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EAT - Q3 2019 Brinker International Inc Earnings Call

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OVERVIEW:

EAT reported 3Q19 revenues of $839m and adjusted EPS of $1.26.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International Q3 2019 Earnings Call. (Operator Instructions) It is now my pleasure to turn the floor over to your host, Mika Ware, Vice President of Finance and Investor Relations. Ma'am, the floor is yours.

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

Thank you, Kate, and good morning, everyone. Welcome to the earnings call for Brinker International's third quarter of fiscal year 2019. With me today on the 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. 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 risk 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.

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*

All right. Thanks, Mika. Good morning, everyone. As you saw in this morning's press release, third quarter was another solid quarter for Brinker.

We delivered adjusted earnings per share of $1.26, an increase of more than 16% over prior year. Total comp sales were up 2.6%. This performance was driven by Chili's comp sales growth of 2.9%, sequential margin improvements and positive traffic of 3% during the quarter.

Our momentum is broad-based across company and franchise restaurants, and it spans the country. It's not regionally driven, and it's withstood what's been a more challenging winter than normal. We continue to grow sales through traffic and gain share from our competitors. Q3 marked the fifth consecutive quarter of significantly outperforming the category in traffic and the third consecutive quarter with a positive sales gap.

Our consumers are in a good place. Economically, with record low unemployment and income growth now expanding throughout the middle class, more people are choosing to dine out, which is strengthening our whole industry right now, and we see this into the foreseeable future. While this environment does allow some pricing power to help manage costs, we've chosen to maintain a tight pricing strategy, staying in our targeted range of 1.5% to 2%, which we did take late this quarter. We believe this discipline further strengthens our value position for the long run versus taking a more aggressive approach to pricing.

A little more than a year ago, we transitioned our strategy from being more marketing-centric, leaning heavily into traditional marketing to continually bring new guests to the -- new news to the consumer, to a more guest-centric model, focused on the fundamentals of delivering a craveable, quality core menu at a compelling value, executing consistently for our guests. Because what matters most to us is that we create a better guest experience every day; that we strengthen the connection with our guests; we inspire them to visit more often with relevant, targeted communication; and we deliver better food and service every time they come in. And our guests are seeing the difference. When we look at our guest metrics compared to last year before we put this model into place, every metric is up significantly and climbing. We're increasing trust with our guests, which supports our business in the short term and increases the longer-term sustainability of our strategy.

In terms of our value proposition, what sets us apart is we've devised this flexible platform with the same commitment to quality and the experience our guests expect from us now. We haven't reduced our portions or compromised on quality. Instead, we've maintained and even improved our products, and we offer it at a price point that's compelling to our guests and works for our business model.

Take our $5 margarita program. We didn't go to the lowest possible price point. Instead, we created a program that features premium liquors, and we change the offering every month to keep it fresh and relevant to the changing seasons. For example, our recent value margaritas feature premier brands like Hennessy, St-Germain, Jameson Whiskey and Grand Marnier. The program generates significant social media buzz, drives traffic and strengthens the brand.

The same goes for our 3 for $10 program. I know there's been a lot of concern about the sustainability of this offering. Could we really deliver quality products at that price point and sustain the volume that it's helping drive? And the answer is yes. 3 for $10 has been in place for a year, and our business model has held up. Our cost of sales are in line, we're managing labor and delivering positive cash and flow-through. The value strategy is compelling. It's profitable, and it's a differentiator for us.

And like everyone in our category, we continue to be aware and engaged in growing our off-premise business to go with a solid driver again this quarter, with both brands up over 17%. We're starting to wrap on solid results from last year, and we're still seeing double-digit growth. We're getting smarter about execution and delivery -- delivering the best possible experience to our to-go guests. More than half of our order's coming through digital platforms, which integrates directly into our system and offers a seamless experience for guests and operators, enabling us to efficiently manage this ever-growing part of our business.

At Maggiano's, our delivery business continues to grow, up double digits year-to-date primarily through our third-party partnerships. We clearly see the opportunity delivery could bring to our business. And just like with our value strategy, we're holding true to what works for us, committing to do it right for the guest every time.

We've seen a lot of players skin their knees on the bleeding edge of this burgeoning business, and frankly, for us, it's been too high a risk as we worked hard the past year to build trust with our guests. Now that our foundational business is strong, we're committed to figuring out a delivery program that integrates with our system and delivers a high-quality experience to our guests just as they're experiencing inside the restaurants and with take-out. We're close to finding a partner capable of managing our scale, one who is just as committed to our guests as well as profits for our shareholders.

As we wrap on our first year of this foundational shift in our strategy, we're highly encouraged by our momentum, both from a sales and traffic standpoint but even more importantly, from a consumer perspective. We're strengthening the trust our guests have in us, and we've done that with a relentless commitment to operational execution. The momentum builds over time with every experience we create, so we'll continue working closely with our operators to understand what they need to run great shifts every day.

Our leadership team is spending more and more time in the restaurants with our operators and guests to understand where our opportunities are, what we can do to better support our team and remove any obstacles to better enable them to connect with our guests and drive traffic. We'll continue to keep our team aligned and focused and eliminate any distractions that may drive a short-term lift but create chaos for our operators and confusion for our guests. That discipline and commitment runs across every part of our business, from our value proposition to how we execute our food, to what our service model looks like, to how our off-premise business operates and how we set ourselves up for success in that rapidly growing part of our business.

I'd like to thank our operators at both brands for their continued hard work and dedication to making our guests feel special every day.

And now I'll turn the call over to Joe to walk you through the numbers. Joe?

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

Thanks, Wyman, and good morning to everyone. The third quarter results we reported this morning represent another step forward for both our top line strategies and our efforts to continue the upper trajectory of our bottom line earnings. Our third quarter revenues of $839 million, up 3.3% from prior year, were driven by positive comp sales at both Chili's and Maggiano's. The combined Brinker comp sales growth for the quarter was 2.6%. Franchise and other revenue was up $5.7 million year-over-year effectively due to our adoption of the revenue recognition accounting standard.

At the brand level, Maggiano's continued its streak of positive comp sales, reporting a 0.4% gain for the quarter. Chili's reported its fourth consecutive quarter of positive comp sales, up 2.9% driven by traffic gains of 3%. With our acute focus on traffic-driving strategies, our outperformance of the casual dining sector accelerated in the third quarter. Chili's outperformed the sector by nearly 5% in traffic, driving a positive gap of more than 2% in comp sales. Chili's has now maintained a positive traffic gap to the casual dining sector for 5 quarters.

These results are also in the context of some tougher weather months, with Chili's comps being negatively impacted by 70 basis points for the quarter, while Maggiano's was impacted by approximately 140 basis points. Overall, the combined Brinker comp sales performance would have increased approximately 80 basis points without the weather impacts throughout the quarter.

We reported restaurant operating margin of 14.3% for the third quarter, a meaningful sequential improvement from our last quarter. While this is a reduction compared to the third quarter of last fiscal year, the change is almost entirely due to our sale-leaseback transaction and our adoption of the revenue recognition accounting standard, moving franchisee marketing contributions out of our ROM calculation. Without these 2 planned impacts, our third quarter restaurant operating margin would have been flat to the prior year's level.

Cost of sales for the quarter increased 50 basis points year-over-year primarily due to our investment in our successful value platforms. Overall, the commodity environment remains in line with our expectations, and we continue to manage price volatility with effective contracting.

Restaurant labor was up a modest 20 basis points comparatively for the quarter. Wage rates continue to increase although staying in our expected range of 3% to 3.5%. We invested incremental hours into the restaurants, particularly in the high-growth area of to-go sales, and overall operating performance increased our manager bonus payouts by almost 30% year-over-year. These increases were offset by sales leverage, efficiencies from our broadening CSL program and improved health care experiences.

The largest change in our operating margin is in the restaurant expense area, which is where the impact of the revenue recognition accounting change and sale-leaseback rent is recorded. Restaurant expense was negatively impacted by 180 basis points in the quarter from these 2 items. 70 basis points of that impact was offset by sales leverage and lower marketing costs driven by our shift to more effective digital marketing. The net result was a 110 basis point increase in restaurant expense margin.

Further down the P&L, depreciation expense was down 40 basis points due to the impact of our asset sales, but G&A expense increased 40 basis points due to IT investments and higher performance-based incentive compensation when compared to third quarter of last fiscal year in both cases. Our quarterly adjusted tax rate of 9.6% reflects the true-up for 3 quarters of a slight downward revision in our forecasted annual tax rate. We believe our annual rate will be at the low end of our 10% to 11% forecast primarily due to increased effectiveness of tax credits emanating from top line performance. The resulting adjusted earnings per share reported this morning for the quarter is $1.26, close to a 17% increase in third quarter earnings.

This quarterly result, combined with our expectation of the final fiscal quarter, leads us to believe our annual EPS achievement will be in the upper half of our guidance range. The cash flow-generating capability of our business model remains sound. EBITDA generated during the quarter exceeded $103 million. After capital expenditures, there were approximately $49 million. Our adjusted free cash flow for the quarter was $53 million, bringing our year-to-date adjusted free cash flow total to almost $98 million.

Free cash flow from the quarter was primarily used to repay revolver borrowings, maintaining our lease-adjusted leverage at 3.9x. As we move into the final quarter of this fiscal year, we remain confident in our strategies to sustain the positive growth of our business, whether the guest is dining in our restaurants or getting food to go. Importantly, we're increasingly aligned with meeting their needs for good food, improved service and everyday value across a varied menu.

With our comments now complete, we can move to questions, which will last until the top of the hour. (Operator Instructions) Kate, let's open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from John Ivankoe.

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

With JPMorgan. I was wondering, in an environment where you're focused on value and, obviously, labor costs are higher for everybody, what type of initiatives that you have in test or that you're looking at or that you think have promise to either stabilize or grow your restaurant-level margins in '20 and, perhaps, '21?

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

John, we're looking at a couple of things on the technology side, obviously, wherever possible, if we can leverage the technology to make us more efficient and effective. And I think, again, one of the keys to being a bigger player in the space is our ability to invest in technology and then bring it to the restaurants in a way that really supports our overall experience for the guests. That's probably the biggest area we see to gain efficiencies.

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

Yes. John, the other one I would mention with our version in the comments is the -- at the managerial level, the CSL program, we are in the process of rolling out. And it's probably about 3/4 to 80% of the way rolled, which is a certified shift leader, one that's creating a great career path for team members who wanted to move into that part of the business. And it's helping to offset some of those labor headwinds and make it a more efficient operation.

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

And Wyman -- sorry, go ahead.

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

Let me just add one other thing to the list. As Joe was talking, it reminded me that we're really getting much more effective with our marketing programs. So the old model of just using traditional media to kind of throw it out there en masse just hasn't been as effective as we found our much more targeted programs, whether using digital and, obviously, using our loyalty databases. It's just much more effective allowing us to kind of reduce some of our traditional marketing expense.

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

And on the technology side, I mean, is it front of house? I mean, I know we've -- pay-at-the-table has been for a long time, but we've talked about the handheld ordering. Or does Brinker now have the scale where you can start to explore more technology in the back of the house? Is there anything that can be done from an automation perspective there?

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

I think near term, it's still some of the front of the house, although we're bringing even more and more technology into the back, mainly more from a management perspective, just to help them understand exactly what they need to be doing and how to do that efficiently, not so much the robotics side of it. But that's -- believe me, we're looking at everything, and we've got ourselves kind of pushed out on some pretty interesting stuff just to make sure we're not leaving any stone unturned.

Operator

Our next question today is coming from Jeffrey Bernstein.

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

From Barclays. Two questions, one just following up on the labor topic. And Joe, I think you mentioned that the third quarter inflation was within, I believe, what you reiterated for full year, which was at 3% to 3.5%. Just wondering if you can give us any more color. Obviously, you had 3%-plus traffic growth. Just wondering, is that inflation prior to the incremental labor you need for that traffic growth? And maybe any color around just how much is mandated versus market pressure, where your turnover stands, anything along the labor line will be great.

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

Jeff, thanks. Yes, that is looking at wage rate pressure, which is one of the components. On top of that, as I indicated, we have added labor hours back into the restaurants, both from a volume standpoint and then also making sure that we're effectively staffing an area like to-go, which, when you have that double-digit year-over-year growth, you want to make sure that you're providing a good guest experience. So that's probably the highlight area when I think about hours going back into the system. Clearly, you have upward expense related to manager bonus, that 30% year-over-year. That's an expense we're glad to see because that's driving up the entire P&L performance of the restaurants. So great job. And our -- and we're pleased to be able to reward our managers for the efforts they're doing in that regard. There's -- labor headwinds are out there. I think we consistently talk that we expect to see them remain out there. The only particular pressure, I guess, I would add in addition to where we're investing into our business is in the back of the house, you do see some higher wage pressure around the cook position. But again, it's well within our ability to manage the business, and it's meeting kind of the expectations. We're not seeing anything really coming out of line with our thought processes for how that would develop.

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

Got it. And my other question was on the outlook, whether it's the -- I guess we have an implied fourth quarter at this point. It seems like the comp range is rather wide considering what your full year comp guidance is. So I'm wondering if there's any help you can give in terms of tightening that range or whether there's any color on trends quarter-to-date and, in conjunction with that, whether you have any directional thoughts, at least, on any specific areas where you have visibility going into fiscal '20.

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

Again, we have a guidance policy, so the guidance that is in place stands unless we change it. I think we'll just reiterate the color I gave you in my comments, which we do expect the upper half of the range as it relates to EPS. We're doing well across -- our performance is doing well across the board of our guidance that we provided you for the year. But I'm very comfortable with the ranges we provided and very comfortable how we're performing against those ranges. So that's kind of the -- we'll talk about fourth quarter in August.

Operator

Our next question today is coming from Chris O'Cull.

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

Stifel. Just a follow-up on the last question. Wyman, your comments during the presentation indicated the company's pretty bullish on the consumer. But it looks like segment sales may appear weaker here in April or at least choppy. I think the company is concerned about consumers maybe receiving less tax benefit year-over-year, and maybe you guys could comment just on whether or not you think the spring break shifts have caused some choppiness in the segment,

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

Yes, Chris. It has been a unique, really, winter just with the shift in the holidays and kind of the delay in some of the taxes. But I think overall, based on everything we've seen, the tax rebates have been not that significantly out of line once you've gotten through the big push. So we don't think that's it. There's obviously a little bit of timing with regard to school calendars and things like that, that are making some of the months and weeks a little bit unique to maybe what we have more historically seen. But overall, we just come back to, hey, the unemployment number is strong. The income growth continues to look positive, and it's broader. And those are good things for the restaurant industry. 1 month here or there isn't going to probably derail that kind of momentum. So we're still kind of, of the belief that it's a pretty good economy right now relative to consumers' willingness to eat out, whether it's in a restaurant or to take it out or to have somebody to bring it to their house.

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

And then just one last one. The company, in the past, had been reluctant to adopt individual order delivery, and now it looks like you guys have overcome some hurdles. Maybe talk a little bit about what were those hurdles that you overcame to decide to move forward.

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

Well, we're still overcoming them, but we're a lot more optimistic, as you've noticed. The biggest one for us was just operational integration. The approach that a lot of the third-party delivery companies were taking, which was, "Hey, we're just going to throw our iPad in your system, and good luck." This doesn't work for us. On our weekends and when we're busy, we have to have a better system running. And we've invested a lot of time, money and resources to making sure we set our operators up for success, and to just throw a wrench in the middle of their business, especially during volume, just wasn't going to happen. So we have found big players that are now willing to do that with us to figure out how to get the technology to work to help better support the operations of the business. And now then the next thing is just, okay, now let's talk about how we all make money off of this, and we're starting to feel good that there is a model now that allows us to do that. So we were just -- it's not like we've never -- we've never doubted the potential of delivery. It's just always been, okay, how does this work in our restaurants and how do we make some money off that as well, and we're starting to overcome some of those hurdles. I always say the Maggiano's business has got a great delivery business. We've had it for, really, almost a decade, and we just continue to kind of now work those systems out for Chili's.

Operator

Our next question today is coming from Will Slabaugh.

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

Stephens. I had a follow-up on delivery, actually. You mentioned you're close to finding a partner. So first, were you looking to partner with only one third-party provider? And then second, as you look at the different offerings of some of the delivery providers today, it seems like that's broadening out as well. So could this partnership involve more than just the logistics of delivery, whether it be customer data sharing, maybe integrate that partner with loyalty, your app or anything else?

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

Will, great questions. Probably not going to give you the answers on this call because they're all fairly strategic for us. We're not necessarily aligned with one partner, but we are setting parameters for whoever we partner with, again, around the ability to execute at a high level in the restaurant. And then all of those other issues are absolutely important, and we are integrating those in any conversations we have with potential partners around how do we leverage our significant database, how do we work with their database, what kind of brands do we want to be associated with and how do they convince us that they can deliver our product in a way that's consistent with what our guests and our brand deserves. So all of those are kind of happening as we speak, and we'll continue to push forward and keep you posted.

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

Understood. And just a quick follow-up on the traffic commentary that you had. Obviously, it's been a nice run here. And as you lap over the startup of positive traffic from last year, how good do you feel about keeping that streak going?

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

Well, we feel good about the strategy in general, right? I mean, our value platform and our overall position with regard to value is one of the key drivers of traffic. Obviously, you roll over to certain things, but our momentum is good, and we think that we've got the ongoing strategy in place to continue to move forward and take share. And we've been talking about this now. This is our fifth quarter of taking share from the category. From a traffic perspective, it's been growing. Yes, we'll start to lap against some of these bigger numbers, but at the same time, the fundamental business imperative that's kind of driving it, it doesn't change. So we like where we're at.

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

Yes. Will, I would just add that from a traffic acceleration as it relates to the rest of the industry, while I indicated it accelerated, it was a 1% acceleration in the last quarter compared to our gap the prior quarters. So that gives a lot of confidence in the direction of these strategies from a traffic perspective.

Operator

Our next question today is coming from Stephen Anderson.

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

From Maxim Group. I wanted to get some of your insight with regard to food cost. We've seen some of the proteins start to move up in the last several weeks with the Midwest and Great Plains flooding. I just wanted to see where you are with food cost for the next quarter and if you have any potential insights into fiscal '20?

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

Yes, Steve. It's Joe. Actually, we're pretty comfortable with the position we have right now on our proteins. They're -- we're lapping over fairly low points in the markets across proteins, so I know that gives some anxiety in the market for the laps as you kind of move forward. But right now, we see our price points relatively under control. There's some inflationary clouds on the horizon around the beef complex, but it's important to remember that despite what's going on in the short-term markets, we do some pretty effective contracting. So a lot of the exposure that you might be assuming when you see some of those price fluctuations has been mitigated by that contracting. I think for the rest of this year, we're running north of 80% contracting, so that really mitigates some of that exposure out there. And for example, things like our chicken contract run out a year. So even when you look at some dislocations that might happen in those markets, the power of a varied menu really comes to play at that point, where we can drive our marketing one direction or the other based on what we're seeing going on in the commodity markets. So we're very comfortable with the job our supply chain has done in the contracting positions and the ability to take volatility out of the equation for our operators.

Operator

Our next question today is coming from Nicole Miller.

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

Piper Jaffray. In terms of delivery, it's been very helpful to hear that you're focusing on using someone in the marketplace that can provide great execution. How are you also prioritizing the geography they can cover, the fees that they charge and the data that they may or may not provide back to you? And I really want to understand, would delivery through a Chipotle app also be an opportunity?

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

The answer to those 3 is yes, yes and yes. That's all definitely an important piece of the equation. One thing you have seen is a lot of your third-party providers broadened their national scale, so I think you are truly starting to get to coverages that can be very meaningful across our restaurant base and where we're located, particularly from a suburban marketplace. So that's important. Data is clearly front and center. We've, for a long time now, talked about and have been focused on the importance of data and how we utilize data to help drive our business, and that's not going to change as it relates to the delivery options. So we have to look at that very closely in that regard and...

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

And then just...

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

Go ahead, Nicole.

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

Thinking big picture about the domestic casual dining segment, could you walk us through what you're seeing in terms of the pace of development for the segment at large? And what I'm wondering is as it's slow to the point where it's a benefit to same-store sales, so clearly not to take anything away from your performance, but I'm thinking there's probably a lack of cannibalization that's happening. And if that's happening, how does that impact your choice or your -- the way you choose your pace of development, meaning do you want to continue to enjoy any comp benefit that you think you might be getting from that? Or do you think it's an opportunity to pick up your pace of growth a little bit faster?

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

Nicole, we're comfortable with how we're kind of bringing new restaurants into the space from our perspective. It's measured. It's -- and our new restaurant openings are doing well. And we are minimizing the cannibalization impact. That said, we're developing in markets where we have a big presence still. So all of that just kind of goes to say that we're comfortable with our current strategy of development. And if it were to move, it would move moderately but not dramatically.

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

Yes. I think that development, Nicole, is both new restaurant development -- and we have opportunities in our system to relocate, too. So we spend a meaningful amount of development time looking at where those trade areas might make sense from a relocation and the incremental growth that they will provide. And then let me circle back to your first question just to close the loop on your last question because I think you were asking about ability to deliver through our app, and we think that is a significant opportunity. So looking at what we would call white label options as we think through the progression of where delivery could go, that's definitely in the thought process. So the ability to have one of our guests choose delivery through our app probably powered by a third party potentially is a nice piece of the equation when we look at the delivery horizon.

Operator

Our next question today is coming from Bob Derrington.

Robert Marshall Derrington - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

Telsey Advisory. Wyman, it looks as though Chili's menu has continued to, I guess, kind of undergo some evolution. I think you all had tested reducing the number of menu items at several different levels. Has there been another level of reductions within the most recent menu that Chili's has rolled out?

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

No, Bob. We're -- we have -- we're always trying things with regard to menu and innovation, and we're testing different propositions, if you will. But we're pretty comfortable with where we're at right now in terms of the variety that we offer our guests and the -- and our ability to deliver that consistently to them day in and day out. So we can -- we're obviously always looking to find a new item here or there that will add some interest to the menu or to improve an item that we see an opportunity on. But overall, we're pretty comfortable with how the menu's sitting today, doing a lot of work with our supply chain to help us better understand how to make the products and the ingredients even better every day and to work on how we can help our operators execute at the highest possible level every day.

Robert Marshall Derrington - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

As a quick follow-up, can you give us some kind of gauge about how the remodeled Chili's are doing? I know you've got a pretty considerable remodel program underway right now. And have they been outperforming the core restaurants within the system?

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

Yes. Bob, we do -- obviously, we look at that closely. We have control groups against the markets as they are reimaged. And generally speaking, we're seeing positive results. We always evaluate as we kind of go through the process to make sure we can value engineer to be as effective as we can in the amount we're putting into the restaurants. We have a variation of investment we make based on the volume in the markets that we're in. We just always want to make sure that those are viable as we go forward, but we are seeing that positive result to control kind of as we move forward.

Operator

Our next question today is coming from Gregory Francfort.

Gregory Ryan Francfort - *BofA Merrill Lynch, Research Division - Associate*

It's Bank of America. I had 2 questions. The first was just on the decision to repay the revolver this quarter. I don't think you bought back any stock during the quarter. Can you explain to us maybe how you're thinking about the debt level from here? Should we think about, basically, your leverage as perfectly flat, and any excess cash from that will go to buy back stock? Or is this maybe a change in the fundamental approach to allocation of capital?

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

Yes. No change at all in the fundamental approach. We always have had the guardrails of our desired leverage level. I mean, we're saying again at that 3.9x, which is flat on an EBITDAR basis compared to the last quarter. I think that's a great target to utilize in your thinking. One of the dynamics of the calculation is that we work our way through the lapping of the sale-leaseback transaction. You have incremental lease expense that works its way into that calculation for a couple of quarters, and we're going through that period right now. So again, we use the guardrails and balance the debt level by free cash flow as that calculation adjusts. Once you get into the lap, which starts in the first quarter, of the sale-leaseback transaction, that's all normalized, and you probably would see a return to a more traditional utilization of free cash at that point.

Gregory Ryan Francfort - *BofA Merrill Lynch, Research Division - Associate*

And then maybe just a question going back to John Ivankoe's question. As you look out over the next 12 months, as we try to frame up the algorithm for the business, I mean, how are you looking at what you think the comp is necessary to be to hold margins flat? I know you guys have had a lot of changes in kind of how you've approached pricing and value. What do you think is the bar to have flat core restaurant margins over the next 12 months?

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

Yes. Greg, I'm going to defer the specific answer on that until we get into our guidance for next year in the Analyst Day in August. Again, we think the -- it's a combination, obviously, of slightly positive comp sales growth. And again, we think traffic will be a big piece of that equation, maintaining that at a flat to positive level. Again, we think we can price on an ongoing basis in that 1.5% to 2% range as they're all components of how we think about the business, and then you bring some capacity increases into the equation, too. But we'll flesh that out more specifically for your next 12 months and forward as we get to that appropriate time.

Operator

Our next question today is coming from John Glass.

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

It's Morgan Stanley. First, could I just ask about mixes? Assuming this quarter at Chili's, it's bounced around a bit quarter to quarter. Is the function of a decline in mix greater than last quarter a function of greater just value preference? Maybe what is that? Or was it maybe more specific to a promotion you ran this quarter, and that kind of decline in mix doesn't persist?

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

Yes. It's probably -- more the first, the level of preference, which is still sitting right in that mid-teens, that 15, 16. It was probably a touch higher preference in the prior quarter. So that's your biggest driver within the mix. We were doing a -- during the quarter, we were also doing a steak promotion as part of the 3 for $10 platform. But primarily, it's lap over prior year in those components.

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

And just related to that, just to understand the cost of that promotion, is the increase in COGS, is that all primarily related to the change in the value mix? And is this kind of where it should sit now, 40, 50 basis points of COGS pressure based on the current mix? Or do you think that there's risk that goes higher or maybe it goes lower, depending on how you're managing other pieces of the COGS equation?

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

John, if I was going to err in that thought process, it's probably on the lower side of the equation. As you start to lap through the more full use of 3 for $10, both from how we first utilized it from a promotional standpoint and then how it moved onto the menu, you get that normalized into the base, and the impact from the mix from that 3 for $10 will normalize.

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

And just to be clear, that normalizes later, like in the first quarter of next year, fiscal year. Is that right?

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

Yes, you're fully wrapped at that point. Again, this quarter had some -- we are lapping a relatively aggressive use of 3 for $10 from a promotional standpoint. So you start going through it this quarter and then fully as we move into the first quarter.

Operator

Our next question today is coming from Jeff Farmer.

Jeffrey Daniel Farmer - *Gordon Haskett Research Advisors - MD & Senior Analyst of Restaurants*

Gordon Haskett. Just following up on 3 for $10. Are you guys doing anything to support current traffic as you lap the introduction of that offer? And again, this is something that really was a material needle-mover over the last 4 quarters. I just didn't know if there was anything you guys could do on the defensive front to help support traffic as you move through a pretty tough comparison period.

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

Yes. Jeff, we're not going to probably get too specific on the marketing plans on the call. But yes, again, we're not going to be doing a lot of things that would create some chaos, if you will, or havoc in the restaurant with kind of limited-time promotion kind of work. But there's always marketing levers that we can pull to help more aggressively address driving traffic. And so we're always evaluating whether or not we want to put more emphasis on various aspects of our marketing mix, and we'll continue to look at that as we get through the rollovers. And we've kind of given ourselves some flexibility on that front. It's not like we had everything wide open all the way through last year. And the beauty of 3 for $10 and having it on the base is it grows on its own as awareness grows over time. So again, instead of having a fixed rate, we got to get them in today and then it leaves. And the awareness continues to grow, and the guest acceptance and potential return based on their experiences is also increasing. So you get some momentum just off having that offer out there and building awareness of it over time.

Jeffrey Daniel Farmer - *Gordon Haskett Research Advisors - MD & Senior Analyst of Restaurants*

That's helpful. And just one more follow-up on an earlier question. So one of your peers did put up an April same-store sales number last night. It's one of their softest monthly numbers in 2 years. Obviously, they were lapping a pretty tough comparison. But is there anything you are willing to offer in terms of what the broader casual dining segment is seeing right now in terms of trends? Is there something that's slowing it down a little bit? Does it seem like it's the same as what we saw in earlier months? Any color you guys can offer?

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

Jeff, as you know, we typically don't give specific guidance as it relates to the inter-quarter periods. So I can't follow up on that piece of the equation. Again, reiterating the comments we made, we're comfortable with the traffic-driving attributes of the strategies, and we're going to continue to move forward in that regard and look to gain the market share that comes with that. So I'll leave it at that, and we'll talk more about it in August.

Operator

Our next question today is coming from Brian Vaccaro.

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

Raymond James. Just a few clarifications, if I could. Back to the check -- and Wyman, I think you said you took pricing late in fiscal third quarter. How much did you take? And thinking about check in the fourth quarter, do you still expect that to be up year-on-year as you lap the initiatives to build loyalty membership in the fourth quarter of last year?

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

Yes. Brian, the price increase we took was right at the end of the quarter, so not much of an impact in this current quarter. Obviously, it will be supported in the current quarter. It was roughly a middle 1.5% -- 1.3% to 1.5% increase, again, well within -- keeping us in that range that we have targeted of 1.5% to 2% for the year. We do start to -- we are lapping now through aggressive activity around driving the loyalty database last year. That's free chips and salsa. So that does have a pricing impact and the fact that we net comp expense change, year-over-year change, from price. So you will actually have a positive impact to price as we lap through those higher use of comp expense last year.

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

Okay. So that expectation is still there. Would you expect a positive average check contribution then?

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

We would expect to be -- yes, to be in that positive range.

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

But the check average, the check average as it relates to pricing is going to be in that 1.5% to 2%. Then there's the effect of just not being as aggressive with regard to loyalty sign-ups that show up as a comp expense. That will be additive to that, so -- but again, our on-menu pricing strategy still holds for 1.5% to 2%.

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

Yes, yes. Okay. Got it. And then on the guidance, I think, Joe, you said you're comfortable with the upper end of the range. Does that comment apply to both comps and store margin expectations?

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

I think I was speaking specific to the EPS guidance at that point. But again, we're comfortable across all of our guidance ranges.

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

And that would include your G&A guidance up $8 million to $10 million for the year?

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

We'll be in that ballpark. If the delta there is the performance compensation fees, which obviously gets finalized as you move throughout the year, and to the extent that, that has a larger impact, you could move outside the range a little bit in that regard. But that's not something you really know till the true-ups at the end of the year.

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

Yes. Okay. Understood. And then just last quick one. On the labor line, Joe, you said, I think, bonuses were up 30% year-on-year in the third quarter. Just how much was that in dollars or in margin percent as a percent of company sales? Could you convert that for us?

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

Well, I won't convert it to the dollar side of the equation, but it's about 30 basis points when you look at the company sales side of the equation. That's the manager bonus piece of the equation.

Operator

Our next question today is coming from Sara Senatore.

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

Bernstein. I just had a question on the comment I think that Wyman made about the consumer being healthy and maybe some -- allowing for some pricing power. And I wanted to ask a couple of sort of follow-ups on that. The first is how do I think about sort of mix versus price, which is to say is it possible that if we take price, you see people trading down? I know you didn't have a lot of price on the menu this first quarter, but to the extent that we do see that move around, is that ever sort of a risk just as we think about average check in aggregate? And then the reason I think it comes a little bit surprising here about pricing power is certainly among the QSRs, there's been intense value competition. And I was wondering, is that a different customer? Do you see any trade-down? It certainly doesn't seem like it based on the traffic, but I'm trying to reconcile all those data points.

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

Sara, well, first, just with regard to people shifting away from an item based on a pricing -- a onetime price change, again, if we're in the 1% to 2% range, that's usually not going to be the -- create the impetus for somebody to, like, not order something they came in to eat. And when the whole check gets added up, you may have some issues with people saying, "Hey, you just pushed me over the edge." The way we always think about it is there's always somebody who's just -- no matter how much they love you, they're just kind of on the edge of their budget. And every time you price, you probably push a couple of people off. And so we're just very cautious about doing that because we really believe in the power of traffic and keeping as many people in the restaurants as possible. With regard to -- so I don't think an individual -- we don't see individual pricing actions of the kind of normal magnitude that we take creating major shifts in the menu, much more merchandising. And as Joe talked about, we create most of our menu shifts through our marketing and merchandising, and oftentimes, these are managed margins or moved products shifting and managed the product shift. The relationship between casual dining and fast food has always been an interesting one. We don't see a huge correlation there as much as some people may think. Obviously, when the fast-fooders, now it's been years now, really got aggressive with some of the value proposition, we did start to feel some impact around this, especially the lunch business. But overall, I think the 2 worlds are still fairly separate. Most of the data that we have says that creating options really come from other casual diners, maybe on the fast casual side, a little bit more there.

Operator

Our next question is coming from Peter Saleh.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

BTIG. I just want to come back to the conversation around delivery. Are you guys seeing better economics on delivery today versus what maybe you would have expected a year or 18 months ago?

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

Yes, Peter. I think as that marketplace becomes more competitive, you're seeing what you would expect to see, people fighting for share, people partnering better and working better together. And so that's what we see and that's what we expect to see. And I think we're also going to see scale matter, so brands that are big that can partner with third-party aggregators and give them something in the equation more than just a big percentage of their sales off the top, they're going to be able to negotiate better deals and partnerships, and that's what we're looking for. We're really looking for partnerships as much as anything, where we can all kind of get a business model that works. And I think that's now happening for some of the reasons I just mentioned.

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

And I think you also see some benefits, Peter, as we can lever off the investments we've made, both in to-go, because there's clearly some opportunities to leverage the systems and the capabilities we've developed there over time. And clearly, the investment we've made in our digital apps, the ability to, at some point, gravitate to a white label through your app delivery option is going to really come from the fact we've been able to invest and develop that capability to date.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

And then just on the -- staying with delivery for a second. Is a partner for Chili's, would that be also leveraged for Maggiano's? Or would you not utilize it that way? And then the last question on this would be when should we expect to hear something more concrete on a partnership.

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

The comment to the -- leveraging it from Maggiano's, Maggiano's already has a couple of third-party providers that they are working with. And it doesn't necessarily have to have that same combination on the Chili's side of the equation, but it's not off the table either. And not putting any time frames around any type of announcements related to the delivery, but it's something we're aggressively working on.

Operator

Our next question is coming from Andrew Strelzik.

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

BMO. I believe you're 2 quarters now into putting advertising support behind the Chili's to-go. So I was wondering, are you seeing any differences in the usage of the platform with the advertising support, whether it's levels of incrementality, daypart, weekpart, anything like that? And are you able to frame up kind of where the awareness sits today versus where it was prior and where it ultimately might be?

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

Andrew, Wyman. We aren't really -- we didn't really put a lot of marketing support behind to-go in this quarter. It was really a second quarter initiative that we ran for partial -- for part of the second quarter. This quarter has been more just around our base messaging from a marketing perspective. And we always keep a low level of to-go messaging out there in the digital space, but it wasn't a significant investment. And it's an opportunity we see down the road to continue to drive awareness and push that part of the business, but it wasn't something we leveraged this quarter.

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

Okay. And I know one of the levers kind of moving forward last time we spoke was the ability to lean into the direct marketing. So I'm wondering, is that something that you started to lean into at this point? Is that something we'd expect to see in the fourth quarter? Or is that more kind of a 2020 story?

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

Yes, still have room there. It didn't change the mix a whole lot in the third quarter from where we've been, so continue to leave our options open on how aggressively we want to use the database and the direct marketing and the loyalty.

Operator

Our next question today is coming from Jon Tower.

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

It's Wells Fargo. Just first on the marketing side, sticking with that. Can you quantify, on a dollar basis, the impact the shift away from traditional media towards kind of the digital and loyalty platforms might have had during the quarter? And then switching gears on the traffic side of the equation. Obviously, 5 quarters in a row, big numbers. Can you give us, in this quarter, some idea of where that traffic is coming from, whether its increased frequency of existing customers, you're drawing in new customers, as well as any commentary around relative performance, weekday versus weekend or dayparts?

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

Jon, related to the relative change in advertising, it was obviously a positive offset to some of the restaurant expense numbers. We typically don't quantify the various components of our multi-tiered marketing campaigns. But we have shifted meaningful dollars to digital over the, really, the course of the last 18 months, 2 years as we kind of moved through this progress. But it was a positive year-over-year and still getting the results we're seeing at the top line. And then, Jon, the second part of your question...

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

Yes. Just on the traffic side, if you can kind of flesh out how -- whether you're seeing increased frequency of existing customers, you're drawing in new customers, how the relative performance is and weekday versus weekend and dayparts during the quarter.

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

Yes. Jon, it's been a really broad-based kind of growth from a traffic perspective, both dayparts, lunch and dinner. I mentioned earlier in my comments, regionally, we're seeing good dispersion, so this isn't just Southeast or West Coast kind of phenomenon. We're seeing it's pretty broad-based and across both lunch and dinner. And with regard to where is it coming from, we are seeing increased frequency against our current user base as you would expect something like this to have a -- especially a value kind of oriented approach. They are the ones that are going to see it first, and so then they start to change their frequency. And what we're continuing to see now is that awareness builds and you start to see more Lighter users. Overall, when you look at the performance in the category, what we continue to see, and I think you guys track the large players, there's a consistent pattern of overperformance by larger concepts versus smaller concepts. So the independents and the smaller concepts really now, for a while, have been losing share to the larger concepts, and we continue to see that as probably something that will play itself out into the future.

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

All right. So I think that's all the time we have. I want to thank everyone for your participation on the call, and we look forward to speaking with you in August about our fourth quarter results. Thank you.

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

Thanks, everybody.

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.
