

Texas Roadhouse, Inc.
Form 10-Q
November 03, 2006

UNITED STATES
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 September 26, 2006
OR
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 000-50972

Texas Roadhouse, Inc.

(Exact name of registrant specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-1083890
(IRS Employer
Identification Number)

6040 Dutchmans Lane, Suite 200

Louisville, Kentucky 40205

(Address of principal executive offices) (Zip Code)

(502) 426-9984

(Registrant's telephone number, including area code)

Indicate by check mark whether 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. Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer x

Accelerated filer o

Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x.

The number of shares of Class A and Class B common stock outstanding were 68,854,169 and 5,265,376, respectively, on October 27, 2006.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	September 26, 2006	December 27, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,290	\$ 28,987
Receivables, net of allowance for doubtful accounts of \$69	8,285	9,613
Inventories	5,904	5,893
Prepaid income taxes		1,866
Prepaid expenses	1,419	2,259
Deferred tax assets	522	621
Other current assets		40
Total current assets	25,420	49,279
Property and equipment, net	280,007	210,382
Goodwill	88,017	51,063
Intangible asset, net	4,969	
Other assets	2,594	1,869
Total assets	\$ 401,007	\$ 312,593
Liabilities and Stockholders Equity		
Current liabilities:		
Current maturities of long-term debt	\$ 588	\$ 498
Current maturities of obligations under capital leases	51	140
Accounts payable	13,812	17,415
Deferred revenue gift certificates	9,446	19,355
Accrued wages	12,119	9,220
Accrued taxes and licenses	6,521	3,646
Income tax payable	2,454	
Other accrued liabilities	5,508	5,695
Total current liabilities	50,499	55,969
Long-term debt, excluding current maturities	19,935	6,255
Obligations under capital leases, excluding current maturities	588	626
Stock option deposits	3,969	3,404
Deferred rent	5,413	4,502
Deferred tax liabilities	7,404	6,679
Other liabilities	2,817	2,932
Total liabilities	90,625	80,367
Minority interest in consolidated subsidiaries	1,282	651
Stockholders equity		
Preferred stock (\$0.001 par value, 1,000,000 shares authorized; no shares issued or outstanding)		
Common stock, Class A, (\$0.001 par value, 100,000,000 shares authorized, 68,825,789 and 65,267,655 shares issued and outstanding at September 26, 2006 and December 27, 2005, respectively)	69	65
Common stock, Class B, (\$0.001 par value, 8,000,000 shares authorized, 5,265,376 shares issued and outstanding)	5	5
Additional paid in capital	253,119	201,764
Retained earnings	55,901	29,738
Accumulated other comprehensive income	6	3
Total stockholders equity	309,100	231,575

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Total liabilities and stockholders' equity	\$	401,007	\$	312,593
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See accompanying notes to condensed consolidated financial statements.

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Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(in thousands, except per share data)

	13 Weeks Ended September 26, 2006	September 27, 2005	39 Weeks Ended September 26, 2006	September 27, 2005
Revenue:				
Restaurant sales	\$ 145,859	\$ 111,642	\$ 436,804	\$ 333,357
Franchise royalties and fees	2,595	2,685	7,769	7,794
Total revenue	148,454	114,327	444,573	341,151
Costs and expenses:				
Restaurant operating costs:				
Cost of sales	51,243	39,335	153,335	117,275
Labor	40,509	30,715	120,675	90,431
Rent	2,588	2,099	7,397	6,225
Other operating	23,481	19,205	70,374	54,697
Pre-opening	2,948	2,306	8,759	5,265
Depreciation and amortization	5,580	3,818	15,641	10,541
General and administrative	7,864	5,725	25,773	19,132
Total costs and expenses	134,213	103,203	401,954	303,566
Income from operations	14,241	11,124	42,619	37,585
Interest expense, net	64	93	533	162
Minority interest	76	181	361	402
Equity (income) from investments in unconsolidated affiliates	(47)	(65)	(182)	(87)
Income before taxes	\$ 14,148	\$ 10,915	\$ 41,907	\$ 37,108
Provision for income taxes	4,998	3,854	15,744	13,099
Net income	\$ 9,150	\$ 7,061	\$ 26,163	\$ 24,009
Net income per common share:				
Basic	\$ 0.12	\$ 0.10	\$ 0.35	\$ 0.35
Diluted	\$ 0.12	\$ 0.10	\$ 0.34	\$ 0.33
Weighted average shares outstanding:				
Basic	74,052	69,471	73,774	68,166
Diluted	76,323	73,833	76,437	72,538

See accompanying notes to condensed consolidated financial statements.

Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

	39 Weeks Ended September 26, 2006	September 27, 2005
Cash flows from operating activities:		
Net income	\$ 26,163	\$ 24,009
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,641	10,541
Deferred income taxes	(1,366)	(1,348)
(Gain) loss on disposal of assets, net of impairments	205	164
Minority interest	361	402
Equity (income) from investments in unconsolidated affiliates	(182)	(87)
Distributions received from investments in unconsolidated affiliates	248	204
Share-based compensation expense	5,020	
Changes in operating working capital:		
Receivables	1,384	(1,346)
Inventories	289	(478)
Prepaid expenses and other current assets	873	1,748
Other assets	166	(255)
Accounts payable	(3,603)	(1,111)
Deferred revenue gift certificates	(12,072)	(8,537)
Accrued wages	1,673	(704)
Income tax benefit from exercise of stock options		7,645
Excess tax benefits from share-based compensation	(3,483)	
Prepaid income taxes and income taxes payable	7,803	(1,268)
Accrued taxes and licenses	2,573	249
Other accrued liabilities	(2,163)	1,264
Deferred rent	761	469
Other liabilities	(934)	64
Net cash provided by operating activities	39,357	31,625
Cash flows from investing activities:		
Capital expenditures property and equipment	(66,264)	(40,270)
Proceeds from sale of property and equipment, including insurance proceeds	1,332	
Acquisitions of franchise restaurants, net of cash acquired	(13,203)	
Net cash used in investing activities	(78,135)	(40,270)
Cash flows from financing activities:		
Proceeds from revolving credit facility, net	15,000	
Proceeds from minority interest contributions and other	737	70
Excess tax benefits from share-based compensation	3,483	
Repayment of stock option deposits	(335)	(170)
Proceeds from stock option deposits	1,129	888
Principal payments on long-term debt	(3,521)	(6,414)
Principal payments on capital lease obligations	(127)	(151)
Proceeds from exercise of stock options	3,308	4,018
Proceeds from follow-on offering		12,163
Payment of follow-on offering expenses		(1,197)
Distributions to minority interest holders	(593)	(485)
Distributions to members		(31,176)
Net cash provided by (used in) financing activities	19,081	(22,454)

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Net decrease in cash	(19,697)	(31,099)
Cash and cash equivalents beginning of period	28,987		46,235	
Cash and cash equivalents end of period	\$ 9,290		\$ 15,136	
Supplemental disclosures of cash flow information:				
Cash paid for interest, net of amounts capitalized	\$ 697		\$ 612	
Cash paid for income taxes	\$ 9,230		\$ 8,069	
Supplemental schedule for non-cash investing and financing activities:				
Stock acquisition of franchise restaurants	\$ 39,394			
Assumption of debt acquisitions	\$ 2,291			

See accompanying notes to condensed consolidated financial statements.

Texas Roadhouse, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Tabular dollar amounts in thousands, except per share data)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Texas Roadhouse, Inc. (the Company) and its wholly-owned subsidiaries, Texas Roadhouse Holdings LLC (Holdings), Texas Roadhouse Development Corporation (TRDC) and Texas Roadhouse Management Corp. (Management Corp.), as of and for the 13 and 39 weeks ended September 26, 2006 and September 27, 2005. The Company and its wholly-owned subsidiaries operate Texas Roadhouse restaurants. Holdings also provides supervisory and administrative services for certain other franchise and license restaurants. TRDC sells franchise rights and collects the franchise royalties and fees. Management Corp. provides management services to the Company, Holdings and certain franchise and license restaurants.

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reporting of revenue and expenses during the period to prepare these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, goodwill, valuation of share-based payment awards and obligations related to workers' compensation, general liability and property insurance. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position, the results of operations and cash flows of the Company for the periods presented. The financial statements have been prepared in accordance with U.S. generally accepted accounting principles, except that certain information and footnotes have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission (SEC). Operating results for the 13 and 39 weeks ended September 26, 2006 are not necessarily indicative of the results that may be expected for the year ending December 26, 2006. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 27, 2005.

(2) Stock-Based Employee Compensation

In May 2004, the Company adopted a stock option plan (the Plan) for eligible employees. This Plan amended and restated the 1997 Texas Roadhouse Management Corp. Stock Option Plan. The Plan provides for granting of incentive and non-qualified stock options to purchase shares of Class A common stock, stock bonus awards and restricted stock awards. The Plan provides for the issuance of 16,000,000 shares of Class A common stock plus an annual increase to be added on the first day of the year for a period of ten years, commencing on January 1, 2005 and ending on (and including) January 1, 2014, equal to the lesser of one percent of the shares of Class A common stock outstanding or 1,000,000 shares of Class A common stock. Options become vested at various periods ranging from one to five years from the date of grant and expire ten years from the date of grant. The Company requires certain of its eligible employees to make refundable deposits to be applied to the exercise price of the options. These deposits are classified as stock option deposits in the accompanying condensed consolidated balance sheets.

In the first quarter of 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share-Based Payment* (SFAS 123R), which replaces SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), supersedes APB 25, *Accounting for Stock Issued to Employees*, and related interpretations and amends SFAS No. 95, *Statement of Cash Flows*. The provisions of SFAS 123R are similar to those of SFAS 123. However, SFAS 123R requires all new, modified and unvested share-based payments to employees, including grants of employee stock options and restricted stock, be recognized in the financial statements as compensation cost over the service period based on their fair value on the date of grant. Compensation cost is recognized over the service period on a straight-line basis for the fair value of awards that actually vest.

In accordance with the Financial Accounting Standards Board (FASB) Position FAS123(R) 3, *Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*, the Company has elected the alternative transition method to calculate the beginning balance of the pool of excess tax benefits. The beginning balance of excess tax benefits was calculated as the sum of all net increases in additional paid-in-capital related to tax benefits from stock-based employee compensation, less the incremental stock-based after-tax compensation costs that would have been recognized if the fair value recognition provisions of SFAS 123 had been used to account for stock-based compensation costs.

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The Company adopted SFAS 123R using a modified version of prospective application effective December 28, 2005, the beginning of its 2006 fiscal year. The adoption of SFAS 123R has resulted in a reduction of operating profit of \$1.5 million (\$0.7 million included in labor expense and \$0.8 million included in general and administrative expense), a reduction of net income of \$1.2 million and a reduction of both basic and fully diluted earnings per share of \$0.02 per share for the 13 weeks ended September 26, 2006. For the 39 weeks ended September 26, 2006, the adoption of SFAS 123R has resulted in a reduction of operating profit of \$5.0 million (\$2.4 million included in labor expense and \$2.6 million included in general and administrative expense), a reduction of net income of \$4.0 million, a reduction of both basic and fully diluted earnings per share of \$0.05 per share, a decrease of \$3.5 million in cash flows from operating activities and an increase of \$3.5 million in cash flows from financing activities.

Prior to 2006, all share-based payments were accounted for under the recognition and measurement principles of APB 25 and its related interpretations. Accordingly, no expense was reflected in the condensed consolidated statements of income, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following table illustrates the pro forma effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to all share-based payments for the 13 and 39 weeks ended September 27, 2005.

	13 Weeks Ended September 27, 2005	39 Weeks Ended September 27, 2005
Net income	\$ 7,061	\$ 24,009
Deduct total stock-based-employee compensation expense determined under fair-value-based method for all awards, net of taxes	(1,695) (3,812
Pro forma net income	\$ 5,366	\$ 20,197
Earnings per share:		
Basic as reported	\$ 0.10	\$ 0.35
Basic pro forma	\$ 0.08	\$ 0.30
Diluted as reported	\$ 0.10	\$ 0.33
Diluted pro forma	\$ 0.07	\$ 0.28

The Company estimated the fair value of the option grants made during the 13 and 39 weeks ended September 26, 2006 and September 27, 2005 as of the dates of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	13 Weeks Ended September 26, 2006	13 Weeks Ended September 27, 2005	39 Weeks Ended September 26, 2006	39 Weeks Ended September 27, 2005	
Risk-free interest rate	4.84	% 4.11	% 4.83	% 3.97	%
Expected term (years)	3.0 5.0	4.0	3.0 5.0	4.0	
Expected volatility	43.1	% 44.6	% 43.2	% 44.2	%
Expected dividend yield	0.0	% 0.0	% 0.0	% 0.0	%

In connection with its adoption of SFAS 123R, the Company determined that it was appropriate to group stock option grants into three homogeneous groups when estimating expected term. These groups consist of grants made primarily to executives, grants made primarily to restaurant-level employees and grants made to corporate office employees.

Prior to the adoption of SFAS 123R, the Company used four years as the expected term of all stock option grants. In connection with its adoption of SFAS 123R and the increasing amount of historical data the Company now possesses with regard to stock option exercise activity, the Company re-evaluated its expected term assumptions. Based on historical exercise and post-vesting employee termination behavior, the expected life for options granted to its executives is approximately 5.0 years. For options granted to restaurant-level employees, the expected life is approximately 4.0 years. For options granted to its corporate office employees, the expected life is approximately 3.0 years. The Company based its expected volatility on the volatilities of similar entities for an appropriate period of time along with the volatility of the Company's stock since its initial public offering.

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A summary of option activity as of September 26, 2006 and changes during the period then ended is presented below.

Summary Details for Plan Share Options

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 27, 2005	7,403,522	\$ 6.66		
Granted	662,763	13.36		
Forfeited	123,710	13.62		
Exercised	1,071,137	3.28		
Outstanding at September 26, 2006	6,871,438	\$ 7.71	6.96	\$ 37,406
Exercisable at September 26, 2006	4,053,636	\$ 5.72	6.07	\$ 29,905