coming off a very low-commodity cycle, it's prudent for us to expect a little bit of low-level inflation into it and to also make sure we protect against any spikes that might hit the system from time to time.

Operator

Your next question is coming from Brian Vaccaro.

Brian M. Vaccaro - *Raymond James & Associates, Inc., Research Division - VP*

Can you guys hear me?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

We can. We can, Brian.

Brian M. Vaccaro - *Raymond James & Associates, Inc., Research Division - VP*

Just want to circle back on the quarter-to-date comments. Did I hear correctly that you said quarter-to-date comps are in line with your annual guidance, implying 1.75% or higher?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

You heard very well, yes. They -- we are moving through this quarter right in line with what we would expect to do for that guidance level we provided you.

Brian M. Vaccaro - *Raymond James & Associates, Inc., Research Division - VP*

All right. I had a question on the ERJ acquisition. What have you assumed in terms of EPS accretion? Could you help us with the sort of the building blocks, AUVs, store margins? And also, any incremental G&A needed to support these units?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. And I think -- and obviously, on Thursday at the Analyst Day, we'll go into a little bit more detail. What I'll tell you today, one, all of those are incorporated into those numbers. I think you can think of the accretive nature, it is accretive even after taking into consideration the debt we're taking on for that and the fact we will pay that debt down over the year back to our current target rate.

It's -- I would think mid-single digits to a little bit above that would be your -- the thinking from an accretion standpoint. Haven't closed it yet. Obviously, we'll -- we're well down the path and right on track to close it here in a couple of weeks, which will also give us the opportunity to get more directly involved in the restaurants and really understand where some of the opportunities. We're not baking into this guidance a lot of upside from those restaurants until we have a better feel for where we can impact that in the short run. So -- and they will be held as non-comp restaurants during this fiscal year too, so their performance is not assumed in that comp guidance we gave you.

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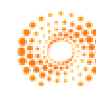

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Brian M. Vaccaro - *Raymond James & Associates, Inc., Research Division - VP*

Okay. And when you say mid-single digits, you're talking about as a percentage of -- you're talking about EPS accretion percentage? Or are you talking mid-single-digit EPS pennies?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Pennies. Thank you for the clarification. Yes.

Brian M. Vaccaro - *Raymond James & Associates, Inc., Research Division - VP*

Okay. All right. And then on the G&A guide for fiscal '20. Last one for me. But the fiscal '20 G&A guide, flat in dollars. I assume there's some inflation in there. I assume there's some level of incremental G&A on ERJ, maybe in the regional infrastructure. Can you help us with what some of the offsets to maintain flat dollars would be into fiscal '20?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. I think it's important to remember the incentive compensation piece of the equation, that -- and I'm glad you raised the point. The F '19 performance allowed incentive compensation programs to pay out on the profit sharing side at a nice pace. When you move above target, there's -- like most of the programs, there's multipliers in there. So there is a -- over $7 million year-over-year incremental payout related to profit sharing in the F '19 numbers. A little over $4 million of that was in the fourth quarter. So we're happy to be able to see performance that pays our team members out at that rate.

But then we bring it back to the target for next year. It's very similar to what we talked on the manager bonus side of the equation. So resetting that target -- resetting that amount to target is a big piece of managing. Yes, there is some other inflation in there. There's not much incremental G&A required from an ERJ perspective in that equation. In fact, we think we can bring some efficiencies to the equation over time. So -- but that's the biggest delta, but it's important to understand the expense that flow through F '19 and how that now sits back in a positive way.

Operator

Your next question is coming from John Ivankoe.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

A couple of questions on the composition of the comp, please. Could you remind us, especially just in terms of the price in the fourth quarter, and I'm sorry if I missed that, how much of that price was driven by the lapping of the My Chili's Rewards from the prior year?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. John, there's about a 60 basis points impact from that year-over-year change in comp expense.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

Okay. And as we go through fiscal '20, I mean how much do you think that will be? I mean, will we get ¾ of that? Do you expect any change and why?

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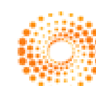

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Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

¾ of the...

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

Of the 60 basis point benefit in comp expense.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

No. I think it'll come in definitely below that. I mean again, it depends on some of the decision-making we do too relative to any quarter-over-quarter and when we may or may not run promotional -- our expectations is it's going to be less than that 60 basis points. You'll start to see the impact from price again move down over the next couple of quarters back into that 1.5% to 2% range.

I think over time, you're going to get a fairly neutral -- we should get a fairly neutral impact between gross and net pricing. We'd like it to be in a smaller range. We've had -- last year, we had a -- in the fourth quarter, we had a big differential. You're seeing some big differentials this year. So that'll normalize over the year. But we're comfortable being in that 1.5% to 2% range.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

And the -- go ahead, Wyman. Sorry.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Sorry, John. I was just saying that we also offset that last year, obviously, a lot of mix shifts with 3 for $10 being in for the whole year. That's in the base now. So you won't have that offset either. So the price will flow through more evenly. The mix will not be as dramatic probably this year as last year.

And then we'll play the marketing comps, if you will, and the loyalty program really to the market right now. Again, we're not fully -- we're not as aggressive as we could be or as we -- with our loyalty program. We're kind of saying, "Hey, listen, we like the trends we're on now. We don't have to be kind of pedal to the metal on the loyalty." And so we're saving some of that for maybe a future day if we need it.

John William Ivankoe - *JP Morgan Chase & Co, Research Division - Senior Restaurant Analyst*

That's great. And actually, the next question was exactly on mix. As we fully lap 3 for $10, I mean is there any reason you to believe that mix isn't something like flat in fiscal '20 just as we lap 3 for $10?

And secondly, I mean we've talked about value and the possibility of maybe doing a little bit more with that. But do you have opportunity elsewhere in the menu for some of your higher-income customers, maybe introduce some higher-price things or maybe more opportunity for trade-up? We've obviously seen other brands that have given opportunity for trade-ups that have actually been surprised at the success of that. So where are we thinking in mix for fiscal '20 in terms of where you'd like to live?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Yes. I think you kind of hit it, John. We're doing the same thing, right? We're going to address the different segments of the audience in our guests with appropriate. So we will probably continue to put 3 for $10 out there with some innovations, some target marketing to those guests and value

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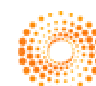

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(inaudible) families and those folks that are really kind of more focused on that aspect of it. But we are also going to have messaging and offers that appeal kind of on the other end of the menu, if you will, from a quality perspective in terms of bigger portions and maybe more abundance. And then we've got this whole delivery channel that's got a whole different mix associated with it. So we're looking at the various guest segments and going to put offerings out there that are, we think, appropriate and compelling for each of those and that drive the business.

Operator

Your next question is coming from Stephen Anderson.

Stephen Anderson - *Maxim Group LLC, Research Division - Senior VP & Senior Equity Research Analyst*

From Maxim Group. One name that hasn't been discussed on this call has been Maggiano's. I just want to ask -- you're not looking for any new unit growth there. I just want to see like what you want -- what you plan to do to drive top line there, and I just want to hear more -- what you have going on with delivery as well.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Okay, Stephen. Well, let me just talk about Maggiano's. Maggiano's had a good year. They ended the year with positive comp sales. It was a year with a new leader. So Kelly Baltes comes in, and he's really now focused this year on how to grow organically at Maggiano's, both within the 4 walls of the existing restaurants. And then we're also very excited about some of the ideas about how we can take Maggiano's to new locations, both traditional and nontraditional.

This year, we opened our first airport location Maggiano's. It's done extremely well. There's a lot of energy around that brand. It's such a powerful brand, so kind of beloved by its guests that we're -- we continue to just have a lot of excitement about the potential for Maggiano's to continue to grow. And this team is working on initiatives, both again from the perspective of how to grow inside the 4 walls of the restaurants we have today but also where can we take it to get the brand spread out, because with 53 locations, tons of white space for Maggiano's.

Operator

Your next question for today is coming from Eric Gonzales.

Eric Andrew Gonzalez - *KeyBanc Capital Markets Inc., Research Division - Restaurants Analyst*

It's KeyBanc. Just 2 quick ones here. If we can go back to the ERJ acquisition and the margin guidance, can you maybe talk about what the margin impact is from ERJ?

And then separately, with the 3.3% price that you had this quarter, can you talk about when that is expected to normalize in fiscal '20 and what the pricing impact was in the quarter-to-date comp, if you will?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Eric, I missed the last piece of that. But the ERJ margin actually as ERJ right now, where -- again, we do need to close the acquisition and get a little bit more in the weeds on a day-to-day basis. But we're looking at it from actually a fairly neutral margin perspective. From a 4 walls operating perspective, they do run margins a little bit behind us, not radically different. Some of that is based on the states that they're in, some of the cost dynamics of the states. But they're slightly below, but right in line with what we would've expected to see there.

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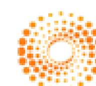

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But you also have a ROM impact that, in essence, is some of the reversal of what you saw last year with the change in accounting standards, so where their marketing contributions ended up being moved over onto the other revenue, so franchise side, the revenue side of equation, not impacting ROM because now they're coming back into the company's sales side of the equation. The support for marketing that will emanate from those 116 restaurants will actually flow through ROM and have a neutral effect due to that year-over-year -- that change in presentation. So all in all, it's a -- as we bring them onboard, we're expecting a fairly neutral overall impact on the ROM line.

Eric Andrew Gonzalez - *KeyBanc Capital Markets Inc., Research Division - Restaurants Analyst*

Okay. The second question was just related to the comp and how the pricing impact is expected to roll off, given that you had a higher level of price in the fourth quarter than your targeted range. Just wondering when that's expected to normalize. Does that have any impact on the quarter-to-date comp?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. I think you'll see it normalize over the first couple of quarters. Again, it's -- that has a timing aspect when you take price versus when other price rolls off. So as you kind of move through, it'll come down, probably be still a little bit above that target range in this quarter and then normalize more as we get to -- into the second quarter.

Operator

Your next question for today is coming from David Palmer.

David Sterling Palmer - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Evercore ISI. Just with regard to your comp for this fiscal '20, I would imagine that people are wrestling with sort of the big 3, which would be the industry comp. And how you're going to lap the 3 for $10 and the incrementality of delivery. Maybe you have another big variable in there. But on the industry comp front, I think there would be investor concern that the comparisons look about 1 point tougher in the coming, quarters. And then of course, there's concerns about the economy. So could you perhaps talk about what your industry same-store sales base expectation is for your guidance?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. David, without -- and again, without giving specifics on some of those drivers, but we do start with a negative belief around the industry. Clearly, over the course of the last 6, 9 months, you've seen some volatilities up and down. So that -- we expect that will probably continue as we go forward. But again, we think we've developed a base business and incremental drivers that work in all of those economic environments. So again, we continue to currently drive through what you have all talked about from an industry perspective, recently in a positive 4, particularly as we start to see the impacts of delivery come in.

But reiterating some of Wyman's comments is we're comfortable at looking at the multiple levels. And as we build that comp, it's built off of very specific insights and confidence we have around what we can control and moving that comp forward. So delivery, to-go, value, driving the base business from a CRM perspective are all levers that come into play and, we think, can drive through variety of economic conditions.

David Sterling Palmer - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

I guess the other 2 major things with -- that I mentioned, that 3 for $10, you're now some weeks into lapping the second phase of that from last year. And delivery, as you mentioned, that's been in place for a couple of months now. So if those are maybe the other big 2 in terms of variables,

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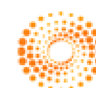

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is it fair to say that you have pretty good visibility on those 2? And that means you -- really, the big variable from here is whether those things fade as helpers or perhaps the 3 for $10 becomes more difficult or if this industry comp just falls apart later in the fiscal year.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Yes. I think you've got it, David. I mean we're sitting here today 7 weeks into the year, and we have wrapped on 3 for $10 for quite a while now. And we've got a couple of months of delivery under us, and our operators are executing at a high level. And we're excited about some other things we have to still kind of bring forward. So that's why we gave the guidance we gave.

Now the industry has seen a couple of soft spots, specifically April and July were not great months for the category. But we continue to weather through. And we're confident that we will continue to be able to do that, and we're excited about the things that we're bringing forward. So that's kind of where we're at.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

David, one thing that's interesting about the discussion around lapping 3 for $10 is I think that there is a belief in that discussion that, that's a promotional lap. But we view it as a core value platform that we have well over 10 years' experience on how to manage that and bring that forward. They have the ability to grow. We've seen it. We've done it. We expect that as we move forward, we have confidence the incrementality we can bring out of a value platform and how we can lean into those guests. As I've mentioned before, we see increased frequency come out of that, which we would expect to continue to pick up as we move forward. So we don't think of it maybe in the same vein that I think underlines that question as being a lap of promotional activity. It's a solid base business that we can grow as we move forward.

Operator

Your next question is coming from John Glass.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

It's Morgan Stanley. I wonder if you could talk about labor for a moment. I think it was more favorable versus our view, at least, on your labor ratios. And you cited a few things, including managerial labor. I think that's part of your certified shift leadership program. Where are we on that journey? Is this accelerating at this moment? Or -- and how many quarters do you have to go before it's lapped? Or is it not -- is that the right construct to think about it? And what else was in the labor line that may have been offsetting that wasn't structural, in other words, I don't know, health care, whatever? Was that a onetime benefit, et cetera?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Let me talk about it. From a CSL standpoint, that certified shift leader program, we're getting close to kind of the target, which means from a -- again, we just talked about laps, so which means we still have a lot of potential favorability in the first half of this year for that program before we get kind of full up to full up. But in the next couple of quarters, we should be fully certified, if you will, with all of our shift leaders kind of out there at the target levels that we want them to be at.

And that program is providing -- really, what it's done beyond the financial impact, it really has changed our belief about where do we develop and recruit new leaders. And we went from significantly external recruits to now mostly internal recruits. And what that has also done is it's proven to be much more effective. The turnover's lower. The results from our -- all of our guest metrics are better. And now we have a career path for our team members that started at the hourly level to move into management and then move their way all the way up through the operational ranks to some really nice career options. So we kind of really love the program, and it's probably about halfway fully rolled, if you will, if you think about this year. Joe?

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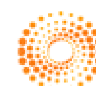

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Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. John, I think as I mentioned, besides certified shift leader, we saw year-over-year benefit from the employee health experience, expenses related to that. Going forward, we continue to feel that that's an inflationary market. We've built that into our thought process on the current guidance. Now we are again continuing to work programs and wellness opportunities to try and manage and mitigate through that. It is an expense that you do see some volatility in because it's based significantly on that -- in the quarter experience as they develop. So that was definitely one of the other items I cited in there.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

Okay. And then Joe, just following up. On your free cash flow guidance, what is the use of the free cash? What are your assumptions built into the guidance on buyback, maybe just on a dollar sense? How much leverage or how much deleveraging? What do you expect to get to your -- on your balance sheet from a target leverage perspective during fiscal '20?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. John, we don't typically give a dollar amount. Again, we do anticipate being in the buyback market this year. Obviously, we have the acquisition to complete here in the short run. That will be financed in the short run out of the revolver. We're going to -- we will return, over the course of the year by year-end, to that right around 4x level that we ended the fiscal year. So year-over-year end, we should be relatively similar from a debt leverage perspective. We will use obviously the free cash flow from a dividend payout scenario as we kind of move. We just approved the dividend, which is part of the press release you saw there. We'll continue to use that. And then the rest will be available for share repurchase. So we will be back in the market as we move throughout the year.

Operator

Your next question is coming from Andrew Strelzik.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

BMO. I'm curious how you're expecting the delivery business to interact with to-go? Was it your expectation that those are different customers? What are you seeing so far, given that to-go has been such a nice contributor to comps?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Yes. I think they're significantly different today, especially because most of the delivery is coming through DoorDash's marketing channels, right? So there's very little crossover. In the future, we'll be pushing some initiatives that may have more direct relationship or more direct contact with our guests that we know are our current guests. And so we may see some trade-offs there, but we think the trade-offs are going to be well worth. And we'll monitor that as we go forward. But right now, we're not -- we like the incrementality that we've seen, both in test.

And it's funny, we introduced this DoorDash partnership but it comes after over 2 years of testing delivery with all of the big players and over an extended period of time, so multiple different channels. So I feel like we -- the team has done a great job setting ourselves and our operators up for success with delivery. We've got the right model. We've got the right partner and we're excited about its ability to grow the business and not cannibalize at a level that has us too concerned.

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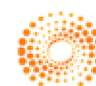

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Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

And then on the My Chili's Rewards Program, you're just over 12 months post the relaunch there. Could you kind of take a step back and give us your assessment of how that's gone? Are you happy with the sign-ups, the deal constructs? How do you plan to leverage the data incrementally going forward now that you have a little bit of hindsight on the program?

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

No. We're extremely happy with the work that's been done to build My Chili's Reward. The level of engagement with our guests in that program is fantastic. It continues to be a real strong element to our marketing program and to continuing to drive traffic. We are able to flex in and out of that program with additional offers, but the base offer is in our mix now and is manageable. So we like all the things about it, and we're just getting smarter and smarter. The teams just now -- with more and more information, more and more data points, the ability to bring in machine learning and some artificial intelligence to help us better understand exactly what each of those guests would like, to motivate them more to come into the restaurant is there, and the team's using it. And we just -- we'll continue to kind of move forward to grow that aspect of the marketing program as we look forward to F '20.

Operator

The next question for today is coming from Dennis Geiger.

Dennis Geiger - *UBS Investment Bank, Research Division - Director and Equity Research Analyst of Restaurants*

It's UBS. Just another one on your margin guidance beyond what you've already mentioned. Just wondering if you could talk a bit more about how to think about the impact from the different efficiencies that you have looking into this year? The CSL program, I think, you covered pretty well. But also just on technology, marketing efficiency as well as any kind of year-over-year tailwinds relative to little bit of a rebase this year. And then just the last piece of that, if there's any thought with an update to what kind of comp levels you're thinking about to kind of hold margins flat, if you care to address that today.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Go ahead, Joe.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Again, we do think there's continued opportunities to work at efficiencies around margins. I think Wyman has talked a little bit about the marketing aspects to continue move. We have -- to the digital side of the equation, which has efficiency to it, but it's also a more effective pace.

Sales leverage is a big piece of the equation. We've been seeing sales leverage move through the margin for the last couple of quarters. I think now as some of the other aspects, as we lap through sale-leaseback, accounting changes, things as that, you're probably getting -- you're seeing it a little more directly. So that's obviously a piece of the equation.

There's variability that builds into our margins from an incentive compensation standpoint in both restaurant operating margin and G&A, and that's the manager bonuses and profit sharing piece of the equations that flex with the business. So it's something that maybe not be as appreciated as much as we look at it.

So again, if performance is there -- because we set these to targets in your guidance. If the performance is there, we will pay out under those programs close to or above the target. If performance is not there and it's not -- it's top line and flow-through performance and guest metrics, it

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all combine into that, you'll see some below-target payouts, which protect the margins, to that extent. And you'll see that both in the restaurant operating margin and the G&A side of the equation. So there's a flex point in there that I think may not be quite as appreciated.

So again, we continue to operate the business at a high level. Managers are looking for those efficiencies. We're making sure we're taking care of the restaurants, disciplines around R&M spend, things of those nature that can get away from it if you're not careful and if you don't have the systems in place, which (inaudible) spends a lot of time and effort in making sure that the systems are in place to help guide and control those spends.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

And I just would add. I think again, if you're just thinking about last year in relationship to this year, the introduction in the -- of 3 for $10 in the platform, it had some impact on the mix and the margins, fully anticipated and kind of where we want to be. But we won't have that kind of margin challenge as we move forward. So our pricing and our merchandising and the things we do to kind of lift check and help margins will flow through at a much higher rate, and that'll help as well.

Operator

The next question is coming from Jon Tower.

Jon Michael Tower - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Great. Wells Fargo. Just pretty much 2 clarifications. First, Joe, on the comments about first quarter earnings being down $0.05 to $0.08 year-over-year, are you talking about off the $0.47 base -- $0.47 base from last year?

And then secondly, Wyman, I think you mentioned earlier in the call developing plans for the 116 acquired stores, including the potential to invest in the store base. On that potential investment, are you speaking about potential margin investment or potential CapEx? And if so, are either of those captured in your fiscal '20 guidance?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

The first, quick answer, yes. That's off the adjusted $0.47 from last year.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Okay. So with regard to the acquisition, yes, we think there's -- similar to the acquisition we made a few years ago of a franchise partner, I think there's some opportunity both with the remodel program that we've got now 2 cycles on that some of these restaurants haven't experienced, and we know there's power in that program. So where they fall into the -- Joe mentioned in his comments that we are going to continue our reimage program, where these new restaurants fall into that cycle, and then we may move some of them up to the front a little more. And then there are some technology investments as well as some other investments that we'll make that we know have shown proven results in our company-owned restaurants, that we're very excited about bringing to these restaurants.

These restaurants have been well-run. I don't want to give the impression that they're not great restaurants. They're great restaurants. It's a great franchise partner. Junior Bridgeman, you couldn't have had a better franchise partner than Junior. So they've chosen to kind of move in a different direction, their company, and we were just excited to get the opportunity to bring 116 Chili's back into the company-owned fold because it really fits our strategy around scale. We believe in this market. In this environment right now, scale is -- it's powerful, and you can bring so much more to the restaurants when you can leverage these investments and technology across a broader base, for example.

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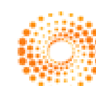

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So that's what we're talking about there in the numbers. We've factored those in. This isn't going to be a surprise in the third or fourth quarter with "Oh, we need some more capital to go do this." But we're excited about bringing those restaurants in.

Operator

The next question is coming from Nicole Miller.

Nicole Miller Regan - *Piper Jaffray Companies, Research Division - MD & Senior Research Analyst*

Piper Jaffray. On that last question, could you talk a little bit more specifically about the CapEx buckets for this year? I imagine, like you just said, the big ones are remodels, technology and then also maintenance. Just kind of compare and contrast with the year just ended, what might be going up. Can't imagine that even more necessarily going down.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

The same big buckets are in place, I think, for 2020 as opposed to '19. We do have a little bit larger spend targeted for a new restaurant development. Again, we think we have the -- with the new prototype coming to the market, we think we have incremental opportunity to increase capacity, nothing radically different than in the past. But we'll start to take that up a notch or 2.

The reimage program is continuing along pretty much at the established level. I think the overall spend for reimage '20 versus '19 is actually probably going to be down a little bit. We've been able to reengineer as we've moved through the program some of the cost dynamics of it. So still getting the same positive response to it. We just -- we want to be able to be as efficient as we can. And again, the R&M spend and the IT spend continuing along at those levels that we've talked about.

On a combined basis, I get -- those 2 buckets are typically in that $60 million to $70 million range, which we think is necessary to keep the condition of the fleet as it should be and also continue to move the technology basket forward. So those are the big thing.

One thing that falls out of the equation is the CapEx accounting that was associated with the new headquarters building, which was part of the '19 bucket is not in the '20 bucket since we've already done that and moved in. And then incorporated in that is some expectation around spend for ERJ that fits into those buckets I've just talked to you about. So again, we're in that $140 million to $150 million range and accomplishing all those programs as we kind of go forward.

Nicole Miller Regan - *Piper Jaffray Companies, Research Division - MD & Senior Research Analyst*

Very helpful. On the 116 units acquired, how have they been comping? Is it similar or higher or lower than your company-owned system? Or if you want to compare it to the franchise system, I'm not sure what's best. And then help us think about when they do fall in the comp base going forward, why would they be higher or lower? Would they essentially comp in line?

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

One -- and again, just so we're clear, we're going to hold them as non-comp. So I talked a little bit about that, but I just want to make sure that people don't embed that into the thinking around the comp guidance we provided. They've been positive. They have been positive comps over the course of really more than 1 year now, been to kind of a low single-digit kind of in that range that, that you expect they drive the comp that you've seen of the franchise network. Again, they're the largest piece of that equation. So that was one of the things we've been pleased about and working with them as franchise partners and now understanding the restaurants that we will be picking is the momentum they've been building into those restaurants from a comp perspective.

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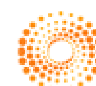

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Operator

Your next question is coming from Sara Senatore.

Sara Harkavy Senatore - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

It's Bernstein. I just wanted to ask a couple of quick follow-ups on the delivery business. You said it was accretive to margins. I just want to make sure I understand. Presumably, that's because it's incremental as opposed to having sort of a similar margin profile as on-premise, unless you're able to sort of minimize the amount of labor associated with it in the store, and in that way, offset the delivery charges, the delivery fees. So I guess that's the first, if you can just sort of clarify the accretive nature of it. Is it only accretive because it's highly incremental?

And then also on the higher PPA. I know you said no 3 for $10. I was a little surprised because I would've thought you might get less attach beverages and desserts and that kind of thing. So it sounds like though you're seeing not just higher check because you have bigger groups that are doing delivery but also higher per-person orders.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Yes. Thanks, Sara. It's definitely in our mind, and it's a piece of equation obviously you will analyze and watch on an ongoing basis. But through the testing we've done and early on in the [process], it is a profitable piece of business. Now that starts with the deal that we negotiated. Again, kind of the base cost structure is, in our minds, the best in the industry, and we're very comfortable with that commentary. Incrementality plays a big role in it, and we're seeing incrementality is at very high levels in excess of 80%. And that's what we saw in our testing, and that's what we're continuing to see as we roll it forward.

But it also has a lot -- I mean there are a lot of costs. We fully allocate costs down through the restaurant, the different channels. There are a lot of costs associated within restaurant dining that don't get applied when you're thinking about to-go or delivery. So they each have different cost attributes, and we look at it at a fully allocated basis.

The mix piece of the equation and not having 3 for $10 in obviously helps in that regard, too. Delivery plays, frankly, probably to a different target customer. The to-go customer has a higher preference for value, which I think basically equates the fact that if I'm a value-oriented guest looking for that strong of an offer, there's probably some willingness to get it on a to-go basis. I think playing delivery is probably playing to a less value-oriented customer, which we have significant numbers of. And I think there's a lot of responsiveness to the ability to get that from a delivery and less sensitivity to maybe some of those charges that go with it. But it is a very profitable guest driven by a number of different attributes now. Now you watch that over time, and incrementality and shifts in the business will be a piece of the equation that you watch closely.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

And marketing channel. Again, we're just running through one marketing channel right now, basically the DoorDash channel for delivery. So we'll see what happens as we open up additional channels and as we really start to market and partner more aggressively with them.

Operator

Your last question is coming from Jeffrey Bernstein.

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Jeffrey Andrew Bernstein - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

From Barclays. Just one question for me. Wyman, you talked about being excited to bring in ERJ and how scale is powerful. I'm just wondering, on the flip side, obviously, you're reducing your franchise mix. I recognize that you view yourselves as restaurant operators and prefer the company-operated model. I'm just wondering is there demand from new or existing franchisees if you were interested in refranchising. Just wondering if you've examined the implications of refranchising which would seemingly help to insulate against the sales volatility you mentioned earlier and then labor and potential commodity inflation. I'm just wondering, not that you're pursuing it now, but whether there's interest from existing or new franchisees and why you would not potentially consider that going forward.

Wyman T. Roberts - *Brinker International, Inc. - CEO, President & Non-Independent Director*

Jeff, I think with the power of our brands, there's always interest in being part of the -- this business. It's a good model and it's a busy -- good business. I think strategically, we look at casual dining. And we think that being an operator in casual dining, at least to a large degree, whether it's 100% company-owned or a significant portion of your restaurant is company-owned, is important. I think that, again, bringing scale to the organization and to the brand is powerful. And when you end up franchised into 2 small units, it makes it difficult. Speed is important in this day and age. And I think in our -- we're able to move more quickly when we have a large restaurant base that are company-owned.

So there are strategic reasons that we like the company-owned model as a predominant model for us. And -- but that doesn't mean there aren't people interested in being part of the organization if we were to put the brand out there to franchise. We just strategically think it's a better model to be company-owned predominantly.

And we love our franchise partners that are out there, and they also -- because we are still embedded in the operations of the business, day in, day out, not just driving top line sales, not just with promotion but what's going on in the kitchens, what's going on with the service models, that we have a partnership that I think is as deep as you can get. And it starts with all of us kind of focusing on the overall aspect of the business from the top line all the way down to the bottom line.

Mika Ware - *Brinker International, Inc. - VP of Finance & IR*

All right. Thank you, everyone. Thanks for joining us today. We appreciate it, and we look forward to seeing many of you here in Dallas on Thursday for our Investor Day. Bye.

Joseph G. Taylor - *Brinker International, Inc. - Senior VP & CFO*

Thanks, everybody.

Operator

Thank you, ladies and gentlemen. This does include 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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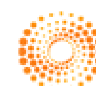

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