

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

incorporation or organization) 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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

The number of shares of common stock outstanding were 71,550,183 on October 24, 2018.

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

<u>Item 1 — Financial Statements (Unaudited) — Texas Roadhouse, Inc. and Subsidiaries</u>	3
<u>Condensed Consolidated Balance Sheets — September 25, 2018 and December 26, 2017</u>	3
<u>Condensed Consolidated Statements of Income and Comprehensive Income — For the 13 and 39 Weeks Ended September 25, 2018 and September 26, 2017</u>	4
<u>Condensed Consolidated Statement of Stockholders' Equity — For the 39 Weeks Ended September 25, 2018</u>	5
<u>Condensed Consolidated Statements of Cash Flows — For the 39 Weeks Ended September 25, 2018 and September 26, 2017</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3 — Quantitative and Qualitative Disclosures About Market Risk</u>	31
<u>Item 4 — Controls and Procedures</u>	31

PART II. OTHER INFORMATION

<u>Item 1 — Legal Proceedings</u>	33
<u>Item 1A — Risk Factors</u>	33
<u>Item 2 — Unregistered Sales of Equity Securities and Use of Proceeds</u>	33
<u>Item 3 — Defaults Upon Senior Securities</u>	33
<u>Item 4 — Mine Safety Disclosures</u>	33
<u>Item 5 — Other Information</u>	33
<u>Item 6 — Exhibits</u>	34
<u>Signatures</u>	35

Table of Contents

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)

(unaudited)

	September 25, 2018	December 26, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 151,190	\$ 150,918
Receivables, net of allowance for doubtful accounts of \$27 at September 25, 2018 and \$43 at December 26, 2017	34,804	76,496
Inventories, net	16,336	16,306
Prepaid income taxes	779	—
Prepaid expenses	13,046	13,361
Total current assets	216,155	257,081
Property and equipment, net of accumulated depreciation of \$583,750 at September 25, 2018 and \$527,710 at December 26, 2017	940,955	912,147
Goodwill	121,040	121,040
Intangible assets, net of accumulated amortization of \$13,231 at September 25, 2018 and \$12,675 at December 26, 2017	2,144	2,700
Other assets	44,532	37,655
Total assets	\$ 1,324,826	\$ 1,330,623
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt and obligation under capital lease	\$ 10	\$ 9
Accounts payable	55,021	57,579
Deferred revenue-gift cards	87,947	156,627
Accrued wages	32,945	29,678
Income taxes payable	3,508	2,494
Accrued taxes and licenses	24,835	21,997
Dividends payable	17,884	14,945
Other accrued liabilities	50,327	46,669
Total current liabilities	272,477	329,998
Long-term debt and obligation under capital lease, excluding current maturities	1,973	51,981

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

Stock option and other deposits	7,300	7,699
Deferred rent	46,285	42,141
Deferred tax liabilities, net	7,102	5,301
Other liabilities	48,391	42,112
Total liabilities	383,528	479,232
Texas Roadhouse, Inc. and subsidiaries stockholders' equity:		
Preferred stock (\$0.001 par value, 1,000,000 shares authorized; no shares issued or outstanding)	—	—
Common stock (\$0.001 par value, 100,000,000 shares authorized, 71,545,237 and 71,168,897 shares issued and outstanding at September 25, 2018 and December 26, 2017, respectively)	72	71
Additional paid-in-capital	250,480	236,548
Retained earnings	675,909	602,499
Accumulated other comprehensive loss	(206)	(39)
Total Texas Roadhouse, Inc. and subsidiaries stockholders' equity	926,255	839,079
Noncontrolling interests	15,043	12,312
Total equity	941,298	851,391
Total liabilities and equity	\$ 1,324,826	\$ 1,330,623

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Statements of Income and Comprehensive Income

(in thousands, except per share data)

(unaudited)

	13 Weeks Ended		39 Weeks Ended	
	September 25, 2018	September 26, 2017	September 25, 2018	September 26, 2017
Revenue:				
Restaurant and other sales	\$ 589,704	\$ 536,341	\$ 1,836,179	\$ 1,661,821
Franchise royalties and fees	4,891	4,166	15,358	12,634
Total revenue	594,595	540,507	1,851,537	1,674,455
Costs and expenses:				
Restaurant operating costs (excluding depreciation and amortization shown separately below):				
Cost of sales	191,990	176,498	598,824	545,862
Labor	197,621	169,355	593,298	514,287
Rent	12,330	11,257	36,300	33,238
Other operating	91,946	83,679	279,182	254,176
Pre-opening	4,378	4,548	13,529	14,302
Depreciation and amortization	25,843	23,534	75,492	69,236
Impairment and closure	20	2	128	13
General and administrative	35,023	26,123	100,202	94,594
Total costs and expenses	559,151	494,996	1,696,955	1,525,708
Income from operations	35,444	45,511	154,582	148,747
Interest expense, net	168	500	810	1,211
Equity income from investments in unconsolidated affiliates	(381)	(359)	(1,150)	(1,149)
Income before taxes	35,657	45,370	\$ 154,922	\$ 148,685
Provision for income taxes	5,398	13,046	22,321	41,159
Net income including noncontrolling interests	30,259	32,324	\$ 132,601	\$ 107,526
Less: Net income attributable to noncontrolling interests	1,134	1,310	4,708	4,618
Net income attributable to Texas Roadhouse, Inc. and subsidiaries	\$ 29,125	\$ 31,014	\$ 127,893	\$ 102,908
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment, net of tax of \$54, (\$55), \$46 and (\$82), respectively	(159)	88	(167)	131
Total other comprehensive (loss) income, net of tax	(159)	88	(167)	131
Total comprehensive income	\$ 28,966	\$ 31,102	\$ 127,726	\$ 103,039
Net income per common share attributable to Texas Roadhouse, Inc. and subsidiaries:				

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

Basic	\$ 0.41	\$ 0.44	\$ 1.79	\$ 1.45
Diluted	\$ 0.40	\$ 0.43	\$ 1.78	\$ 1.44
Weighted average shares outstanding:				
Basic	71,508	71,067	71,429	70,939
Diluted	72,006	71,532	71,906	71,449
Cash dividends declared per share	\$ 0.25	\$ 0.21	\$ 0.75	\$ 0.63

See accompanying notes to condensed consolidated financial statements.

4

Table of Contents

Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders' Equity

(in thousands, except share and per share data)

(unaudited)

	Shares	Par Value	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Texas Roadhouse, Inc. and Subsidiaries	Noncontrolling Interests	Total
Balance, December 26, 2017	71,168,897	\$ 71	\$ 236,548	\$ 602,499	\$ (39)	\$ 839,079	\$ 12,312	\$ 851,391
Net income	—	—	—	127,893	—	127,893	4,708	132,601
Other comprehensive loss, net	—	—	—	—	(167)	(167)	—	(167)
Noncontrolling interests contribution	—	—	—	—	—	—	2,551	2,551
Contribution from executive officer	—	—	1,000	—	—	1,000	—	1,000
Distributions to noncontrolling interest holders	—	—	—	—	—	—	(4,481)	(4,481)
Acquisition of noncontrolling interest	—	—	(75)	—	—	(75)	(47)	(122)
Dividends declared (\$0.75 per share)	—	—	—	(53,605)	—	(53,605)	—	(53,605)
Shares issued under share-based compensation plans including tax effects	580,861	1	(1)	—	—	—	—	—
Indirect repurchase of shares for minimum	(204,521)	—	(11,812)	—	—	(11,812)	—	(11,812)

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

tax withholdings								
Cumulative effect of change in accounting principle	—	—	—	(878)	—	(878)	—	(878)
Share-based compensation	—	—	24,820	—	—	24,820	—	24,820
Balance, September 25, 2018	71,545,237	\$ 72	\$ 250,480	\$ 675,909	\$ (206)	\$ 926,255	\$ 15,043	\$ 941,298

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Texas Roadhouse, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	39 Weeks Ended	
	September 25, 2018	September 26, 2017
Cash flows from operating activities:		
Net income including noncontrolling interests	\$ 132,601	\$ 107,526
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	75,492	69,236
Deferred income taxes	2,146	(5,647)
Loss on disposition of assets	4,339	3,490
Contribution from executive officer	1,000	—
Equity income from investments in unconsolidated affiliates	(1,150)	(1,149)
Distributions of income received from investments in unconsolidated affiliates	521	585
Provision for doubtful accounts	16	19
Share-based compensation expense	24,820	18,826
Changes in operating working capital:		
Receivables	41,676	31,129
Inventories	(30)	805
Prepaid expenses	315	1,689
Other assets	(6,582)	(5,729)
Accounts payable	918	(3,162)
Deferred revenue—gift cards	(68,680)	(59,302)
Accrued wages	3,267	3,541
Prepaid income taxes and income taxes payable	235	9,535
Accrued taxes and licenses	2,838	3,785
Other accrued liabilities	2,593	3,536
Deferred rent	4,144	4,158
Other liabilities	5,100	5,199
Net cash provided by operating activities	225,579	188,070
Cash flows from investing activities:		
Capital expenditures—property and equipment	(110,906)	(117,037)
Acquisition of franchise restaurants, net of cash acquired	—	(16,528)
Net cash used in investing activities	(110,906)	(133,565)
Cash flows from financing activities:		
Debt issuance costs	—	(476)
Proceeds from noncontrolling interest contribution	2,551	3,457
Distributions to noncontrolling interest holders	(4,481)	(4,042)
Proceeds from stock option and other deposits, net	14	438
Indirect repurchase of shares for minimum tax withholdings	(11,812)	(10,097)

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

Principal payments on long-term debt and capital lease obligation	(50,007)	(555)
Proceeds from exercise of stock options	—	1,485
Dividends paid to shareholders	(50,666)	(43,223)
Net cash used in financing activities	(114,401)	(53,013)
Net increase in cash and cash equivalents	272	1,492
Cash and cash equivalents—beginning of period	150,918	112,944
Cash and cash equivalents—end of period	\$ 151,190	\$ 114,436
Supplemental disclosures of cash flow information:		
Interest paid, net of amounts capitalized	\$ 568	\$ 948
Income taxes paid	\$ 19,940	\$ 37,271
Capital expenditures included in current liabilities	\$ 9,415	\$ 5,470

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Texas Roadhouse, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(tabular amounts in thousands, except share and per share data)

(unaudited)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Texas Roadhouse, Inc. ("TRI"), our wholly-owned subsidiaries and subsidiaries in which we have a controlling interest (collectively the "Company," "we," "our" and/or "us") as of September 25, 2018 and September 26, 2017 and for the 13 and 39 weeks ended September 25, 2018 and September 26, 2017.

As of September 25, 2018, we owned and operated 479 restaurants and franchised an additional 91 restaurants in 49 states and eight foreign countries. Of the 479 company restaurants that were operating at September 25, 2018, 460 were wholly-owned and 19 were majority-owned. Of the 91 franchise restaurants, 70 were domestic restaurants and 21 were international restaurants.

As of September 26, 2017, we owned and operated 455 restaurants and franchised an additional 85 restaurants in 49 states and six foreign countries. Of the 455 company restaurants that were operating at September 26, 2017, 437 were wholly-owned and 18 were majority-owned. Of the 85 franchise restaurants, 70 were domestic restaurants and 15 were international restaurants.

As of September 25, 2018 and September 26, 2017, we owned 5.0% to 10.0% equity interest in 24 franchise restaurants. Additionally, as of September 25, 2018 and September 26, 2017, we owned a 40% equity interest in four non-Texas Roadhouse restaurants as part of a joint venture agreement with a casual dining restaurant operator in China. The unconsolidated restaurants are accounted for using the equity method. Our investments in these unconsolidated affiliates are included in other assets in our unaudited condensed consolidated balance sheets, and we record our percentage share of net income earned by these unconsolidated affiliates in our unaudited condensed consolidated statements of income and comprehensive income under equity income from investments in unconsolidated affiliates. All significant intercompany balances and transactions for these unconsolidated restaurants as well as the entities whose accounts have been consolidated have been eliminated.

We have made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements

and the reporting of revenue and expenses during the periods to prepare these unaudited condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP"). Significant items subject to such estimates and assumptions include the carrying amounts of property and equipment and goodwill, obligations related to insurance reserves, leases and leasehold improvements, legal reserves, gift card breakage and third party fees and income taxes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our consolidated financial position, results of operations and cash flows for the periods presented. The unaudited condensed consolidated financial statements have been prepared in accordance with GAAP, 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 25, 2018 are not necessarily indicative of the results that may be expected for the year ending December 25, 2018. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 26, 2017.

Our significant interim accounting policies include the recognition of income taxes using an estimated annual effective tax rate.

Table of Contents

(2) Recent Accounting Pronouncements

Revenue Recognition

(Accounting Standards Codification 606, "ASC 606")

On December 27, 2017, we adopted ASC 606, Revenue from Contracts with Customers. This ASC requires an entity to allocate the transaction price received from customers to each separate and distinct performance obligation and recognize revenue as these performance obligations are satisfied. This standard replaces most existing revenue recognition guidance in GAAP. The adoption of this standard did not have an impact on our recognition of sales from company restaurants or our recognition of continuing fees from franchisees, which are based on a percentage of franchise restaurant sales. As further detailed below, the adoption of this standard did have an impact on the recognition of initial franchise fees and upfront fees from international development agreements. In addition, certain transactions that were previously recorded as expense are now classified as revenue. We utilized the cumulative-effect method of adoption and recorded a \$0.9 million reduction, net of tax, to retained earnings as of the first day of fiscal 2018 to reflect the change in the recognition pattern of initial franchise fees and upfront fees. The comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The cumulative effects of the changes made to our unaudited condensed consolidated balance sheet as of December 26, 2017 as a result of the adoption of ASC 606 were as follows:

	Balance at December 26, 2017	ASC 606 Adjustments	Balance at December 27, 2017
Liabilities			
Deferred tax liabilities, net	\$ 5,301	\$ (299)	\$ 5,002
Other liabilities, non-current	42,112	1,177	43,289
Equity			
Retained earnings	\$ 602,499	\$ (878)	\$ 601,621

Under ASC 606, because the services we provide related to initial franchise fees and upfront fees from international development agreements do not contain separate and distinct performance obligations from the franchise right, these fees will be recognized on a straight-line basis over the term of the associated franchise agreement. Under previous guidance, initial franchise fees were recognized when the related services had been provided, which was generally upon the opening of the restaurant, and upfront fees were recognized on a pro-rata basis as restaurants under the development agreement were opened. These fees will continue to be recorded as a component of franchise royalties and fees in our unaudited condensed consolidated statements of income and comprehensive income. ASC 606

requires sales-based royalties to continue to be recognized as franchise restaurant sales occur.

In addition, certain transactions that were previously recorded as expense are now classified as revenue. These transactions include breakage income and third party gift card fees from our gift card program as well as accounting fees, supervision fees and advertising contributions received from our franchisees. Under ASC 606, breakage income and third party gift card fees are recorded as a component of restaurant and other sales in our unaudited condensed consolidated statements of income and comprehensive income. Under previous guidance, these transactions were recorded as a component of other operating expense. Also under ASC 606, accounting fees, supervision fees and advertising contributions received from our franchisees are recorded as a component of franchise royalties and fees in our unaudited condensed consolidated statements of income and comprehensive income. Under previous guidance, these transactions were recorded as a reduction of general and administrative expense. As noted above, we adopted ASC 606 as of the first day of fiscal 2018. The comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods.

Table of Contents

The impact of adopting ASC 606 as compared to the previous revenue recognition guidance on our unaudited condensed consolidated balance sheet and unaudited condensed consolidated statements of income and comprehensive income was as follows:

	September 25, 2018					
	As Reported	Balances Without Adoption of ASC 606	Adoption Impact of ASC 606			
Balance Sheet						
Liabilities						
Deferred tax liabilities, net	\$ 7,102	\$ 7,398	\$ (296)			
Other liabilities, non-current	48,391	47,223	1,168			
Equity						
Retained earnings	\$ 675,909	\$ 676,781	\$ (872)			
	13 Weeks Ended September 25, 2018			39 Weeks Ended September 25, 2018		
	As Reported	Balances Without Adoption of ASC 606	Adoption Impact of ASC 606	As Reported	Balances Without Adoption of ASC 606	Adoption Impact of ASC 606
Income Statement						
Revenue						
Restaurant and other sales	\$ 589,704	\$ 590,928	\$ (1,224)	\$ 1,836,179	\$ 1,840,678	\$ (4,499)
Franchise royalties and fees	4,891	4,299	592	15,358	13,529	1,829
Costs and expenses						
Other operating	91,946	93,170	(1,224)	279,182	283,681	(4,499)
General and administrative	35,023	34,439	584	100,202	98,383	1,819
Provision for income taxes	5,398	5,396	2	22,321	22,317	4
Net Income	\$ 29,125	\$ 29,119	\$ 6	\$ 127,893	\$ 127,887	\$ 6

Statement of Cash Flows

(Accounting Standards Update 2016-15, "ASU 2016-15")

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which adds and/or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. We adopted this guidance as of the beginning of our 2018 fiscal year. The adoption of this guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

Income Taxes

(Accounting Standards Update 2016-16, "ASU 2016-16")

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740), which addresses the income tax consequences of intra-entity transfers of assets other than inventory. Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. This standard will require recognition of current and deferred income taxes resulting from an intra-entity transfer of an asset other than inventory when the transfer occurs. We adopted this guidance as of the beginning of our 2018 fiscal year. The adoption of this guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

Table of Contents

Compensation – Stock Compensation

(Accounting Standards Update 2017-09, "ASU 2017-09")

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which clarifies when a change in the terms or conditions of a share-based payment award must be accounted for as a modification. ASU 2017-09 requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change in the terms and conditions of the award. We adopted this guidance as of the beginning of our 2018 fiscal year. The adoption of this guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

Leases

(Accounting Standards Update 2016-02, "ASU 2016-02")

In February 2016, the FASB issued ASU 2016-02, Leases, which requires an entity to recognize a right-of-use asset and a lease liability for virtually all leases. This update also requires additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (our 2019 fiscal year). In March 2018, the FASB approved an amendment that allowed a modified retrospective approach and new required lease disclosures for all leases existing or entered into after either the beginning of the year of adoption or the earliest comparative period in the consolidated financial statements. We currently plan to adopt ASU 2016-02 using a modified retrospective approach as of the beginning of the year of adoption. We plan to take advantage of the transition package of practical expedients permitted within the new standard which will allow us to carryforward the historical lease classification. We also plan to elect the hindsight practical expedient to determine the reasonably certain lease term for existing leases.

We had operating leases with remaining rental payments of approximately \$894.6 million as of September 25, 2018. The discounted minimum remaining rental payments will be the starting point for determining the right-of-use asset and lease liability. While we are still in the process of assessing the impact of this new standard on our consolidated financial position, results of operations and cash flows, we expect the adoption of this standard will have a material impact on our consolidated financial position due to the recognition of the right-of-use asset and lease liability related to operating leases. While the new standard is also expected to impact the measurement and presentation of elements of expenses and cash flows related to leasing arrangements, we do not presently believe there will be a material impact on our consolidated results of operations, cash flows, or the related notes.

Financial Instruments

(Accounting Standards Update 2016-13, "ASU 2016-13")

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected versus incurred losses for financial assets held. ASU 2016-13 is effective for annual periods beginning after December 15, 2019 (our 2020 fiscal year), with early adoption permitted for annual periods beginning after December 15, 2018. We are currently assessing the impact of this new standard on our consolidated financial position, results of operations and cash flows.

Goodwill

(Accounting Standards Update 2017-04, "ASU 2017-04")

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the accounting for goodwill impairment and is expected to reduce the cost and complexity of accounting for goodwill. ASU 2017-04 removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Instead, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of the goodwill. ASU 2017-04 is effective for fiscal years beginning after December 15, 2019 (our 2020 fiscal year) and will be applied on a prospective basis. Early adoption is permitted for interim and annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently assessing the impact of this new standard on our consolidated financial position, results of operations and cash flows.

Table of Contents

Fair Value Measurements

(Accounting Standards Update 2018-13, "ASU 2018-13")

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement, which eliminates, modifies and adds disclosure requirements for fair value measurements. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019 (our 2020 fiscal year) and for interim periods within those years, with early adoption permitted. We are currently assessing the impact of this new standard on our consolidated financial statements.

(3) Revenue

The following table disaggregates our revenue by major source (in thousands):

	13 Weeks Ended September 25, 2018	39 Weeks Ended September 25, 2018
Restaurant and other sales	\$ 589,704	\$ 1,836,179
Franchise royalties	4,249	13,069
Franchise fees	642	2,289
Total revenue	\$ 594,595	\$ 1,851,537

Restaurant sales include the sale of food and beverage products to our customers. We recognize this revenue when the products are sold. All sales taxes collected from customers and remitted to governmental authorities are accounted for on a net basis and therefore are excluded from revenue in the unaudited condensed consolidated statements of income and comprehensive income.

Other sales include the amortization of gift card breakage and fees associated with third party gift card sales. We record deferred revenue for gift cards that have been sold but not yet redeemed. When the gift cards are redeemed, we recognize restaurant sales and reduce deferred revenue. For some of the gift cards that are sold, the likelihood of redemption is remote. When the likelihood of a gift card's redemption is determined to be remote, we record a breakage adjustment and reduce deferred revenue by the amount never expected to be redeemed. We use historic gift card redemption patterns to determine when the likelihood of a gift card's redemption becomes remote and have determined that approximately 4% of the value of the gift cards sold by our company and our third party retailers will never be redeemed. This breakage adjustment is recorded consistent with the historic redemption pattern of the associated gift card. In addition, we incur fees on all gift cards that are sold through third party retailers. These fees are also deferred and recorded consistent with the historic redemption pattern of the associated gift cards. For the 13 and 39 weeks ended September 25, 2018, we recognized gift card fees, net of gift card breakage income, of approximately \$1.2 million and \$4.5 million, respectively. Total deferred revenue related to our gift cards is included in deferred revenue-gift cards in our unaudited condensed consolidated balance sheets and includes the full value of

unredeemed gift cards less the amortized portion of the breakage rates and the unamortized portion of third party fees. As of September 25, 2018 and December 26, 2017, our deferred revenue balance related to gift cards was approximately \$87.9 million and \$156.6 million, respectively. This change was primarily due to the redemption of gift cards partially offset by the sale of additional gift cards. We recognized sales of approximately \$12.9 million and \$99.3 million for the 13 and 39 weeks ended September 25, 2018, respectively, related to the amount in deferred revenue as of December 26, 2017.

Franchise royalties include continuing fees received from our franchising of Texas Roadhouse restaurants. We execute franchise agreements for each franchise restaurant which sets out the terms of our arrangement with the franchisee. These agreements require the franchisee to pay ongoing royalties of generally 4.0% of gross sales from our domestic franchisees, along with royalties paid to us by our international franchisees. Franchise royalties are recognized as revenue as the corresponding franchise restaurant sales occur.

Franchise fees are all remaining fees from our franchisees including initial fees, upfront fees from international agreements, fees paid to our domestic marketing and advertising fund, and fees for supervisory and administrative services. Our franchise agreements typically require the franchisee to pay an initial, non-refundable fee. Subject to our approval and payment of a renewal fee, a franchisee may generally renew the franchise agreement upon its expiration. These initial fees and renewal fees are deferred and recognized over the term of the agreement. We also enter into area

Table of Contents

development agreements for the development of international Texas Roadhouse restaurants. Upfront fees from development agreements are deferred and recognized on a pro-rata basis over the term of the individual restaurant franchise agreement as restaurants under the development agreement are opened. Our domestic franchise agreement also requires our franchisees to remit 0.3% of sales to our system-wide marketing and advertising fund. These amounts are recognized as revenue as the corresponding franchise restaurant sales occur. Finally, we perform supervisory and administrative services for certain franchise restaurants for which we receive management fees, which are recognized as the services are performed. Total deferred revenue related to our franchise agreements is included in other liabilities in our unaudited condensed consolidated balance sheets and was approximately \$1.2 million as of September 25, 2018 and December 26, 2017. We recognized revenue of approximately \$0.1 million and \$0.2 million for the 13 and 39 weeks ended September 25, 2018, respectively, related to the amount in deferred revenue as of December 26, 2017.

(4) Long-term Debt and Obligation Under Capital Lease

Long-term debt consisted of the following:

	September 25, 2018	December 26, 2017
Obligation under capital lease	\$ 1,983	\$ 1,990
Revolver	—	50,000
	1,983	51,990
Less current maturities	10	9
	\$ 1,973	\$ 51,981

On August 7, 2017, we entered into the Amended and Restated Credit Agreement (the "Amended Credit Agreement") with respect to our revolving credit facility with a syndicate of commercial lenders led by JPMorgan Chase Bank, N.A., PNC Bank, N.A., and Wells Fargo Bank, N.A. The revolving credit facility remains an unsecured, revolving credit agreement under which we may borrow up to \$200.0 million with the option to increase the revolving credit facility by an additional \$200.0 million subject to certain limitations. The Amended Credit Agreement extends the maturity date of our revolving credit facility until August 5, 2022.

The terms of the Amended Credit Agreement require us to pay interest on outstanding borrowings at the London Interbank Offered Rate ("LIBOR") plus a margin of 0.875% to 1.875% and to pay a commitment fee of 0.125% to 0.30% per year on any unused portion of the revolving credit facility, in each case depending on our leverage ratio, or the Alternate Base Rate, which is the highest of the issuing banks' prime lending rate, the Federal Reserve Bank of New York rate plus 0.50% or the Adjusted Eurodollar Rate for a one month interest period on such day plus 1.0%. In April 2018, we paid off our outstanding credit facility of \$50.0 million. The weighted-average interest rate for the amended revolving credit facility as of September 25, 2018 and December 26, 2017 was 3.11% and 2.37%, respectively. As of September 25, 2018, we had \$192.3 million of availability, net of \$7.7 million of outstanding letters of credit.

The lenders' obligation to extend credit pursuant to the Amended Credit Agreement depends on us maintaining certain financial covenants, including a minimum consolidated fixed charge coverage ratio of 2.00 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. The Amended Credit Agreement permits us to incur additional secured or unsecured indebtedness outside the amended revolving credit facility, except for the incurrence of secured indebtedness that in the aggregate is equal to or greater than \$125.0 million and 20% of our consolidated tangible net worth. We were in compliance with all financial covenants as of September 25, 2018.

Table of Contents

(5) Income Taxes

A reconciliation of the statutory federal income tax rate to our effective tax rate for the 13 and 39 weeks ended September 25, 2018 and September 26, 2017 is as follows:

	13 Weeks Ended		39 Weeks Ended	
	September 25, 2018	September 26, 2017	September 25, 2018	September 26, 2017
Tax at statutory federal rate	21.0	% 35.0	% 21.0	% 35.0
State and local tax, net of federal benefit	3.8	3.4	3.8	3.4
FICA tip tax credit	(8.3)	(7.1)	(9.1)	(7.1)
Work opportunity tax credit	(1.9)	(0.9)	(1.5)	(0.8)
Stock compensation	(1.4)	(0.9)	(1.4)	(2.0)
Net income attributable to noncontrolling interests	(1.2)	(1.1)	(0.8)	(1.1)
Officer compensation	2.3	0.1	1.4	0.1
Other	0.8	0.3	1.0	0.2
Total	15.1	% 28.8	% 14.4	% 27.7

Our effective tax rate decreased to 15.1% for the 13 weeks ended September 25, 2018 compared to 28.8% for the 13 weeks ended September 26, 2017. For the 39 weeks ended September 25, 2018, our effective tax rate decreased to 14.4% compared to 27.7% for the 39 weeks ended September 26, 2017. These decreases are driven by new tax legislation that was enacted in late 2017. As a result of the new tax legislation, significant tax changes were enacted including a reduction of the federal corporate tax rate from 35.0% to 21.0%. These changes were generally effective at the beginning of our 2018 fiscal year.

(6) Commitments and Contingencies

The estimated cost of completing capital project commitments at September 25, 2018 and December 26, 2017 was approximately \$152.5 million and \$150.0 million, respectively.

As of September 25, 2018 and December 26, 2017, we were contingently liable for \$15.0 million and \$15.6 million, respectively, for seven lease guarantees, listed in the table below. These amounts represent the maximum potential liability of future payments under the guarantees. In the event of default, the indemnity and default clauses in our assignment agreements govern our ability to pursue and recover damages incurred. No material liabilities have been recorded as of September 25, 2018 and December 26, 2017 as the likelihood of default was deemed to be less than probable and the fair value of the guarantees is not considered significant.

Table of Contents

	Lease Assignment Date	Current Lease Term Expiration
Everett, Massachusetts (1)(2)	September 2002	February 2023
Longmont, Colorado (1)	October 2003	May 2029
Montgomeryville, Pennsylvania (1)	October 2004	March 2021
Fargo, North Dakota (1)(2)	February 2006	July 2021
Logan, Utah (1)	January 2009	August 2019
Irving, Texas (3)	December 2013	December 2019
Louisville, Kentucky (3)(4)	December 2013	November 2023

-
- (1) Real estate lease agreements for restaurant locations which we entered into before granting franchise rights to those restaurants. We have subsequently assigned the leases to the franchisees, but remain contingently liable under the terms of the lease if the franchisee defaults.
- (2) As discussed in note 7, these restaurants are owned, in whole or part, by certain officers, directors and 5% shareholders of the Company.
- (3) Leases associated with non-Texas Roadhouse restaurants which were sold. The leases were assigned to the acquirer, but we remain contingently liable under the terms of the lease if the acquirer defaults.
- (4) We may be released from liability after the initial contractual lease term expiration contingent upon certain conditions being met by the acquirer.

During the 13 and 39 weeks ended September 25, 2018, we bought most of our beef from three suppliers. A change in suppliers could cause supply shortages and/or higher costs to secure adequate supplies and a possible loss of sales, which would affect operating results adversely. We have no material minimum purchase commitments with our vendors that extend beyond a year.

We and the U.S. Equal Employment Opportunity Commission entered into a consent decree dated March 31, 2017 (the "Consent Decree") to settle the lawsuit styled Equal Employment Opportunity Commission v. Texas Roadhouse, Inc., Texas Roadhouse Holdings LLC and Texas Roadhouse Management Corp. in the United States District Court, District of Massachusetts, Civil Action Number 1:11-cv-11732 (the "Lawsuit"). The Consent Decree resolves the issues litigated in the Lawsuit. Under the Consent Decree, among other terms, we have established a fund of \$12.0 million, from which awards of monetary relief, allocated as wages for tax purposes, may be made to eligible claimants in accordance with procedures set forth in the Consent Decree. We recorded a pre-tax charge of \$14.9 million (\$9.2 million after-tax) related to the Lawsuit and Consent Decree during the 13 weeks ended March 28, 2017. The pre-tax charge includes \$12.6 million of costs associated with the legal settlement and \$2.3 million of legal fees associated with the defense of the case. In addition, we recorded \$0.9 million and \$1.5 million of claims administration costs during the 13 and 39 week periods ended September 25, 2018, respectively. These pre-tax charges were recorded in general and administrative expense in our unaudited condensed consolidated statements of income and comprehensive income.

Occasionally, we are a defendant in litigation arising in the ordinary course of our business, including "slip and fall" accidents, employment related claims, claims related to our service of alcohol, and claims from guests or employees

alleging illness, injury or food quality, health or operational concerns. None of these types of litigation, most of which are covered by insurance, has had a material effect on us and, as of the date of this report, we are not party to any litigation that we believe could have a material adverse effect on our business.

(7) Related Party Transactions

As of September 25, 2018, we had 10 franchise restaurants and one majority-owned company restaurant owned in part by certain officers, directors and 5% stockholders of the Company. As of September 26, 2017, we had 10 franchise restaurants owned in part by certain officers, directors and 5% stockholders of the Company. For both of the 13 week periods ended September 25, 2018 and September 26, 2017, these franchise entities paid us fees of approximately \$0.5 million. For both of the 39 week periods ended September 25, 2018 and September 26, 2017, these franchise entities paid us fees of approximately \$1.6 million. As disclosed in note 6, we are contingently liable on leases related to two of these franchise restaurants.

Table of Contents

In addition, for the 13 weeks ended June 26, 2018, our founder made a personal contribution of \$1.0 million to cover a portion of the planned expenses incurred as part of the annual managing partner conference which marked our 25th anniversary. This amount was recorded as general and administrative expense on the condensed consolidated statement of income and as additional paid-in-capital on the condensed consolidated statement of stockholders' equity.

(8) Earnings Per Share

The share and net income per share data for all periods presented are based on the historical weighted-average shares outstanding. The diluted earnings per share calculations show the effect of the weighted-average stock options and restricted stock units outstanding from our equity incentive plans. Performance stock units are not included in the diluted earnings per share calculation until the performance-based criteria have been met.

For both 13 week periods ended September 25, 2018 and September 26, 2017, there were no shares of nonvested stock that were outstanding but not included in the computation of diluted earnings per share because their inclusion would have had an anti-dilutive effect. For the 39 week periods ended September 25, 2018 and September 26, 2017, there were 220 and 7,960 shares of nonvested stock, respectively, that were not included because they would have had an anti-dilutive effect.

The following table sets forth the calculation of earnings per share and weighted-average shares outstanding (in thousands) as presented in the accompanying unaudited condensed consolidated statements of income and comprehensive income:

	13 Weeks Ended		39 Weeks Ended	
	September 25, 2018	September 26, 2017	September 25, 2018	September 26, 2017
Net income attributable to Texas Roadhouse, Inc. and subsidiaries	\$ 29,125	\$ 31,014	\$ 127,893	\$ 102,908
Basic EPS:				
Weighted-average common shares outstanding	71,508	71,067	71,429	70,939
Basic EPS	\$ 0.41	\$ 0.44	\$ 1.79	\$ 1.45
Diluted EPS:				
Weighted-average common shares outstanding	71,508	71,067	71,429	70,939
Dilutive effect of stock options and nonvested stock	498	465	477	510
Shares-diluted	72,006	71,532	71,906	71,449
Diluted EPS	\$ 0.40	\$ 0.43	\$ 1.78	\$ 1.44

(9) Fair Value Measurements

ASC 820, Fair Value Measurements ("ASC 820"), establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820 establishes a three-level hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs in measuring fair value. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date.

Level 1 Inputs based on quoted prices in active markets for identical assets.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the assets, either directly or indirectly.

Level 3 Inputs that are unobservable for the asset.

There were no transfers among levels within the fair value hierarchy during the 13 and 39 weeks ended September 25, 2018.

Table of Contents

The following table presents the fair values for our financial assets and liabilities measured on a recurring basis:

	Fair Value Measurements		
	Level	September 25, 2018	December 26, 2017
Deferred compensation plan—assets	1	\$ 34,239	\$ 28,754
Deferred compensation plan—liabilities	1	(34,273)	(28,829)

The Second Amended and Restated Deferred Compensation Plan of Texas Roadhouse Management Corp., as amended, (the "Deferred Compensation Plan") is a nonqualified deferred compensation plan which allows highly compensated employees to defer receipt of a portion of their compensation and contribute such amounts to one or more investment funds held in a rabbi trust. We report the amounts of the rabbi trust in other assets and the corresponding liability in other liabilities in our unaudited condensed consolidated financial statements. These investments are considered trading securities and are reported at fair value based on quoted market prices. The realized and unrealized holding gains and losses related to these investments, as well as the offsetting compensation expense, are recorded in general and administrative expense in the unaudited condensed consolidated statements of income and comprehensive income.

At September 25, 2018 and December 26, 2017, the fair values of cash and cash equivalents, accounts receivable and accounts payable approximated their carrying values based on the short-term nature of these instruments. The fair value of our revolving credit facility at December 26, 2017 approximated its carrying value since it is a variable rate credit facility (Level 2).

(10) Stock Repurchase Program

On May 22, 2014, our Board of Directors approved a stock repurchase program under which we may repurchase up to \$100.0 million of our common stock. This stock repurchase program has no expiration date and replaced a previous stock repurchase program which was approved on February 16, 2012. All repurchases to date under our stock repurchase program have been made through open market transactions. The timing and the amount of any repurchases will be determined by management under parameters established by our Board of Directors, based on an evaluation of our stock price, market conditions and other corporate considerations.

We did not repurchase any shares of common stock during the 13 and 39 week periods ended September 25, 2018 or September 26, 2017, respectively. As of September 25, 2018, we had approximately \$69.9 million remaining under our authorized stock repurchase program.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT

This report contains forward-looking statements based on our current expectations, estimates and projections about our industry and certain assumptions made by us. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "may," "will" and variations of these words or similar expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. Such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. The section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 26, 2017, and in Part II, Item 1A in this Form 10-Q, along with disclosures in our other Securities and Exchange Commission ("SEC") filings discuss some of the important risk factors that may affect our business, results of operations, or financial condition. You should carefully consider those risks, in addition to the other information in this report, and in our other filings with the SEC, before deciding to invest in our Company or to maintain or increase your investment. We undertake no obligation to revise or update publicly any forward-looking statements for any reason. The information contained in this Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC that discuss our business in greater detail and advise interested parties of certain risks, uncertainties and other factors that may affect our business, results of operations or financial condition.

OVERVIEW

Texas Roadhouse, Inc. is a growing restaurant company operating predominately in the casual dining segment. Our founder, chairman and chief executive officer, W. Kent Taylor, started the business in 1993 with the opening of the first Texas Roadhouse restaurant in Clarksville, Indiana. Since then, we have grown to 570 company and franchise restaurants in 49 states and eight foreign countries. Our mission statement is "Legendary Food, Legendary Service®." Our operating strategy is designed to position each of our restaurants as the local hometown favorite for a broad segment of consumers seeking high quality, affordable meals served with friendly, attentive service. As of September 25, 2018, our 570 restaurants included:

- 479 "company restaurants," of which 460 were wholly-owned and 19 were majority-owned. The results of operations of company restaurants are included in our unaudited condensed consolidated statements of income and

comprehensive income. The portion of income attributable to noncontrolling interests in company restaurants that are not wholly-owned is reflected in the line item entitled "Net income attributable to noncontrolling interests" in our unaudited condensed consolidated statements of income and comprehensive income. Of the 479 restaurants we owned and operated as of September 25, 2018, we operated 453 as Texas Roadhouse restaurants and operated 24 as Bubba's 33 restaurants. In addition, we operated two restaurants outside of the casual dining segment.

- 91 "franchise restaurants," 24 of which we have a 5.0% to 10.0% ownership interest. The income derived from our minority interests in these 24 franchise restaurants is reported in the line item entitled "Equity income from investments in unconsolidated affiliates" in our unaudited condensed consolidated statements of income and comprehensive income. Additionally, we provided various management services to these franchise restaurants, as well as six additional franchise restaurants in which we have no ownership interest. All of the franchise restaurants are operated as Texas Roadhouse restaurants. Of the 91 franchise restaurants, 70 were domestic restaurants and 21 were international restaurants.

We have contractual arrangements that grant us the right to acquire at pre-determined formulas the remaining equity interests in 17 of the 19 majority-owned company restaurants and 68 of the 70 domestic franchise restaurants.

Table of Contents

Throughout this report, we use the term "restaurants" to include Texas Roadhouse and Bubba's 33, unless otherwise noted.

Presentation of Financial and Operating Data

Throughout this report, the 13 weeks ended September 25, 2018 and September 26, 2017 are referred to as Q3 2018 and Q3 2017, respectively. The 39 weeks ended September 25, 2018 and September 26, 2017 are referred to as 2018 YTD and 2017 YTD, respectively.

As further noted in note 2 to the unaudited condensed consolidated financial statements, we adopted Accounting Standards Codification 606, Revenue from Contracts with Customers as of the beginning of our 2018 fiscal year. As a result of this adoption, certain transactions that were previously recorded as expense are now classified as revenue. These include breakage income and third party gift card fees from our gift card program which are included in other sales and previously were included in other operating expense as well as certain fees received from our franchisees which are included in franchise royalties and fees and previously were a reduction of general and administrative expense. In addition, we reclassified certain amounts between restaurant operating costs and general and administrative expenses. None of the above mentioned reclassifications had an impact to income before taxes and the comparative financial information has not been restated for these reclassifications. The comparative impact of these reclassifications is further detailed below.

Long-Term Strategies to Grow Earnings Per Share and Create Shareholder Value

Our long-term strategies with respect to increasing net income and earnings per share, along with creating shareholder value, include the following:

Expanding Our Restaurant Base. We will continue to evaluate opportunities to develop restaurants in existing markets and in new domestic and international markets. Domestically, we will remain focused primarily on markets where we believe a significant demand for our restaurants exists because of population size, income levels, competitors in the area and the presence of shopping and entertainment centers and a significant employment base. Our ability to expand our restaurant base is influenced by many factors beyond our control and, therefore, we may not be able to achieve our anticipated growth.

In 2018 YTD, we opened 17 company restaurants, which includes four Bubba's 33 restaurants, while our franchise partners opened four restaurants. We currently plan to open 27 or 28 company restaurants in 2018 including five Bubba's 33 restaurants. Our existing franchise partners have opened four international Texas Roadhouse restaurants in

2018 YTD. In early Q4 2018, we had one additional international franchise opening.

Our average capital investment for the 23 Texas Roadhouse restaurants opened during 2017, including pre-opening expenses and a capitalized rent factor, was \$5.3 million. We expect our average capital investment for Texas Roadhouse restaurants opening in 2018 to be approximately \$5.3 million. For 2017, the average capital investment, including pre-opening expenses and a capitalized rent factor, for the four Bubba's 33 restaurants opened during the year was \$6.1 million. We expect our average capital investment for Bubba's 33 restaurants opened in 2018 to be approximately \$7.0 million. The increase in our 2018 average capital investment for our Bubba's 33 restaurants is primarily due to higher costs at one urban site in New Jersey as well as higher rent and pre-opening costs. We continue to evaluate our Bubba's 33 prototype.

We remain focused on driving sales and managing restaurant investment costs to maintain our restaurant development in the future. Our capital investment (including cash and non-cash costs) for new restaurants varies significantly depending on a number of factors including, but not limited to: the square footage, layout, scope of required site work, type of construction labor (union or non-union), local permitting requirements, our ability to negotiate with landlords, cost of liquor and other licenses and hook-up fees and geographical location.

We have entered into area development and/or franchise agreements for the development and operation of Texas Roadhouse restaurants in multiple foreign countries. As of September 25, 2018, we have 21 restaurants open in eight foreign countries including 15 restaurants in five countries in the Middle East, three restaurants in Taiwan, two

Table of Contents

restaurants in the Philippines and one restaurant in Mexico. For most of the existing international agreements, the franchisee is required to pay us a franchise fee for each restaurant to be opened, royalties on the gross sales of each restaurant and a development fee for our grant of development rights in the named countries. We anticipate that the specific business terms of any future franchise agreement for international restaurants might vary significantly from the standard terms of our domestic agreements and from the terms of existing international agreements, depending on the territory to be franchised and the extent of franchisor-provided services to each franchisee.

Maintaining and/or Improving Restaurant Level Profitability. We plan to maintain restaurant-level profitability (restaurant margin) through a combination of increased comparable restaurant sales and operating cost management. Restaurant margin is not a U.S. generally accepted accounting principle ("GAAP") measure and should not be considered in isolation, or as an alternative to income from operations. See further discussion of restaurant margin below. In general, we continue to balance the impacts of inflationary pressures with our value positioning as we remain focused on our long-term success. This may create a challenge in terms of maintaining and/or increasing restaurant margin, as a percentage of restaurant and other sales, in any given year, depending on the level of inflation we experience. In addition to restaurant margin, as a percentage of restaurant and other sales, we also focus on the growth of restaurant margin dollars per store week as a measure of restaurant-level profitability. In terms of driving comparable restaurant sales, we remain focused on encouraging repeat visits by our guests and attracting new guests through our continued commitment to operational standards relating to food and service quality. To attract new guests and increase the frequency of visits of our existing guests, we also continue to drive various localized marketing programs, focus on speed of service and increase throughput by adding seats and parking at certain restaurants.

Leveraging Our Scalable Infrastructure. To support our growth, we continue to make investments in our infrastructure. Over the past several years, we have made significant investments in our infrastructure, including information and accounting systems, real estate, human resources, legal, marketing, international and restaurant operations, including the development of new concepts. Our goal is to increase general and administrative costs at a slower growth rate than our revenue. Whether we can leverage our infrastructure in future years will depend, in part, on our new restaurant openings, our comparable restaurant sales growth rate going forward and the level of investment we continue to make in our infrastructure.

Returning Capital to Shareholders. We continue to pay dividends and evaluate opportunities to return capital to our shareholders through repurchases of common stock. In 2011, our Board of Directors declared our first quarterly dividend of \$0.08 per share of common stock. We have consistently grown our per share dividend each year since that time and our long-term strategy includes increasing our regular quarterly dividend amount over time. On August 23, 2018, our Board of Directors declared a quarterly dividend of \$0.25 per share of common stock. The declaration and payment of cash dividends on our common stock is at the discretion of our Board of Directors, and any decision to declare a dividend will be based on many factors, including, but not limited to, earnings, financial condition, applicable covenants under our revolving credit facility, other contractual restrictions and other factors deemed relevant.

In 2008, our Board of Directors approved our first stock repurchase program. From inception through September 25, 2018, we have paid \$216.6 million through our authorized stock repurchase programs to repurchase 14,844,851 shares

of our common stock at an average price per share of \$14.59. On May 22, 2014, our Board of Directors approved a stock repurchase program under which we may repurchase up to \$100.0 million of our common stock. This stock repurchase program has no expiration date and replaced a previous stock repurchase program which was approved on February 16, 2012. All repurchases to date have been made through open market transactions. As of September 25, 2018, approximately \$69.9 million remains authorized for stock repurchases.

Key Measures We Use to Evaluate Our Company

Key measures we use to evaluate and assess our business include the following:

Number of Restaurant Openings. Number of restaurant openings reflects the number of restaurants opened during a particular fiscal period. For company restaurant openings, we incur pre opening costs, which are defined below, before the restaurant opens. Typically, new Texas Roadhouse restaurants open with an initial start up period of higher than normalized sales volumes, which decrease to a steady level approximately three to six months after opening. However,

Table of Contents

although sales volumes are generally higher, so are initial costs, resulting in restaurant margins that are generally lower during the start up period of operation and increase to a steady level approximately three to six months after opening.

Comparable Restaurant Sales Growth. Comparable restaurant sales growth reflects the change in restaurant sales for company restaurants over the same period in prior years for the comparable restaurant base. We define the comparable restaurant base to include those restaurants open for a full 18 months before the beginning of the period measured excluding restaurants closed during the period. Comparable restaurant sales growth can be impacted by changes in guest traffic counts or by changes in the per person average check amount. Menu price changes and the mix of menu items sold can affect the per person average check amount.

Average Unit Volume. Average unit volume represents the average quarterly or annual restaurant sales for company restaurants open for a full six months before the beginning of the period measured excluding restaurants closed during the period. Historically, average unit volume growth is less than comparable restaurant sales growth which indicates that newer restaurants are operating with sales levels lower than the company average. At times, average unit volume growth may be more than comparable restaurant sales growth which indicates that newer restaurants are operating with sales levels higher than the company average.

Store Weeks. Store weeks represent the number of weeks that our company restaurants were open during the period measured.

Restaurant Margin. Restaurant margin (in dollars and as a percentage of restaurant and other sales) represents restaurant and other sales less restaurant-level operating costs, including cost of sales, labor, rent and other operating costs. Restaurant margin is not a measurement determined in accordance with GAAP and should not be considered in isolation, or as an alternative, to income from operations. This non-GAAP measure is not indicative of overall company performance and profitability in that this measure does not accrue directly to the benefit of shareholders due to the nature of the costs excluded. Restaurant margin is widely regarded as a useful metric by which to evaluate restaurant-level operating efficiency and performance. In calculating restaurant margin, we exclude certain non-restaurant-level costs that support operations, including pre-opening and general and administrative expenses, but do not have a direct impact on restaurant-level operational efficiency and performance. We also exclude depreciation and amortization expense, substantially all of which relates to restaurant-level assets, as it represents a non-cash charge for the investment in our restaurants. We also exclude impairment and closure expense as we believe this provides a clearer perspective of the Company's ongoing operating performance and a more useful comparison to prior period results. Restaurant margin as presented may not be comparable to other similarly titled measures of other companies in our industry. A reconciliation of income from operations to restaurant margin is included in the Results of Operations section below.

Other Key Definitions

Restaurant and Other Sales. Restaurant sales include gross food and beverage sales, net of promotions and discounts, for all company restaurants. Sales taxes collected from customers and remitted to governmental authorities are accounted for on a net basis and therefore are excluded from restaurant sales in the unaudited condensed consolidated statements of income and comprehensive income. Beginning in 2018, with the adoption of new revenue recognition accounting guidance, other sales include the amortization of fees associated with our third party gift card sales net of the amortization of gift card breakage income which had previously been recorded in restaurant other operating expense. These amounts are amortized over a period consistent with the historic redemption pattern of the associated gift cards.

Franchise Royalties and Fees. Franchise royalties consist of royalties, as defined in our franchise agreements, paid to us by domestic and international franchisees. Domestic and international franchisees also typically pay an initial franchise fee and/or development fee for each new restaurant or territory. The terms of the international agreements may vary significantly from our domestic agreements. Beginning in 2018, with the adoption of new revenue recognition accounting guidance, franchise royalties and fees include certain fees which had previously been recorded as a reduction of general and administrative expenses. These include advertising fees paid by domestic franchisees to our system-wide marketing and advertising fund and management fees paid by certain domestic franchisees for supervisory and administrative services that we perform.

Table of Contents

Restaurant Cost of Sales. Restaurant cost of sales consists of food and beverage costs of which approximately half relates to beef costs.

Restaurant Labor Expenses. Restaurant labor expenses include all direct and indirect labor costs incurred in operations except for profit-sharing incentive compensation expenses earned by our restaurant managing partners and market partners. These profit-sharing expenses are reflected in restaurant other operating expenses. Restaurant labor expenses also include share-based compensation expense related to restaurant-level employees.

Restaurant Rent Expense. Restaurant rent expense includes all rent, except pre-opening rent, associated with the leasing of real estate and includes base, percentage and straight-line rent expense.

Restaurant Other Operating Expenses. Restaurant other operating expenses consist of all other restaurant-level operating costs, the major components of which are utilities, supplies, local store advertising, repairs and maintenance, equipment rent, property taxes, credit card fees and general liability insurance. Profit-sharing incentive compensation expenses earned by our restaurant managing partners and market partners are also included in restaurant other operating expenses.

Pre-opening Expenses. Pre-opening expenses, which are charged to operations as incurred, consist of expenses incurred before the opening of a new restaurant and are comprised principally of opening team and training team compensation and benefits, travel expenses, rent, food, beverage and other initial supplies and expenses. On average, over 70% of total pre-opening costs incurred per restaurant opening relate to the hiring and training of employees. Pre-opening costs vary by location depending on many factors, including the size and physical layout of each location; the number of management and hourly employees required to operate each restaurant; the availability of qualified restaurant staff members; the cost of travel and lodging for different geographic areas; the timing of the restaurant opening; and the extent of unexpected delays, if any, in obtaining final licenses and permits to open the restaurants.

Depreciation and Amortization Expenses. Depreciation and amortization expenses ("D&A") include the depreciation of fixed assets and amortization of intangibles with definite lives, substantially all of which relates to restaurant-level assets.

Impairment and Closure Costs. Impairment and closure costs include any impairment of long-lived assets, including goodwill, and expenses associated with the closure of a restaurant. Closure costs also include any gains or losses associated with a relocated restaurant or the sale of a closed restaurant and/or assets held for sale as well as lease costs associated with closed or relocated restaurants.

General and Administrative Expenses. General and administrative expenses ("G&A") are comprised of expenses associated with corporate and administrative functions that support development and restaurant operations and provide an infrastructure to support future growth including certain advertising costs incurred. G&A also includes legal fees, settlement charges and share-based compensation expense related to executive officers, support center employees, and market partners, and the realized and unrealized holding gains and losses related to the investments in our deferred compensation plan.

Interest Expense, Net. Interest expense includes the cost of our debt or financing obligations including the amortization of loan fees, reduced by interest income and capitalized interest. Interest income includes earnings on cash and cash equivalents.

Equity Income from Unconsolidated Affiliates. As of September 25, 2018 and September 26, 2017, we owned a 5.0% to 10.0% equity interest in 24 franchise restaurants. Additionally, as of September 25, 2018 and September 26, 2017, we owned a 40% equity interest in four non-Texas Roadhouse restaurants as part of a joint venture agreement with a casual dining restaurant operator in China. Equity income from unconsolidated affiliates represents our percentage share of net income earned by these unconsolidated affiliates.

Net Income Attributable to Noncontrolling Interests. Net income attributable to noncontrolling interests represents the portion of income attributable to the other owners of the majority-owned restaurants. Our consolidated subsidiaries at September 25, 2018 and September 26, 2017 included 19 and 18 majority-owned restaurants, respectively, all of which were open.

Table of Contents

Q3 2018 Financial Highlights

Total revenue increased \$54.1 million, or 10.0%, to \$594.6 million in Q3 2018 compared to \$540.5 million in Q3 2017 primarily due to the opening of new restaurants combined with an increase in average unit volume driven by comparable restaurant sales growth. Store weeks and comparable restaurant sales increased 5.6% and 5.5%, respectively, at company restaurants in Q3 2018.

Restaurant margin increased \$0.3 million, or 0.3%, to \$95.8 million in Q3 2018 compared to \$95.6 million in Q3 2017 while restaurant margin, as a percentage of restaurant and other sales, decreased to 16.2% in Q3 2018 compared to 17.8% in Q3 2017. The decrease in restaurant margin, as a percentage of restaurant and other sales, was primarily due to higher labor costs as a result of higher average wage rates and current staffing initiatives and higher costs associated with workers' compensation and health insurance. The decrease was partially offset by the reclassification of certain amounts between restaurant operating costs and general and administrative expenses as noted above. These reclassifications increased restaurant margin by approximately 0.3%, as a percentage of restaurant and other sales, for Q3 2018 and had no impact on income before taxes.

Net income decreased \$1.9 million, or 6.1%, to \$29.1 million in Q3 2018 compared to \$31.0 million in Q3 2017 primarily due to higher general and administrative expenses partially offset by lower income tax expense. General and administrative expenses were higher primarily due to higher incentive compensation costs and higher legal settlement costs related to a previously disclosed legal matter. Income tax expense was lower due to a decrease in our effective income tax rate to 15.1% in Q3 2018 from 28.8% in Q3 2017 primarily due to the impact of new tax legislation. Diluted earnings per share decreased 6.7% to \$0.40 in Q3 2018 from \$0.43 in Q3 2017.

Table of Contents

Results of Operations

	13 Weeks Ended		September 26,		39 Weeks Ended		September 26,	
	September 25, 2018		September 26, 2017		September 25, 2018		September 26, 2017	
	\$	%	\$	%	\$	%	\$	%
	(In thousands)				(In thousands)			
Consolidated Statements of Income:								
Revenue:								
Restaurant and other sales	589,704	99.2	536,341	99.2	1,836,179	99.2	1,661,821	99.2
Franchise royalties and fees	4,891	0.8	4,166	0.8	15,358	0.8	12,634	0.8
Total revenue	594,595	100.0	540,507	100.0	1,851,537	100.0	1,674,455	100.0
Costs and expenses:								
(As a percentage of restaurant and other sales)								
Restaurant operating costs (excluding depreciation and amortization shown separately below):								
Cost of sales	191,990	32.6	176,498	32.9	598,824	32.6	545,862	32.8
Labor	197,621	33.5	169,355	31.6	593,298	32.3	514,287	30.9
Rent	12,330	2.1	11,257	2.1	36,300	2.0	33,238	2.0
Other operating	91,946	15.6	83,679	15.6	279,182	15.2	254,176	15.3
(As a percentage of total revenue)								
Pre-opening	4,378	0.7	4,548	0.8	13,529	0.7	14,302	0.9
Depreciation and amortization	25,843	4.3	23,534	4.4	75,492	4.1	69,236	4.1
Impairment and closure	20	NM	2	NM	128	NM	13	NM
General and administrative	35,023	5.9	26,123	4.8	100,202	5.4	94,594	5.6
Total costs and expenses	559,151	94.0	494,996	91.6	1,696,955	91.7	1,525,708	91.1
Income from operations	35,444	6.0	45,511	8.4	154,582	8.3	148,747	8.9
Interest expense, net	168	0.0	500	0.1	810	0.0	1,211	0.1
Equity income from investments in unconsolidated affiliates								
	(381)	(0.1)	(359)	NM	(1,150)	(0.1)	(1,149)	(0.1)
Income before taxes	35,657	6.0	45,370	8.4	154,922	8.4	148,685	8.9
Provision for income taxes	5,398	0.9	13,046	2.4	22,321	1.2	41,159	2.5
Net income including noncontrolling interests	30,259	5.1	32,324	6.0	132,601	7.2	107,526	6.4
Net income attributable to noncontrolling interests	1,134	0.2	1,310	0.2	4,708	0.3	4,618	0.3
Net income attributable to Texas Roadhouse, Inc. and	29,125	4.9	31,014	5.7	127,893	6.9	102,908	6.1

subsidiaries

NM — Not meaningful

23

Table of Contents

	Reconciliation of Income from Operations to Restaurant Margin			
	13 Weeks Ended		39 Weeks Ended	
	September 25, 2018	September 26, 2017	September 25, 2018	September 26, 2017
Income from operations	\$ 35,444	\$ 45,511	\$ 154,582	\$ 148,747
Less:				
Franchise royalties and fees	4,891	4,166	15,358	12,634
Add:				
Pre-opening	4,378	4,548	13,529	14,302
Depreciation and amortization	25,843	23,534	75,492	69,236
Impairment and closure	20	2	128	13
General and administrative	35,023	26,123	100,202	94,594
Restaurant margin	\$ 95,817	\$ 95,552	\$ 328,575	\$ 314,258
Restaurant margin \$/store week	15,464	16,284	17,871	18,140
Restaurant margin (as a percentage of restaurant and other sales)	16.2%	17.8%	17.9%	18.9%

See above for the definition of restaurant margin.

Restaurant Unit Activity

	Total	Texas Roadhouse	Bubba's 33	Other
Balance at December 26, 2017	549	527	20	2
Company openings	17	13	4	—
Franchise openings - Domestic	—	—	—	—
Franchise openings - International	4	4	—	—
Balance at September 25, 2018	570	544	24	2

	September 25, 2018	September 26, 2017
Company - Texas Roadhouse	453	433

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

Company - Bubba's 33	24	20
Company - Other	2	2
Franchise - Texas Roadhouse - U.S.	70	70
Franchise - Texas Roadhouse - International	21	15
Total	570	540

Table of Contents

Q3 2018 (13 weeks) compared to Q3 2017 (13 weeks) and 2018 YTD (39 weeks) compared to 2017 YTD (39 weeks)

Restaurant and Other Sales. Restaurant and other sales increased by 9.9% in Q3 2018 as compared to Q3 2017 and by 10.5% in 2018 YTD compared to 2017 YTD. The following table summarizes certain key drivers and/or attributes of restaurant and other sales at company restaurants for the periods presented. Company restaurant count activity is shown in the restaurant unit activity table above.

	Q3 2018		Q3 2017		2018 YTD		2017 YTD	
Company Restaurants:								
Increase in store weeks	5.6	%	8.1	%	6.1	%	8.0	%
Increase in average unit volume	4.8	%	3.9	%	4.7	%	3.1	%
Other(1)	(0.2)	%	0.3	%	-	%	0.2	%
Total increase in restaurant sales	10.2	%	12.3	%	10.8	%	11.3	%
Other sales(2)	(0.3)	%	-	%	(0.3)	%	-	%
Total increase in restaurant and other sales	9.9	%	12.3	%	10.5	%	11.3	%
Store weeks								
Store weeks	6,196		5,868		18,386		17,324	
Comparable restaurant sales growth	5.5	%	4.5	%	5.4	%	4.0	%
Texas Roadhouse restaurants only:								
Comparable restaurant sales growth	5.5	%	4.6	%	5.3	%	4.0	%
Average unit volume (in thousands)	\$ 1,255		\$ 1,197		\$ 3,954		\$ 3,776	
Weekly sales by group:								
Comparable restaurants (417 and 396 units, respectively)	\$ 97,137		\$ 92,712					
Average unit volume restaurants (23 and 21 units, respectively)(3)	\$ 85,217		\$ 79,891					
Restaurants less than six months old (13 and 16 units for each period)	\$ 96,347		\$ 93,419					

-
- (1) Includes the impact of the year-over-year change in sales volume of all non-Texas Roadhouse restaurants, along with Texas Roadhouse restaurants open less than six months before the beginning of the period measured and, if applicable, the impact of restaurants closed or acquired during the period.
- (2) Other sales, for Q3 2018, represent \$2.7 million related to the amortization of third party gift card fees net of \$1.5 million related to the amortization of gift card breakage income. For 2018 YTD, other sales represent \$11.0 million related to the amortization of third party gift card fees net of \$6.5 million related to the amortization of gift card breakage income.
- (3) Average unit volume restaurants include restaurants open a full six and up to 18 months before the beginning of the period measured.

Edgar Filing: Texas Roadhouse, Inc. - Form 10-Q

The increases in restaurant sales for all periods presented were primarily attributable to the opening of new restaurants combined with an increase in average unit volume driven by comparable restaurant sales growth. Comparable restaurant sales growth for all periods presented was due to an increase in our guest traffic counts and an increase in our per person average check as shown in the table below.

	Q3 2018		Q3 2017		2018 YTD		2017 YTD	
Guest traffic counts	4.0	%	3.5	%	4.2	%	3.2	%
Per person average check	1.5	%	1.0	%	1.2	%	0.8	%
Comparable restaurant sales growth	5.5	%	4.5	%	5.4	%	4.0	%

Year-over-year sales for newer restaurants included in our average unit volume, but excluded from our comparable restaurant sales, partially offset the impact of positive comparable restaurant sales growth in Q3 2018 and 2018 YTD.

The increases in our per person average check for the periods presented were primarily driven by menu price increases taken in 2018, 2017 and 2016. In 2018, we increased menu prices in the first quarter by 0.8%. In 2017, we

Table of Contents

increased menu prices in the second quarter and fourth quarter by approximately 0.5% and 0.3%, respectively. In 2016, we increased menu prices in the fourth quarter by approximately 1.0%. These menu price increases were taken as a result of inflationary pressures, primarily commodities and/or labor. We currently plan to take an additional price increase of approximately 1.7% in November 2018 and may take additional pricing in 2019 if needed.

In 2018, we plan to open 27 or 28 company restaurants, including five Bubba's 33 restaurants. We opened 17 company restaurants in 2018 YTD including 13 Texas Roadhouse restaurants and four Bubba's 33 restaurants. We have begun construction for all of our expected 2018 openings. Additionally, we currently plan to open approximately 25 to 30 company restaurants in 2019, including four Bubba's 33 restaurants.

Franchise Royalties and Fees. Franchise royalties and fees increased by \$0.7 million, or by 17.4%, in Q3 2018 from Q3 2017 and increased by \$2.7 million, or by 21.6%, in 2018 YTD from 2017 YTD. Included in these increases are the reclassifications of approximately \$0.6 million and \$2.0 million in Q3 2018 and 2018 YTD, respectively, in conjunction with the implementation of new revenue recognition accounting guidance as previously described. The remaining increase in Q3 2018 and 2018 YTD was attributable to an increase in average unit volume at domestic restaurants, driven by comparable restaurant sales growth, and the opening of new franchise restaurants. These increases were partially offset by a decrease in average unit volume at international restaurants, driven by a decrease in comparable restaurant sales at those locations.

Franchise comparable restaurant sales increased 1.8% and 2.0% in Q3 2018 and 2018 YTD, respectively, which included an increase in domestic franchise comparable restaurant sales of 4.2% and 4.1%, respectively. Franchise restaurant count activity is shown in the restaurant activity table above. Our existing franchise restaurant partners have opened four international Texas Roadhouse restaurants in 2018. In early Q4 2018, we had one additional international franchise opening. Additionally, we currently anticipate our franchise partners will open as many as eight Texas Roadhouse restaurants, primarily international, in 2019.

Restaurant Cost of Sales. Restaurant cost of sales, as a percentage of restaurant and other sales, decreased to 32.6% in Q3 2018 and 2018 YTD from 32.9% and 32.8% in Q3 2017 and 2017 YTD, respectively. These decreases were primarily due to the benefit of menu pricing actions along with the reclassification of \$1.3 million in Q3 2018 and \$3.9 million in 2018 YTD in conjunction with the implementation of new revenue recognition accounting guidance as previously described. The decrease was partially offset by commodity inflation of approximately 0.7% in Q3 2018 and approximately 0.9% in 2018 YTD driven by higher food costs.

For 2018, we expect commodity cost inflation of approximately 1.0% with fixed price contracts for approximately 65% of our overall food costs and the remainder subject to fluctuating market prices.

For 2019, we currently expect commodity cost inflation to be approximately 1.0% to 2.0% with fixed price contracts for approximately 40% of our overall food costs and the remainder subject to floating market prices.

Restaurant Labor Expenses. Restaurant labor expenses, as a percentage of restaurant and other sales, increased to 33.5% in Q3 2018 compared to 31.6% in Q3 2017 and increased to 32.3% in 2018 YTD compared to 30.9% in 2017 YTD. These increases were primarily attributable to higher average wage rates and current staffing initiatives along with higher costs associated with workers' compensation and health insurance expense partially offset by the benefit from an increase in average unit volume. Higher workers' compensation expense was driven by a \$0.9 million increase in costs recorded in Q3 2018 compared to a \$1.5 million reduction in Q3 2017. Higher health insurance expense was driven by a \$0.9 million increase in costs recorded in Q3 2018 compared to a \$0.9 million reduction in Q3 2017. The changes in workers' compensation and health insurance expense are both due to changes in our claims development history included in our quarterly actuarial reserve estimate.

For the remainder of 2018, we anticipate our labor costs will continue to be pressured by mid-single digit inflation due to increases in state-mandated minimum and tipped wage rates, ongoing labor market pressures, current staffing initiatives, and increased investment in our people. In 2019, we anticipate our labor costs will continue to be pressured by mid-single digit inflation due to the factors discussed above. These increases may or may not be offset by additional menu price adjustments or guest traffic growth.

Table of Contents

Restaurant Rent Expense. Restaurant rent expense, as a percentage of restaurant and other sales, remained relatively unchanged at 2.1% in Q3 2018 and Q3 2017 and at 2.0% in 2018 YTD and 2017 YTD. Higher rent expense, as a percentage of restaurant and other sales, at our newer restaurants was offset by the benefit from an increase in average unit volume.

Restaurant Other Operating Expenses. Restaurant other operating expenses, as a percentage of restaurant and other sales, remained relatively unchanged at 15.6% in Q3 2018 and Q3 2017 and decreased to 15.2% in 2018 YTD compared to 15.3% in 2017 YTD. In both periods, higher costs associated with restaurant supplies, repairs and maintenance and gift card production were offset by lower general liability insurance costs and the reclassifications made in conjunction with the implementation of new revenue recognition accounting guidance as previously described. In Q3 2018 and 2018 YTD, reclassifications of \$1.5 million and \$3.7 million, respectively, were made in conjunction with the implementation of the new revenue recognition accounting guidance.

Restaurant Pre-opening Expenses. Pre-opening expenses decreased to \$4.4 million in Q3 2018 from \$4.5 million in Q3 2017 and decreased to \$13.5 million in 2018 YTD from \$14.3 million in 2017 YTD. This variance was primarily due to the timing of restaurant openings as average pre-opening expenses incurred for each restaurant remained relatively unchanged for both Q3 2018 and 2018 YTD compared to the prior year periods.

Overall, we plan to open 27 or 28 company restaurants in 2018 compared to 27 company restaurants in 2017. Pre-opening costs will fluctuate from quarter to quarter based on the specific pre-opening costs incurred for each restaurant, the number and timing of restaurant openings and the number and timing of restaurant managers hired.

Depreciation and Amortization Expense. D&A, as a percentage of total revenue, decreased to 4.3% in Q3 2018 compared to 4.4% in Q3 2017 and remained relatively unchanged at 4.1% in 2018 YTD compared to 2017 YTD. These changes were primarily due to the benefit of an increase in average unit volume offset by higher depreciation, as a percentage of revenue, at new restaurants and increased re-investment in equipment at older restaurants.

General and Administrative Expenses. G&A, as a percentage of total revenue, increased to 5.9% in Q3 2018 compared to 4.8% in Q3 2017 and decreased to 5.4% in 2018 YTD compared to 5.6% in 2017 YTD. The increase in Q3 2018 was due to higher incentive compensation costs, higher claims administration costs of \$0.9 million related to a previously disclosed legal settlement and reclassifications of \$2.2 million made in conjunction with the implementation of new revenue recognition accounting guidance as previously described. This increase was partially offset by the benefit of an increase in average unit volume. The decrease in 2018 YTD was primarily due to a pre-tax charge of \$14.9 million (\$9.2 million after-tax) related to legal fees and the settlement of a legal matter in 2017 YTD and the benefit of an increase in average unit volume. This decrease was partially offset by higher managing partner

conference costs, higher incentive compensation costs, and reclassifications of \$5.2 million made in conjunction with the implementation of new revenue recognition accounting guidance as previously described.

Interest Expense, Net. Interest expense decreased to \$0.2 million in Q3 2018 compared to \$0.5 million in Q3 2017 and to \$0.8 million in 2018 YTD compared to \$1.2 million 2017 YTD, primarily driven by paying off our outstanding credit facility of \$50.0 million in April 2018. As a result, we anticipate our interest expense will be lower in 2018 compared to the prior year.

Income Tax Expense. Our effective tax rate decreased to 15.1% in Q3 2018 compared to 28.8% in Q3 2017 and decreased to 14.4% in 2018 YTD compared to 27.7% in 2017 YTD primarily due to new tax legislation that was enacted in late 2017. As a result of the new tax legislation, significant tax changes were enacted including a reduction of the federal corporate tax rate from 35.0% to 21.0%. These changes were generally effective at the beginning of our 2018 fiscal year. For 2018, we expect the effective tax rate to be 14.0% to 15.0%. For 2019, we expect the effective tax rate to be between 14.0% and 15.0%.

Table of Contents

Liquidity and Capital Resources

The following table presents a summary of our net cash provided by (used in) operating, investing and financing activities (in thousands):

	39 Weeks Ended	
	September 25, 2018	September 26, 2017
Net cash provided by operating activities	\$ 225,579	\$ 188,070
Net cash used in investing activities	(110,906)	(133,565)
Net cash used in financing activities	(114,401)	(53,013)
Net increase in cash and cash equivalents	\$ 272	\$ 1,492

Net cash provided by operating activities was \$225.6 million in 2018 YTD compared to \$188.1 million in 2017 YTD. This increase was primarily due to an increase in net income and deferred income taxes partially offset by a decrease in cash flows related to changes in working capital. The decrease in working capital was primarily due to decreases in income taxes payable and deferred revenue related to gift cards partially offset by an increase in cash flows from accounts receivable.

Our operations have not required significant working capital and, like many restaurant companies, we have been able to operate with negative working capital. Sales are primarily for cash, and restaurant operations do not require significant inventories or receivables. In addition, we receive trade credit for the purchase of food, beverages and supplies, thereby reducing the need for incremental working capital to support growth.

Net cash used in investing activities was \$110.9 million in 2018 YTD compared to \$133.6 million in 2017 YTD. The decrease was primarily due to the acquisition of four franchise restaurants in Q1 2017 for the aggregate purchase price of \$16.5 million and a decrease in capital expenditures, primarily due to the timing of restaurant openings, as further noted below.

We require capital principally for the development of new company restaurants, the refurbishment of existing restaurants and the acquisition of franchise restaurants, if any. We either lease our restaurant site locations under operating leases for periods of five to 30 years (including renewal periods) or purchase the land when appropriate. As of September 25, 2018, we had developed 142 of the 479 company restaurants on land which we own.

The following table presents a summary of capital expenditures related to the development of new restaurants and the refurbishment of existing restaurants (in thousands):

	2018 YTD	2017 YTD
New company restaurants	\$ 65,088	\$ 78,943
Refurbishment of existing restaurants(1)	45,818	38,094
Total capital expenditures	\$ 110,906	\$ 117,037

(1) Includes capital expenditures related to the support center office.

Our future capital requirements will primarily depend on the number of new restaurants we open, the timing of those openings and the restaurant prototype developed in a given fiscal year. These requirements will include costs directly related to opening new restaurants and may also include costs necessary to ensure that our infrastructure is able to support a larger restaurant base. In 2018, we expect our capital expenditures to be approximately \$160.0 million to \$165.0 million, the majority of which will relate to planned restaurant openings, including 27 or 28 restaurant openings. These amounts exclude any cash used for franchise acquisitions. In Q1 2017, we acquired four franchise restaurants for an aggregate purchase price of \$16.5 million. We intend to satisfy our capital requirements over the next 12 months with cash on hand, net cash provided by operating activities and, if needed, funds available under our amended credit facility. For 2018, we anticipate net cash provided by operating activities will exceed capital expenditures, which we plan to use to pay dividends, as approved by our Board of Directors and/or repurchase common stock.

Table of Contents

Net cash used in financing activities was \$114.4 million in 2018 YTD compared to \$53.0 million in 2017 YTD. The increase is primarily due to the repayment of our revolving credit facility in Q2 2018 along with an increase in dividends paid.

On May 22, 2014, our Board of Directors approved a stock repurchase program under which we may repurchase up to \$100.0 million of our common stock. This stock repurchase program has no expiration date and replaced a previous stock repurchase program which was approved on February 16, 2012. All repurchases to date under our stock repurchase program have been made through open market transactions. The timing and the amount of any repurchases will be determined by management under parameters established by the Board of Directors, based on an evaluation of our stock price, market conditions and other corporate considerations. During 2018 YTD, we made no share repurchases and had approximately \$69.9 million remaining under our authorized stock repurchase program as of September 25, 2018.

On August 23, 2018, our Board of Directors authorized the payment of a cash dividend of \$0.25 per share of common stock. The payment of this dividend totaling \$17.9 million was distributed on September 28, 2018 to shareholders of record at the close of business on September 12, 2018. The declared dividend is included as a liability in our unaudited condensed consolidated balance sheet as of September 25, 2018.

We paid distributions of \$4.5 million to equity holders of all 19 majority-owned company restaurants in 2018 YTD. In 2017 YTD, we paid distributions of \$4.0 million to equity holders of 17 of our 18 majority-owned company restaurants.

On August 7, 2017 we entered into the Amended and Restated Credit Agreement (the "Amended Credit Agreement") with respect to our revolving credit facility with a syndicate of commercial lenders led by JPMorgan Chase Bank, N.A., PNC Bank, N.A., and Wells Fargo Bank, N.A. The revolving credit facility remains an unsecured, revolving credit agreement under which we may borrow up to \$200.0 million with the option to increase the revolving credit facility by an additional \$200.0 million subject to certain limitations. The Amended Credit Agreement extends the maturity date of our revolving credit facility until August 5, 2022.

The terms of the Amended Credit Agreement require us to pay interest on outstanding borrowings at the London Interbank Offered Rate plus a margin of 0.875% to 1.875% and to pay a commitment fee of 0.125% to 0.30% per year on any unused portion of the revolving credit facility, in each case depending on our consolidated net leverage ratio, or the Alternate Base Rate, which is the highest of the issuing banks' prime lending rate, the Federal Reserve Bank of New York rate plus 0.50% or the Adjusted Eurodollar Rate for a one month interest period on such day plus 1.0%. The weighted-average interest rate for the revolving credit facility as of September 25, 2018 and December 26, 2017 was 3.11% and 2.37%, respectively. As of September 25, 2018, we had \$192.3 million of availability, net of \$7.7 million of outstanding letters of credit.

The lenders' obligation to extend credit pursuant to the Amended Credit Agreement depends on us maintaining certain financial covenants, including a minimum consolidated fixed charge coverage ratio of 2.00 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. The Amended Credit Agreement permits us to incur additional secured or unsecured indebtedness outside the revolving credit facility, except for the incurrence of secured indebtedness that in the aggregate is equal to or greater than \$125.0 million and 20% of our consolidated tangible net worth. We were in compliance with all financial covenants as of September 25, 2018.

Table of Contents

Contractual Obligations

The following table summarizes the amount of payments due under specified contractual obligations as of September 25, 2018 (in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 Years	3 - 5 Years	More than 5 years
Obligation under capital lease	\$ 1,983	\$ 10	\$ 26	35	1,912
Interest on capital lease	5,365	223	508	498	4,136
Operating lease obligations	894,585	48,845	96,362	97,425	651,953
Capital obligations	152,527	152,527	—	—	—
Total contractual obligations(1)	\$ 1,054,460	\$ 201,605	\$ 96,896	\$ 97,958	\$ 658,001

(1) Excluded from this amount are certain immaterial items including unrecognized tax benefits under Accounting Standards Codification 740 and the one-time transition tax on foreign earnings required under the new tax legislation.

We have no material minimum purchase commitments with our vendors that extend beyond a year. See notes 4 and 6 to the unaudited condensed consolidated financial statements for a discussion of contractual obligations.

Off-Balance Sheet Arrangements

Except for operating leases (primarily restaurant leases), we do not have any material off-balance sheet arrangements.

Guarantees

As of September 25, 2018 and December 26, 2017, we are contingently liable for \$15.0 million and \$15.6 million, respectively, for seven lease guarantees, listed in the table below. These amounts represent the maximum potential liability of future payments under the guarantees. In the event of default, the indemnity and default clauses in our assignment agreements govern our ability to pursue and recover damages incurred. No material liabilities have been recorded as of September 25, 2018 and December 26, 2017 as the likelihood of default was deemed to be less than probable and the fair value of the guarantees is not considered significant.

Table of Contents

	Lease Assignment Date	Current Lease Term Expiration
Everett, Massachusetts (1)(2)	September 2002	February 2023
Longmont, Colorado (1)	October 2003	May 2029
Montgomeryville, Pennsylvania (1)	October 2004	March 2021
Fargo, North Dakota (1)(2)	February 2006	July 2021
Logan, Utah (1)	January 2009	August 2019
Irving, Texas (3)	December 2013	December 2019
Louisville, Kentucky (3)(4)	December 2013	November 2023

-
- (1) Real estate lease agreements for restaurant locations which we entered into before granting franchise rights to those restaurants. We have subsequently assigned the leases to the franchisees, but remain contingently liable under the terms of the lease if the franchisee defaults.
- (2) As discussed in note 7 to the unaudited condensed consolidated financial statements, these restaurants are owned, in whole or part, by certain officers, directors and 5% shareholders of the Company.
- (3) Leases associated with non-Texas Roadhouse restaurants which were sold. The leases were assigned to the acquirer, but we remain contingently liable under the terms of the lease if the acquirer defaults.
- (4) We may be released from liability after the initial contractual lease term expiration contingent upon certain conditions being met by the acquirer.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates on variable rate debt and changes in commodity prices. Our exposure to interest rate fluctuations is limited to our outstanding bank debt. The terms of the revolving credit facility require us to pay interest on outstanding borrowings at London Interbank Offering Rate plus a margin of 0.875% to 1.875%, depending on our consolidated net leverage ratio, or the Alternate Base Rate, which is the highest of the issuing banks' prime lending rate, the Federal Reserve Bank of New York rate plus 0.50% or the Adjusted Eurodollar Rate for a one month interest period on such day plus 1.0%. As of September 25, 2018, we had no outstanding borrowings under our revolving credit facility.

In an effort to secure high quality, low cost ingredients used in the products sold in our restaurants, we employ various purchasing and pricing contract techniques. When purchasing certain types of commodities, we may be subject to prevailing market conditions resulting in unpredictable price volatility. For certain commodities, we may also enter into contracts for terms of one year or less that are either fixed price agreements or fixed volume agreements where the price is negotiated with reference to fluctuating market prices. We currently do not use financial instruments to hedge commodity prices, but we will continue to evaluate their effectiveness. Extreme and/or long term increases in commodity prices could adversely affect our future results, especially if we are unable, primarily due to competitive reasons, to increase menu prices. Additionally, if there is a time lag between the increasing commodity prices and our

ability to increase menu prices or if we believe the commodity price increase to be short in duration and we choose not to pass on the cost increases, our short term financial results could be negatively affected.

We are subject to business risk as our beef supply is highly dependent upon three vendors. If these vendors were unable to fulfill their obligations under their contracts, we may encounter supply shortages and/or higher costs to secure adequate supplies and a possible loss of sales, any of which would harm our business.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to, and as defined in, Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on the evaluation, performed under the supervision and with the

Table of Contents

participation of our management, including the Chief Executive Officer (the "CEO") and the Chief Financial Officer (the "CFO"), our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective as of September 25, 2018.

Changes in Internal Control

There were no changes in the Company's internal control over financial reporting that occurred during the period covered by this report that materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Occasionally, we are a defendant in litigation arising in the ordinary course of our business, including "slip and fall" accidents, employment related claims, claims related to our service of alcohol, and claims from guests or employees alleging illness, injury or food quality, health or operational concerns. None of these types of litigation, most of which are covered by insurance, has had a material effect on us and, as of the date of this report, we are not party to any litigation that we believe could have a material adverse effect on our business.

ITEM 1A. RISK FACTORS

Information regarding risk factors appears in our Annual Report on Form 10-K for the year ended December 26, 2017, under the heading "Special Note Regarding Forward-looking Statements" and in the Form 10-K Part I, Item 1A, Risk Factors. There have been no material changes from the risk factors previously disclosed in our Form 10-K for the year ended December 26, 2017.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 22, 2014, our Board of Directors approved a stock repurchase program which authorized us to repurchase up to \$100.0 million of our common stock. For both the 13 and 39 weeks ended September 25, 2018, we did not repurchase any shares of common stock. As of September 25, 2018, we had approximately \$69.9 million remaining under our authorized repurchase program. This stock repurchase program has no expiration date and replaced a previous stock repurchase program which was approved on February 16, 2012. All repurchases to date under our stock repurchase program have been made through open market transactions. The timing and the amount of any repurchases through this program will be determined by management under parameters established by our Board of Directors, based on an evaluation of our stock price, market conditions and other corporate considerations.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

33

Table of Contents

ITEM 6. EXHIBITS

Exhibit No.	Description
10.1	<u>Employment Agreement between Texas Roadhouse Management Corp. and Doug Thompson entered into as of August 23, 2018</u>
10.2	<u>Master Lease Agreement dated October 26, 2018 between Paragon Centre Holdings, LLC and Texas Roadhouse Holdings LLC</u>
31.1	<u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

Table of Contents

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.

TEXAS ROADHOUSE, INC.

Date: November 2, 2018 By: /s/ W. KENT TAYLOR
W. Kent Taylor
Chief Executive Officer (principal executive officer)

Date: November 2, 2018 By: /s/ TONYA R. ROBINSON
Tonya R. Robinson
Chief Financial Officer
(principal financial officer)
(principal accounting officer)