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EAT - Q1 2018 Brinker International Inc Earnings Call

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OVERVIEW:

EAT reported 1Q18 adjusted EPS of $0.42.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International Fiscal '18 Q1 Earnings Call. (Operator Instructions)

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

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

Thank you, Kate, and good morning, everyone. We appreciate you joining us today for the -- our first quarter earnings call. Joining me here in Dallas is our CEO, Wyman Roberts.

And before we jump into the prepared comments, I want to take the opportunity to introduce the newest member of the Brinker finance team, Mika Ware, our new VP Finance and Investor Relations. Now, while Mika is new to this position, she is a very long time Chili head, who has served the last 7 years as VP Finance for Chili's. She brings an incredible wealth of knowledge to her new position, and I know you will enjoy getting to know her in a very short while. I'm very pleased and very privileged to have her working directly with me in this important role.

And with that introduction, I'm going to turn the call over to Mika for her first run of our safe harbor statements.

Mika Ware

Thank you, Joe, and good morning. I look forward to meeting and working with all of you. Results for the quarter were released earlier this morning and are available on our website at brinker.com.

Wyman Roberts, Chief Executive Officer and President; and Joe Taylor, Chief Financial Officer, join me this morning here in Dallas.

As is our practice, Wyman and Joe will first make prepared comments related to our operating performance and strategic initiatives underway at the company. 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 risk 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*

Thanks, Mika. Good morning, everyone, and thanks for joining us today as we recap first quarter, share our insights from the launch of our Chili's turnaround strategy and how we'll build on that momentum going forward.

As you saw in the press release, Brinker delivered earnings per share of $0.42 for the quarter, and when you adjust for the impact of hurricanes, which we believe is about $0.03, we actually performed ahead of expectations. Joe will provide more detail in a moment.

First quarter did present the most significant weather events our company has ever seen. I'm pleased to share all our company-owned restaurants that were impacted by the hurricanes are back up and running, and we took care of our Brinker family during this time of crisis with relief pay, temporary housing and emergency supplies. We also continue to work closely with our franchise partner in Puerto Rico to provide ongoing support during their recovery efforts and to help them reopen their remaining 2 restaurants, which we anticipate will open within the next few weeks.

Hurricanes aside, our plan for the year is playing out as we designed it. First quarter was all about finalizing our turnaround strategy for Chili's and training and preparing our teams for the new menu launch. For the balance of the year, we're focused on marketing and operational execution that will bring guests in, increase future visits and capture market share. And to make that happen, everyone on our team is aligned and committed to improving the guest experience by offering higher-quality food at more compelling price points and delivering it faster and hotter.

Our strategy started with the new menu. We reduced the menu by 40% and improved quality across signature items that present the biggest opportunity to move our business forward, specifically burgers, ribs and fajitas. With this simplified menu, we now offer guests full-on fajitas with improved-quality products and presentation and nearly 50% more meat; Texas-sized ribs, a new meatier rib offered at the same price as our original product; and bigger, Big Mouth Burgers, industry-leading, half-pound, handcrafted patties across the category, smashed for greater flavor and served on a brioche bun. We also established a solid value foundation in this important category with the long-time favorite, Oldtimer with cheese, served with fries, for just $6.99 all day, every day. We're about 6 weeks into the new menu and preference is up to nearly 40% across these signature entrées. And with so many of our guests choosing burgers, ribs and fajitas, our operators can focus on delivering faster, hotter foods. Our teams are guided by the principle that nothing matters, except that the guest returns. We've been training at every level to improve the consistency and speed of the guest experience, and so far, overall ticket times have decreased 12%. More importantly, tickets longer than 15 minutes, and those are ones that generate the greatest number of guest complaints, have dropped 40%, and those guests are now much more likely to return.

We also launched a new marketing creative to tell consumers Chili's is back and give them reasons to try us. We're about 4 weeks into the new campaign, with media weight levels at or above prior year, all set -- also set the brand up for longer-term sustainable traffic growth. A new menu and new marketing, that's phase 1.

Going forward, while our operations teams continue to focus on consistent execution inside the restaurants, we'll build on our momentum by leaning more aggressively into the areas that present the biggest opportunities for traffic growth. And the first is our value proposition. The industry remains highly competitive when it comes to value, and we're turning up the dial on our value strategy. Now that we have the right foundation and menu in place, the team is working hard to strengthen the value proposition for our target consumers beyond the $6.99 half-pound burger and fries. In the future, you'll see us more aggressively address dayparts, products and price points to execute a value strategy that works even harder to drive traffic.

We're also improving the quality of our atmosphere with a reimage program that makes the brand more relevant and appealing. We're nearly halfway through the latest round of reimages in the Northeast and preliminary results are encouraging. We continue to leverage the scale and strength of this organization to build the right foundation so we can master the things that are most effective, lean, moving the business forward, yet remain nimble enough to pivot when we need to. We have the best operators in the business, and they're aligned and committed to delivering a better experience for every guest. We've built an infrastructure second to none with the ability to support restaurants through supply chain and technology, and we maintain a strong business model that allows us to invest back into the business and maximize returns for our shareholders.

Everyone on the Brinker team is focused on driving traffic at Chili's, and we're gaining traction. I'm pleased with the operators' improvements in speed, with the higher quality of our signature items and with our menu performance in terms of mix and margins. It's affirmation that the things we put in place are working. We're seeing a shift in traffic, and we're working hard to quickly build on that momentum.

And now, I'll hand the call over to Joe to give you some more insights into first quarter results. Joe?

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

Great. Thanks, Wyman, and good morning, again, to everybody. During our last call in August, we indicated the first quarter of this fiscal year would be weaker than last year, primarily due to the timing of our new menu and marketing initiatives. And that was the case as we reported adjusted earnings per share of $0.42 for the quarter. What we did not anticipate was the meaningful impact from Harvey and Irma in our South Texas and Florida markets. During the course of the 2 storms, 202 restaurants were impacted, resulting in almost 850 closed days of operations.

Let me provide some insights as to the effect of the storms on the numbers we reported this morning. I would note, we are including both the lost sales resulting from the storms and the positive bounce-back sales seen in those markets as to provide you with a net impact to our numbers.

We estimate Brinker's comp sales for the quarter were reduced by 70 basis points due to the storms, with Chili's and Maggiano's impacted by approximately 60 and 130 basis points, respectively. The hurricanes negatively impacted our adjusted earnings per share by approximately $0.03. When adding back in the hurricane impact, our adjusted earnings performance for the quarter would have been $0.45, above -- several cents above our internal plan and Street expectations. The process of determining insurance recoverability, including business interruption for lost sales, is ongoing. Insurance recoveries, if any, will be accounted for in future quarters as that process unfolds.

Now looking at first quarter performance compared to last year. It's important to note our new menu launch and marketing campaign were both timed to meaningfully impact the last 3 quarters of the fiscal year. As such, this year's first quarter will lap the quarter from a year ago that included 30% higher marketing weights as well as a successful burger promotion. First quarter restaurant operating margin decreased from prior year by 70 basis points due to increased labor cost and sales deleverage, inclusive of a 20 to 30 basis point negative impact from the hurricanes. Labor wage rates have increased in line with our expectations, 3% to 4% for the year, and are anticipated to remain a headwind for the foreseeable future. For the full year, we do believe the year-over-year percentage increase in restaurant labor will be slightly below the 1% increase recorded in Q1.

Our cost of sales as a percentage of company sales for the quarter increased 10 basis points compared to prior year. We are investing into our core food equities of ribs, burgers and fajitas, and we'll spend increased amounts in each of these areas. However, much of this increased expense is supported by savings in restaurant expenses and increased menu price. As a result, we are anticipating an overall marginal increase in cost of sales percentage for the year. We do expect some inflationary pressures in parts of the commodity complex over the course of the year, with fresh produce of particular note. It is likely the effect of Irma on the Florida produce crops, particularly tomatoes, will be felt as we move through the next couple of quarters. Currently, we are 87% contracted across our commodity basket in the second quarter and 74% contracted to the end of the fiscal year.

Interest expense for the quarter was up approximately $5 million year-over-year, as this was the remaining quarter to be impacted by our recapitalization from last September, an event we have now lapped.

As it relates to our capital allocation for the quarter, we recorded capital expenditures of $22.5 million, primarily in support of restaurant maintenance, new restaurant development and reimages in our Northeastern markets. We're pleased with the performance of recently opened restaurants and particularly pleased with the initial lift we are seeing from the reimaged restaurants, with comp sales above target in the mid-single percent range.

For the quarter, we generated free cash flow of just under $28 million. Along with some incremental debt, this was used to repurchase 1.3 million shares. Our quarter-ending adjusted leverage ratio at 3.8% (sic) [3.8x] is slightly above the 3.75x high end of our target range. We anticipate leverage returning into the upper end of our range, that is under 3.75x, over the course of the next couple quarters.

In summary, we delivered against our expectations for the quarter, and we remain on track for the year. I'm encouraged by the early momentum resulting from the launch of our simplified menu as the fundamental move in the process of growing traffic at Chili's. We believe this now provides us multiple near-term opportunities to build further momentum as we move through the upcoming quarters.

With our prepared comments now complete, we can open the call for your questions. Kate, let's go ahead and begin the Q&A.

QUESTIONS AND ANSWERS

Operator

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

Jonathan Clifton Conley - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

This is Jon Conley on for Chris. Wyman, are you considering any additional changes to the menu that was introduced in mid-September? And was this based on guest feedback or margin implication?

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

Hey, Jon. We're -- we will definitely -- the team's definitely working hard to move forward off the menu that was rolled out late first quarter, but in line with our strategy to really own burgers, ribs and fajitas. So we're not -- so innovation hasn't stopped with this menu. The team's working very hard. We've got an amazing culinary team that's just bringing us a bunch of really interesting and exciting ideas all the time. I'd say the difference between kind of what we're doing now and what we may have been doing more of in the past is we're just so much more focused on the categories that we think are going to drive the business forward. So yes, there will be innovation to continue, and it'll be along the lines of both recipe as well as value propositions and how we bring even stronger, more compelling value offers to our guests.

Jonathan Clifton Conley - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Do you have any early indications on what some of those value items might be? I know you highlighted the burger, but where else could you go from there?

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

Well, I wouldn't want to share too much of that detail right now, but again, it'll be around these core equities, burgers, ribs and fajitas; around dayparts; around some of the more specific parts of the business like takeout. Again, looking at the business and segmenting, but focusing on burgers, ribs and fajitas.

Operator

Our next question today is coming from Gregory Francfort.

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

This is Greg from Bank of America. I just have two questions. The first one's on the marketing plan as we move throughout this year and the cadence. Given the menu launches, do you expect it to be sort of more weighted to 2Q than it was last year? And then the second question is just on value scores and speed of service scores and, I guess, around the new menu. Have you seen either of those change? And kind of what was the magnitude of the change?

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

Greg, yes, the marketing, as we said, the first quarter, we had pulled back on marketing as we just kind of set the organization up for the rollout of the new menu and the speed in operational initiatives. Marketing now throughout the rest of the year will be more aligned with prior years, and there'll be opportunities where we may be a little heavier, but a much more consistent kind of marketing plan to what we have historically run. With regard to the guest feedback on the menu, it's been strong. Whenever you take away 40% of the items that are on your menu, there's a chance that you're going to have some pushback from guests because you may have touched one of their favorites. So that's been the biggest challenge with reducing menus, and we've gone through that as well as we ever have. I think the work that's been done in the field and with the marketing group and the culinary group has been exceptional in getting us through that first phase of "Hey, where is my favorite, or the item I used to eat?" And now we're getting good feedback on both, especially on the speed of service. Those improvements that I mentioned in my prepared remarks are showing up in the guest comments, and we're confident that the other aspects of the menu are going to play themselves out as well.

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

Are value scores up, I guess? I see the mix and check numbers in the quarter and -- but I think you guys are reinvesting a lot back into quality. I guess, I'm wondering if the customer is recognizing that quality improvement and you're seeing an improvement on the value side.

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

Yes, especially -- on the things that we are -- like the $6.99 burgers in the burger category specifically, we're seeing the guest react and respond to that very positively. So yes.

Operator

Our next question today is coming from Greg Badishkanian.

Fred Wightman

This is actually Fred Wightman on for Greg from Citi. I know that you mentioned, when you were talking about the hurricane impacts, you guys had netted out some of the bounce-backs following the reopening. Could you just talk a bit more about what you saw there? I mean are things sort of back to normal, broadly speaking?

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

Fred, I would say -- generally say that we're back to a more normal situation. Obviously, we have launched the menu and launched the marketing afterwards, too, so you're going to have some impact. Generally speaking, Florida bounced back in a more traditional manner. You always do see a bounce-back from these kinds of events, maybe a little bit slightly longer bounce-back in Texas, but we're back into what we consider to be a much more normal cadence at this point, but we did want to make sure that we didn't overstate the impact of those hurricanes by giving you that net approach.

Fred Wightman

Makes sense. And then if we look -- I would assume -- I know marketing was down in the quarter, but I would assume you sort of pulled back on marketing in Texas and Florida following the storms as well. I mean, is it fair to assume a bit more of a delayed response as you look to ramp those moving forward from the new marketing program too?

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

No, Fred. Most of our marketing is national, and so we don't do a whole lot of local marketing. So from that perspective, those markets were getting the messaging just as everyone else would have.

Operator

Our next question today is coming from Brian Vaccaro.

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

Wyman, you said that you've seen a shift in the traffic after the menu and advertising launched, and we've heard that industry trends seem to have improved a bit sequentially in October. Would you be willing to qualify or provide some more context on the lift? And how much you think is sort of industry stability versus maybe attributed to the new menu and your repositioning?

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

Brian, as is our policy, we're not going to provide specific details. I can confirm kind of what you've seen as well, that the industry had performed a little better here in October. Some of that's related to some weather rafts last year that kind of helped us a little bit early as an industry in the early part of the month, but it does feel like, and we're optimistic that maybe the industry and the economy are going to start to perform at a little bit more positive level than they had kind of going through the summer, so we'll continue to watch that. We know our trend change relative to the industry is positive. So again, when we say we've started to see the traffic trends turn and start turning into the direction we need them to move, that's above and beyond kind of what we've seen with the industry.

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

And Brian, just to remind you, when we talk about the year performance, we did not build into the guidance we provided to you much industry lift at all from that. So I just want to again make sure we level set on that issue. I mean, our effort is designed to capture market share in whatever the conditions the industry throws at us.

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

Okay, that's helpful. And a question on the Chili's average check growth specifically, if I could. Could you provide some additional color just on the mix dynamic that played out in the quarter? Pretty significant lift there, but how you expect that mix dynamic to play out moving forward? And also just confirm that you continue to expect a more normal level of menu pricing starting in the second half of your fiscal year.

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

Yes, I'll make check off first. The mix in the first quarter was driven primarily by in-restaurant feature card merchandising of our smokehouse combos. So again, a very popular guest item and does mix and moved mix up a little bit in that quarter, and particularly in that context, [before] you weren't doing heavy marketing weights outside of that effort. I would anticipate as we kind of move forward, as we bring the new menu further along, as you hear us talk about incremental opportunity within the value space, that, that will have an impact on the mix too as we move forward, such as the $6.99 OTC burger that we have on the menu right now and where we will go from that as it relates to value. The pricing dynamics are the same as we had kind of talked about last quarter. We will remain elevated in our pricing position through the end of this calendar year, so this last quarter. We then lap some of our larger price increases from last year as we move into the month of December. So you will see the pricing levels come back down into our 1% to 2% range as we move into the third and fourth quarters, and our intent is to stay well within that range.

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

Okay, that's very helpful. And just last one for me, Joe, I just wanted to make sure I heard correctly. In terms of your annual store margin guidance, you expect to see labor costs up a little bit less than they were for the year compared to fiscal first quarter. You expect some modest pressure, I think, on the food cost line for all the reasons you've described. Can you maybe provide a little more color on the other operating cost there? That would seem to be a pretty meaningful source of offset to those pressure points.

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

You did hear correctly. What you just played back is the message. Our operating costs within the restaurant operating margin are tracking pretty much along the line of our plan and expectations, and you will, again, see that level of pressure on the labor line, a small increase in cost of sales, and benefits coming to us from the restaurant expense line. And we are still within the guidance we provided you for the overall restaurant operating margin.

Operator

Our next question today is coming from Sara Senatore.

Anna Papp

This is actually Anna Papp representing Sara from Bernstein. First, as you think about where this traffic is coming from in response to the new menu, can you tell where it might be coming from? Is it other bar and grill restaurants? Or maybe from the QSR burger category where you might have lost some traffic to trade-down?

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

Anna, it's a little early to kind of talk about shifts in traffic from segments. What we do know is we're seeing some lighter users, and we get an earlier read on who's coming into the restaurant from the advertising and the messaging and the changes. And so we are seeing an increase in guests that haven't been to Chili's in a while, which is encouraging to us and exciting from the standpoint of getting to introduce some folks that haven't been in for a while to the new menu and the faster, hotter food.

Anna Papp

Okay. And then just a quick follow-up, please. Given pricing and lower advertising, it looks like there's a pretty clear margin-versus-sales trade-off. As you increase marketing spend and perhaps moderate pricing, what type of comp increase do you need to hold margins?

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

Again, we will -- we continue to guide to that flat to up 1% for the year on comp, so you would obviously expect to see a sequential move upward from the first quarter within this comp sales. Again, from a long-term business model standpoint, we've typically talked about comps in that same range, that flat to positive 1% as a stability to margin kind of driver. So I don't think that the business model dynamics have changed in that regard on us. We've kind of moved down the pike. But yes, the annual guidance would suggest a build in comps as we move through the next couple quarters.

Operator

Our next question today is coming from Will Slabaugh.

William Everett Slabaugh - *Stephens Inc., Research Division - MD and Associate Director of Research*

With Stephens. Had a question around the new menu rollout, and if you could follow with just a little bit more kind of in terms of what you've seen, what you're expecting in terms of sales impact, either early on from potentially guests not finding what they want or hearing that what they used to get is not there? And if you're expecting any sort of sales dislocation before loyalty likely improves as execution improves, quality improves, et cetera? How you're kind of thinking about that playing out over -- throughout, I guess, the end of '17 and through 2018?

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

Will, Wyman. Yes, it's a great question. As I've mentioned, any time you make that magnitude of a change to a menu, there is that risk. That's why it was important for us to put it in a test market or 2 and get a pretty good read on guest response before we rolled it out last month. And looking at that test market, we anticipated a little bit of a pushback as you always get when you make changes, but that it was at a very low level, especially given the magnitude of the change, and that we were quickly kind of through that curve. So there's always a little bit of a pushback when you make a change like this, but it's been fairly minimal, and we're confident that we're going to be on the upside of that and moving to the traffic trends that'll build from there.

William Everett Slabaugh - *Stephens Inc., Research Division - MD and Associate Director of Research*

Got you. And also just around the new menu and the impact that you've seen so far, or I guess that you saw in the test market as well. Should we think about that as being a benefit to check over time? Just considering that as you focus a little bit more on proteins, maybe it hits your cost of sales margin, but the dollar profit could be a little bit better? Or am I taking a big jump there?

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

Yes, I mean, I think we didn't build the new menu with the expectation of growing margins, right? So there's -- there are some categories in there that are margin enhancing. The fajita category is a strong category for us from a margin and check standpoint, but at the same time, we really want to create those value platforms within the menu that work to drive those more value-conscious consumers in. So again, burger category is a good example. Overall, there is an opportunity there with margin potentially, but then we bring in the $6.99 price point to give that value proposition the kind of foundation it needs in the category. So net-net, we're where we want to be with margin and mix right now, and I think it gives us a great foundation to build off of.

Operator

Our next question today is coming from Howard Penney.

Howard W. Penney - *Hedgeye Risk Management LLC - MD*

Two questions, if that's okay. First one on the menu change, Wyman. So trying to be all things to all people sort of got you into trouble, I guess, if I could use that phrase. So eliminating some of things is going to eliminate some customers, but, to be blunt, who cares, I guess, is the kind of the question because if you're going to drive traffic, you're going to give up some people that maybe didn't want to be there in the first place. So can you just sort of address that issue of losing customers versus gaining traffic? And how you expect to see that play out? And then I have a follow-up so.

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

Yes, I think -- I mean, not that we would ever kind of take anyone that comes into our restaurant for granted, Howard, but I do think you have to make some tough calls and we had -- with kind of losing some of the focus on what the brand really stands for and how we can compete the most effectively, we may have been chasing some customers that just weren't necessarily worth the trade-off. And so you'll lose some of those guys early, but we think the trade-off, obviously, with owning the burgers, ribs and fajitas group, which we can own much -- is a much better place to be. And so we'll see that again in this menu change. We think getting through that cycle is going to be a fairly quick exercise relative to the magnitude of the changes we've made.

Howard W. Penney - *Hedgeye Risk Management LLC - MD*

So losing customers is, in a sense, a good thing. I mean not that you want to lose any customers, but it's ultimately a good thing to a certain degree.

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

I'd put it more as trading, trading off. And the other thing that's happening a lot is when guests come in and they say, "Hey, where's my whatever," pick the item that we don't have any more, our operators are doing a great job of saying, "Hey, listen, you should try this new burger though. If you haven't had a burger in a while, what we've done was half-pound, smashed, the whole -- the new bun, and you really should give it a shot." And again, we're seeing significant improvements in guest satisfaction on our burger category, for example.

Howard W. Penney - *Hedgeye Risk Management LLC - MD*

So as being blunt on the menu side in terms of losing guests, because I'm going to try to relate that to the labor piece as well. So casual -- the casual dining industry, 20 years ago, at $5 labor, was operating at a different model than today at $10 labor or $9 labor. So are there aspects of the labor that you have that you're providing customers that you don't necessarily need to provide customers because you're not getting paid for it? And

I'm going to throw out the receptionist or the hostess. Maybe you don't need a hostess anymore with technology going the way? So I'm just kind of curious if you're taking the evolution of the menu to the labor as well, knowing what's happening with labor costs and where that's going?

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

Yes. I think the teams have done a great job of analyzing and evaluating every dollar that we spend or invest in the labor component of the business to make sure that, is there a payback for it? Do guests appreciate it? We believe that service and hospitality in casual dining is important, and there's a labor component that has to be involved in that, and it's a little more in our model than obviously some other models, but that we can't afford to not evaluate and scrutinize kind of how that's being invested. I'd say right now, an example would be with the handhelds that we've rolled out in California, we're really evaluating, okay, what's the best way, the most effective way to deliver hospitality and speed and quality food most efficiently? And so technology enhancements that are enablers to doing that efficiently, that still create a connection for guests and allows you to make them feel special, is one way to get to what you're kind of hitting on. So we're looking at it across the board on all aspects of labor, both front, back, management. It's just too big a category for us to not continue to look at alternative ways to deliver a great experience as efficiently as possible.

Howard W. Penney - *Hedgeye Risk Management LLC - MD*

And if I could just throw in one last one, and if you've said this, I apologize. Is there a cost savings aspect to the lower number -- reduced menu items in terms of the supply chain and what you're bringing into the back of the house?

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

Not so much with the supply chain. There's some efficiency, obviously, with labor and back of the house because your SKUs go down. Your -- theoretically, we should be able to manage waste better. Theoretically, we should be able to manage labor better because you are just not doing as many things and that should make you more efficient as well. So those are some byproducts of a simpler menu that we anticipate taking some advantage of over -- once the menu gets established and the teams are just kind of very comfortable with it.

Operator

Our next question today is coming from Robert Derrington.

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

Telsey Advisory. Couple questions, if I may. Specifically, Joe, on the drag on the store-level margins from the hurricanes, can you quantify that? Or is this simple as adding back the costs you broke out within the -- your filing, the hurricane-related cost, the store-level margins?

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

Yes, Bob, I think that's the most straight-forward way to do it. Clearly, when we indicated -- as we indicated, revenues were impacted by roughly $5.5 million -- $5.4 million. There's obviously good leverage across a number of aspects of the restaurant operating margin that comes from that, that's the 20 to 30 basis points of the deleverage that went into it. We also -- from a cash flow perspective, we felt it was very appropriate to do some things like the relief pay for our team members, and so we were willing to do that while restaurants were closed. We obviously did dial that into other gains and charges, but another piece of the equation. So I think thinking about that 20 to 30 basis points is probably applicable. You would have had probably a little more favorable margin perspective on the restaurant expenses because you would have been able to leverage some of those items slightly, but not adjusting significantly off that 20 to 30 basis points.

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

Okay, that's helpful. Wyman, on the -- the company has historically been pretty forward-looking, pretty aggressive around investing within ways to find efficiencies, technology-related, and we know that you've done a pretty fair amount, a pretty heavy amount of that over the last year or so. Is there some time at -- in the not-too-distant future we'll begin to see some benefit? Or can you kind of update us on how those begin to come into fruition potentially, maybe helping sales trends?

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

Yes, Bob. I think the investments in technology, I'll just use the Olo investment in our -- on our curbside application in our app, is an investment we've made over time to provide us now with what we think is industry-leading to-go process, where you can go to our app, order, pay, pull up, hit a button, and we'll run it out to you. It's those kinds of things now that are in place, that are investments we've made really over the years. And by the way, now we have the back end of the system that allows us to really communicate with you ongoing, create a relationship, put you into our databases and create an ongoing dialogue with you that's kind of, again, I think, industry-leading. So those things pay off now as we are -- we're now able to start communicating those and marketing those more aggressively. So yes, that's one example of technology investments we've made over the years that is now kind of maturing and allowing us to push it more aggressively and separate ourselves from others out there that we don't think have quite the same level of sophistication.

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

Yes, Bob, there was just recently, just within last couple weeks, a rating of the -- within the restaurant industries of those companies that are viewed as being the leadership team from a technology standpoint, looking at everything from how you approach digital marketing to mobile applications. It's just really the broad utilization of technology to drive the business, and we were the leading casual dining company and -- in the top 5, and when you say top 5, you're talking about Starbucks, Domino's, Panera, those folks that are typically cited significantly for driving their business with technology, and we are right there with them. So I think, again, we have set ourselves up well to use all of these points to drive business off of this fundamental change we've made in the approach in Chili's.

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

That's super helpful. And the reason I think it's interesting is because as you've lowered some of the prices, for example, for the burger, is -- does the new curbside program, does that allow you to get more aggressive at lunchtime with some of the offers that are in the marketplace from the fast food chains?

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

Sure.

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

Sure, absolutely.

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

Okay. And then lastly, within -- I know the company had looked at testing some tablets. Can you give us any kind of an update on where that stands? And ultimately, how you view that across the business over the course of this year?

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

Sure. We've rolled out handhelds in all of California and the work that's been done to understand how to -- how can we leverage this technology to provide a better guest experience. Is there an opportunity to become more efficient? All of those things are kind just being evaluated now. Getting the technology in the restaurant right. When you move to a handheld technology, you have to make sure your WiFi system is up and running at 100% all the time. There's -- so there's a learning curve here that we're going through, but we continue to make these investments because we do see opportunity, especially in high-wage states, where we can become -- deliver a great guest experience and maybe do it a little more efficiently. And so those are -- we're -- so we're happy with what we've seen so far. We're not announcing that we're going to roll it company-wide yet as we continue to evaluate and determine the appropriateness for this technology throughout the restaurants.

Operator

Our next question today is coming from Jeff Farmer.

Jeffrey Daniel Farmer - *Wells Fargo Securities, LLC, Research Division - MD and Senior Restaurant Analyst*

Wells Fargo. So just following up on some of the earlier questions. I understand the cost efficiencies that could come with that new menu or the rollout of the new menu, but are you guys actively pursuing cost control opportunities either at the restaurant level or the corporate level, above and beyond some of the efficiencies that you might get with that new menu?

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

Jeff, yes, we're always looking at those opportunities. I think, historically, we have proven to be an effective and efficient operator. We'll continue to look at that, whether it is how we utilize technology that we just discussed, how we look at the managerial structures of the restaurants, how we look at supply chain opportunities, it's across the board. So it is -- efficiency is always front and center as long as it's in the context of a guest-driven hospitality-centric model that works within our restaurants.

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

Yes, I'll just add, Jeff. One of the things that kind of I'm most proud of is the work that the marketing team's done over the last 6 months. Steve and Kelli have done a great job just looking at that marketing budget and finding ways to take cost out of it, not that we could -- we would necessarily drive those to the bottom line, but -- that we could put a more aggressive marketing plan in place or that we could invest in margins on the menu. And so literally tens of millions of dollars of what we would consider nonworking dollars, nonmedia dollars, that they've been able to kind of squeeze out of the system that we aren't necessarily flowing to the bottom line, that we're investing in other parts of the business, whether it's through additional media weights or working dollars or into the menu in terms of helping support some of the margin improvements to the menu. So that's probably the best example, but may not be as obvious as some of the things that we've done in the past where it's a G&A rightsizing, where you just see those things kind of fall to the floor.

Jeffrey Daniel Farmer - *Wells Fargo Securities, LLC, Research Division - MD and Senior Restaurant Analyst*

Okay. That's helpful. And just one more somewhat unrelated -- or somewhat unrelated. You touched on it, but when did you officially introduce the Curbside To Go platform? And what have been some of the early results, meaning things like off-premise, mix change? Anything you guys can provide color on would be helpful.

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

We have been a little bit slow to market it. It's been company-wide now for the quarter, but our whole franchise system is getting up to speed. And so again, doing national efforts has not been -- we haven't been able to push it nationally yet. Now we're almost there. We've almost having the whole franchise organization up and running, and so we'll quickly start to be pushing curbside more aggressively. And we started that kind of really in the last few weeks, and we're seeing some positive results with growth in to-go, and we think there's just a lot of upside still. And we'll do more innovation around to-go. Now that we've got the infrastructure, again, we've kind of talked about the strategy of let's get the infrastructure in place and the foundational things right, and then we can innovate off that, and that's where I feel we're at with to-go now. We've got the model right now. Now we can start to market it and innovate against it much more aggressively.

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. As most of the questions today have focused on Chili's turnaround, but wanted to discuss Maggiano's briefly and wanted to talk about -- you saw a 2.5% comp decline in the quarter, a lot of that higher than -- higher exposure to Harvey and Irma. But wanted to talk about second quarter, if you can -- without going specifically into comp, but I want to see what you're seeing in terms of how are the booking trends and other business-related spending as it relates to Maggiano's?

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

Yes, Stephen, it's a great question. It's nice to have you guys ask a question about Maggiano's. I appreciate it. It's a great concept. A little bit of a tough quarter for them and -- but the good news is, again, with the hurricanes that hit them a little harder and some additional softness in some of the banquet business early in the summer, but things have rebounded nicely. The team's gotten much more kind of aggressive, and they've got some great tactical strategies, if you will, around -- or some tactics that they're putting against their strategy to grow the banquet business that are really resonating well. Their to-go and delivery have gotten much stronger, and we're really optimistic kind of about how they're walking into the holiday season, which again, for Maggiano's, the holiday season is significantly more important to them than to Chili's, for example, and they're walking and feeling much better about kind of how the trends are looking.

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

I also want to ask about your -- the Saturday brunch, how that's been doing as well since you rolled that out?

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

Good. It's really -- brunch is available all week, but we really push it on the weekends with a more expanded menu, and we're continuing to see positive comps and great guest satisfaction. The team's looking at how to continue to keep it fresh and address any kind of opportunities they have to push that daypart. So it's been a nice addition to the Maggiano's kind of business model.

Operator

Our next question today is coming from Jeffrey Bernstein.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

From Barclays. Two questions. Just one, Wyman, maybe just a clarification. I know you mentioned in recent weeks or maybe in the last months that you've thought you were -- or you were able to confirm that the casual dining industry comp has reaccelerated, which I'm assuming is beyond just what you believe the hurricane bounce-back, just to be clear. But I think you had mentioned Chili's as well and that maybe you went from lagging to leading that industry. I just wanted to make sure I understood the trajectory of both the industry and where Chili's fit within that, even if it's just qualitative, and whether you attribute that entirely to the new menu, most recently? And then, I had one follow-up.

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

Jeff, yes, no, I mean just to clarify, we're not giving specifics, but we -- what I was just confirming was that both the industry has seen some better results and Chili's has seen some better results, and that wasn't making any comparison to the relative movement.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Got you. Okay, so both you and the industry are seeing an improvement, but you weren't commenting on whether you've now passed the industry or lagging or whatnot, just both have improved.

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

Correct.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Got it. And then, well, I know, Joe, last quarter you gave color on the first quarter in terms of the nuances of earnings and whatnot. Should we assume that for the rest of the year -- I mean, just based on your comp guidance, it seems like we should assume comps accelerate sequentially rest of the year and that EPS is more stable, maybe modest growth in the forward quarters? Or is there anything unusual to recognize in terms of the comp or EPS growth for the rest of the year?

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

I don't think there's anything unusual. I would add the color that, obviously, as we move through the rest of this quarter, we will lap some issues that we talked about over the course of last year. If you think about the commentary around November with the PR incident and the -- some of the softness we saw on the retail side of the equation in December. So there are some opportunities we view there as we lap through this quarter, in particular. But yes, our guidance for the year is very much intact.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Got it. And then just lastly, Joe, now that you've had some time in the new seat, I figured I'd just ask on the franchise mix. I didn't know whether you ever gave or whether you'd give ongoing or further consideration. Obviously, you are very familiar with the franchise model, and it seems like it provides some cost-cutting benefits and return of cash. I'm just wondering how you think about that mix. And what might be the reasons why you wouldn't consider significantly increasing your franchise mix over the coming years?

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

Well, Jeff, I think as we've said previously, we would consider it in the right circumstances. Again, we like the mix we have, particularly in the environment of driving some of the improvements and changes that we have been making in the business model. And obviously, from a corporate perspective, you can drive more heavily in that regard. But we do look at opportunities, and we'll continue to consider that kind of as we move forward. The who you're partnering with is a very important aspect of that simply, which is really the bigger driver beyond just what do the mix numbers look like. So we have great franchise partners today, and we would look to continue that piece as we would evaluate opportunities that I do believe will present themselves.

Operator

Our next question today is coming from John Ivankoe.

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

Great. And just a clarification on Jeff's last question. So I want to make sure I've heard it correctly as well. Wyman, you did say in answer to one of the questions, the trend change versus the industry is positive, I think, if I got that quote right. Does that just mean that your same-store traffic second quarter has improved more [than] the first quarter than the industry's traffic has improved second quarter versus first quarter? Or one could interpret that your same-store traffic is actually outperforming the industry based on that answer.

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

Yes, John. I think what I was confirming, without getting into specifics for the second quarter, was that -- what we all have seen in the public data, is that the industry has gotten better in October. Again, some of that is the lap of a hurricane last year, so there were a couple of days early in the quarter that -- or early in the month that were benefited from that. But overall, we're optimistic about what we're seeing in the industry trends relative to how the industry performed in the first quarter. It's early so we're not counting on a big industry turnaround. And then what we've said is that we are -- we have seen our traffic trends turn. They're starting -- they're turning, and we're going to move -- use that momentum to continue to focus on building traffic at Chili's.

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

And I'm so sorry to belabor this point. I mean, is turning meaning it's less negative or it's actually positive?

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

Well, we're not giving specific details, so it's...

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

Okay. All right. I understand. It's just -- it's one of those -- we get very into semantics with things -- with comments like that, so I do apologize, but I understand. And then secondly, could you remind us what kind of -- or tell us what the average check is at Chili's in the first quarter of '18, especially on that 5.3% increase in ticket, which obviously we understand is above average pricing, and also, the promotion of the smokehouse combo in-store? And whether you think that's the right average ticket for the brand going forward? Or you do want to see it come down?

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

John, for the first quarter, we were ticking up right around $15.70 from a PPA standpoint, again, driven very heavily off of that smokehouse combo promotion. I think the opportunity, as we discussed, is going to be how we lean more aggressively into the value messaging, similar to what you're seeing from the $6.99 burger, and how we layer incremental value on top of that. So I think that will have -- that will be the more meaningful driver to PPA as we move forward.

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

And then the final question or point, I guess, is on loyalty. And I know last year was a little bit noisy in terms of the shift from My Chili's Rewards to Plenti, and you started off with some very strong rewards that ended up getting dialed back to some extent. So how much -- just remind us of some of the history there. But how much of some of the change in loyalty, and maybe it sounds like a less dependence on it, actually benefits the margins in '18 versus '17, because that might shed some light on your expectation of margins?

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

I think, John, from a loyalty perspective, obviously, it's been a process, and we've kind of gone through the spectrum, really, going from a high-cost, but high-engagement program to a very low-cost, less-engagement environment these last several months. I think our belief is -- I mean, loyalty is definitely a piece of the equation that will be really part of our -- a central piece of our direct marketing program as we go forward. We are understanding, I think, balancing those costs better than we have in the past. It'll be a component of what we do. We'll think about it in the context of the broader marketing efforts, but I think we are getting through the learnings of the last, really 18 months, 2 years. We're getting to a point where we really understand what is the right level of cost to drive the right level of engagement from our loyal guests. The incrementality we can drive from that and how we look at the return to that cost, is, I think, much better understood internally now so -- but it has been a journey.

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

But John, I wouldn't anticipate seeing huge margin improvement based on becoming more efficient with loyalty. We'll probably -- I think we've got the efficiency piece of that pretty well under control now. It's more about how heavy do we want to lean into that, how much do we want to turn that dial-up, if you will, to drive traffic is what we're -- those are decisions the team is working on now.

Operator

Our next question today is coming from Andrew Strelzik.

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

BMO. I have two things. First, I think originally, if I recall correctly, the marketing campaign was not intended to have a price point in the promotion and, obviously, it did with the burger promo and you've referenced that as kind of a model going forward. I guess, can you just give us some background, what went into the change in the philosophy there to look at price points more aggressively? Was it something in the markets, something in test? Just wanted to better understand that change.

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

Andrew, no change. So I don't know if we communicated something to you, but there was never our expectation that we wouldn't go out with a compelling value component to the new menu. We've made these improvements, and we want to drive people in with a mix, right? So multiple messages were used to communicate the change in the menu, various spots. The $6.99 burger spot was in the rotation, had a pretty good mix, but less than half of the rotation. And so it was always meant to be a combination of tell the message and then provide some compelling reasons to come in quickly to see.

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

Okay. Appreciate the clarification there, and I apologize for misunderstanding that. The other question I had was just on the pace of the repo, it was a little bit stronger than we had anticipated for the quarter. You mentioned a little bit of -- using a little bit of the balance sheet to facilitate that, and now we're talking about leverage coming down. So I guess I'm wondering, does that necessarily mean that the pace of repo might slow for the rest of the year? Or you might shift some of that capital to paying down debt? What are the implications then for the repo?

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

Yes, actually, no. I would take the opposite stance. We understood the value that we saw in the stock price, we are aware of that. We aren't changing necessarily the guidance for the year for the amount spent on share repurchase, but we definitely took advantage of our -- both our cash flows and our balance sheet capabilities to expedite in the first quarter, and you will see a subsequent event comment in our Q when it's filed later this week, that we continued that in the month of October with an incremental $30 million of share repurchase activity. So we want to take advantage of value when we see it, and we have moved to do that. And again, we will see the -- we do anticipate seeing the leverage ratio move back below 3.75x in the second half of the fiscal year.

Operator

Our final questioner today is John Glass.

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

It's Morgan Stanley. My question is just on timing in terms of incremental value items in the menu. Is this the kind of situation where you'd like the current menu to sit for a while and then you're thinking about adding value items later in the year? Or do you think at any time you'll put some new value offers into the market? And maybe just related to that, how do you think about December? Caught the industry by surprise last year. I know it looks like an easy lap, but if it's driven by retail traffic, maybe it's not a very easy lap. And how do you think about having to be more focal in that particular period of time to make sure that it doesn't repeat itself?

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

Good question, John. Well, the first one is probably a little bit easier because we control that. So it's -- the work that's being done on the new menu from an innovation and a value perspective is both short and long term. So I think in the short term, there are obviously some marketing approaches that we can use to provide some value offers, whether they're more a limited time or whether they're through a channel, if you will, to our database and our direct market audience or whether we go with advertisement. I think those will be relatively manageable in the next period of time, but then there's continued work on a broader or more comprehensive next step to the menu that would include additional value levers and platforms. So we're doing some shorter- and some longer-term work in the brand to kind of address that. So the answer is yes, there'll be some shorter term, but there's also some longer-term work that's being done as well. With regard to the holidays, again, it's a great question. I haven't seen anything that would indicate that we would see the kind of drop-off we saw last year. It seems to be a more stable environment, and we're anticipating that. But again, that's something we don't control as much, so you probably have as good an insight as I do because we're all looking at kind of secondary consumer data.

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

Yes, I'm looking at the fact that e-commerce takes a greater share of retail sales, and footfall in every year goes further down in malls. So that was my only comment. Joe, just as sort of a more wonky modeling question, your tax rate was higher because I think of the stock option expensing or the way the accounting changed. So are you guiding the year still to 27% to 28% tax rate and you'll back out any exceptions to that? Or was it -- how are you thinking about this tax rate relative to the year? Was it higher than you anticipated even given that accounting change? And are we just supposed to back out that change? I think others don't back out that change. I'm just trying to understand how you'd treat that?

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

Yes, we back it out from an adjusted earning standpoint because you could -- that's the type of tax-driven change that you could see some volatility in, depending on where the stock prices go quarter-to-quarter. So that's typically an expense that is going to be more stilted to the first quarter because that's when vesting takes place, which drives -- which actually drives that number. So we're going to a take a stance of backing that out on an ongoing basis. Yes, we are very much still guiding to that tax rate for the year.

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

Without that -- but without those changes, you're just saying that you're going to back into (inaudible).

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

From an adjusted earnings perspective.

Operator

That's all the time we have for questions today. Gentlemen, do you have any closing comments?

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

No. Just again, we'd like to thank everybody for joining us this morning. We look forward to talking again early on in calendar '18 about the current second quarter. And with that, everybody, have a good day, and a good rest of the week. Thank you.

Operator

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