RARE HOSPITALITY INTERNATIONAL INC
Form 10-Q
May 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2002

Commission file number 0-19924

RARE Hospitality International, Inc.

(Exact name of registrant as specified in its charter)

Internal Revenue Service - Employer Identification No. 58-1498312

8215 Roswell Rd; Bldg. 600; Atlanta, GA 30350
(770) 399-9595

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

XX Yes ___No

As of May 9, 2002, there were 21,878,220 shares of common stock of the Registrant outstanding.

RARE Hospitality International, Inc. and Subsidiaries

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Part I. Financial Information
Item 1. Financial Statements

RARE Hospitality International, Inc. and Subsidiaries
Consolidated Balance Sheets
(In thousands, except share amounts)
(Unaudited)

Assets	March 31, 2002
Current assets:	
Cash and cash equivalents	$ 27,715
Accounts receivable	7,630
Inventories	13,800
Prepaid expenses	4,827
Refundable income taxes	887
Deferred income taxes	6,792
Total current assets	61,651
Property & equipment, less accumulated depreciation	272,678
Goodwill, net	19,187
Deferred income taxes	637

Other	2,824
Total assets	$356,977
Liabilities and Shareholders' Equity	
Current liabilities:	
Accounts payable	$ 21,541
Accrued expenses	33,630
Current installments of obligations under capital leases	15
Total current liabilities	55,186
Debt, net of current installments	10,000
Obligations under capital leases, net of current installments	20,852
Total liabilities	86,038
Minority interest	1,352
Shareholders' equity:	
Preferred stock	-
Common stock	182,172
Unearned compensation-restricted stock	(665)
Retained earnings	88,742
Accumulated other comprehensive loss	(503)
Treasury stock at cost; 10,000 shares in 2002 and 2001	(159)
Total shareholders' equity	269,587
Total liabilities and shareholders' equity	$356,977

See accompanying notes to consolidated financial statements

RARE Hospitality International, Inc. and Subsidiaries
Consolidated Statements of Earnings
(In thousands, except per share data) (Unaudited)

	13 Week
	March 31, 2002
Revenues:	
Restaurant sales:	
LongHorn Steakhouse	$ 104,385
The Capital Grille	21,854
Bugaboo Creek Steak House	17,246
Specialty concepts	1,728
Total restaurant sales	145,213
Franchise revenues	85
Total revenues	145,298
Costs and expenses:	
Cost of restaurant sales	52,812
Operating expenses - restaurants	62,280

Depreciation and amortization - restaurants	5,760
Pre-opening expense - restaurants	914
General and administrative expenses	8,373
Total costs and expenses	130,139
Operating income	15,159
Interest expense, net	449
Early termination of interest rate swap agreement	--
Minority interest	180
Earnings before income taxes	14,530
Income tax expense	4,795
Net earnings	$ 9,735
Weighted average common shares outstanding:	
Basic	21,477
Diluted	22,758
Basic earnings per common share	$ 0.45
Diluted earnings per common share	$ 0.43

See accompanying notes to consolidated financial statements

RARE Hospitality International, Inc. and Subsidiaries
Consolidated Statement of Shareholders' Equity
and Comprehensive Income
For the quarter ended March 31, 2002
(In thousands, unaudited)

	Common Stock				
	Shares	Amount	Restricted Stock	Retained Earnings	Trea St
Balance, December 30, 2001	21,522	$178,787	$(522)	$79,007	$ (
Comprehensive income:					
Net earnings	--	--	--	9,735	
Change in unrealized loss from interest rate swaps	--	--	--	--	
Total comprehensive income					
Amortization of restricted stock	--	--	134	--	
Issuance of shares to retirement plans	11	219	--	--	
Issuance of shares pursuant to restricted stock award	14	277	(277)	--	
Issuance of shares pursuant to exercise of stock					

options	187	2,137	--	--	
Tax benefit of stock options exercised	--	752	--	--	
Balance, March 31, 2002	21,734	$182,172	$(665)	$88,742	$ (

See accompanying notes to consolidated financial statements

RARE Hospitality International, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(In thousands, unaudited)

	March 31 2002
Cash flows from operating activities:	
Net earnings	$ 9,735
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	6,256
Changes in working capital accounts	(6,132
Minority interest	180
Deferred tax(benefit) expense	(1,488
Issuance of common stock to employee retirement plans	219
Net cash provided by operating activities	8,770
Cash flows from investing activities:	
Purchase of property and equipment	(9,429
Net cash used by investing activities	(9,429
Cash flows from financing activities:	
Proceeds from exercise of stock options	2,137
Proceeds from (repayments of) credit facilities	--
Proceeds from issuance of common stock	--
Distributions to minority partners	(157
Increase in bank overdraft included in accounts payable and accrued liabilities	473
Principal payments on capital leases	(58
Net cash provided by financing activities	2,395
Net increase in cash and cash equivalents	1,736
Cash and cash equivalents, beginning of period	25,979
Cash and cash equivalents, end of period	$ 27,715

See accompanying notes to consolidated financial statements

RARE Hospitality International, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The consolidated financial statements of RARE Hospitality International, Inc. and subsidiaries (the Company) as of March 31, 2002 and December 30, 2001 and for the quarters ended March 31, 2002 and April 1, 2001 have been prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments), which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. Certain information and footnote disclosures normally presented in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the year ended December 30, 2001.

The Company operates on a 52 or 53 week fiscal year ending on the last Sunday in December. The fiscal quarters ended March 31, 2002 and April 1, 2001 each contained 13 weeks and are referred to hereafter as the first quarter of 2002 and the first quarter of 2001, respectively.

2. New Accounting Pronouncements

In November 2001, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) reached a consensus on EITF Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer . EITF 01-9 addresses the recognition, measurement and income statement classification for sales incentives offered to customers. Sales incentives include discounts, coupons, free products or services and generally any other offers that entitle a customer to receive a reduction in the price of a product. Under EITF 01-9, the reduction in the selling price of the product resulting from any sales incentives should be classified as a reduction of revenue. Historically, the Company recognized certain sales incentives as restaurant operating and general and administrative expenses. Although this pronouncement does not have any impact on the Company s consolidated results of operations or financial position, the presentation prescribed has the effect of reducing sales, restaurant operating expense, and general and administrative expenses. Due to the adoption of EITF 01-9 as of the beginning of fiscal 2002, sales, restaurant operating expense, and general and administrative expenses have been restated for the first quarter of 2001 to conform to the new presentation requirement. Same store sales comparisons for each of the Company s restaurant concepts for the first quarter of 2002, consist of sales at restaurants opened prior to July 2, 2000 and consistent with prior years are calculated using sales prior to being reduced for discounts, coupons, free products or services.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , effective as of the beginning of fiscal year 2002. SFAS No. 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This Statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. In the first quarter of fiscal 2002, the Company ceased amortization of goodwill and performed the required goodwill impairment testing. The impairment test requires the Company to compare the fair value of each reporting unit to its carrying value to determine whether there is an indication that an impairment may exist. If an impairment of goodwill is determined to exist, it is measured as the excess of its carrying value over its fair value. Upon performing the initial test of the carrying value of the Company s goodwill, it was concluded that there was no current indication of impairment to goodwill. Accordingly, no impairment losses were recorded upon the initial adoption of SFAS No. 142.

As of the date of adoption, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was $272,000 and approximately $1.1 million for the first quarter of 2001 and fiscal year 2001, respectively. In accordance with SFAS No. 142, no goodwill amortization expense was recorded in the Company s financial statements for the first quarter of 2002. For the foreseeable future, management believes the only impact on the Company s consolidated financial statements from the adoption of SFAS 142 will be the elimination of goodwill amortization expense.

The pro forma effects of the adoption of SFAS No. 142 on net earnings and basic and diluted earnings per share is as follows (in thousands, except per share amounts):

	13 Weeks Ended	
	March 31, 2002	April 1, 2001
Net earnings, as reported	$ 9,735	$ 8,551
Goodwill amortization, net of tax benefit	-	169

Net earnings, pro forma	$ 9,735	$ 8,720
Basic earnings per common share:		
Net earnings, as reported	$ 0.45	$ 0.43
Goodwill amortization, net of tax benefit	-	0.01
Net Earnings, pro forma	$ 0.45	$ 0.44
Diluted earnings per common share:		
Net earnings, as reported	$ 0.43	$ 0.40
Goodwill amortization, net of tax benefit	-	0.01
Net Earnings, pro forma *	$ 0.43	$ 0.40

* Due to rounding of diluted earnings per share, both net earnings and pro forma net earnings for the period ended April 1, 2001 are $0.40 per share.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets", which supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of APB No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. SFAS No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company adopted SFAS No. 144 effective as of the beginning of fiscal 2002. The adoption of SFAS No. 144 did not have a material impact on the Company's consolidated financial statements.

3. Long-Term Debt

At March 31, 2002, $10 million was outstanding under the Company s $100 million revolving credit agreement at a weighted average interest rate of 7.77% after considering the effect of the Company s interest rate swap agreement.

4. Income Taxes

Income tax expense for the first quarter of 2002 has been provided for based on an estimated 33% effective tax rate expected to be applicable for the full 2002 fiscal year. The effective income tax rate differs from applying the statutory federal income tax rate of 35% to pre-tax earnings primarily due to employee FICA tip tax credits (a reduction in income tax expense) and work opportunity tax credits partially offset by state income taxes.

5. Earnings Per Share

Basic earnings per common share equals net earnings divided by the weighted average number of common shares outstanding and does not include the dilutive effect of stock options or restricted stock. Diluted earnings per common share equals net earnings divided by the weighted average number of common shares outstanding, after giving effect to dilutive stock options and restricted stock. A reconciliation between basic and diluted weighted average shares outstanding and the related earnings per share calculation is presented below (in thousands, except per share amounts):

	13 Weeks Ended	
	March 31, 2002	Ap
Net earnings	$9,735	
Basic weighted average shares outstanding	21,477	
Dilutive effect of stock options	1,196	

Dilutive effect of restricted stock	85	
Diluted weighted average shares outstanding	22,758	
Basic earnings per common share	$ 0.45	$
Diluted earnings per common share	$ 0.43	$

6. Derivative Instruments and Comprehensive Income

The Company uses an interest rate swap agreement to effectively fix the interest rate on variable rate borrowings under the Company s $100 million revolving credit facility. This interest rate swap agreement is classified as a hedge of a cash flow exposure and accordingly, the initial fair value and subsequent changes therein was reported as a component of other comprehensive loss and subsequently reclassified into earnings when the forecasted cash flows affect earnings. The estimated fair value of the Company s interest rate swap agreement at March 31, 2002 was a payable of $812,000 ($503,000 net of tax benefit). $317,000 of the net payable was classified as current on March 31, 2002. A reconciliation of net earnings and total comprehensive income is as follows (in thousands):

	13 Weeks Ended	
	March 31, 2002	April 1, 2001
Net earnings	$9,735	$8,551
Cumulative effect of change in accounting principle	--	(624)
Change in unrealized loss from interest rate swap agreement	80	91
Total comprehensive income	$9,815	$8,018

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

First quarter 2002 compared to first quarter 2001

Revenues

The Company currently derives all of its revenues from restaurant sales and franchise revenues. Total revenues increased 10.1% to approximately $145.3 million for the first quarter of 2002 compared to approximately $132.0 million for the first quarter of 2001.

Same store sales comparisons for each of the Company's restaurant concepts for the first quarter of 2002, consist of sales at restaurants opened prior to July 2, 2000 and are calculated using sales prior to being reduced for discounts, coupons, free products or services.

LongHorn Steakhouse:

Sales in the LongHorn Steakhouse restaurants increased 8.3% to approximately $104.4 million for the first quarter of 2002 compared to approximately $96.4 million for the first quarter of 2001. The increase reflects an 11.8% increase in restaurant operating weeks in the first quarter of 2002 as compared to the prior year, resulting from an increase in the restaurant base from 146 LongHorn Steakhouse restaurants at the end of the first quarter of 2001 to 160 at the end of the first quarter of 2002. Average weekly sales for all LongHorn Steakhouse restaurants in the first quarter of 2002 was $51,120, a 1.0% decrease as compared to the first quarter of 2001. Same store sales for the comparable LongHorn Steakhouse restaurants increased 0.5% in the first quarter of 2002 as compared to the same period in 2001, due to small increases in both guest counts and average check. Same store sales increased during a period in which average weekly sales decreased due to lower than average weekly sales rates for some small market LongHorn Steakhouse restaurants that are not yet in the comparable sales base.

The Capital Grille:

Sales in The Capital Grille restaurants increased 15.1% to approximately $21.9 million for the first quarter of 2002, compared to approximately $19.0 million for the same period in 2001. The increase reflects a 16.8% increase in restaurant weeks in the first quarter of 2002, as compared to the first quarter of 2001. Same store sales during the first quarter of 2002 at The Capital Grille restaurants were level with the same period of the prior year. Average weekly sales for all The Capital Grille restaurants in the first quarter of 2002 were $112,068, a 1.5% decrease from the comparable period in 2001. This decrease in average weekly sales volume is due to the opening of three new The Capital Grille restaurants in fiscal 2001. The Capital Grille restaurants have historically opened at lower sales volumes and, correspondingly, have not experienced the higher honeymoon sales period followed by a sales decline that is commonly characteristic in the restaurant industry.

Bugaboo Creek Steak House:

Sales in the Bugaboo Creek Steak House restaurants increased 2.1% to approximately $17.2 million for the first quarter of 2002, compared to approximately $16.9 million for the same period in 2001. The increase reflects a 2.1% increase in average weekly sales for all Bugaboo Creek Steak House restaurants in the first quarter of 2002 to $69,824 from average weekly sales of $68,379 for the comparable period of 2001. Same store sales for the comparable Bugaboo Creek Steak House restaurants in the first quarter of 2002 increased 3.0% as compared to the same period in 2001, primarily due to an increase in guest counts and average check.

Franchise Revenue:

Franchise revenues decreased to $85,000 for the first quarter of 2002, from $90,000 for the same period in 2001.

Costs and Expenses

Cost of restaurant sales as a percentage of restaurant sales increased to 36.4% for the first quarter of 2002 from 36.3% for the same period of 2001. Favorable contract pricing on red-meat products offset most of the significantly higher produce costs, particularly with respect to lettuce, experienced during the first quarter of 2002. The Company is currently under fixed price contracts with respect to over 90% of its beef and pork products for the remainder of 2002 and into early 2003. Many of the food products, other than beef and pork products, purchased by the Company are affected by commodity pricing and are, therefore, subject to price volatility caused by weather, production problems, delivery difficulties and other factors, which are outside the control of the Company.

Restaurant operating expense as a percentage of restaurant sales increased to 42.9% for the first quarter of 2002 as compared to 41.7% for the same period of 2001. This increase as a percentage of restaurant sales was due to increases in restaurant labor costs and, to a lesser extent, to higher marketing and insurance costs. Restaurant depreciation increased to approximately $5.8 million from approximately $4.9 million in the corresponding period of the prior year primarily due to the depreciation associated with capital lease accounting for the three new The Capital Grille restaurants opened during the first half of 2001 and the cost of remodeling 19 existing LongHorn Steakhouse restaurants during 2001.

Pre-opening expense for the first quarter of 2002 was $914,000, a decrease from approximately $1.8 million in the same period of the prior year. This decrease related to the six restaurants opened during the first quarter of 2002 as compared to thirteen restaurants opened in the same period of the prior year.

General and administrative expenses as a percentage of total revenues decreased slightly for the first quarter of 2002 as compared to the corresponding period of the prior year. This decrease was principally due to the elimination of goodwill amortization in accordance with SFAS No. 142.

As a result of the relationships between revenues and expenses discussed above, the Company s operating income increased to approximately $15.2 million for the first quarter of 2002 from approximately $14.7 million for the corresponding period of the prior year.

Interest expense, net decreased to $449,000 in the first quarter of 2002 from $673,000 in the same period of the prior year. The decrease in interest expense is due to the timing of the Company s common stock offering in February 2001.

Minority interest expense decreased to $180,000 for the first quarter of 2002 from $245,000 for the same period of the prior year primarily due to the effect of the Company s acquisition of the joint venture partner s interest in three restaurants subsequent to the first quarter of 2001.

Income tax expense for the first quarter of 2002 was 33.0% of earnings before income taxes, based on a 33% effective tax rate expected to be applicable for the full 2002 fiscal year. This compares to 32.6% of earnings before income taxes for the first quarter of 2001. The lower effective income tax rate in the first quarter of 2001 as compared to the first quarter of 2002 is due to the tax benefit realized in 2001 from the early termination of an interest rate swap agreement. The Company s effective income tax rate differs from applying the statutory federal income tax rate of 35% to pre-tax income, primarily due to employee FICA tip tax credits and work opportunity tax credits partially offset by state income taxes.

Net earnings increased to $9.7 million for the first quarter of 2002 from net earnings of $8.6 million for the first quarter of 2001, reflecting the net effect of the items discussed above.

Liquidity and Capital Resources:

The Company requires capital primarily for the development of new restaurants, selected acquisitions and the remodeling of existing restaurants. During the first quarter of 2002 the Company s principal sources of working capital were cash provided by operating activities ($8.8 million) and proceeds from the exercise of employee stock options ($2.1 million). For the first quarter of 2002 the principal use of working capital was capital expenditures ($9.4 million) for new and improved facilities. As of March 31, 2002 the Company had $10.0 million outstanding under the Company s $100 million revolving credit facility. The Company is currently in compliance with the provisions of the revolving credit facility.

The Company intends to open 17 to 20 Company-owned LongHorn Steakhouse restaurants, one The Capital Grille restaurant and two or three Bugaboo Creek Steak House restaurants in fiscal year 2002. The Company estimates that its capital expenditures for fiscal year 2002 will be approximately $65-70 million. During the first quarter of 2002, the Company opened six LongHorn Steakhouse restaurants. Management believes that available cash, cash provided by operations, and available borrowings under the Company s $100 million revolving credit facility will provide sufficient funds to finance the Company s expansion plans through the year 2005.

Since substantially all sales in the Company s restaurants are for cash, and accounts payable are generally due in seven to 30 days, the Company operates with little or negative working capital.

Forward-Looking Statements

Statements contained in this Report concerning future results, performance or expectations are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All forward-looking statements in this Report are based upon information available to the Company on the date of this Report. All forward-looking statements involve risks and uncertainties that could cause actual results, performance or developments to differ materially from those expressed or implied by those forward-looking statements, such as: the Company s ability to open the anticipated number of new restaurants on time and within budget; the Company s ability to continue to increase same-store sales at anticipated rates, a recession or other negative effect on business dining patterns, or some other negative effect on the economy in general, unexpected increases in cost of sales or other expenses, and the impact of any negative publicity or public attitudes related to the consumption of beef. Other risks and uncertainties include fluctuations in quarterly operating results, seasonality, guest trends, competition and risks associated with the development and management of new restaurant sites. More information about factors that potentially may affect the Company s results, performance or development is included in the Company s other filings with the Securities and Exchange Commission, including its annual report on Form 10-K for the year ended December 30, 2001, and the Company s press releases and other communications.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

As of May 1, 2002, $10.0 million was outstanding under the Company s $100 million revolving credit facility. Amounts outstanding under such credit facility bear interest at LIBOR plus a margin of 1.25% to 2.0% (depending on the Company s leverage ratio), or the administrative agent s prime rate of interest plus a margin of 0% to 0.75% (depending on the Company s leverage ratio) at the Company s option. Accordingly, the Company is exposed to the impact of interest rate fluctuations. To achieve the Company s objective of managing its exposure to interest rate changes, the Company from time to time uses interest rate swaps.

The Company has an interest rate swap agreement with a commercial bank, which effectively fixes the interest rate at 6.52%, plus the margin on $10.0 million from July 2001 through June 2002; on $15.0 million from July 2002 through March 2003; and on $17.5 million from April 2003 through August 2004. The Company is exposed to credit losses on this interest rate swap in the event of counterparty non-performance, but does not anticipate any such losses.

While changes in LIBOR and the administrative agent s prime rate of interest could affect the cost of borrowings under the credit facility in excess of amounts covered by the interest rate swap agreement in the future, the Company does not consider its current exposure to changes in such rates to be material, and the Company believes that the effect, if any, of reasonably possible near-term changes in interest rates on the Company s financial condition, results of operations or cash flows would not be material.

Investment Portfolio

The Company invests portions of its excess cash, if any, in highly liquid investments. At March 31, 2002, the Company had $25.0 million invested in high-grade overnight repurchase agreements.

Part II - Other Information

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Securities Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits Filed.

3.1 Amended and Restated Articles of Incorporation of the Company, as amended
3.2 Bylaws of the Company, as amended

(b) Reports filed on Form 8-K.

None

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

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Date:      May 14, 2002                                       /s/ W. Douglas Benn
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                                                              W. Douglas Benn
                                                              Executive Vice President, Financ
                                                              and Chief Financial Officer
                                                              (Principal Financial and
                                                              Accounting Officer)
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