

Texas Roadhouse, Inc.  
Form 10-K  
February 23, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 26, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

## Texas Roadhouse, Inc.

(Exact name of registrant specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**000-50972**

(Commission File Number)

**20-1083890**

(IRS Employer Identification Number)

**6040 Dutchmans Lane, Suite 200**

**Louisville, Kentucky 40205**

(Address of principal executive offices) (Zip Code)

**(502) 426-9984**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Class A Common Stock, par value \$0.001 per share

Name of Each Exchange on Which Registered

Nasdaq Global Select Market

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

Securities registered pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No .

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K. .

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last day of the second fiscal quarter ended June 27, 2006 was \$691,258,900 based on the closing stock price of \$13.64. Shares of voting stock held by each officer and director and by each person who owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The registrant has no shares of non-voting common stock authorized or outstanding. The market value calculation was determined using the closing stock price of our Class A common stock on the Nasdaq Global Select Market.

The number of shares of Class A and Class B common stock outstanding were 69,076,631 and 5,265,376, respectively, on February 16, 2007.

Portions of the registrant's definitive Proxy Statement for the registrant's 2007 Annual Meeting of Stockholders, which is expected to be filed pursuant to Regulation 14A within 120 days of the registrant's fiscal year ended December 26, 2006, are incorporated by reference into Part III of the Form 10-K. With the exception of the portions of the Proxy Statement expressly incorporated by reference, such document shall not be deemed filed with this Form 10-K.

TABLE OF CONTENTS

	Page	
<b><u>PART I</u></b>		
<u>Item 1.</u>	<u>Business</u>	5
<u>Item 1A.</u>	<u>Risk Factors</u>	15
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	24
<u>Item 2.</u>	<u>Properties</u>	25
<u>Item 3.</u>	<u>Legal Proceedings</u>	26
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	26
<b><u>PART II</u></b>		
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	26
<u>Item 6.</u>	<u>Selected Financial Data</u>	27
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	45
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	45
<u>Item 9A.</u>	<u>Controls and Procedures</u>	45
<u>Item 9B.</u>	<u>Other Information</u>	46
<b><u>PART III</u></b>		
<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	47
<u>Item 11.</u>	<u>Executive Compensation</u>	47
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	47
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	47
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>	47
<b><u>PART IV</u></b>		
<u>Item 15.</u>	<u>Exhibits, Financial Statement Schedules</u>	48
	<u>Signatures</u>	51

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains statements about future events and expectations that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are based on our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we express or imply in any forward-looking statements. In addition to the other factors discussed under **Risk Factors** elsewhere in this report, factors that could contribute to these differences include, but are not limited to:

- our ability to raise capital in the future;
- our ability to successfully execute our growth strategy;
- our ability to successfully open new restaurants, acquire franchise restaurants or execute other strategic transactions;
- our ability to integrate the franchise or other restaurants which we acquire;
- the continued service of key management personnel;
- health concerns about our food products;
- our ability to attract, motivate and retain qualified employees;
- the impact of federal, state or local government regulations relating to our employees or production and the sale of food and alcoholic beverages;
- the impact of litigation;
- the cost of our principal food products;
- labor shortages or increased labor costs;
- inflationary increases in the costs of construction and real estate;
- changes in consumer preferences and demographic trends;
- increasing competition in the casual dining segment of the restaurant industry;
- our ability to successfully expand into new markets;
- the rate of growth of general and administrative expenses associated with building a strengthened corporate infrastructure to support our growth initiatives;
- negative publicity regarding food safety, health concerns and other food or beverage related matters;
- our franchisees' adherence to our practices, policies and procedures;
- potential fluctuation in our quarterly operating results due to seasonality and other factors;

- supply and delivery shortages or interruptions;
- inadequate protection of our intellectual property;
- volatility of actuarially determined insurance losses and loss estimates;
- adoption of new, or changes in existing, accounting policies and practices;

3

---

- adverse weather conditions which impact guest traffic at our restaurants; and
- adverse economic conditions.

The words believe, may, should, anticipate, estimate, expect, intend, objective, seek, plan, strive or similar words, or the n words, identify forward-looking statements. We qualify any forward-looking statements entirely by these cautionary factors.

Other risks, uncertainties and factors, including those discussed under Risk Factors, could cause our actual results to differ materially from those projected in any forward-looking statements we make.

We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

4

---

## PART I

### ITEM 1 BUSINESS

Texas Roadhouse, Inc. ( Texas Roadhouse or the Company ) was incorporated under the laws of the state of Delaware in 2004. From April 1, 1997 through October 8, 2004, the business of the Company was conducted by Texas Roadhouse Holdings LLC ( Holdings ) and its affiliates. On October 8, 2004, Holdings and its wholly-owned and majority-owned affiliates completed a reorganization and initial public offering. In connection with the reorganization and public offering, Holdings became a subsidiary of the Company. The principal executive office is located in Louisville, Kentucky.

#### General Development of Business

Texas Roadhouse is a growing, moderately priced, full-service, casual dining restaurant chain. Our founder and chairman, W. Kent Taylor, started the business in 1993. Our mission statement is *Legendary Food, Legendary Service®*. Our operating strategy is designed to position each of our restaurants as the local hometown destination for a broad segment of consumers seeking high quality, affordable meals served with friendly, attentive service. As of December 26, 2006, there were 251 Texas Roadhouse restaurants operating in 43 states. We owned and operated 163 restaurants in 37 states and franchised and licensed an additional 88 restaurants in 23 states.

Over the past five years, the total number of Texas Roadhouse company and franchise restaurants increased from 120 restaurants as of the end of 2001 to 251 restaurants as of the end of 2006, representing a 15.9% compounded annual growth rate. Over the same period, our revenue increased from \$159.9 million to \$597.1 million, our income from operations increased from \$13.7 million to \$54.4 million, and our net income increased from \$7.3 million to \$34.0 million, representing compounded annual growth rates of 30.2%, 31.8% and 36.1%, respectively.

#### Financial Information about Operating Segments

As of December 26, 2006, we operated 163 Texas Roadhouse restaurants, each as a single operating segment, and franchised and licensed an additional 88 restaurants. The restaurants operate exclusively in the U.S. within the casual dining restaurant industry, providing similar products to similar customers. The restaurants also possess similar pricing structures, resulting in similar long-term expected financial performance characteristics. We consider our restaurant and franchising operations as similar and have aggregated them into a single reportable segment.

#### Narrative Description of Business

Texas Roadhouse is a full-service, casual dining restaurant chain. We offer an assortment of specially seasoned and aged steaks hand-cut daily on the premises and cooked to order over open gas-fired grills. In addition to steaks, we also offer our guests a selection of ribs, fish, seafood, chicken and vegetable plates, and an assortment of hamburgers, salads and sandwiches. The majority of our entrées include two made-from-scratch side items, and we offer all our guests a free unlimited supply of roasted in-shell peanuts and made-from-scratch yeast rolls.

The operating strategy that underlies the growth of our concept is built on the following key components:

- *Offering performance-based manager compensation.* We offer a performance-based compensation program to our restaurant managers and area managers, who are called managing partners and market partners, respectively. Each of these partners earns a base salary plus a performance bonus, which represents a percentage of their respective restaurant's pre-tax net income. By providing our partners with a significant stake in the success of our restaurants, we believe that we

are able to attract and retain talented, experienced and highly motivated managing and market partners.

- *Offering high quality, freshly prepared food.* We place a great deal of emphasis on ensuring our guests receive high quality, freshly prepared food. We have developed proprietary recipes to provide consistency in quality and taste throughout all restaurants. We expect a management level employee to inspect every entrée before it leaves the kitchen to confirm it matches the guest's order and meets our standards for quality, appearance and presentation. In addition, we employ a team of product coaches whose sole function is to provide continual, hands-on training and education to our kitchen staff for the purpose of assuring uniform adherence to recipes, food preparation procedures, food safety standards, food appearance, freshness and portion size.
- *Focusing on dinner.* In a high percentage of our restaurants, we limit our operating hours to dinner only during the weekdays. By focusing on dinner, our restaurant teams have to prepare for and manage only one shift per day during the week. We believe this allows our restaurant teams to offer higher quality, more consistent food and service to our guests. We believe the dinner focus provides a better quality-of-life for our management teams and, therefore, is a key ingredient in attracting and retaining talented and experienced management personnel. We also focus on keeping our table-to-server ratios low to allow our servers to truly focus on their guests and serve their needs in a personal, individualized manner.
- *Offering attractive price points.* We offer our food and beverages at moderate price points that are as low as or lower than those offered by many of our competitors. Within each menu category, we offer a choice of several price points with the goal of fulfilling each guest's budget and value expectations. For example, our steak entrées, which include the choice of two side items, generally range from \$8.99 for our 6-ounce sirloin to \$19.99 for our 18-ounce T-bone. The per guest average check for the restaurants we owned and operated in 2006 was approximately \$14.50. Per person average check represents restaurant sales divided by the number of guests served. We considered each sale of an entrée to be a single guest served. Our per guest average check is highly influenced by our weekday dinner only focus.
- *Creating a fun and comfortable atmosphere.* We believe the atmosphere we establish in our restaurants is a key component for fostering repeat business. Our restaurants feature a rustic southwestern lodge décor accentuated with hand-painted murals, neon signs, and southwestern prints, rugs and artifacts. Additionally, we offer jukeboxes, which continuously play upbeat country hits, and in-house entertainment such as line dancing and birthday celebrations.

#### **Unit Prototype and Economics**

We designed our prototype Texas Roadhouse restaurant to provide a relaxed atmosphere and maximize restaurant sales. The Texas Roadhouse prototypical restaurant consists of a freestanding building with approximately 6,300 to 6,900 square feet of space constructed on sites of approximately 1.7 to 2.0 acres, with seating at approximately 56 tables for a total of 239 guests, including 15 bar seats, and parking for approximately 150 automobiles. Our current prototype is adaptable to in-line locations such as spaces within an enclosed mall or a shopping center.



The total cash cost of developing the current prototype Texas Roadhouse restaurant in which we own the land is approximately \$3.0 to \$4.0 million or \$2.6 to \$3.6 million excluding pre-opening costs. This cost includes approximately \$0.7 million to \$1.2 million for land, approximately \$1.2 million to \$1.6 million for building and site construction, approximately \$0.7 million to \$0.8 million for furniture, fixtures, signage and equipment and approximately \$0.4 million for pre-opening costs. When we lease the land, the total cash cost of developing our prototype restaurant is between \$2.3 million and \$2.8 million including pre-opening costs or \$1.9 to \$2.4 million excluding pre-opening costs. As of December 26, 2006, we owned 83 properties and leased 80 properties.

Our average unit volume for 2006 was \$4.0 million. The time required for a new restaurant to reach a steady level of cash flow is approximately three to six months.

#### Site Selection

We continue to develop and refine our site selection process. In analyzing each prospective site, management devotes significant time and resources to the evaluation of local market demographics, population density, household income levels and site-specific characteristics such as visibility, accessibility, traffic generators, proximity of other retail activities, traffic counts and parking. Our management works actively with real estate brokers in target markets to select high quality sites and to maintain and regularly update our database of potential sites. Management typically requires three to six months to locate, approve and control a restaurant site and typically four to eight additional months to obtain necessary permits. Upon receipt of permits, it requires approximately four months to construct, equip and open a restaurant.

#### Existing Restaurant Locations

As of December 26, 2006, we had 163 company restaurants and 88 franchise restaurants in 43 states as shown in the chart below.

	Number of Restaurants		
	Company	Franchise	Total
Alabama	2		2
Arizona	6		6
Arkansas	1		1
California		3	3
Colorado	11	1	12
Connecticut	2		2
Delaware	2		2
Florida	1	5	6
Georgia	2	7	9
Idaho	2		2
Illinois	5	2	7
Indiana	3	15	18
Iowa	4		4
Kansas	2	1	3
Kentucky	5	4	9
Louisiana	5	1	6
Maine	1		1
Maryland		5	5
Massachusetts	4	1	5
Michigan	5	2	7
Mississippi	1		1

7

Missouri	2	2	4
Montana		1	1
Nebraska		1	1
New Hampshire	1		1
New Jersey	1		1
New Mexico	2		2
New York	3		3
North Carolina	10		10
North Dakota	1	1	2
Ohio	14	4	18
Oklahoma	4		4
Pennsylvania	9	5	14
Rhode Island	1		1
South Carolina		6	6
South Dakota	1		1
Tennessee		12	12
Texas	34	4	38
Utah	2		2
Virginia	7		7
West Virginia	1	2	3
Wisconsin	5	3	8
Wyoming	1		1
Total	163	88	251

## Food

*Menu.* Texas Roadhouse restaurants offer a wide variety of menu items at attractive prices that are designed to appeal to a broad range of consumer tastes. Our dinner entrée prices generally range from \$7.99 to \$19.99. We offer a broad assortment of specially seasoned and aged steaks, including 6 and 8 oz. Filets; 6, 8, 11 and 16 oz. Sirloins; 10, 12 and 16 oz. Rib-eyes; Prime Rib; and T-Bones, most of which are hand-cut daily on the premises and cooked over open gas-fired grills. We also offer our guests a selection of fish, seafood, chicken, pork chops, ribs, and vegetable plates, and an assortment of hamburgers, salads and sandwiches. Entrée prices include made-from-scratch yeast rolls and most include two of the following made from scratch sides: baked potato, sweet potato, steak fries, mashed potatoes, house or Caesar salad, green beans, chili, seasoned rice, baked beans and steamed vegetables. Our menu allows guests to customize their meals by ordering steaks that are smothered either in cheese, onions, gravy or mushrooms and baked potatoes loaded with cheese and bacon. Other menu items include specialty appetizers such as the Cactus Blossom® and Chicken Critters® (chicken tenders). We also provide a 12 & Under menu for children that includes a sirloin steak, rib basket, Chicken Critters, cheeseburger, hot dog and macaroni and cheese, all served with a beverage at prices generally between \$2.99 and \$6.99.

Most of our restaurants feature a full bar that offers an extensive selection of draft and bottled beer. Managing partners are encouraged to tailor their beer selection to include regional brands and microbrews. We serve a selection of major brands of liquor and wine as well as frozen margaritas. Alcoholic beverages accounted for 11.6% of restaurant sales at Texas Roadhouse in fiscal 2006.

We have maintained a consistent menu over time, with a selection of approximately 60 menu items. We continually review our menu to consider enhancements to existing menu items or the introduction of new items. We change our menu only after guest feedback and an extensive study of the operational and economic implications. To maintain our high levels of food quality and service, we generally remove one menu item for every new menu item introduced so as to facilitate our ability to execute high quality meals on a focused range of menu items.

*Food Quality.* We are committed to serving a varied menu of high-quality, great tasting food items with an emphasis on freshness. We have developed proprietary recipes to ensure consistency in quality and taste throughout all restaurants and provide a unique flavor experience to our guests. At each restaurant, a fully trained meat cutter hand cuts our steaks and other restaurant team members prepare all side items and yeast rolls from scratch in the restaurants daily. We assign individual kitchen employees to the preparation of designated food items in order to focus on quality, consistency and speed. Additionally, we expect a management level employee to inspect every entrée before it leaves the kitchen to confirm it matches the guest's order and meets our standards for quality, appearance and presentation.

We employ a team of product coaches whose sole function is to provide continual, hands-on training and education to the kitchen staff in all Texas Roadhouse restaurants for the purpose of assuring uniform adherence to recipes, food preparation procedures, food safety standards, food appearance, freshness and portion size. The team currently consists of over 20 product coaches, each handling an average of ten restaurants system-wide. We expect to maintain a comparable ratio of product coaches to restaurants as we continue to grow.

*Purchasing.* Our purchasing philosophy is designed to consistently supply fresh, quality products to the restaurants at competitive prices while maximizing operating efficiencies. We negotiate directly with suppliers for substantially all food and beverage products to ensure consistent quality and freshness and obtain competitive prices. Certain products, such as dairy products and select produce, are purchased locally to assure freshness.

Food and supplies are ordered by, and shipped directly to, the restaurants, as we do not maintain a central product warehouse or commissary. Most food products used in the operation of the Company's restaurants are distributed to individual restaurants through an independent national distribution company. We strive to qualify more than one supplier for all key food items and believe that beef of comparable quality as well as all other essential food and beverage products are available, upon short notice, from alternative qualified suppliers.

*Food Safety.* Food safety is of utmost importance to Texas Roadhouse. We currently employ several programs to ensure adherence to proper food preparation procedures and food safety standards. Texas Roadhouse has an established Quality Assurance department whose function is to develop, enforce and maintain programs designed to ensure strict adherence to food safety guidelines. Where required, food items purchased from qualified vendors have been inspected by reputable, outside inspection services confirming that the vendor is compliant with FDA and USDA guidelines.

Each product coach is required to perform a sanitation audit on two restaurants each month and send the results to our Quality Assurance department for review. To reinforce the importance of food safety, Texas Roadhouse has printed all HACCP (Hazard Analysis and Critical Points) points in bold type on each recipe.

## **Service**

*Guest Satisfaction.* Through the use of guest surveys, our website [texasroadhouse.com](http://texasroadhouse.com), a toll-free guest response telephone line and personal interaction in the restaurant, we receive valuable feedback from guests. Additionally, we employ an outside service to administer a Secret Shopper program

whereby trained individuals periodically dine and comprehensively evaluate the guest experience at each of our restaurants. Particular attention is given to food and service quality, cleanliness, staff attitude and teamwork, and manager visibility and interaction. The resulting reports are used for follow up training feedback to both staff and management.

*Atmosphere.* The atmosphere of Texas Roadhouse restaurants is intended to appeal to broad segments of the population, children and adults, families, couples, single adults and business persons. Substantially all Texas Roadhouse restaurants are of our prototype design, reflecting a rustic southwestern lodge atmosphere, featuring an exterior of rough-hewn cedar siding and corrugated metal. The interiors feature pine floors and stained concrete and are decorated with hand-painted murals, neon signs, southwestern prints, rugs and artifacts. The restaurants contain jukeboxes that continuously play upbeat country hits. Guests may also view a display-cooking grill and a meat cooler displaying fresh cut steaks, and may wait for seating in either a spacious, comfortable waiting area or a southwestern style bar. While waiting for a table, guests can enjoy complimentary roasted in-shell peanuts and watch as cooks prepare steaks and other entrées on the gas-fired grills. Immediately upon being seated at a table, guests can enjoy made-from-scratch yeast rolls along with roasted in-shell peanuts.

### **People**

*Management and Employees.* Each of our restaurants has one managing partner, one kitchen manager and one service manager, and, in many cases, one or more additional assistant managers and/or key employees. The managing partner of each restaurant has primary responsibility for the day-to-day operations of the entire restaurant and is responsible for maintaining the standards of quality and performance established by us. We use market partners to supervise the operation of our restaurants including the continuing development of each restaurant's management team. Through regular visits to the restaurants, the market partners ensure adherence to all aspects of our concept, strategy and standards of quality. To further assure adherence to our standards of quality and to achieve uniform execution throughout the system, we employ product coaches who regularly visit the restaurants to assist in training of both new and existing employees and to grade food quality. The attentive service and high quality food, which results from each restaurant having a managing partner, two to three managers and the hands-on assistance of a product coach, are critical to our success.

*Training and Development.* All restaurant employees are required to complete varying degrees of training before and during employment. Our detailed training program emphasizes our operating strategy, procedures and standards and is conducted individually at Texas Roadhouse restaurants and in groups in Louisville, Kentucky.

Our managing and market partners are generally required to have significant experience in the full-service restaurant industry and are generally hired at a minimum four to 12 months before their placement in a new or existing restaurant to allow time to fully train in all aspects of restaurant operations. All managing partners, kitchen and service managers and other management team members are required to complete a comprehensive 16-week training program, which includes training for every position in the restaurant. Trainees are validated at pre-determined points during their training by either the market partner, product coach or managing partner.

A number of our restaurants have been certified as training centers by our training department. This certification confirms that the training center adheres to established operating procedures and guidelines. Additionally, most restaurants are staffed with training coordinators responsible for ongoing daily training needs.

For new restaurant openings, a full team of designated trainers, each specializing in a specific restaurant position, is deployed to the restaurant at least ten days before opening. Formal employee

training begins seven days before opening, and follows a uniform, comprehensive training course as directed by a training manager.

### **Marketing**

Our marketing strategy aims to promote the Texas Roadhouse brand, while retaining a localized focus, to:

- increase comparable restaurant sales by attracting new guests to our restaurants and increase the frequency of visits by our current guests;
- support new restaurant openings to achieve restaurant sales and operating margin goals; and
- communicate and promote the uniqueness, appeal, quality and consistency of our brand.

We accomplish these objectives through three major initiatives.

*In-restaurant Marketing.* A significant portion of our marketing fund is spent in communicating with our guests while they are in our restaurants through point of purchase materials. We believe special promotions such as Valentine's Day and Mother's Day drive significant repeat business. In addition, our mascot, Andy Armadillo, provides our guests with a familiar and easily identifiable face.

*Local Restaurant Area Marketing.* Given our strategy to be a neighborhood destination, local area marketing is integral in developing brand awareness in each market. To enhance our visibility in new markets, we deliver free food to local businesses in connection with new restaurant openings. Managing partners are encouraged to participate in creative community-based marketing, such as hosting local radio or television programs. We also engage in a variety of promotional activities, such as contributing time, money and complimentary meals to charitable, civic and cultural programs. For instance, our involvement with the Special Olympics, a local Little League baseball team, a local church or the Armed Forces, shows our Legendary Care, Concern and Support for our communities. We leverage the corresponding recognition in our public relations and marketing efforts to communicate our corporate values and mission statement to our guests. We employ marketing coordinators at the restaurant and market level to develop and execute the majority of the local marketing strategies.

*Advertising.* Although our restaurant concept is not media driven, to build brand awareness we spend a limited amount of our marketing dollars on various advertising channels, including billboard, print, radio and television. These advertisements are designed to reflect Legendary Food, Legendary Service as well as our fun and welcoming restaurant environment.

### **Restaurant Franchise Arrangements**

*Franchise Restaurants.* As of December 26, 2006, we had 20 franchisees that operated 88 restaurants in 23 states. Franchise rights are granted for specific restaurants, and we do not grant any rights to develop a territory. Approximately 70% of our franchise restaurants are operated by eight franchisees. No franchisee operates more than 15 restaurants.

Our standard franchise agreement has a term of ten years with two renewal options for an additional five years each if certain conditions are satisfied. Our current form of franchise agreement requires the franchisee to pay a royalty fee of 4.0% of gross restaurant sales. The royalty fee varies depending on when the agreements were entered into and range from 2.0% of gross sales to the current 4.0% fee. Gross sales means the total selling price of all services and products related to the restaurant. Gross sales do not include:

- employee discounts or other discounts;

- tips or gratuities paid directly to employees by guests;

11

---

- any federal, state, municipal or other sales, value added or retailer's excise taxes; or
- adjustments for net returns on salable goods and discounts allowed to guests on sales.

Franchisees are currently required to pay 0.3% of gross sales to a national advertising and marketing fund for the development of advertising materials, system-wide promotions and related marketing efforts. We have the ability under our agreements to increase the required national advertising and marketing fund contribution up to 2.5% of gross sales. We may also charge a marketing fee of 0.5% of gross sales, which we may use for market research and to develop system-wide promotional and advertising materials. A franchisee's total required advertising contribution or spending will not be more than 3.0% of gross sales.

A franchise agreement may be terminated if the franchisee defaults in the performance of any of its obligations under the franchise agreement, including its obligations to operate the restaurant in strict accordance with our standards and specifications. A franchise agreement may also be terminated if a franchisee dies, becomes disabled or becomes insolvent, fails to make its required payments, creates a threat to the public health or safety, ceases to operate the restaurant, or misuses the Texas Roadhouse trademarks.

Our standard franchise agreement gives us the right, but not the obligation, to compel a franchisee to transfer its assets to us in exchange for shares of our stock, or to convert its equity interests into shares of our stock. The amount of shares that a franchisee would receive is based on a formula that is included in the franchise agreement.

*Franchise Compliance Assurance.* We have instituted a comprehensive system to ensure compliance with our systems and standards, both during the development and operating of franchise restaurants. After a preliminary franchise agreement is signed, we actively work with and monitor our franchisees to ensure successful franchise operations as well as compliance with the Texas Roadhouse standards and procedures. During the restaurant development phase, we approve the selection of restaurant sites and make available copies of our prototype building plans to franchisees. During construction, we review the building for compliance with our standards. We provide training to the managing partner and up to three other managers of a franchisee's first restaurant. We also provide trainers for a period of 12 to 15 days to assist in the opening of every franchise restaurant. Finally, on an ongoing basis, we conduct reviews on all franchise restaurants to determine their level of effectiveness in executing our concept at a variety of operational levels. Our franchisees are required to follow the same standards and procedures regarding equipment, food purchases and food preparation as we maintain in our company restaurants. Reviews are conducted by seasoned operations teams, and focus on key areas including health, safety and execution proficiency.

To continuously improve our communications with franchisees and the consistency of the brand, we maintain a business development council that includes representatives of our franchisees, company operations personnel and vendors. The council's functions are advisory. Its members review and comment on proposed advertising campaigns and materials and budget expenditures.

*Management Services.* We provide management services to 18 of the franchise restaurants in which we or our founder have an ownership interest. Such management services include accounting, operational supervision, human resources, training, and food, beverage and equipment consulting for which we receive monthly fees of up to 2.5% of gross sales. We also make available to these restaurants certain legal services through outside sources on a pass-through cost basis. We also provide restaurant employees on a pass-through cost basis to three franchise restaurants in which we or our founder have an ownership interest. In addition, we receive a monthly fee of \$1,250 from two franchise restaurants for providing payroll and accounting services.

### **Management Information Systems and Restaurant Reporting**

All of our company restaurants use computerized management information systems, which are designed to improve operating efficiencies, provide restaurant and Support Center management with timely access to financial and operating data and reduce administrative time and expense. With our current information systems, we have the ability to generate reports showing weekly and period-to-date numbers on a company-wide, regional or individual restaurant basis. Together, this enables us to closely monitor sales, food and beverage costs and labor and operating expenses at each of our restaurants. We have created reports that provide comparative information that enables both restaurant and Support Center management to supervise the financial and operational performance of our restaurants and to recognize and understand trends in the business. Our accounting department prepares monthly profit and loss statements, which provide a detailed analysis of sales and costs, and which are compared both to the restaurant-prepared reports and to prior periods. We have implemented satellite technology at the restaurant level, which serves as a communication link between the restaurants and our Support Center as well as our credit and gift card processor.

### **Competition**

According to the National Restaurant Association, or NRA, restaurant industry sales in 2007 will represent approximately 4% of the United States gross domestic product. The NRA also forecasts that restaurant industry sales will reach \$537 billion and will encompass approximately 935,000 restaurants.

Competition in the restaurant industry is intense. Texas Roadhouse restaurants compete with mid-priced, full-service, casual dining restaurants primarily on the basis of taste, quality and price of the food offered, service, atmosphere, location and overall dining experience. Our competitors include a large and diverse group of restaurants that range from independent local operators to well-capitalized national restaurant chains. Although we believe that we compete favorably with respect to each of the above factors, other restaurants operate with concepts that compete for the same casual dining guests as we do, with the number of casual dining restaurants emphasizing steaks increasing in recent years. We also compete with other restaurants and retail establishments for quality site locations and restaurant-level employees.

### **Trademarks**

Our registered trademarks and service marks include, among others, the marks Texas Roadhouse® and our stylized logo. We have registered all of our marks with the United States Patent and Trademark Office. We have registered or have registrations pending for our most significant trademarks and service marks in 13 foreign jurisdictions including the European Union. To better protect our brand, we have also registered the Internet domain name [www.texasroadhouse.com](http://www.texasroadhouse.com). We believe that our trademarks, service marks, and other proprietary rights have significant value and are important to our brand-building efforts and the marketing of our restaurant concept.

### **Government Regulation**

We are subject to a variety of federal, state and local laws. Each of our restaurants is subject to permitting, licensing and regulation by a number of government authorities relating to alcoholic beverage control, health, safety, sanitation, building and fire codes, and to compliance with the applicable zoning, land use and environmental laws and regulations. Difficulties in obtaining or failure to obtain required licenses or approvals could delay or prevent the development of a new restaurant in a particular area.

In 2006, 11.6% of our restaurant sales were attributable to the sale of alcoholic beverages. Alcoholic beverage control regulations require each of our restaurants to apply to a state authority and, in certain locations, county or municipal authorities for a license that must be renewed annually and may be revoked



or suspended for cause at any time. Alcoholic beverage control regulations affect numerous aspects of restaurant operations, including minimum age of patrons and employees, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages.

The failure of a restaurant to obtain or retain liquor or food service licenses would have a material adverse effect on the restaurant's operations. To reduce this risk, each company restaurant is operated in accordance with procedures intended to assure compliance with applicable codes and regulations.

We are subject in certain states to dram shop statutes, which generally provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. We carry liquor liability coverage as part of our existing comprehensive general liability insurance, as well as excess umbrella coverage of \$100.0 million per occurrence, with a \$10,000 deductible for the first \$25.0 million.

Our restaurant operations are also subject to federal and state laws governing such matters as the minimum hourly wage, minimum tipped wage, unemployment tax rates, sales tax and similar matters, over which we have no control. Significant numbers of our service, food preparation and other personnel are paid at rates related to the federal minimum wage (which currently is \$5.15 per hour) or the applicable state minimum wage, and further increases in federal or state minimum wage would increase our labor costs.

**Seasonality**

Our business is subject to minor seasonal fluctuations. Historically, sales in most of our restaurants have been higher during the winter and summer months of each year.

**Employees**

As of December 26, 2006, we employed approximately 19,000 people, of whom 255 were executive and administrative personnel, 754 were restaurant management personnel and the remainder were hourly restaurant personnel. Many of our hourly restaurant employees work part-time. None of our employees are covered by a collective bargaining agreement.

**Executive Officers of the Company**

Set forth below are the name, age, position and a brief account of the business experience of each of our executive officers:

Name	Age	Position
W. Kent Taylor	51	Chairman of the Company, Director
G.J. Hart	49	President, Chief Executive Officer, Director
Steven L. Ortiz	49	Chief Operating Officer
Scott M. Colosi	42	Chief Financial Officer
Sheila C. Brown	54	General Counsel, Corporate Secretary

*W. Kent Taylor.* Mr. Taylor is our founder and was, until the completion of our initial public offering, Chief Executive Officer. Upon the completion of the initial public offering, Mr. Taylor became Chairman of the Company, an executive position. Before his founding of our concept, Mr. Taylor founded and co-owned Buckhead Bar and Grill in Louisville, Kentucky. Mr. Taylor has over 20 years of experience in the restaurant industry.

*G.J. Hart.* Mr. Hart has served as our President since May 15, 2000. Upon the completion of the initial public offering, Mr. Hart became President and Chief Executive Officer. From October 1995 until May 2000, Mr. Hart was President of Al Copeland Investments in Metairie, Louisiana, a privately held business consisting of four restaurant concepts, hotels, gaming, entertainment and food processing operations. From June 1991 to September 1995, Mr. Hart was President of TriFoods International, Inc., a producer of prepared food products. Mr. Hart has over 25 years of experience in the food industry.

*Steven L. Ortiz.* Mr. Ortiz has served as our Executive Vice President of Operations since May 2001. Upon the completion of the initial public offering, Mr. Ortiz became Chief Operating Officer. Mr. Ortiz joined our company in 1996 as a Market Partner in which capacity he was responsible for developing and starting new Texas Roadhouse restaurants in Texas. From 1982 to 1996, Mr. Ortiz was employed by Bennigan's Restaurants in various capacities, including General Manager, Area Director and Regional Vice President. Mr. Ortiz has over 20 years of experience in the restaurant industry.

*Scott M. Colosi.* Mr. Colosi has served as our Chief Financial Officer since September 2002. From 1992 until September 2002, Mr. Colosi was employed by YUM! Brands, Inc., owner of the A&W, KFC, Pizza Hut, Long John Silver's and Taco Bell brands. During this time, Mr. Colosi served in various financial positions and, immediately prior to joining us, was Director of Investor Relations. Mr. Colosi has 19 years of experience in the restaurant industry.

*Sheila C. Brown.* Ms. Brown has served as our General Counsel and Secretary since November 2001. From August 2000 to November 2001, Ms. Brown was our Director of Property Acquisition and, from September 1998 to August 2000, Development Coordinator, in which capacity Ms. Brown was responsible for our real estate development activities. Ms. Brown has over 20 years of experience in the restaurant industry.

#### **Website Access To Reports**

We make our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, available, free of charge on or through the Internet website, [www.texasroadhouse.com](http://www.texasroadhouse.com), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

#### **ITEM 1A. RISK FACTORS**

From time to time in annual reports and oral statements, and in this Annual Report on Form 10-K, we present statements about future events and expectations that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are based on our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we express or imply in any forward-looking statements. Risks and uncertainties that could cause actual results to differ materially include, but are not limited to, those discussed below.

#### **Risks Related to Our Business**

##### **If we fail to manage our growth effectively, it could harm our business.**

Failure to manage our growth effectively could harm our business. We have grown significantly since our inception and intend to grow substantially in the future. Our existing restaurant management systems,

financial and management controls and information systems may not be adequate to support our planned expansion. Our ability to manage our growth effectively will require us to continue to enhance these systems, procedures and controls and to locate, hire, train and retain management and operating personnel. We cannot assure you that we will be able to respond on a timely basis to all of the changing demands that our planned expansion will impose on management and on our existing infrastructure. If we are unable to manage our growth effectively, our business and operating results could be materially adversely impacted.

**You should not rely on past increases in our average unit volumes or our comparable restaurant sales as an indication of our future results of operations because they may fluctuate significantly.**

A number of factors have historically affected, and will continue to affect, our average unit volumes and comparable restaurant sales, including, among other factors:

- our ability to execute our business strategy effectively;
- unusually strong initial sales performance by new restaurants;
- competition;
- weather and acts of God;
- consumer trends;
- introduction of new menu items; and
- general regional and national economic conditions.

Our average unit volumes and comparable restaurant sales may not increase at rates achieved over the past several years. Changes in our average unit volumes and comparable restaurant sales could cause the price of our Class A common stock to fluctuate substantially.

**Our growth strategy, which primarily depends on our ability to open new restaurants that are profitable, is subject to many factors, some of which are beyond our control.**

Our objective is to grow our business and increase stockholder value by (1) expanding our base of company restaurants (and, to a lesser extent, franchise restaurants) that are profitable and (2) increasing sales and profits at existing restaurants. While both these methods of achieving our objective are important to us, historically the most significant means of achieving our objective has been through opening new restaurants and operating these restaurants on a profitable basis. We expect this to continue to be the case in the future.

We cannot assure you that we will be able to open new restaurants in accordance with our expansion plans. We have experienced delays in opening some of our restaurants in the past and may experience delays in the future. Delays or failures in opening new restaurants could materially adversely affect our growth strategy. One of our biggest challenges in executing our growth strategy is locating and securing an adequate supply of suitable new restaurant sites. Competition for suitable restaurant sites in our target markets is intense and we cannot assure you that we will be able to find sufficient suitable locations, or suitable purchase or lease terms, for our planned expansion in any future period. Our ability to open new restaurants will also depend on numerous other factors, some of which are beyond our control, including, but not limited to, the following:

- our ability to hire, train and retain qualified operating personnel, especially market partners and managing partners;
- the availability of construction materials and labor;



- our ability to control construction and development costs of new restaurants;
- our ability to secure required governmental approvals and permits in a timely manner, or at all;
- our ability to secure liquor licenses;
- the cost and availability of capital to fund construction costs and pre-opening expenses; and
- weather and acts of God.

Once opened, we anticipate that our new restaurants will generally take several months to reach planned operating levels due to start-up inefficiencies typically associated with new restaurants. We cannot assure you that any restaurant we open will be profitable or obtain operating results similar to those of our existing restaurants. Our ability to operate new restaurants profitably will depend on numerous factors, some of which are beyond our control, including, but not limited to, the following:

- competition;
- consumer acceptance of our restaurants in new markets;
- the ability of the market partner and the managing partner to execute our business strategy at the new restaurant;
- general regional and national economic conditions;
- changes in government regulation; and
- road construction and other factors limiting access to the restaurant.

Our failure to successfully open new restaurants that are profitable in accordance with our growth strategy could harm our business and future prospects.

**Our franchisees could take actions that could harm our business.**

Our franchisees are contractually obligated to operate their restaurants in accordance with Texas Roadhouse standards. We also provide training and support to franchisees. However, franchisees are independent third parties that we do not control, and the franchisees own, operate and oversee the daily operations of their restaurants. As a result, the ultimate success and quality of any franchise restaurant rests with the franchisee. If franchisees do not successfully operate restaurants in a manner consistent with our standards, the Texas Roadhouse image and reputation could be harmed, which in turn could adversely affect our business and operating results.

**Our quarterly operating results may fluctuate significantly and could fall below the expectations of securities analysts and investors due to a number of factors, some of which are beyond our control, resulting in a decline in our stock price.**

Our quarterly operating results may fluctuate significantly because of several factors, including:

- the timing of new restaurant openings and related expenses;
- restaurant operating costs for our newly-opened restaurants, which are often materially greater during the first several months of operation than thereafter;
- labor availability and costs for hourly and management personnel including mandated changes in federal and/or state minimum wage rates or health benefits;

- profitability of our restaurants, especially in new markets;
- changes in interest rates;

17

---

- increases and decreases in average unit volumes and comparable restaurant sales;
- impairment of long-lived assets, including goodwill, and any loss on restaurant closures;
- general economic conditions, both nationally and locally;
- negative publicity relating to the consumption of beef or other products we serve;
- changes in consumer preferences and competitive conditions;
- expansion to new markets;
- increases in infrastructure costs; and
- fluctuations in commodity prices.

Our business is also subject to minor seasonal fluctuations. Historically, sales in most of our restaurants have been higher during the winter and summer months of each year. As a result, our quarterly operating results and comparable restaurant sales may fluctuate as a result of seasonality. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year and comparable restaurant sales for any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors. In that event, the price of our Class A common stock would likely decrease.

**If we lose the services of any of our key management personnel, our business could suffer.**

Our future success significantly depends on the continued services and performance of our key management personnel, particularly G.J. Hart, our president and chief executive officer; Scott M. Colosi, our chief financial officer; Steven L. Ortiz, our chief operating officer; and W. Kent Taylor, our founder and chairman. Our future performance will depend on our ability to motivate and retain these and other key officers and managers, particularly market partners and managing partners. Competition for these employees is intense. The loss of the services of members of our senior management or other key officers or managers or the inability to attract additional qualified personnel as needed could materially harm our business.

**Our failure or inability to enforce our trademarks or other proprietary rights could adversely affect our competitive position or the value of our brand.**

We own certain common law trademark rights and a number of federal and international trademark and service mark registrations, including the Texas Roadhouse® name and logo, and proprietary rights relating to certain of our core menu offerings. We believe that our trademarks and other proprietary rights are important to our success and our competitive position. We, therefore, devote appropriate resources to the protection of our trademarks and proprietary rights. The protective actions that we take, however, may not be enough to prevent unauthorized usage or imitation by others, which could harm our image, brand or competitive position and, if we commence litigation to enforce our rights, cause us to incur significant legal fees.

We cannot assure you that third parties will not claim that our trademarks or menu offerings infringe upon their proprietary rights. Any such claim, whether or not it has merit, could be time-consuming, result in costly litigation, cause delays in introducing new menu items in the future or require us to enter into royalty or licensing agreements. As a result, any such claim could have a material adverse effect on our business, results of operations, financial condition or liquidity.

**We may need additional capital in the future and it may not be available on acceptable terms.**

The development of our business may require significant additional capital in the future to, among other things, fund our operations and growth strategy. We have historically relied upon bank financing and private sales of equity interests in certain restaurants to fund our operations. Going forward, we will continue to rely on bank financing and also expect to access the debt and/or equity capital markets. There can be no assurance, however, that these sources of financing will be available on terms favorable to us, or at all. Our ability to obtain additional financing will be subject to a number of factors, including market conditions, our operating performance, investor sentiment and our ability to incur additional debt in compliance with agreements governing our outstanding debt. These factors may make the timing, amount, terms and conditions of additional financings unattractive to us. If we are unable to raise additional capital, our growth could be impeded.

**Our existing credit facility limits our ability to incur additional debt.**

Our credit facility prohibits us from incurring additional debt outside the facility except for equipment financing up to \$3 million, unsecured debt up to \$500,000, up to \$20 million of debt incurred by majority-owned companies formed to own new restaurants and up to \$30 million in debt incurred in connection with acquiring franchise restaurants. Additionally, the lenders' obligation to extend credit under the facility depends on our maintaining certain financial covenants, including a minimum consolidated fixed charge coverage ratio of 1.50 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. If we are unable to maintain these ratios, we would be unable to obtain additional financing under this facility.

We have also entered into other loan agreements with other lenders to finance various restaurants which impose financial covenants that are less restrictive than those imposed by our existing credit facility. A default under these loan agreements could result in a default under our existing credit facility, which in turn would limit our ability to secure additional funds under that facility. As of December 26, 2006, we were in compliance with all of our lenders' covenants.

**The acquisition of existing restaurants from our franchisees and licensees and other strategic transactions may have unanticipated consequences that could harm our business and our financial condition.**

We have previously announced our intention to selectively acquire existing restaurants from our franchisees or licensees. Additionally, from time to time, we evaluate potential mergers, acquisitions, joint ventures or other strategic initiatives to acquire or develop additional concepts. To successfully execute any acquisition or development strategy, we will need to identify suitable acquisition or development candidates, negotiate acceptable acquisition or development terms and obtain appropriate financing. Any acquisition or future development that we pursue, whether or not successfully completed, may involve risks, including:

- material adverse effects on our operating results, particularly in the fiscal quarters immediately following the acquisition as the acquired restaurants are integrated into our operations;
- risks associated with entering into markets or conducting operations where we have no or limited prior experience;
- risks inherent in accurately assessing the value, future growth potential, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition candidates, and our ability to achieve projected economic and operating synergies; and
- the diversion of management's attention from other business concerns.

Future acquisitions of existing restaurants from our franchisees or licensees or other strategic partners, which may be accomplished through a cash purchase transaction, the issuance of shares of our



Class A common stock or a combination of both, could have a dilutive impact on holders of our Class A common stock, and result in the incurrence of debt and contingent liabilities and impairment charges related to goodwill and other tangible and intangible assets, any of which could harm our business and financial condition. The development of additional concepts may not be as successful as our experience in the development of the Texas Roadhouse concept. Development rates for newer brands may differ significantly as there is increased risk in the development of a new restaurant concept or system.

**Approximately 21% of our company restaurants are located in Texas and, as a result, we are sensitive to economic and other trends and developments in that state.**

As of December 26, 2006, we operated a total of 34 company restaurants in Texas. As a result, we are particularly susceptible to adverse trends and economic conditions in this state, including its labor market. In addition, given our geographic concentration in this state, negative publicity regarding any of our restaurants in Texas could have a material adverse effect on our business and operations, as could other occurrences in Texas such as local strikes, energy shortages or increases in energy prices, droughts, earthquakes, fires or other natural disasters.

**Our expansion into new markets may present increased risks due to our unfamiliarity with the area.**

Some of our new restaurants will be located in areas where we have little or no meaningful experience. Those markets may have different competitive conditions, consumer tastes and discretionary spending patterns than our existing markets, which may cause our new restaurants to be less successful than restaurants in our existing markets. An additional risk of expanding into new markets is the lack of market awareness of the Texas Roadhouse® brand. Restaurants opened in new markets may open at lower average weekly sales volumes than restaurants opened in existing markets, and may have higher restaurant-level operating expense ratios than in existing markets. Sales at restaurants opened in new markets may take longer to reach average unit volumes, if at all, thereby affecting our overall profitability.

#### **Risks Relating to the Food Service Industry**

**Our business is affected by changes in consumer preferences and discretionary spending.**

Our success depends, in part, upon the popularity of our food products. Shifts in consumer preferences away from our restaurants or cuisine, particularly beef, would harm our business. Also, our success depends to a significant extent on discretionary consumer spending, which is influenced by general economic conditions and the availability of discretionary income. Accordingly, we may experience declines in sales during economic downturns or during periods of uncertainty like that which followed the terrorist attacks on the United States on September 11, 2001. Any material decline in the amount of discretionary spending could have a material adverse effect on our sales, results of operations, business, financial condition and liquidity.

**Our success depends on our ability to compete with many food service businesses.**

The restaurant industry is intensely competitive and we compete with many well-established food service companies on the basis of taste, quality and price of products offered, guest service, atmosphere, location and overall guest experience. Our competitors include a large and diverse group of restaurant chains and individual restaurants that range from independent local operators that have opened restaurants in various markets to well-capitalized national restaurant companies. Many of our competitors or potential competitors have substantially greater financial and other resources than we do, which may allow them to react to changes in pricing, marketing and the casual dining restaurant industry better than we can. As our competitors expand their operations, we expect competition to intensify. We also compete with other restaurant chains and other retail businesses for quality site locations and hourly employees.

**Changes in food and supply costs could adversely affect our results of operations.**

Our profitability depends in part on our ability to anticipate and react to changes in food and supply costs. Any increase in food prices, particularly proteins, could adversely affect our operating results. In addition, we are susceptible to increases in food costs as a result of factors beyond our control, such as weather conditions, food safety concerns, product recalls and government regulations. We cannot predict whether we will be able to anticipate and react to changing food costs by adjusting our purchasing practices and menu prices, and a failure to do so could adversely affect our operating results. In addition, because we provide a moderately priced product, we may not seek to or be able to pass along price increases to our guests.

We currently purchase most of our beef from four of the largest beef suppliers in the country under fixed price contracts. If these vendors were unable to fulfill its obligations under its contracts, we could encounter supply shortages and incur higher costs to secure adequate supplies, either of which would harm our business.

**The food service industry is affected by litigation and publicity concerning food quality, health and other issues, which can cause guests to avoid our restaurants and result in significant liabilities or litigation costs.**

Food service businesses can be adversely affected by litigation and complaints from guests, consumer groups or government authorities resulting from food quality, illness, injury or other health concerns or operating issues stemming from one restaurant or a limited number of restaurants. Adverse publicity about these allegations may negatively affect us, regardless of whether the allegations are true, by discouraging guests from eating at our restaurants. We could also incur significant liabilities if a lawsuit or claim results in a decision against us or litigation costs regardless of the result.

**Health concerns relating to the consumption of beef or other food products could affect consumer preferences and could negatively impact our results of operations.**

Like other restaurant chains, consumer preferences could be affected by health concerns about the consumption of beef, the key ingredient in many of our menu items, or negative publicity concerning food quality, illness and injury generally. In recent years there has been negative publicity concerning e-coli, hepatitis A, mad cow, foot-and-mouth disease and bird flu. This negative publicity, as well as any other negative publicity concerning food products we serve, may adversely affect demand for our food and could result in a decrease in guest traffic to our restaurants. If we react to the negative publicity by changing our concept or our menu, we may lose guests who do not prefer the new concept or menu, and may not be able to attract sufficient new guests to produce the revenue needed to make our restaurants profitable. In addition, we may have different or additional competitors for our intended guests as a result of a change in our concept and may not be able to compete successfully against those competitors. A decrease in guest traffic to our restaurants as a result of these health concerns or negative publicity or as a result of a change in our menu or concept could materially harm our business.

**Our business could be adversely affected by increased labor costs or labor shortages.**

Labor is a primary component in the cost of operating our business. We devote significant resources to recruiting and training our managers and hourly employees. Increased labor costs due to competition, increased minimum wage or employee benefits costs or otherwise, would adversely impact our operating expenses. Recently, numerous states have enacted legislation resulting in tip and minimum wage increases, and we anticipate that additional legislation may be enacted in 2007 and future periods. Our operating expenses could be adversely affected to the extent that we are not able to offset these costs. In addition, our success depends on our ability to attract, motivate and retain qualified employees, including restaurant

managers and staff, to keep pace with our growth strategy. If we are unable to do so, our results of operations may be adversely affected.

**We may not be able to obtain and maintain licenses and permits necessary to operate our restaurants and compliance with laws could adversely affect our operating results.**

The restaurant industry is subject to various federal, state and local government regulations, including those relating to the sale of food and alcoholic beverages. Such regulations are subject to change from time to time. The failure to obtain and maintain these licenses, permits and approvals, including liquor licenses, could adversely affect our operating results. Difficulties or failure to obtain the required licenses and approvals could delay or result in our decision to cancel the opening of new restaurants. Local authorities may revoke, suspend or deny renewal of our liquor licenses if they determine that our conduct violates applicable regulations.

In addition to our having to comply with these licensing requirements, various federal and state labor laws govern our relationship with our employees and affect operating costs. These laws include minimum wage requirements, overtime pay, unemployment tax rates, workers compensation rates, citizenship requirements and sales taxes. A number of factors could adversely affect our operating results, including:

- additional government-imposed increases in minimum wages, overtime pay, paid leaves of absence and mandated health benefits;
- increased tax reporting and tax payment requirements for employees who receive gratuities;
- a reduction in the number of states that allow gratuities to be credited toward minimum wage requirements; and
- increased employee litigation including claims relating to the Fair Labor Standards Act.

The federal Americans with Disabilities Act prohibits discrimination on the basis of disability in public accommodations and employment. Although our restaurants are designed to be accessible to the disabled, we could be required to make modifications to our restaurants to provide service to, or make reasonable accommodations for disabled persons.

**Complaints or litigation may hurt us.**

Occasionally, our guests file complaints or lawsuits against us alleging that we are responsible for some illness or injury they suffered at or after a visit to our restaurants, or that we have problems with food quality or operations. We are also subject to a variety of other claims arising in the ordinary course of our business, including personal injury claims, contract claims, claims from franchisees and claims alleging violations of federal and state laws regarding workplace and employment matters, discrimination and similar matters, or we could become subject to class action lawsuits related to these matters in the future. The restaurant industry has also been subject to a growing number of claims that the menus and actions of restaurant chains have led to the obesity of certain of their guests. In addition, we are subject to dram shop statutes. These statutes generally allow a person injured by an intoxicated person to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. Recent litigation against restaurant chains has resulted in significant judgments, including punitive damages, under dram shop statutes. Because a plaintiff may seek punitive damages, which may not be covered by insurance, this type of action could have an adverse impact on our financial condition and results of operations. Regardless of whether any claims against us are valid or whether we are liable, claims may be expensive to defend and may divert time and money away from our operations and hurt our performance. A judgment significantly in excess of our insurance coverage for any claims could materially adversely affect our financial condition, results of operations or liquidity. Further, adverse publicity resulting from these allegations may materially adversely affect us and our restaurants.

**Our current insurance may not provide adequate levels of coverage against claims.**

We currently maintain insurance customary for businesses of our size and type. However, there are types of losses we may incur that cannot be insured against or that we believe are not economically reasonable to insure. Such damages could have a material adverse effect on our business and results of operations. In addition, we self-insure a significant portion of expected losses under our workers compensation, general liability and property insurance programs. Unanticipated changes in the actuarial assumptions and management estimates underlying our reserves for these losses could result in materially different amounts of expense under these programs, which could have a material adverse effect on our financial condition, results of operations and liquidity.

**Risks Related to Our Stock and Corporate Structure**

**Provisions in our charter documents and Delaware law may delay or prevent our acquisition by a third party.**

Our certificate of incorporation and by-laws contain several provisions that may make it more difficult for a third party to acquire control of us without the approval of our Board of Directors. These provisions include, among other things, elimination of stockholder action by written consent, advance notice for raising business or making nominations at meetings and blank check preferred stock. Blank check preferred stock enables our Board of Directors, without approval of the Class A stockholders, to designate and issue additional series of preferred stock with such dividend, liquidation, conversion, voting or other rights, including the right to issue convertible securities with no limitations on conversion, as our Board of directors may determine. The issuance of blank check preferred stock may adversely affect the voting and other rights of the holders of our common stock as our Board of Directors may designate and issue preferred stock with terms that are senior to our common stock. These provisions may make it more difficult or expensive for a third party to acquire a majority of our outstanding common stock. These provisions also may delay, prevent or deter a merger, acquisition, tender offer, proxy contest or other transaction that might otherwise result in our stockholders receiving a premium over the market price for their Class A common stock.

The Delaware General Corporation Law prohibits us from engaging in business combinations with interested shareholders (with some exceptions) unless such transaction is approved in a prescribed manner. The existence of this provision could have an anti-takeover effect with respect to transactions not approved in advance by the Board of Directors, including discouraging attempts that might result in a premium over the market price for our common stock.

**There may be an adverse effect on the value of our Class A common stock due to the disparate voting rights of our Class A common stock and our Class B common stock.**

The holders of our Class A common stock and Class B common stock generally have identical rights except that (1) on all matters to be voted on by stockholders, holders of our Class A common stock are entitled to one vote per share while holders of our Class B common stock are entitled to ten votes per share, and (2) holders of our Class A common stock are not entitled to vote on any alteration of the powers, preferences or special rights of the Class B common stock that would not adversely affect the holders of our Class A common stock. The difference in the voting rights of our Class A common stock and Class B common stock could adversely affect the value of the Class A common stock to the extent that any investor or potential future purchaser of our Class A common stock ascribes value to the superior voting rights of our Class B common stock.

**Our founder and chairman controls our company and this control could inhibit potential changes of control.**

As of February 16, 2007, our founder and chairman, W. Kent Taylor, beneficially owned all of our outstanding shares of Class B common stock and 13,954,896 shares of Class A common stock, representing approximately 55% of our voting power. As a result, Mr. Taylor has the ability to control our management and affairs and the outcome of all matters requiring stockholder approval, including the election and removal of our entire Board of Directors, and any merger, consolidation or sale of all or substantially all of our assets. The Class B common stock has ten votes per share, while Class A common stock has one vote per share. While this dual-class structure is in effect, Mr. Taylor is able to control all matters submitted to our stockholders even if in the future he were to own significantly less than 50% of the equity of our company. This concentrated control could discourage others from initiating any potential merger takeover or other change of control transaction that may otherwise be beneficial to our businesses. As a result, the market price of Class A common stock could be adversely affected.

**Our founder and chairman controls our company and his interests may differ from your interests.**

As a result of W. Kent Taylor's controlling interests in our company as described above, Mr. Taylor is able to exercise a controlling influence over our business and affairs and to unilaterally determine the outcome of any matter submitted to a vote of our stockholders. Mr. Taylor's interests in our company may differ from the interests of our other stockholders, and Mr. Taylor could take actions or make decisions that are not in the best interests of our stockholders.

**ITEM 1B UNRESOLVED STAFF COMMENTS**

None.

24

---

**ITEM 2 PROPERTIES****Properties**

Our Support Center is located in Louisville, Kentucky. We occupy this facility under leases with Paragon Centre Holdings, LLC, a limited liability company in which we have a minority ownership position. As of December 26, 2006, we leased 52,170 square feet. Our leases expire between March 31, 2014 and December 31, 2020. We have rights to expand our leased space as additional space in the building becomes available. We have an option to renew the leases for an additional five years. Of the 163 company restaurants in operation as of December 26, 2006, 83 locations are owned and 80 are leased, as shown in the following table.

State	Owned	Leased	Total
Alabama	2		2
Arizona	4	2	6
Arkansas		1	1
Colorado	7	4	11
Connecticut		2	2
Delaware	1	1	2
Florida		1	1
Georgia	2		2
Idaho		2	2
Illinois	2	3	5
Indiana	2	1	3
Iowa	2	2	4
Kansas	2		2
Kentucky	3	2	5
Louisiana	1	4	5
Maine		1	1
Massachusetts	1	3	4
Michigan	2	3	5
Mississippi	1		1
Missouri		2	2
New Hampshire	1		1
New Jersey		1	1
New Mexico	1	1	2
New York	1	2	3
North Carolina	4	6	10
North Dakota		1	1
Ohio	9	5	14
Oklahoma	1	3	4
Pennsylvania	3	6	9
Rhode Island		1	1
South Dakota	1		1
Texas	23	11	34
Utah		2	2
Virginia	3	4	7
West Virginia	1		1
Wisconsin	2	3	5
Wyoming	1		1
Total	83	80	163

Additional information concerning our properties and leasing arrangements is included in note 2(p) and note 9 to the Consolidated Financial Statements appearing in Part II, Item 8 of this Annual Report on Form 10-K.

**ITEM 3 LEGAL PROCEEDINGS**

Occasionally, we are a defendant in litigation arising in the ordinary course of our business, including claims resulting from slip and fall accidents, employment related claims and claims from guests or employees alleging illness, injury or other 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 a party to any litigation that we believe would have a material adverse effect on our business.

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**PART II**

**ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Class A common stock is traded on the Nasdaq Global Select Market under the symbol TXRH. The Class A common stock has been quoted on the Nasdaq Global Select Market since October 5, 2004. On August 18, 2005, the Company declared a two-for-one stock split of the Company's Class A and Class B common stock to stockholders of record as of the close of business on September 6, 2005. The stock split was effected in the form of a 100% stock dividend on September 23, 2005. All share and per share information included throughout this report for all periods presented has been adjusted to retroactively reflect the stock split. The quarterly high and low closing price of our Class A common stock by quarter were as follows:

	High	Low
<b>Year ended December 27, 2005</b>		
First Quarter	\$ 16.12	\$ 13.04
Second Quarter	\$ 17.55	\$ 12.84
Third Quarter	\$ 19.05	\$ 13.57
Fourth Quarter	\$ 16.89	\$ 13.95
<b>Year ended December 26, 2006</b>		
First Quarter	\$ 16.90	\$ 13.80
Second Quarter	\$ 17.09	\$ 12.66
Third Quarter	\$ 13.84	\$ 9.74
Fourth Quarter	\$ 14.76	\$ 12.28

The number of holders of record of our Class A common stock as of February 16, 2007 was 319. The number of holders of record of our Class B common stock as of February 16, 2007 was one. There is no established trading market for our Class B common stock.

We have never declared or paid cash dividends on our 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 a number of factors, including, but not limited to, earnings, financial

condition, applicable covenants under our credit facility and other contractual restrictions, or other factors deemed relevant.

As of December 26, 2006, shares of Class A common stock authorized for issuance under our equity compensation plan are summarized in the following table. See note 16 to the Consolidated Financial Statements for a description of the plan.

Plan Category	Shares to Be Issued Upon Exercise	Weighted-Average Option Exercise Price	Shares Available for Future Grants
Plan approved by stockholders	6,933,236	\$ 7.98	4,742,575
Plans not approved by stockholders			
<b>Total</b>	<b>6,933,236</b>	<b>\$ 7.98</b>	<b>4,742,575</b>

#### Unregistered Sales of Equity Securities

Except as previously reported, there were no equity securities sold by the Company during the period covered by this Annual Report on Form 10-K that were not registered under the Securities Act of 1933, as amended.

#### Issuer Repurchases of Securities

During the year ended December 26, 2006, there were no repurchases made by us or on our behalf, or by any affiliated purchaser, of shares of our Class A common stock.

#### ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

We derived the selected consolidated financial data as of and for the years 2006, 2005 and 2004 from our audited consolidated financial statements. The 2004 financial data give effect to the combination of our operations under Texas Roadhouse, Inc., a C corporation, and the closing of the Company's initial public offering, both of which occurred on October 8, 2004. The 2004 financial data also give effect to an income tax provision for the period after October 8, 2004 and include an adjustment to establish a deferred tax liability related to the \$5.0 million excess of the reported amounts of the Company's assets and liabilities over the tax basis of those assets and liabilities at October 8, 2004.



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

The selected consolidated financial data as of and for the years 2002 and 2003 and from December 31, 2003 through October 8, 2004 were derived from our audited consolidated financial statements and present the consolidated operations of Texas Roadhouse Holdings LLC and its wholly-owned and majority-owned restaurants, Texas Roadhouse Development Corporation, Texas Roadhouse Management Corp., WKT Restaurant Corp., and nine franchise restaurants, all of which were entities under the common control of Mr. Taylor. The Company utilizes a 52 or 53 week accounting period that ends on the last Tuesday in December. Beginning with fiscal year 2002, for operational reasons, the Company changed its fiscal year end from the last Sunday in December to the last Tuesday in December. This change resulted in fiscal year 2002 consisting of 52 weeks and two days as compared to fiscal years 2003 through 2006, which were all 52 weeks in length. The Company utilizes a 13 week accounting period for quarterly reporting purposes. Our historical results are not necessarily indicative of our results for any future period.

	<b>Fiscal Year</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(in thousands, except per share data)</b>				
<b>Consolidated Statements of Income:</b>					
Revenue:					
Restaurant sales	\$ 586,557	\$ 448,341	\$ 354,190	\$ 279,519	\$ 226,756
Franchise royalties and fees	10,574	10,443	8,821	6,934	6,080
Total revenue	597,131	458,784	363,011	286,453	232,836
Income from operations	54,369	47,296	38,682	34,258	26,312
Income before taxes	53,390	46,614	28,860	23,143	16,953
Provision for income taxes(1)	19,381	16,292	7,159		
Net income	\$ 34,009	\$ 30,322	\$ 21,701	\$ 23,143	\$ 16,953

	<b>Pro forma</b>				
Historical net income				\$ 23,143	\$ 16,953
Pro forma provision for income taxes(2)			7,869	8,379	6,041
Net income adjusted for pro forma provision for income taxes			\$ 13,832	\$ 14,764	\$ 10,912
Net income per common share:					
Basic	\$ 0.46	\$ 0.44	\$ 0.27	\$ 0.31	\$ 0.23
Diluted	\$ 0.44	\$ 0.42	\$ 0.24	\$ 0.30	\$ 0.22
Weighted average shares outstanding(3):					
Basic	73,876	68,677	51,890	46,880	46,668
Diluted	76,520	72,565	56,514	49,544	49,376

	Fiscal Year				
	2006	2005	2004	2003	2002
	(\$ in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Total assets	\$ 452,588	\$ 312,593	\$ 275,854	\$ 148,193	\$ 128,527
Long-term debt, net of current maturities	34,787	6,255	12,760	56,254	59,094
Obligations under capital leases, net of current maturities	575	626	771	914	1,095
Total liabilities	132,209	80,367	101,944	104,606	95,690
Minority interest	1,305	651	699	5,685	5,850
Total stockholders' equity(4)	319,074	231,575	173,211	37,902	26,987
<b>Selected Operating Data:</b>					
Company restaurants:					
Number open at end of period	163	127	107	87	77
Average unit volumes(5)	\$ 3,979	\$ 3,891	\$ 3,679	\$ 3,401	\$ 3,270
Comparable restaurant sales growth(6)	3.5	%	5.6	%	7.6
				%	3.4
				%	3.7
				%	3.7
Net cash provided by operating activities	79,744	64,384	\$ 57,275	\$ 42,158	31,718
Net cash used in investing activities	\$ (109,845 )	\$ (61,021 )	\$ (49,735 )	\$ (26,524 )	(32,764 )
Net cash provided by (used in) financing activities	\$ 34,898	\$ (20,611 )	\$ 32,967	\$ (17,722 )	\$ 4,945

(1) Until October 8, 2004, we operated as a limited liability company and were taxed as a partnership. Accordingly, we paid no significant income taxes on our own behalf and there is no provision for income taxes prior to October 8, 2004 in our consolidated financial statements.

Our results for the year ended December 28, 2004 include a cumulative net deferred income tax provision of \$5.0 million. As a result of our conversion from a nontaxable limited liability company to a taxable C corporation as of our October 8, 2004 initial public offering, and in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*, we established the beginning balances in our deferred tax assets and liabilities. Our net deferred tax liabilities are comprised primarily of differences in depreciation which were previously expensed for income tax purposes, but had not yet been expensed for financial reporting purposes. Such amounts were required to be recognized through the income tax provision in the period of the change in our tax status.

Our effective tax rate is determined based on estimates of pre-tax income, permanent differences and credits, and is reviewed quarterly to determine if actual results require modifying the effective tax rate. Our actual effective tax rate for 2006 was 36.3%, comprised of a combined state tax rate of 3.1% and an effective federal rate of 33.2%. Our actual effective tax rate for 2005 was 34.9%, comprised of a combined state tax rate of 3.1% and an effective federal rate of 31.8%. Our actual effective tax rate for October 8, 2004 through December 28, 2004 was 33.6%, excluding the \$5.0 million deferred tax charge discussed above, comprised of a combined state tax rate of 3.4% and an effective federal rate of 30.2%.

(2) The pro forma provision for income taxes gives effect to our reorganization as a C corporation. The adjustment is based upon the information shown in the table below. The combined state tax rate is our estimate of the average state tax rate we would have incurred based on the mix and volume of business we do in the states and the relevant apportionment factors for those states. The combined federal and state tax rates shown below give effect to the deductibility of state taxes at the federal level and tip tax credits from 2002 through October 7, 2004.

	2004	2003	2002
Effective federal tax rate	31.6 %	32.5 %	32.1 %
Combined state tax rate	3.3 %	3.7 %	3.5 %
Combined effective federal and state tax rate	34.9 %	36.2 %	35.6 %

- (3) See note 13 to the Consolidated Financial Statements.
- (4) See note 12 to the Consolidated Financial Statements.
- (5) Average unit volume represents the average annual restaurant sales for all company restaurants open for a full six months before the beginning of the period measured.
- (6) Comparable restaurant sales growth reflects the change in year-over-year sales 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 later fiscal period.

30

---

**ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Our Company**

Texas Roadhouse is a growing, moderately priced, full-service restaurant chain. Our founder and chairman, W. Kent Taylor, started the business in 1993. Our mission statement is "Legendary Food, Legendary Service®." Our operating strategy is designed to position each of our restaurants as the local hometown destination for a broad segment of consumers seeking high-quality, affordable meals served with friendly, attentive service. As of December 26, 2006, there were 251 Texas Roadhouse restaurants operating in 43 states. We owned and operated 163 restaurants in 37 states, and franchised and licensed an additional 88 restaurants in 23 states.

The first Texas Roadhouse restaurant opened in Clarksville, Indiana in February 1993. As of December 26, 2006, there were 251 Texas Roadhouse restaurants in existence including:

- 163 company restaurants, of which 158 were wholly-owned and five were majority-owned. The results of operations of company restaurants are included in our consolidated operating results. The portion of income attributable to minority interests in company restaurants that are not wholly-owned is reflected in the line item entitled "Minority interest" in our consolidated statements of income.
- 88 franchise restaurants, of which 85 were franchise restaurants and three were license restaurants. We have a 5.0% to 10.0% ownership interest in 18 franchise restaurants. The income derived from our minority interests in these franchise restaurants is reported in the line item entitled "Equity income from investments in unconsolidated affiliates" in our consolidated statements of income. Additionally, we provide various management services to these franchise restaurants, as well as two additional franchise restaurants in which we have no ownership interest.

We have contractual arrangements which grant us the right to acquire at pre-determined valuation formulas (i) the remaining equity interests in three of the five majority-owned company restaurants and (ii) 65 of the franchise restaurants.

**Presentation of Financial and Operating Data**

We operate on a fiscal year that ends on the last Tuesday in December. Fiscal years 2006, 2005 and 2004 were 52 weeks in length. Our quarters are 13 weeks in length.

Through the closing of our reorganization and initial public offering on October 8, 2004, we conducted the Texas Roadhouse restaurant business through:

- Texas Roadhouse Holdings LLC and its wholly-owned and 22 majority-owned restaurants;
- Texas Roadhouse Development Corporation, holding the rights to franchise Texas Roadhouse restaurants;
- Texas Roadhouse Management Corp., providing management services to Texas Roadhouse Holdings LLC, Texas Roadhouse Development Corporation and certain license and franchise restaurants; and
- nine controlled franchise restaurants

all of which were entities under the common control of W. Kent Taylor, our founder and chairman. Our consolidated historical financial statements and financial and operating data reflect the consolidated operations and financial position of Texas Roadhouse Holdings LLC and the above affiliated entities.

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

Since the closing of our reorganization and initial public offering on October 8, 2004, we conduct the Texas Roadhouse restaurant business through Texas Roadhouse, Inc.

On August 18, 2005, the Company declared a two-for-one stock split of the Company's Class A and Class B common stock to stockholders of record as of the close of business on September 6, 2005. The stock split was effected in the form of a 100% stock dividend on September 23, 2005. All share and per share information included in this report for all periods presented have been adjusted to retroactively reflect the stock split.

### Public Offerings and Corporate Reorganization

In connection with our follow-on Class A common stock offering on July 5, 2005, we:

- issued and sold 700,000 new shares of Class A common stock at \$17.38 per share, raising approximately \$11.0 million after underwriting discounts and transaction costs;
- repaid \$4.0 million of indebtedness on our credit facility with the proceeds raised in the offering; and
- used the remaining proceeds to fund development of new restaurants and for general corporate purposes.

In connection with the closing of our reorganization and initial public offering on October 8, 2004, we:

- became a C corporation through the combination of our operations into a new holding company, Texas Roadhouse, Inc.;
- issued an aggregate of 42,515,558 shares of Class A common stock and 5,265,376 shares of Class B common stock in the combination of our operations under Texas Roadhouse, Inc.;
- issued an aggregate of 6,178,160 shares of Class A common stock to acquire the remaining equity interests in Texas Roadhouse Development Corporation and all 31 of our majority-owned company restaurants (including the remaining equity interests in the nine controlled franchise restaurants), and all of the equity interests in one franchise restaurant;
- issued and sold 13,162,962 new shares of Class A common stock at \$8.75 per share, raising approximately \$105.1 million after underwriting discounts and transactions costs;
- repaid \$68.9 million of indebtedness on our then existing credit facility with the proceeds raised in the public offering;
- recorded distributions payable of \$31.2 million to the equity holders of Texas Roadhouse Holdings LLC in redemption of its preferred shares relating to its income for the periods prior to October 8, 2004; and
- recorded a cumulative net deferred tax liability and a corresponding charge to our provision for income taxes of approximately \$5.0 million.

### Long-Term Strategies to Grow Earnings Per Share

Our long-term strategies with respect to increasing net income and earnings per share include the following:

*Expanding Our Restaurant Base.* We will continue to evaluate opportunities to develop Texas Roadhouse restaurants in existing and new markets. We will remain focused primarily on mid-sized markets where we believe there exists a significant demand for our restaurants because of population size, income levels and the presence of shopping and

entertainment centers and a significant employment base.

32

---

Restaurants that we owned and operated for the full six months before the beginning of 2006 generated average unit volumes of \$4.0 million for 2006. Our average cash investment to develop and open a new restaurant, including the cost of land and pre-opening expenses, is approximately \$3.0 million to \$4.0 million. Our ability to expand our restaurant base is influenced by factors beyond our control and therefore we may not be able to achieve our anticipated growth. See Forward-looking Statements.

We may, at our discretion, add franchise restaurants primarily with franchisees who have demonstrated prior success with the Texas Roadhouse or other restaurant concepts and in markets in which the franchisee demonstrates superior knowledge of the demographics and restaurant operating conditions. We may, also, look to acquire franchise restaurants under terms favorable to the Company and our stockholders. Additionally, from time to time, we may evaluate potential mergers, acquisitions, joint ventures or other strategic initiatives to acquire or develop additional concepts.

*Improving Restaurant Level Profitability.* We plan to increase restaurant level profitability through a combination of increased comparable restaurant sales and operating cost management.

*Leveraging Our Scalable Infrastructure.* Over the past several years, we have made significant investments in our infrastructure, including information systems, real estate, human resources, legal, marketing and operations. As a result, we believe that our general and administrative costs will increase at a slower growth rate than our revenue.

### **Key Operating Personnel**

Key personnel who have a significant impact on the performance of our restaurants include managing and market partners. Each company restaurant has one managing partner who serves as the general manager. Market partners can provide supervisory services for up to 12 to 15 managing partners and their respective management teams. Market partners also assist with our site selection process and recruitment of new management teams. The managing partner of each company restaurant and their corresponding market partners are required, as a condition of employment, to sign a multi-year employment agreement. The annual compensation of our managing and market partners includes a base salary plus a percentage of the pre-tax net income of the restaurant(s) they operate or supervise. Managing and market partners are eligible to participate in our stock option plan and are required to make deposits of \$25,000 and \$50,000, respectively, which can be used towards the exercise price of such options.

### **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 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, although sales volumes are generally higher, so are initial costs, resulting in restaurant operating 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 year-over-year sales 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 later fiscal period. Comparable restaurant sales growth can be generated by an increase in guest traffic counts or by increases 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 annual restaurant sales for all company restaurants open for a full six months before the beginning of the period measured. Growth in average unit volumes in excess of comparable restaurant sales growth is generally an indication that newer restaurants are operating with sales levels in excess of the system average. Conversely, growth in average unit volumes less than growth in comparable restaurant sales growth is generally an indication that newer restaurants are operating with sales levels lower than the system average.

*Store Weeks.* Store weeks represent the number of weeks that our company restaurants were open during the year.

#### **Other Key Definitions**

*Restaurant Sales.* Restaurant sales include gross food and beverage sales, net of promotions and discounts.

*Franchise Royalties and Fees.* Franchisees typically pay a \$40,000 initial franchise fee for each new restaurant and a franchise renewal fee equal to the greater of 30% of the then-current initial franchise fee or \$10,000 to \$15,000. Franchise royalties consist of royalties in the amount of 2.0% to 4.0% of gross sales paid to us by our franchisees.

*Restaurant Cost of Sales.* Restaurant cost of sales consists of food and beverage 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 managing 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 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, advertising, repair and maintenance, property taxes, credit card fees and general liability insurance. Profit sharing allocations to 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 salaries, travel expenses, rent, and food, beverage and other initial supplies and expenses.

*Depreciation and Amortization Expenses.* Depreciation and amortization expenses ( D&A ) includes the depreciation of fixed assets and amortization of intangibles with definite lives.

*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. Supervision and accounting fees received from certain franchise restaurants and license restaurants are offset against G&A. G&A also includes share-based compensation expense related to corporate office employees.

*Interest Expense, Net.* Interest expense includes the cost of our debt obligations including the amortization of loan fees, reduced by interest income and capitalized interest. Interest income includes earnings on cash and cash equivalents. In 2004, interest expense included write-offs of loan fees related to the disposition of the July 2003 facility.



*Minority Interest.* Our consolidated subsidiaries at December 26, 2006 included five majority-owned restaurants. Our consolidated subsidiaries at December 27, 2005 included four majority-owned restaurants,

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

three of which were open. In conjunction with the closing of our reorganization and initial public offering on October 8, 2004, we acquired the remaining equity interests in 31 majority-owned company restaurants. As a result, subsequent to October 8, 2004, minority interest included three majority-owned restaurants, two of which were open at December 28, 2004. Minority interest represents the portion of income attributable to the other owners of the majority-owned restaurants and, for periods prior to our IPO, Texas Roadhouse Development Corporation.

*Equity Income from Unconsolidated Affiliates.* We own 5.0% to 10.0% equity interest in 18 franchise restaurants. At December 27, 2005 and December 28, 2004, we owned 5% to 10% equity interest in 16 and 12 franchise restaurants, respectively. Also, at December 27, 2005 and December 28, 2004, we also owned 1% equity interest in one franchise restaurant. Equity income from unconsolidated affiliates represents our percentage share of net income earned by these unconsolidated affiliates.

	Results of Operations					
	Fiscal Year		2005		2004	
	2006		2005		2004	
	\$	%	\$	%	\$	%
(in thousands)						
<b>Consolidated Statements of Income:</b>						
Revenue:						
Restaurant sales	586,557	98.2	448,341	97.6	354,190	97.6
Franchise royalties and fees	10,574	1.8	10,443	2.3	8,821	2.4
Total revenue	597,131	100.0	458,784	100.0	363,011	100.0
Costs and expenses:						
<i>(As a percentage of restaurant sales)</i>						
Restaurant operating costs:						
Cost of sales	205,615	35.1	158,004	35.2	123,531	34.9
Labor	162,610	27.7	122,090	27.2	97,196	27.4
Rent	10,052	1.7	8,397	1.9	8,261	2.3
Other operating	96,088	16.4	75,083	16.7	58,044	16.4
<i>(As a percentage of total revenue)</i>						
Pre-opening	12,508	2.1	8,092	1.8	6,743	1.9
Depreciation and amortization	21,357	3.6	14,582	3.2	11,005	3.0
General and administrative	34,532	5.8	25,240	5.5	19,549	5.4
Total costs and expenses	542,762	90.9	411,488	89.7	324,329	89.3
Income from operations	54,369	9.1	47,296	10.3	38,682	10.7
Interest expense, net	645	(0.1 )	263	(0.1 )	4,654	(1.3 )
Minority interest	585	(0.1 )	549	(0.1 )	5,278	(1.5 )
Equity income from investments in unconsolidated affiliates	(251 )	0.0	(130 )	0.0	(110 )	0.0
Income before taxes	53,390	8.9	46,614	10.2	28,860	8.0
Provision for income taxes	19,381	3.2	16,292	3.6	7,159	2.0
Net income	34,009	5.7	30,322	6.6	21,701	6.0

**Restaurant Unit Activity**

	<b>Company</b>	<b>Franchise</b>	<b>Total</b>
Balance at December 30, 2003	87	75	162
Openings	19	12	31
Acquisitions (Dispositions)	1	(1 )	
Closures			
Balance at December 28, 2004	107	86	193
Openings	20	8	28
Acquisitions (Dispositions)			
Closures			
Balance at December 27, 2005	127	94	221
Openings	25	5	30
Acquisitions (Dispositions)	11	(11 )	
Closures			
Balance at December 26, 2006	163	88	251

*Restaurant Sales*

Restaurant sales increased by 30.8% in 2006 as compared to 2005. This increase was primarily attributable to the opening of new restaurants, the acquisitions of 11 franchise restaurants on the first day of fiscal 2006 and comparable restaurant sales growth. Restaurant sales from the 11 acquired franchise restaurants were \$41.0 million in 2006. Restaurant sales increased by 26.6% in 2005 as compared to 2004. This increase was primarily attributable to the opening of new restaurants and comparable restaurant sales growth.

The following table summarizes certain key drivers and/or attributes of restaurant sales at company restaurants for 2006, 2005 and 2004.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Company Restaurants</b>			
Store weeks	7,648	5,984	4,920
Comparable restaurant sales growth	3.5	% 5.6	% 7.6
Average unit volumes (in thousands)	\$ 3,979	\$ 3,891	\$ 3,679

The 2006 amounts in table above include the impact of increased menu pricing of approximately 1.0% and 0.8% implemented in January 2006 and October 2006, respectively. All of these menu price increases were principally driven by industry wide increases in commodity costs. In addition, the table above includes the impact of increased menu pricing of approximately 1.8%, 0.5% and 2.0% implemented in November 2003, March 2004 and November 2004, respectively. All of these menu price increases were also principally driven by a significant industry wide increase in commodity costs. We have recently increased menu pricing approximately 2.0%. This increase was principally driven by increases in minimum and tip wages which took effect in numerous states at the beginning of 2007.

On December 28, 2005, we acquired 11 franchise restaurants. These acquisitions were accretive to 2006 diluted earnings per share by approximately \$ 0.02 prior to any acquisition-related charges. We recorded a charge of \$0.8 million on the first quarter 2006 acquisitions as discussed in note 3 to the Consolidated Financial Statements.

In 2007, we plan to open approximately 28 to 30 additional company restaurants. We have either begun construction or have sites currently under contract for purchase or lease for all of these restaurants.

In addition, we will continue to evaluate opportunities for acquiring additional franchise restaurants in 2007.

*Franchise Royalties and Fees*

Franchise royalties and fees increased by \$0.1 million, or by 1.3%, from 2005 to 2006. This increase was primarily attributable to the impact of the opening of new franchise restaurants and comparable restaurant sales growth of 2.7% offset by the impact of our acquisition of 11 franchise restaurants on December 28, 2005. These acquired franchise restaurants generated approximately \$1.3 million in franchise royalties in 2005. Franchise restaurant count activity is shown in the restaurant unit activity table above. In 2007, franchisees plan to open two to four new franchise restaurants.

Franchise royalties and fees increased by \$1.6 million, or by 18.4%, from 2004 to 2005. This increase was primarily attributable to the opening of new franchise restaurants and comparable restaurant sales growth of 4.4%. Franchise restaurant count activity is shown in the restaurant unit activity table above.

*Restaurant Cost of Sales*

Restaurant cost of sales decreased as a percentage of restaurant sales to 35.1% in 2006 from 35.2% in 2005. This decrease was primarily due to menu price increases of approximately 1.0% and 0.8% in January 2006 and October 2006, respectively, partially offset by higher commodity costs, principally produce costs.

Restaurant cost of sales increased as a percentage of restaurant sales to 35.2% in 2005 from 34.9% in 2004. This increase was primarily due to the higher cost of pork ribs and was partially offset by menu price increases of approximately 2%.

*Restaurant Labor Expenses*

Restaurant labor expenses, as a percentage of restaurant sales, increased to 27.7% in 2006 from 27.2% in 2005. The increase was primarily due to the expensing of stock options in conjunction with the adoption of Statement of Financial Accounting Standards ( SFAS ) No. 123 (Revised 2004), *Share-Based Payment* ( SFAS 123R ), at the beginning of fiscal 2006, offset by a reduction in our workers' compensation insurance expense. We recorded share-based compensation expense of \$2.9 million (0.5% as a percentage of restaurant sales) in 2006, as discussed in note 2 to the Consolidated Financial Statements. Our workers' compensation insurance expense decreased 0.1% as a percentage of restaurant sales in 2006 due to more favorable claims experience. The remaining increase is primarily due to restaurants opened in 2006 as we generally incur higher labor costs during the first few months after the opening of a new restaurant, partially offset by the percentage of sales benefit generated from comparable restaurant sales growth. Effective at the beginning of 2007, numerous states enacted legislation resulting in tip wage and minimum wage increases. In an effort to mitigate the impact of these additional costs, we have recently increased our menu prices by approximately 2.0%. We anticipate that additional legislation may be enacted in future periods that, if enacted, would have an adverse effect on our labor costs.

Restaurant labor expenses, as a percentage of restaurant sales, decreased to 27.2% in 2005 from 27.4% in 2004. The percentage of sales benefit generated from comparable restaurant sales growth more than offset modest wage rate inflation.

*Restaurant Rent Expense*

Restaurant rent expense, as a percentage of restaurant sales, decreased to 1.7% in 2006 from 1.9% in 2005. The decrease was due to the impact associated with the 11 acquired franchise restaurants (eight of

the 11 acquired franchise restaurants are on owned properties) and the benefit generated from comparable restaurant sales growth.

Restaurant rent expense, as a percentage of restaurant sales, decreased to 1.9% in 2005 from 2.3% in 2004. In the fourth quarter of 2004, we recorded a \$1.2 million pre-tax, non-cash charge due to the correction of our lease accounting practices. Excluding this charge, restaurant rent expense, as a percentage of restaurant sales, decreased slightly to 1.9% in 2005 from 2.0% in 2004 due primarily to the percentage of sales benefit generated from comparable restaurant sales growth.

#### *Restaurant Other Operating Expenses*

Restaurant other operating expenses, as a percentage of restaurant sales, decreased to 16.4% in 2006 from 16.7% in 2005. The decrease was primarily due to lower insurance costs, equipment rent, credit card fees and the sales benefit generated from comparable restaurant sales growth, partially offset by higher impairment costs. General liability insurance expense decreased 0.1% as a percentage of restaurant sales due to more favorable claims experience, while credit cards fees were 0.1% lower as a percentage of restaurant sales than in 2005 due to a \$0.8 million pre-tax, non-cash charge to credit card fees in the third quarter of 2005 to recognize an accounting policy change. Additionally, equipment rent decreased 0.1% as a percentage of restaurant sales due to no longer utilizing leasing arrangements to finance equipment packages on new stores. These decreases were partially offset by impairment costs of \$0.5 million (0.1% as a percentage of restaurant sales) incurred in conjunction with the planned relocation of two restaurant sites in 2007.

Restaurant other operating expenses, as a percentage of restaurant sales, increased to 16.7% in 2005 from 16.4% in 2004. The increase was due in part to higher credit card fees, gift card fees, utilities and hurricane-related closure costs. The increase was partially offset by decreases in general liability insurance, supplies costs and equipment rent. Credit card fees included a \$0.8 million (0.2% as a percentage of sales) pre-tax, non-cash charge to recognize an accounting policy change. As a result of the change in accounting policy regarding credit card fees, we had approximately 13 months of credit card fees in 2005 and 12 months in 2004 and future years. Gift card fees increased in 2005 due to the decrease in gift card breakage as compared to 2004. In 2004, we recorded a cumulative adjustment for gift card breakage of \$1.7 million for cards sold from 2000 to 2004 and still outstanding at the end of 2004. In 2005, we recorded gift card breakage of \$0.7 million on gift cards sold in 2005. In 2005, we recorded a \$0.8 million (0.2% as a percentage of sales) decrease in general liability insurance expense due to changes in our claim development history based on our fourth quarter actuarial analysis compared to a \$1.0 million (0.3% as a percentage of sales) increase in 2004.

#### *Restaurant Pre-opening Expenses*

Pre-opening expenses in 2006 increased to \$12.5 million from \$8.1 million in 2005. This increase was primarily due to substantially more restaurants being in the development pipeline in 2006 versus 2005. Additionally, we opened 25 restaurants in 2006 compared to 20 restaurants in 2005. Pre-opening costs will fluctuate from period to period, based on the number and timing of restaurant openings. We incurred additional pre-opening expense in 2006 of \$0.4 million related to expensing rental costs associated with the construction of new restaurants as required by Staff Position FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period* as discussed in note 2 to the Consolidated Financial Statements.

Pre-opening expenses in 2005 increased to \$8.1 million from \$6.7 million in 2004. We opened 20 restaurants in 2005 compared to 19 restaurants in 2004. In addition, pre-opening costs were incurred in both periods for restaurant openings in progress.

*Depreciation and Amortization Expenses*

D&A, as a percentage of revenue, increased to 3.6% in 2006 from 3.2% in 2005 which was an increase from 3.0% in 2004. These increases were primarily related to capital spending on new restaurants.

*General and Administrative Expenses*

G&A increased in 2006 to \$34.5 million (5.8% of revenue) from \$25.2 million (5.5% of revenue) in 2005. This increase was primarily due to the adoption of SFAS 123R and the application of Emerging Issues Task Force ( EITF ) No. 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination* ( EITF 04-1 ), offset by the leveraging of other G&A costs as our system continues to grow. In 2006, we recorded share-based compensation expense of \$3.3 million (0.5% of revenue) in conjunction with the adoption of SFAS 123R, as discussed in note 2 to the Consolidated Financial Statements, and a charge of \$0.8 million (0.1% of revenue) in conjunction with the application of EITF 04-1 relating to the acquisition of the 11 franchise restaurants in the first quarter of 2006, as discussed in note 3 to the Consolidated Financial Statements.

G&A increased in 2005 to \$25.2 million (5.5% of revenue) from \$19.5 million (5.4% of revenue) in 2004. This increase was primarily due to general business growth and public company costs which did not exist until the fourth quarter of 2004.

*Interest Expense, Net*

Interest expense increased to \$0.6 million in 2006 from \$0.3 million in 2005. This increase was primarily due to increased borrowings under our credit facility, offset by increased capitalized interest. Borrowings under our credit facility increased as a result of us acquiring the land and buildings leased by eight of the 11 franchise restaurants acquired on December 28, 2005 and increased capital expenditures relating to new restaurants.

Interest expense decreased to \$0.3 million in 2005 from \$4.7 million in 2004. Interest expense in 2005 included interest income of \$0.6 million. Excluding this income, interest expense decreased by approximately \$3.8 million from 2004 to 2005 due to a significant reduction in our long term debt.

*Income Taxes*

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Our effective tax rate for 2006 increased to 36.3% from 34.9% in 2005. The increase in 2006 was due to the non-deductibility of certain incentive stock options in accordance with SFAS 123R and the charge relating to the application of EITF 04-1, partially offset by higher federal tax credits. We expect the effective tax rate to be approximately 36.0% for fiscal 2007.

Our effective tax rate for 2005 was 34.9%. Until October 8, 2004, we operated as a limited liability company and were taxed as a partnership. Accordingly, we paid no significant income taxes on our own behalf and there is no provision for income taxes prior to October 8, 2004 in our consolidated financial statements. In connection with the closing of our corporate reorganization and initial public offering, we became a C corporation subject to federal and state income taxes. Accordingly, our effective tax rate for October 8, 2004 to December 28, 2004 was 33.6%. We had income tax expense of \$2.2 million for 2004, excluding the \$5.0 million deferred tax charge that was recognized in the fourth quarter of 2004 as a result of our conversion from a limited liability company to a C corporation. See note 10 to the Consolidated Financial Statements.

**Liquidity and Capital Resources**

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

	<b>Fiscal Year 2006 (in thousands)</b>	<b>2005</b>	<b>2004</b>
Net cash provided by operating activities	\$ 79,744	\$ 64,384	\$ 57,275
Net cash used in investing activities	(109,845 )	(61,021 )	(49,735 )
Net cash provided by (used in) financing activities	34,898	(20,611 )	32,967
Net increase (decrease) in cash	\$ 4,797	\$ (17,248 )	\$ 40,507

Net cash provided by operating activities was \$79.7 million in 2006 compared to \$64.4 million in 2005. The increase was driven by changes in net income, depreciation and amortization and share-based compensation expense. 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 received trade credit for the purchase of food, beverages and supplies, thereby reducing the need for incremental working capital to support growth. Net cash provided by operating activities was \$64.4 million in 2005 compared to \$57.3 million in 2004. The increase was driven primarily by the tax benefit from the exercise of stock options, net income and higher gift card sales in 2005, offset by deferred income taxes and changes in working capital.

Net cash used in investing activities was \$109.8 million in 2006 compared to \$61.0 million in 2005. The increase was primarily due to an increase in capital spending associated with new restaurant development and the \$13.3 million use of cash associated with the acquisitions of the 11 franchise restaurants in the first quarter of 2006. This increase included \$15.6 million for the acquisition of land and buildings previously leased by eight of the 11 franchise restaurants acquired on the same date and \$2.1 million of cash paid in partial consideration for ten of the 11 franchise restaurants, offset by \$3.8 million of acquired cash from the franchise restaurants and \$0.8 million related to the applications of EITF 04-1. Net cash used in investing activities was \$61.0 million in 2005 compared to \$49.7 million in 2004. The increase was primarily due to an increase in capital spending associated with new restaurant construction.

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 where it is cost effective. As of December 26, 2006, there were 83 restaurants developed on land which we owned.

Our future capital requirements will primarily depend on the number of new restaurants we open and the timing of those openings 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 2007, we expect our capital expenditures to be \$90.0 to \$100.0 million, excluding franchise acquisitions, substantially all of which will relate to planned restaurant openings. We intend to satisfy our capital requirements over the next 12 months with cash on hand, net cash provided by operating activities and funds available under our credit facility.

Net cash provided by financing activities was \$34.9 million in 2006 compared to net cash used in financing activities of \$20.6 million in 2005. This increase was due primarily to net borrowings of \$30.0 million under our credit facility to fund capital expenditures and the acquisition of franchise restaurants, excess tax benefits from share-based compensation recognized in accordance with SFAS 123R of \$3.8 million and the payment of distributions of \$31.2 million in 2005, offset by net proceeds from our

secondary offering in 2005 of \$11.0 million. In 2005, \$31.2 million of distributions was paid to members of our predecessor company, Texas Roadhouse Holdings LLC, in redemption of its preferred shares related to its income for periods prior to and through October 8, 2004. Net cash used in financing activities was \$20.6 million in 2005 compared to net cash provided by financing activities of \$33.0 million in 2004. The change was due primarily to the payment of distributions of \$31.2 million to members of our predecessor company in 2005, offset by net proceeds from our secondary offering of \$11.0 million and net proceeds from the exercise of stock options of \$5.8 million in 2005. Additionally, 2004 included net proceeds from short-term and long-term debt of \$15.1 million.

On July 5, 2005, we issued 700,000 shares as part of a follow-on Class A common stock offering and received net offering proceeds of \$11.0 million, net of \$1.2 million of offering expenses. In conjunction with the offering, we paid off \$4.0 million of borrowings under our credit facility, with the remaining proceeds used to fund development of new restaurants and for general corporate purposes.

In 2006, we paid distributions of \$0.8 million to equity holders of our five majority-owned company restaurants. In 2005, we paid distributions of \$0.7 million to equity holders of our three majority-owned company restaurants. We have also paid distributions to our equity holders relating to periods before our initial public offering. Our predecessor companies paid aggregate distributions to their equity holders in 2004 of \$22.7 million. Currently, our intent is to retain our future earnings, if any, primarily to finance the future development and operation of our business.

On October 8, 2004, we entered into a \$150.0 million, five-year revolving credit facility with a syndicate of commercial lenders led by Bank of America, N.A., Banc of America Securities LLC and National City Bank of Kentucky. The facility replaced the previous credit facility. The terms of the facility require us to pay interest on outstanding borrowings at LIBOR plus a margin of 0.75% to 1.50% and to pay a commitment fee of 0.15% to 0.25% per year on any unused portion of the facility, in both cases depending on our leverage ratio. The facility prohibits us from incurring additional debt outside the facility with certain exceptions, including equipment financing up to \$3.0 million, unsecured debt up to \$500,000 and up to \$20.0 million of debt incurred by majority-owned companies formed to open new restaurants. The credit facility was amended on December 27, 2005 to allow additional indebtedness up to \$30.0 million outside the facility in connection with acquiring franchisees. The facility also prohibits the declaration or payment of cash dividends on our stock and requires W. Kent Taylor to maintain beneficial ownership of at least 20% of the voting power of our stock. Additionally, the lenders' obligations to extend credit under the facility depends upon maintaining certain financial covenants, including a minimum fixed charge coverage ratio of 1.50 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. We are currently in compliance with such covenants.

At December 26, 2006, we had \$30.0 million of outstanding borrowings under our credit facility and \$117.5 million of availability net of \$2.5 million of outstanding letters of credit. In addition, we had various other notes payable totaling \$5.4 million with interest rates ranging from 4.35% to 10.80%. Each of these notes relate to the financing of specific restaurants. Our total weighted average effective interest rate at December 26, 2006 was 6.62%.

At December 27, 2005, we had no outstanding borrowings under our credit facility and \$147.6 million of availability net of \$2.4 million of outstanding letters of credit. In addition, we had various other notes payable totaling \$6.8 million with interest rates ranging from 5.7% to 10.8%. Each of these notes relate to the financing of specific restaurants. Our total weighted average effective interest rate at December 27, 2005 was 9.2%.



**Contractual Obligations**

The following table summarizes the amount of payments due under specified contractual obligations as of December 26, 2006:

	Payments Due by Period				
	Total (in thousands)	Less than 1 year	1-3 Years	3-5 Years	More than 5 years
Long-term debt obligations	\$ 35,388	\$ 601	\$ 31,059	\$ 739	\$ 2,989
Capital lease obligations	627	52	123	152	300
Interest(1)	9,098	2,586	4,673	754	1,085
Operating lease obligations	108,150	10,742	19,779	19,964	57,665
Capital obligations	81,127	81,127			
Total contractual obligations	\$ 234,390	\$ 95,108	\$ 55,634	\$ 21,609	\$ 62,039

(1) Assumes constant rate until maturity for our fixed and variable rate debt and capital lease obligations. Uses interest rates as of December 26, 2006 for our variable rate debt.

The Company has no material minimum purchase commitments with its vendors that extend beyond a year. See notes 4 and 9 to the Consolidated Financial Statements for details of contractual obligations.

**Off-Balance Sheet Arrangements**

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

**Guarantees**

We entered into real estate lease agreements for franchise restaurants located in Everett, MA, Longmont, CO, Montgomeryville, PA and Fargo, ND prior to our granting franchise rights for those restaurants. We have subsequently assigned the leases to the franchisees, but we remain contingently liable if a franchisee defaults under the terms of a lease. The Longmont lease expires in May 2014, the Everett lease expires in February 2018, the Montgomeryville lease expires in March 2021 and the Fargo lease expires in July 2016.

**Recent Accounting Pronouncements**

In June 2006, Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS 109* ( FIN 48 ), was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of the Company's 2008 fiscal year. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial position, results of operations or cash flows.

### Critical Accounting Policies and Estimates

The above discussion and analysis of our financial condition and results of operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosures of contingent assets and liabilities. Our significant accounting policies are described in note 2 to the accompanying Consolidated Financial Statements. Critical accounting policies are those that we believe are most important to portraying our financial condition and results of operations and also require the greatest amount of subjective or complex judgments by management. Judgments or uncertainties regarding the application of these policies may result in materially different amounts being reported under different conditions or using different assumptions. We consider the following policies to be the most critical in understanding the judgments that are involved in preparing the Consolidated Financial Statements.

*Share-based Employee Compensation.* Beginning in the first quarter of 2006, we account for share-based compensation in accordance with SFAS 123R. As required by SFAS 123R, share-based compensation expense is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires various highly judgmental assumptions including the expected dividend yield, stock price volatility and life of the award. If any of the assumptions used in the model change significantly, share-based compensation expense may differ materially in the future from that recorded in the current period. See note 2 in the Consolidated Financial Statements for further discussion of share-based employee compensation.

*Impairment of Long-Lived Assets.* We evaluate the carrying value of individual restaurants for impairment annually or when events or circumstances indicate these assets might be impaired. In making these judgments, we consider the period of time since the restaurant was opened and the trend of operations and expectations for future sales growth. For a restaurant selected for review, we estimate the future undiscounted cash flows from operating the restaurant over its estimated useful life. In determining future cash flows, significant estimates are made by us with respect to future operating results of each restaurant. Our judgments and estimates related to the expected useful lives of long-lived assets are affected by factors such as changes in economic conditions and changes in operating performance. As we assess the ongoing expected cash flows and carrying amounts of our long-lived assets, these factors could cause us to realize a material impairment charge.

If assets are determined to be impaired, we would measure the impairment charge by calculating the amount by which the asset carrying amount exceeds its fair value. The determination of asset fair value is also subject to significant judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

The Company recorded an impairment loss in restaurant other operating expenses of \$0.5 million in 2006 with respect to two restaurants that were approved to relocate to better sites in their respective markets. One of these restaurants opened at its new site in January 2007. We concluded that no other impairment charge was necessary as a result of our impairment evaluations for 2006, 2005 and 2004.

*Goodwill.* Goodwill is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the implied fair value of goodwill. The determination of impairment consists of two steps. First, we determine the fair value of the reporting unit and compare it to its carrying amount. Fair value is determined based on discounted cash flows. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of the goodwill. The implied

fair value of goodwill is determined by allocating the fair value of the reporting unit, which we consider to be at the restaurant level, in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

The most significant assumptions we use in this analysis are those made in estimating future cash flows. In estimating future cash flows, we use the assumptions from our strategic plan for items such as sales growth and operating costs. If our assumptions used in performing the impairment test prove inaccurate, the fair value of the restaurants may ultimately prove to be significantly lower, thereby causing the carrying value to exceed the fair value and indicating impairment has occurred. We concluded that no impairment charge was required for the years ended December 26, 2006, December 27, 2005 and December 28, 2004.

*Insurance Reserves.* We self-insure a significant portion of expected losses under our workers compensation, general liability and property insurance programs. We purchase insurance for individual claims that exceed the amounts listed below:

Workers compensation	\$ 250,000
General liability	\$ 100,000
Property	\$ 25,000

We record a liability for unresolved claims and for an estimate of incurred but not reported claims at the anticipated cost to us based on estimates provided by a third party administrator and actuary. Our estimated liability is based on a number of assumptions and factors regarding economic conditions, the frequency and severity of claims and claim development history and settlement practices. Estimates of claims reserves are discounted using a discount rate of approximately 3.0% at December 26, 2006 resulting in a discount of \$0.2 million. An increase or decrease in the discount rate of 100 basis points would change the reserve, and resulting expense, by an immaterial amount. We also monitor actuarial observations of historical claim development for the industry. Our assumptions are reviewed, monitored, and adjusted when warranted by changing circumstances.

*Income Taxes.* We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, under which deferred assets and liabilities are recognized based upon anticipated future tax consequences attributable to differences between financial statement carrying values of assets and liabilities and their respective tax bases. A valuation allowance is established to reduce the carrying value of deferred tax assets if it is considered more likely than not that such assets will not be realized. Any change in the valuation allowance would be charged to income in the period such determination was made.

Prior to converting to a C corporation on October 8, 2004, the Company operated as a limited liability company and was taxed as a partnership. As such, the Company's income or losses were passed through to its owners who are liable for any related income taxes.

#### **Effects of Inflation**

We do not believe inflation has had a significant effect on our operations during the past several years as we generally have been able to substantially offset increases in our restaurant and operating costs resulting from inflation by altering our menu, increasing menu prices or making other adjustments.

#### **ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES OF MARKET RISK**

We are exposed to market risk from changes in interest rates on debt and changes in commodity prices. Our exposure to interest rate fluctuations is limited to our outstanding bank debt. At December 26, 2006, there was \$30.0 million in outstanding borrowings under our revolving line of credit, which bears

interest at approximately 75 to 150 basis points (depending on our leverage ratios) over the London Interbank Offered Rate ( LIBOR ). We had various other notes payable totaling \$5.4 million with fixed interest rates ranging from 4.35% to 10.80%. Should interest rates based on these borrowings increase by one percentage point, our estimated annual interest expense would increase by \$0.3 million.

Many of the ingredients used in the products sold in our restaurants are commodities that are subject to unpredictable price volatility. Although we attempt to minimize the effect of price volatility by negotiating fixed price contracts for the supply of key ingredients, there are no established fixed price markets for certain commodities such as produce and cheese and we are subject to prevailing market conditions when purchasing those types of commodities. For commodities that are purchased under fixed price contracts, the prices are based on prevailing market conditions at the time the contract is entered into and do not fluctuate during the contract period. We currently do not use financial instruments to hedge commodity prices but 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 four vendors. If these vendors were unable to fulfill its obligations under its contracts, we may encounter supply shortages and incur higher costs to secure adequate supplies, any of which would harm our business.

#### **ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY FINANCIAL DATA**

See Index to Consolidated Financial Statements at Item 15.

#### **ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

#### **ITEM 9A 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) 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 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 December 26, 2006.

##### **Changes in internal control**

During the fourth quarter of 2006, there were no changes with respect to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

##### **Management's Report on Internal Control over Financial Reporting**

Under Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to assess the effectiveness of the Company's internal control over financial reporting as of the end of each fiscal year

and report, based on that assessment, whether the Company's internal control over financial reporting is effective.

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Exchange Act Rule 13a-15(f), internal control over financial reporting is a process designed by, or under the supervision of, our principal executive and principal financial officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

Under the supervision and with the participation of our management, including our CEO and CFO, we assessed the effectiveness of the Company's internal control over financial reporting as of the end of the period covered by this report. In this assessment, the Company applied criteria based on the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). These criteria are in the areas of control environment, risk assessment, control activities, information and communication, and monitoring. The Company's assessment included documenting, evaluating and testing the design and operating effectiveness of its internal control over financial reporting. Based upon this evaluation, our management concluded that our internal control over financial reporting was effective as of December 26, 2006.

KPMG LLP, the independent registered public accounting firm that audited our Consolidated Financial Statements included in the Annual Report on Form 10-K, has also audited our management's assessment of the effectiveness of the Company's internal control over financial reporting and the effectiveness of the Company's internal control over financial reporting as of December 26, 2006 as stated in their report therein.

**ITEM 9B OTHER INFORMATION**

None.

46

---

**PART III**

**ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Incorporated by reference from the Company's Definitive Proxy Statement to be dated approximately April 23, 2007.

**ITEM 11 EXECUTIVE COMPENSATION**

Incorporated by reference from the Company's Definitive Proxy Statement to be dated approximately April 23, 2007.

**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Incorporated by reference from the Company's Definitive Proxy Statement to be dated approximately April 23, 2007.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Incorporated by reference from the Company's Definitive Proxy Statement to be dated approximately April 23, 2007.

**ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES**

Incorporated by reference from the Company's Definitive Proxy Statement to be dated approximately April 23, 2007.

47

---

**PART IV****ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES***(a)* 1. Consolidated Financial Statements

Description	Page Number in Report
Reports of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets as of December 26, 2006 and December 27, 2005	F-3
Consolidated Statements of Income for the years ended December 26, 2006, December 27, 2005 and December 28, 2004	F-4
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 26, 2006, December 27, 2005 and December 28, 2004	F-5
Consolidated Statements of Cash Flows for the years ended December 26, 2006, December 27, 2005 and December 28, 2004	F-6
Notes to Consolidated Financial Statements	F-7

**2. Financial Statement Schedules**

Omitted due to inapplicability or because required information is shown in the Company's Consolidated Financial Statements or notes thereto.

**3. Exhibits**

Exhibit No.	Description
2.1	Master Transaction Agreement, dated as of May 7, 2004, among Registrant and others (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
3.1	Form of Amended and Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
3.2	Bylaws of the Registrant (incorporated by reference to Exhibit 3.3 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
4.1	Registration Rights Agreement, dated as of May 7, 2004, among Registrant and others (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
10.1	Credit Agreement dated as of October 8, 2004, among Texas Roadhouse, Inc., each lender from time to time party thereto, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and National City Bank of Kentucky, as Syndication Agent (incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
10.2*	Employment Agreement between Registrant and G.J. Hart (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
10.3*	Employment Agreement between Registrant and Scott M. Colosi (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
48	

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

- 10.4\* Employment Agreement between Registrant and Steven L. Ortiz (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
- 10.5\* Employment Agreement between Registrant and W. Kent Taylor (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
- 10.6\* Employment Agreement between Registrant and Sheila C. Brown (incorporated by reference to Exhibit 10.6 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2004) (File No. 000-50972))
- 10.7\* Texas Roadhouse, Inc. 2004 Equity Incentive Plan (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-8 of Registrant (File No. 333-121241))
- 10.8 Amended and Restated Office Lease Agreement (One Paragon Centre), dated as of August 15, 2003, by and between Paragon Centre Associates, LLC and Texas Roadhouse Holdings LLC, as amended (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
- 10.9 Form of Director and Executive Officer Indemnification Agreement (incorporated by reference to Exhibit 10.9 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
- 10.10 Form of Limited Partnership Agreement and Operating Agreement for company-managed Texas Roadhouse restaurants, including schedule of the owners of such restaurants and the interests held by directors, executive officers and 5% stockholders who are parties to such an agreement (incorporated by reference to Exhibit 10.10 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
- 10.11 Lease Agreement dated as of November 1999, by and between TEAS II, LLC and Texas Roadhouse Holdings LLC (incorporated by reference to Exhibit 10.13 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
- 10.12 Form of Franchise Agreement and Preliminary Agreement for a Texas Roadhouse restaurant franchise, including schedule of directors, executive officers and 5% stockholders which have entered into either agreement (incorporated by reference to Exhibit 10.14 to the Registration Statement on Form S-1 of Registrant (File No. 333-115259))
- 10.13 Updated schedule as of December 26, 2006 of the owners of company-managed Texas Roadhouse restaurants and the interests held by directors, executive officers and 5% stockholders who are parties to Limited Partnership Agreements and Operating Agreements as set forth at Exhibit 10.10 of this Form 10-K
- 10.14 Updated schedule as of December 26, 2006 of the directors, executive officers and 5% stockholders which have entered into Franchise Agreements or Preliminary Agreements for a Texas Roadhouse Franchise as set forth at Exhibit 10.12 of this Form 10-K
- 10.15\* First Amendment to Employment Agreement between Registrant and Sheila C. Brown dated March 3, 2005 (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 28, 2004 (File No. 000-50972))
- 10.16\* Information concerning the potential bonuses to be paid to each of the named executive officers under the Registrant's bonus incentive program for fiscal 2006 (incorporated by reference to the Registrant's Current Report on Form 8-K dated February 8, 2006 (File No. 000-50972))



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

- 10.17 First Amendment to Credit Agreement dated December 27, 2005 among Registrant, the lenders from time to time party thereto and Bank of America, N.A., as Administrative Agent (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 27, 2005 (File No. 000-50972))
- 10.18 Amended and Restated Lease Agreement (Two Paragon Centre) dated January 1, 2006 between Paragon Centre Holdings, LLC and Texas Roadhouse Holdings LLC (incorporated by reference to Exhibit 10.17 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 27, 2006) (File No. 000-50972))
- 10.19 Second Amendment to Credit Agreement dated July 10, 2006 among Texas Roadhouse, Inc., the lenders from time to time party thereto and Bank of America, N.A., as Administrative Agent (incorporated by reference to Exhibit 10.20 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 27, 2006) (File No. 000-50972))
- 10.20 Third Amendment and Consent to Credit Agreement dated as of September 14, 2006 to the Credit Agreement dated as of October 8, 2004 by and among Registrant, the lenders named therein and Bank of America, N.A., as Administrative Agent (incorporated by reference to the Registrant's Current Report on Form 8-K dated September 20, 2006 (File No. 000-50972))
- 10.21 First Amendment to Amended and Restated Lease Agreement (Two Paragon Centre) dated December 27, 2006 between Paragon Centre Holdings, LLC and Texas Roadhouse Holdings LLC
- 21.1 List of Subsidiaries
- 23.1 Consent of KPMG LLP, Independent Registered Public Accounting Firm
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

---

\* *Management* contract or compensatory plan or arrangement required to be filed as an exhibit to the Annual Report on Form 10-K.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TEXAS ROADHOUSE, INC.

By: /s/ G.J. HART  
 G.J. Hart  
*President, Chief Executive Officer, Director*  
 Date: February 23, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Annual Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ W. KENT TAYLOR W. Kent Taylor	Chairman of the Company, Director	February 23, 2007
/s/ G.J. HART G.J. Hart	President, Chief Executive Officer, Director (Principal Executive Officer)	February 23, 2007
/s/ SCOTT M. COLOSI Scott M. Colosi	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 23, 2007
/s/ GREGORY N. MOORE Gregory N. Moore	Director	February 23, 2007
Martin T. Hart	Director	
/s/ JAMES F. PARKER James F. Parker	Director	February 23, 2007
/s/ JAMES R. RAMSEY James R. Ramsey	Director	February 23, 2007
/s/ JAMES R. ZARLEY James R. Zarley	Director	February 23, 2007



**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Stockholders  
Texas Roadhouse, Inc.:**

We have audited the accompanying consolidated balance sheets of Texas Roadhouse, Inc. and subsidiaries (the Company) as of December 26, 2006 and December 27, 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 26, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas Roadhouse, Inc. and subsidiaries as of December 26, 2006 and December 27, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 26, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, effective December 28, 2005, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, and changed its method of accounting for share-based payments.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Texas Roadhouse, Inc.'s internal control over financial reporting as of December 26, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Louisville, Kentucky  
February 23, 2007

F-1

---

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Texas Roadhouse, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that Texas Roadhouse, Inc. and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 26, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Texas Roadhouse, Inc. maintained effective internal control over financial reporting as of December 26, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Texas Roadhouse, Inc., maintained, in all material respects, effective internal control over financial reporting as of December 26, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Texas Roadhouse, Inc. and subsidiaries as of December 26, 2006 and December 27, 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 26, 2006, and our report dated February 23, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Louisville, Kentucky  
February 23, 2007

F-2

---

## Texas Roadhouse, Inc. and Subsidiaries

## Consolidated Balance Sheets

(in thousands, except share and per share data)

	December 26, 2006	December 27, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 33,784	\$ 28,987
Receivables, net of allowance for doubtful accounts of \$69 in 2006 and 2005	8,299	9,613
Inventories	6,436	5,893
Prepaid income taxes		1,866
Prepaid expenses	2,920	2,259
Deferred tax assets	1,066	621
Other current assets		40
Total current assets	52,505	49,279
Property and equipment, net	305,731	210,382
Goodwill	86,649	51,063
Intangible asset, net	4,880	
Other assets	2,823	1,869
Total assets	\$ 452,588	\$ 312,593
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 601	\$ 498
Current maturities of obligations under capital leases	52	140
Accounts payable	18,794	17,415
Deferred revenue gift certificates	26,205	19,355
Accrued wages	13,737	9,220
Income tax payable	3,725	
Accrued taxes and licenses	6,726	3,646
Other accrued liabilities	8,139	5,695
Total current liabilities	77,979	55,969
Long-term debt, excluding current maturities	34,787	6,255
Obligations under capital leases, excluding current maturities	575	626
Stock option deposits	4,102	3,404
Deferred rent	5,829	4,502
Deferred tax liabilities	7,823	6,679
Other liabilities	1,114	2,932
Total liabilities	132,209	80,367
Minority interest in consolidated subsidiaries	1,305	651
Stockholders equity		
Preferred stock (\$0.001 par value, 1,000,000 shares authorized; no shares outstanding or issued)		
Common stock, Class A, (\$0.001 par value, 100,000,000 shares authorized, 69,002,925 and 65,267,655 shares issued and outstanding at December 26, 2006 and December 27, 2005, respectively)	69	65
Common stock, Class B, (\$0.001 par value, 8,000,000 shares authorized, 5,265,376 shares issued and outstanding)	5	5
Additional paid in capital	255,253	201,764
Retained earnings	63,747	29,738
Accumulated other comprehensive income		3
Total stockholders equity	319,074	231,575
Total liabilities and stockholders equity	\$ 452,588	\$ 312,593

See accompanying notes to Consolidated Financial Statements.

## Texas Roadhouse, Inc. and Subsidiaries

## Consolidated Statements of Income

(in thousands, except per share data)

	Fiscal Year Ended December 26, 2006	December 27, 2005	December 28, 2004
<b>Revenue:</b>			
Restaurant sales	\$ 586,557	\$ 448,341	\$ 354,190
Franchise royalties and fees	10,574	10,443	8,821
Total revenue	597,131	458,784	363,011
<b>Costs and expenses:</b>			
<b>Restaurant operating costs:</b>			
Cost of sales	205,615	158,004	123,531
Labor	162,610	122,090	97,196
Rent	10,052	8,397	8,261
Other operating	96,088	75,083	58,044
Pre-opening	12,508	8,092	6,743
Depreciation and amortization	21,357	14,582	11,005
General and administrative	34,532	25,240	19,549
Total costs and expenses	542,762	411,488	324,329
Income from operations	54,369	47,296	38,682
Interest expense, net	645	263	4,654
Minority interest	585	549	5,278
Equity income from investments in unconsolidated affiliates	(251 )	(130 )	(110 )
Income before taxes	\$ 53,390	\$ 46,614	\$ 28,860
Provision for income taxes	19,381	16,292	7,159
Net income	\$ 34,009	\$ 30,322	\$ 21,701

	<b>Proforma</b>
Historical net income	\$ 21,701
Pro forma provision for income taxes	7,869
Net income adjusted for pro forma provision for income taxes	\$ 13,832
<b>Net income per common share:</b>	
Basic	\$ 0.46
Diluted	\$ 0.44
<b>Weighted average shares outstanding:</b>	
Basic	73,876
Diluted	76,520

See accompanying notes to Consolidated Financial Statements.

## Texas Roadhouse, Inc. and Subsidiaries

## Consolidated Statements of Stockholders Equity and Comprehensive Income

(in thousands, except share data)

	Class A		Class B		Paid in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Par Value	Shares	Par Value				
Balance, December 30, 2003	37,236,426	\$ 38		\$	\$ 17,657	\$ 20,372	\$ (165 )	\$ 37,902
Comprehensive income:								
Unrealized gain on derivative, net of tax		\$			\$	\$	\$ 272	\$ 272
Net income						21,701		21,701
Total comprehensive income								21,973
Shares issued under stock option plan	504,094				1,144			1,144
Distribution to members					(5,325 )	(42,657 )		(47,982 )
Noncash compensation expense					931			931
Minority interest liquidation adjustments					85			85
Issuance of Class A Common Stock in initial public offering	13,162,962	14			115,158			115,172
Issuance of Class A Common Stock in acquisition	6,178,160	6			54,053			54,059
Issuance of Class B Common Stock for the acquisition of WKT Restaurant Corp.			5,265,376	5				5
Initial public offering expenses					(10,082 )			(10,082 )
Merger of entities under common control	4,775,038	4						4
Balance, December 28, 2004	61,856,680	\$ 62	5,265,376	\$ 5	\$ 173,621	\$ (584 )	\$ 107	\$ 173,211
Comprehensive income:								
Realized gain on derivatives, net of tax		\$				\$	\$ (107 )	\$ (107 )
Unrealized gain on available for sale securities							3	3
Net income						30,322		30,322
Total comprehensive income								30,218
Shares issued under stock option plan including tax effects	2,710,975	3			16,850			16,853
Minority interest liquidation adjustments					327			327
Issuance of Class A Common Stock in follow-on offering	700,000				12,163			12,163
Follow-on offering expenses					(1,197 )			(1,197 )
Balance, December 27, 2005	65,267,655	\$ 65	5,265,376	\$ 5	\$ 201,764	\$ 29,738	\$ 3	\$ 231,575
Comprehensive income:								
Realized gain on available for sale securities		\$			\$	\$	\$ (3 )	\$ (3 )
Net income						34,009		34,009
Total comprehensive income								34,006
Issuance of Class A Common Stock in acquisition	2,478,531	3			39,235			39,238
Shares issued under stock option plan including tax effects	1,256,739	1			8,043			8,044
Stock-based compensation expense					6,211			6,211
Balance, December 26, 2006	69,002,925	\$ 69	5,265,376	\$ 5	\$ 255,253	\$ 63,747	\$	\$ 319,074

See accompanying notes to Consolidated Financial Statements.





## Texas Roadhouse, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

(in thousands)

	Fiscal Year Ended		
	December 26, 2006	December 27, 2005	December 28, 2004
<b>Cash flows from operating activities:</b>			
Net income	\$ 34,009	\$ 30,322	\$ 21,701
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	21,357	14,582	11,005
Deferred income taxes	(679 )	(24 )	4,533
Loss on impairment and disposition of assets	729	219	91
Noncash compensation expense			931
Write-off of debt issuance costs			998
Minority interest	585	549	5,278
Equity income from investments in unconsolidated affiliates	(251 )	(130 )	(110 )
Distributions received from investments in unconsolidated affiliates	309	263	137
Provision for doubtful accounts		45	5
Share-based compensation expense	6,211		
Changes in operating working capital:			
Receivables	1,360	(3,519 )	4,329
Inventories	(243 )	(724 )	(1,647 )
Prepaid expenses and other current assets	(611 )	393	(1,420 )
Other assets	(16 )	(453 )	291
Accounts payable	1,379	5,322	693
Deferred revenue gift certificates	5,006	4,679	3,674
Accrued wages	3,107	1,935	3,013
Income tax benefit from exercise of stock options		10,759	
Excess tax benefits from share-based compensation	(3,767 )		
Prepaid income taxes and income taxes payable	9,358	(2,410 )	544
Accrued taxes and licenses	2,778	(629 )	796
Other accrued liabilities	603	2,048	558
Deferred rent	1,157	721	1,559
Other liabilities	(2,637 )	436	316
Net cash provided by operating activities	79,744	64,384	57,275
<b>Cash flows from investing activities:</b>			
Capital expenditures property and equipment	(97,926 )	(61,043 )	(49,985 )
Proceeds from sale of property and equipment, including insurance proceeds	1,362	22	47
Acquisition of franchise restaurants, net of cash acquired	(13,281 )		203
Net cash used in investing activities	(109,845 )	(61,021 )	(49,735 )
<b>Cash flows from financing activities:</b>			
Proceeds from revolving credit facility, net	30,000		
Proceeds from issuance of long-term debt			24,562
Proceeds from minority interest contributions and other	737	89	997
Excess tax benefits from share-based compensation	3,767		
Repayment of stock option deposits	(412 )	(230 )	(281 )
Proceeds from stock option deposits	1,514	1,331	547
Principal payments on long-term debt	(3,656 )	(6,532 )	(75,591 )
Principal payments on capital lease obligations	(139 )	(203 )	(166 )
Payments for debt issuance costs			(559 )
Proceeds from exercise of stock options	3,881	5,780	1,040
Proceeds from initial public offering, net of offering costs			105,094
Proceeds from follow-on offering, net of offering costs		10,966	
Distributions to minority interest holders	(794 )	(636 )	(5,870 )
Distributions to members		(31,176 )	(16,806 )
Net cash provided by (used in) financing activities	34,898	(20,611 )	32,967
Net increase (decrease) in cash	4,797	(17,248 )	40,507
Cash and cash equivalents beginning of year	28,987	46,235	5,728
Cash and cash equivalents end of year	\$ 33,784	\$ 28,987	\$ 46,235
Supplemental disclosures of cash flow information:			
Interest, net of amounts capitalized	\$ 2,824	\$ 728	\$ 3,523
Income taxes	\$ 10,887	\$ 8,082	\$ 2,014

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

### Supplemental schedule of noncash financing activities:

Adjustment to fair value of long-lived asset acquired	\$	\$ 1,171	\$
Accrual of distribution to members	\$	\$	\$ 31,176
Stock acquisition of franchise restaurants	\$ 39,260	\$	\$ 2,329
Assumption of debt acquisitions	\$ 2,2911	\$	\$

See accompanying notes to Consolidated Financial Statements.

F-6

---

**Texas Roadhouse, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**(Tabular amounts in thousands, except share and per share data)**

**(1) Description of Business**

The accompanying Consolidated Financial Statements as of December 26, 2006 and December 27, 2005 include the accounts of Texas Roadhouse, Inc. (the Company), and its wholly-owned subsidiaries, Texas Roadhouse Holdings LLC (Holdings), Texas Roadhouse Development Corporation (TRDC), and Texas Roadhouse Management Corp. The Company and its wholly-owned subsidiaries operate Texas Roadhouse restaurants. Holdings also provides supervisory and administrative services for certain other license and franchise restaurants. TRDC sells franchise rights and collects the franchise royalties and fees. Texas Roadhouse Management Corp. provides management services to Holdings, TRDC and certain other license and franchise restaurants.

Prior to October 8, 2004, the combined financial statements included the accounts of Holdings and its wholly-owned and majority-owned subsidiaries, TRDC, WKT Restaurant Corporation (WKT), Texas Roadhouse Management Corp. and six license and three franchise restaurants, all of which were under common control by one controlling shareholder. The controlling shareholder had the unilateral ability to implement major operating and financial policies for the entities. On October 8, 2004, Holdings and its wholly-owned and majority-owned subsidiaries completed a reorganization and initial public offering. In connection with the reorganization and public offering, Holdings became a subsidiary of the Company. See note 12.

At December 26, 2006 and December 27, 2005, there were 251 and 221 Texas Roadhouse restaurants operating in 43 and 41 states, respectively. Of the 251 restaurants that were operating at December 26, 2006, (i) 163 were Company restaurants, 158 of which were wholly-owned and five of which were majority-owned, (ii) 85 were franchise restaurants and (iii) three were license restaurants. Of the 221 restaurants that were operating at December 27, 2005, (i) 127 were Company restaurants, 124 of which were wholly-owned and three of which were majority-owned, (ii) 90 were franchise restaurants and (iii) four were license restaurants.

**(2) Summary of Significant Accounting Policies**

*(a) Principles of Consolidation*

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

At December 26, 2006 and December 27, 2005, the Company had minority ownership in 18 and 17 restaurants, respectively. The unconsolidated restaurants are accounted for using the equity method. The Company exercises significant control over the operating and financial policies of these entities based on the rights granted to the Company under each entity's operating or partnership agreement. Notwithstanding the significant control exercised by the Company over their affairs, the Company does not consolidate such entities because (i) the Company owns only 5% to 10% of these entities and (ii) the revenue, expense and net income, and assets and liabilities that would be attributable to these entities would not be material to our financial position or results of operations. Should the financial position and results of operations of these entities become material to the Company's financial position and results of operations in future periods, the Company will consolidate the entities into its results. All significant intercompany balances and transactions for these unconsolidated restaurants as well as the companies whose accounts have been consolidated have been eliminated.

F-7

---

**(b) Fiscal Year**

The Company utilizes a 52 or 53 week accounting period that ends on the last Tuesday in December. The Company utilizes a 13 week accounting period for quarterly reporting purposes. Fiscal years 2004, 2005 and 2006 were 52 weeks in length.

**(c) Cash and Cash Equivalents**

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

**(d) Receivables**

Receivables consist principally of amounts due from certain franchise and license restaurants for reimbursement of pre-opening and other expenses, amounts due for royalty fees from franchise restaurants and credit card receivables.

Receivables are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews its allowance for doubtful accounts quarterly. Past due balances over 90 days and a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

**(e) Inventories**

Inventories, consisting principally of food, beverages and supplies, are valued at the lower of cost (first-in, first-out) or market. The Company purchases its products from a number of suppliers and believes there are alternative suppliers.

**(f) Pre-opening Expenses**

Pre-opening expenses are charged to operations as incurred. These costs include wages, benefits, travel and lodging for the training and opening management teams, rent and food, beverage and other restaurant operating expenses incurred prior to a restaurant opening for business.

**(g) Property and Equipment**

Property and equipment are stated at cost. Expenditures for major renewals and betterments are capitalized while expenditures for maintenance and repairs are expensed as incurred. Depreciation is computed on property and equipment, including assets located on leased properties, over the shorter of the estimated useful lives of the related assets or the underlying lease term using the straight-line method. In some cases, assets on leased properties are depreciated over a period of time which includes both the initial term of the lease and one or more option periods. See note 2(p).

The estimated useful lives are:

Land improvements	10-25 years
Buildings and leasehold improvements	10-25 years
Equipment and smallwares	3-10 years
Furniture and fixtures	3-10 years

**(h) Goodwill**

Goodwill represents the excess of cost over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). Goodwill is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's implied fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of the goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, *Business Combinations* ( SFAS No. 141 ). The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* ( SFAS No. 144 ).

**(i) Other Assets**

Other assets consist primarily of deposits and costs related to the issuance of debt. The debt issuance costs are being amortized to interest expense over the term of the related debt.

**(j) Impairment of Long-lived Assets**

In accordance with SFAS No. 144, long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and would no longer be depreciated. The assets and liabilities of a disposal group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

The Company recorded, in restaurant other operating expenses, impairment losses totaling \$0.5 million in 2006 with respect to two restaurants that were approved to relocate to better sites in their respective markets.

**(k) Insurance Reserves**

The Company self-insures a significant portion of expected losses under its workers compensation, general liability and property insurance programs. The Company purchases insurance for individual claims that exceed the amounts listed below:

Workers compensation	\$ 250,000
General liability	\$ 100,000
Property	\$ 25,000

The Company records a liability for unresolved claims and for an estimate of incurred but not reported claims at its anticipated cost based on estimates provided by a third party administrator and actuary. The estimated liability is based on a number of assumptions and factors regarding economic conditions, the frequency and severity of claims and claim development history and settlement practices. Estimates of claims reserves are discounted using a discount rate of approximately 3.0% resulting in a discount of \$0.2 million at December 26, 2006 and December 27, 2005. The Company's assumptions are reviewed, monitored, and adjusted when warranted by changing circumstances.

***(l) Segment Reporting***

As of December 26, 2006, the Company operated 163 Texas Roadhouse restaurants, each as a single operating segment, and franchised and/or licensed an additional 88 restaurants. The restaurants operate exclusively in the U.S. within the casual dining restaurant industry, providing similar products to similar customers. The restaurants also possess similar pricing structures, resulting in similar long-term expected financial performance characteristics. Revenue from external customers is derived principally from food and beverage sales. The Company does not rely on any major customers as a source of revenue. The Company aggregates similar operating segments into a single reportable operating segment if the businesses are considered similar under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company considers restaurant and franchising operations as similar and has aggregated them into a single reportable segment.

***(m) Revenue Recognition***

Revenue from restaurant sales is recognized when food and beverage products are sold. Deferred revenue primarily represents the Company's liability for gift cards and certificates that have been sold, but not yet redeemed, and is recorded at the expected redemption value. When the gift cards and certificates are redeemed, the Company recognizes restaurant sales and reduces the deferred revenue.

The Company began selling gift cards in 2000, and prior to 2004, did not have enough history related to the redemption of gift cards to appropriately estimate a breakage rate (the percentage of gift cards that the Company estimates will never be redeemed). In 2004, the Company determined that a 5% breakage estimate, amortized over 3 years, should be recorded for each gift card that is sold, based on historical redemption trends. The change in estimate resulted in a cumulative adjustment of \$1.7 million in 2004 (\$1.1 million after-tax, \$0.02 per diluted share), primarily as a reduction of other operating expenses. The Company reviews and adjusts its estimates on a quarterly basis. In 2006 and 2005, no adjustments to the breakage estimate were necessary.

The Company franchises Texas Roadhouse restaurants. The Company executes franchise agreements for each franchise restaurant which sets out the terms of our arrangement with the franchisee. Our franchise agreements typically require the franchisee to pay an initial, non-refundable fee and continuing fees based upon a percentage of sales. Subject to the Company's approval and payment of a renewal fee, a franchisee may generally renew the franchise agreement upon its expiration. The Company collects ongoing royalties of 2.0% to 4.0% of sales from franchise restaurants. These ongoing royalties are reflected in the accompanying consolidated statements of income as franchise royalties and fees. The Company recognizes initial franchise fees as revenue after performing substantially all initial services or conditions required by the franchise agreement, which is generally upon the opening of a restaurant. The Company received initial franchise fees of \$0.2 million, \$0.1 million and \$0.4 million for the years ended December 26, 2006, December 27, 2005 and December 28, 2004, respectively. Continuing franchise royalties are recognized as revenue as the fees are earned. The Company also performs supervisory and administrative services for certain franchise and license restaurants for which it receives management fees, which are recognized as the services are performed. Revenue from supervisory and administrative services is recorded as a reduction of general and administrative expenses in the accompanying consolidated



statements of income. Total revenue recorded for supervisory and administrative services for the years ended December 26, 2006, December 27, 2005 and December 28, 2004 was approximately \$0.5 million, \$0.5 million and \$0.3 million, respectively.

**(n) Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ), under which deferred assets and liabilities are recognized based upon anticipated future tax consequences attributable to differences between financial statement carrying values of assets and liabilities and their respective tax bases. A valuation allowance is established to reduce the carrying value of deferred tax assets if it is considered more likely than not that such assets will not be realized. Any change in the valuation allowance would be charged to income in the period such determination was made.

Prior to converting to a C corporation on October 8, 2004, the Company operated as a limited liability company and was taxed as a partnership. As such, the Company's income or losses were passed through to its owners who are liable for any related income taxes.

**(o) Advertising**

The Company has a system-wide marketing and advertising fund. The Company maintains control of the marketing and advertising fund and, as such, has consolidated the fund's activity for the years ended December 26, 2006, December 27, 2005 and December 28, 2004. Company and franchise restaurants are required to remit a designated portion of sales, currently 0.3%, to the advertising fund. Company contributions to the fund are expensed as incurred.

Advertising costs amounted to approximately \$4.1 million, \$3.2 million and \$2.8 million for the years ended December 26, 2006, December 27, 2005 and December 28, 2004, respectively.

**(p) Leases and Leasehold Improvements**

The Company leases land, buildings, and/or certain equipment for several of its restaurants under noncancelable lease agreements. The Company's land and building leases typically have initial terms ranging from 10 to 15 years, and certain renewal options for one or more five-year periods. The Company accounts for leases in accordance with SFAS No. 13, *Accounting for Leases*, and other related authoritative guidance. When determining the lease term, the Company includes option periods for which failure to renew the lease imposes a penalty on the Company in such an amount that a renewal appears, at the inception of the lease, to be reasonably assured. The primary penalty to which the Company is subject is the economic detriment associated with the existence of leasehold improvements which might become impaired if the Company chooses not to continue the use of the leased property.

Effective December 28, 2005, the Company adopted Financial Accounting Standards Board ( FASB ) Staff Position FAS 13-1, *Accounting for Rental Costs Incurred During a Construction Period*, which requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense. Prior to the 2006 fiscal year, the Company capitalized rent incurred during the tenant improvement construction phase. The Company incurred additional pre-opening expense in fiscal 2006 of \$0.4 million related to expensing rental costs associated with the construction of new restaurants. We generally do not receive rent holidays, rent concessions or leasehold improvement incentives upon opening a restaurant that is subject to a lease.

Certain of the Company's operating leases contain predetermined fixed escalations of the minimum rent during the original term of the lease. For these leases, the Company recognized the related rent expense on a straight-line basis over the lease term and records the difference between the amounts charged to operations and amounts paid as deferred rent.

Additionally, certain of the Company's operating leases contain clauses that provide for additional contingent rent based on a percentage of sales greater than certain specified target amounts. The Company recognizes contingent rent expense prior to the achievement of the specified target that triggers the contingent rent, provided achievement of the target is considered probable.

***(q) Use of Estimates***

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reporting of revenue and expenses during the period to prepare these Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, goodwill, obligations related to insurance reserves, income taxes and share-based compensation expense. Actual results could differ from those estimates.

***(r) Comprehensive Income***

**SFAS No. 130, *Reporting Comprehensive Income*, establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income consists of net income and net unrealized gains (losses) on securities and derivatives and is presented in the consolidated statements of stockholders' equity and comprehensive income.**

***(s) Equity Incentive Plan***

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

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

The Company adopted SFAS 123R using a modified version of prospective application effective December 28, 2005, the beginning of the 2006 fiscal year. The adoption of SFAS 123R has resulted in a reduction of operating profit of \$6.2 million, a reduction of net income of \$5.0 million and a reduction of both basic and fully diluted earnings per share of \$0.07 per share for the 52 weeks ended December 26, 2006. Of the \$6.2 million additional expense incurred, \$2.9 million was included in labor expense and \$3.3 million was included in general and administrative expense.

Prior to 2006, all share-based payments were accounted for under the recognition and measurement principles of APB 25 and its related interpretations. Accordingly, no expense was reflected in the consolidated statements of income, as all stock options granted had an exercise equal to the market value of the underlying common stock on the date of grant. The following table illustrates the pro forma effect

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

on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to all share-based payments for the 52 weeks ended December 27, 2005 and December 28, 2004.

	<b>Fiscal Year Ended</b>	
	<b>December 27, 2005</b>	<b>December 28, 2004</b>
Net income, 2004 as adjusted for pro forma provision for income taxes	\$ 30,322	\$ 13,832
Deduct total share-based employee compensation expense determined under fair-value based method for all awards, net of taxes	(5,459 )	(1,076 )
Pro forma net income	\$ 24,863	\$ 12,756
Earnings per share:		
Basic as reported	\$ 0.44	\$ 0.27
Basic pro forma	\$ 0.36	\$ 0.25
Diluted as reported	\$ 0.42	\$ 0.24
Diluted pro forma	\$ 0.34	\$ 0.23

**(t) Fair Value of Financial Instruments**

At December 26, 2006 and December 27, 2005, the fair value of cash and cash equivalents, accounts receivable and accounts payable approximated their carrying value based on the short-term nature of these instruments. The fair value of the Company's long-term debt is estimated based on the current rates offered to the Company for instruments of similar terms and maturities. The carrying amounts and related estimated fair values for the Company's debt are as follows:

	<b>December 26, 2006</b>		<b>December 27, 2005</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
Installment loans	\$ 5,388	\$ 5,518	\$ 6,753	\$ 6,812
Revolver	30,000	30,000		

**(u) Derivative Instruments and Hedging Activities**

The Company accounts for derivatives and hedging activities in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended, which requires that all derivative instruments be recorded on the consolidated balance sheet at their respective fair values. As of December 26, 2006 and December 27, 2005, the Company did not have any derivative contracts.

**(v) Recent Accounting Pronouncements**

In March 2006, the Emerging Issues Task Force (EITF) issued EITF Issue 06-3, *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. An entity should disclose its policy of presenting taxes and, if taxes are reported on a gross basis, the amounts of taxes that are recognized. The guidance is effective for periods beginning after December 15, 2006. The Company presents its sales net of sales taxes. This issue will have no impact on the Company's Consolidated Financial Statements.

In June 2006, FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS 109* (FIN 48), was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157 ( SFAS 157 ), *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of the Company's 2008 fiscal year. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial position, results of operations or cash flows.

### **(w) Reclassification**

Certain prior year amounts have been reclassified to conform with the current year presentation. We reclassified \$1.9 million and \$1.5 million from general and administrative expense to pre-opening expense in fiscal 2005 and 2004, respectively. These amounts represented costs associated with managers hired to operate our new restaurants upon opening. These reclassifications had no effect on previously reported net income.

### **(3) Acquisitions**

On December 28, 2005, the Company completed the acquisitions of 11 franchise restaurants in Ohio, Colorado and Kentucky from three franchise groups. Pursuant to the terms of the various acquisition agreements, the Company issued an aggregate of 2,478,531 shares of the Company's Class A common stock at \$15.84 per share and paid \$2.1 million in cash for these restaurants. These acquisitions, which have been accretive to earnings, are consistent with the Company's long-term strategy to increase net income and earnings per share.

These transactions were accounted for using the purchase method as defined in SFAS No. 141, *Business Combinations*. Based on a purchase price of \$40.7 million, net of the \$0.8 million charge relating to EITF Issue No. 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination*, ( EITF 04-1 ) and the Company's estimates of the fair value of net assets acquired, \$35.6 million of goodwill was generated by the acquisitions, which is not amortizable for book purposes. For tax purposes, \$3.6 million of the total goodwill is deductible.

The purchase price has been allocated as follows:

Current assets	\$ 4,189
Property and equipment, net	4,900
Goodwill	35,586
Intangible asset	5,237
Other assets	19
Current liabilities	(5,397 )
Deferred tax liabilities	(1,378 )
Other liabilities	(170 )
Debt	(2,292 )
	\$ 40,694

During the fourth quarter of 2006, the Company finalized the purchase price allocation which resulted in a \$1.4 million decrease in goodwill from that which had been recorded based on the preliminary purchase price allocation. The net decrease to goodwill was a result of an increase to property and equipment of \$0.2 million, a decrease to current liabilities of \$0.3 million, a decrease to the deferred tax liability of \$0.8 million and a decrease in the net purchase price of \$0.1 million.

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

If the acquisitions had been completed as of the beginning of the year ended December 27, 2005, pro forma revenue, net income and earnings per share for the year ended December 27, 2005 would have been as follows:

	<b>Fiscal Year Ended December 27, 2005</b>
Revenue	\$ 497,830
Net income	\$ 32,648
Basic EPS	\$ 0.46
Diluted EPS	\$ 0.44

The pro forma information is not necessarily indicative of the results of operations had the acquisition actually occurred at the beginning of the period nor is it necessarily indicative of future results.

In conjunction with these acquisitions, the Company acquired the land and buildings leased by eight of the 11 franchise restaurants for approximately \$15.6 million.

As a result of these acquisitions, the Company incurred a charge of \$0.8 million and recorded an intangible asset relating to certain reacquired franchise rights of \$5.2 million in accordance with EITF 04-1. EITF 04-1 requires that a business combination between two parties that have a preexisting relationship be evaluated to determine if a settlement of a preexisting relationship exists. EITF 04-1 also requires that certain reacquired rights (including the rights to the acquirer's trade name under a franchise agreement) be recognized as intangible assets apart from goodwill. However, if a contract giving rise to the reacquired rights includes terms that are favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, EITF 04-1 requires that a settlement gain or loss should be measured as the lesser of (i) the amount by which the contract is favorable or unfavorable under market terms from the perspective of the acquirer or (ii) the stated settlement provisions of the contract available to the counterparty to which the contract is unfavorable.

The intangible asset of \$5.2 million has a weighted average life of approximately 15 years. When calculating this intangible asset, the Company considered the remaining term of the existing franchise agreements including renewals. The remaining terms ranged from 12 to 20 years. The Company recorded amortization expense relating to the intangible asset of approximately \$0.4 million for the year ended December 26, 2006. The Company expects the annual expense for each of the next five years to be \$0.4 million.

**(4) Long-term Debt**

Long-term debt consisted of the following:

	December 26, 2006	December 27, 2005
Installment loans, due 2007-2026	\$ 5,388	\$ 6,753
Revolver	30,000	
	35,388	6,753
Less current maturities	601	498
	\$ 34,787	\$ 6,255

Maturities of long-term debt at December 26, 2006, excluding capital leases, are as follows:

2007	\$ 601
2008	646
2009	30,412
2010	360
2011	379
Thereafter	2,990
	\$ 35,388

The weighted average interest rates for installment loans outstanding at December 26, 2006 and December 27, 2005 were 9.67% and 9.15%, respectively. The debt is secured by certain land, buildings, and equipment.

In October 2004, the Company completed a \$150 million five-year revolving credit facility which replaced the July 2003 credit facility. The terms of this credit facility require the Company to pay interest on outstanding borrowings at LIBOR plus a margin of 0.75% to 1.50%, plus a commitment fee of 0.15% to 0.25% per year on any unused portion of the facility, in both cases, depending on the Company's leverage ratio. The credit facility was amended on December 27, 2005 to allow additional indebtedness up to \$30 million outside the facility in connection with acquiring franchise restaurants. The weighted average interest rate for the revolver at December 26, 2006 and December 27, 2005 was 6.08% and 5.13%, respectively. At December 26, 2006, the Company had \$30.0 million of borrowings outstanding under the credit facility and \$117.5 million of availability, net of \$2.5 million of outstanding letters of credit.

Certain debt agreements require compliance with financial covenants including minimum debt service coverages and maximum debt to worth ratios. The existing credit facility prohibits the Company from incurring additional debt greater than \$30 million outside the facility except for equipment financing up to \$3 million, unsecured debt up to \$500,000 and up to \$20 million of debt incurred by majority-owned companies formed to own new restaurants. Additionally, the lenders' obligation to extend credit under the facility depends on the Company maintaining certain financial covenants, including a minimum consolidated fixed charge coverage ratio of 1.50 to 1.00 and a maximum consolidated leverage ratio of 3.00 to 1.00. The Company is currently in compliance with such covenants.

**(5) Derivative Instruments and Hedging Activities**

The Company had an interest-rate-related derivative instrument to manage its exposure on its debt facility during 2004 and through the second quarter of 2005. The swap was settled in the second quarter of 2005. The Company does not enter into derivative instruments for any purpose other than cash-flow-hedging purposes. That is, the Company does not speculate using derivative instruments.

By using the derivative financial instrument to hedge exposures to changes in interest rates, the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it does not possess credit risk.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Company assesses interest rate cash flow risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Company maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Company's outstanding or forecasted debt obligations as well as the Company's offsetting hedge positions. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on the Company's future cash flows.

The Company uses variable-rate debt to finance a portion of its operations. The debt obligations expose the Company to variability in interest payments due to changes in interest rates. Management believed that it was prudent to limit the variability of a portion of its interest payments. To meet this objective, management entered into an interest rate swap agreement during 2003 with a notional amount of approximately \$31.2 million to manage fluctuations in cash flows resulting from interest rate risk. This swap changed the variable-rate cash flow exposure on a portion of the credit facility to fixed cash flows. Under the terms of the interest rate swap, the Company received variable interest rate payments and made fixed interest rate payments, thereby creating the equivalent of fixed-rate debt for the portion of debt hedged.

Changes in the fair value of the interest rate swap designated as an hedging instrument that effectively offsets the variability of cash flows associated with variable-rate, long-term debt obligations were reported in accumulated other comprehensive income. These amounts subsequently were reclassified into interest expense as a yield adjustment of the hedged interest payments in the same period in which the related interest affects earnings. For the year ended December 28, 2004, the Company reclassified \$0.3 million into interest expense. Approximately \$107,000 of deferred gains on derivative instruments accumulated in other comprehensive income as of December 28, 2004 was reclassified to earnings during 2005.

#### (6) Property and Equipment, Net

Property and equipment were as follows:

	December 26, 2006	December 27, 2005
Land and improvements	\$ 70,387	\$ 47,364
Buildings and leasehold improvements	179,853	124,970
Equipment and smallwares	77,274	57,986
Furniture and fixtures	25,828	19,259
Construction in progress	18,676	9,205
Liquor licenses	2,806	1,846
	374,824	260,630
Accumulated depreciation and amortization	(69,093 )	(50,248 )
	\$ 305,731	\$ 210,382

The amount of interest capitalized in connection with restaurant construction was approximately \$0.9 million, \$0.4 million and \$0.3 million for the years ended December 26, 2006, December 27, 2005 and December 28, 2004, respectively.

**(7) Deferred Rent**

Prior to December 2004, the Company recognized rent expense on a straight-line basis over the base term of the lease, excluding renewals, and recorded the difference between the amounts charged to operations and amounts paid as deferred rent. In December 2004, the Company determined the calculation for straight-line rent should be based on a similar period as that used to depreciate the long-lived assets associated with the underlying leases and thus increased the straight-line term used to calculate deferred rent for those leases where it would be economically detrimental to terminate the leases at the end of the initial lease term.

In December 2004, the Company recorded an adjustment of \$1.3 million (\$0.9 million after-tax), primarily to rent expense. The charges attributable to 2004 and prior periods were \$0.3 million (\$0.2 million after-tax) and \$1.0 million (\$0.7 million after-tax), respectively. As the correction of this error was not material to the Company's 2004 or prior period financial statements, the Company recorded the adjustment in the 2004 consolidated financial statements.

**(8) Goodwill**

The changes in the carrying amount of goodwill are as follows:

Balance as of December 28, 2004	\$ 50,753
Additions	
Disposals and other, net	
Adjustments	310
Balance as of December 27, 2005	51,063
Additions	35,586
Disposals and other, net	
Balance as of December 26, 2006	\$ 86,649

On October 8, 2004, the Company acquired the remaining equity interests in 31 majority-owned or controlled company restaurants and TRDC and all of the equity interests in one franchise restaurant in exchange for an aggregate of 6,178,160 shares of Texas Roadhouse, Inc. Class A common stock. The Company adjusted the basis of certain assets of the acquired entities as the fair market value of the minority interests' portion of such assets at the date of the acquisition was greater than the carrying value of such assets. During 2005, the Company increased property and equipment relating to these acquisitions by \$1.2 million as a result of final appraisals and recorded a \$1.5 million deferred tax liability associated with the acquisition, resulting in a net increase of \$0.3 million in goodwill.

Refer to note 3 for discussion of acquisitions completed during fiscal 2006.



**(9) Leases**

*The following is a schedule of future minimum lease payments required for capital leases and operating leases that have initial or remaining noncancelable terms in excess of one year as of December 26, 2006:*

	Capital Leases	Operating Leases
2007	\$ 117	\$ 10,742
2008	117	9,959
2009	117	9,820
2010	117	9,932
2011	117	10,032
Thereafter	354	57,665
Total	939	\$ 108,150
Less amount representing interest of 11.4%	312	
Present value of minimum capital lease payments	627	
Less current maturities of obligations under capital leases	52	
Obligations under capital leases, excluding current maturities	\$ 575	

Capitalized lease assets, primarily building and equipment, with an original cost of approximately \$1.5 million and \$2.0 million at December 26, 2006 and December 27, 2005, respectively, are being amortized on a straight-line basis over the applicable lease terms and interest expense is recognized on the outstanding obligations. The total accumulated amortization of property and equipment held under capital leases totaled approximately \$1.0 million and \$1.2 million at December 26, 2006 and December 27, 2005, respectively.

Rent expense for operating leases consisted of the following:

	December 26, 2006	December 27, 2005	December 28, 2004
Minimum rent occupancy	\$ 9,342	\$ 7,778	\$ 7,801
Contingency rent	710	619	460
Rent expense, occupancy	10,052	8,397	8,261
Minimum rent equipment	2,770	2,693	2,544
Rent expense	\$ 12,822	\$ 11,090	\$ 10,805

Equipment rent expense is included in other operating expenses in the accompanying consolidated statements of income.

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

**(10) Income Taxes**

Components of the Company's income tax (benefit) and provision for the years ended December 26, 2006, December 27, 2005 and for the period from October 8, 2004 through December 28, 2004 are as follows:

	Year Ended December 26, 2006	Year Ended December 27, 2005	October 8, 2004 through December 28, 2004
<b>Current:</b>			
Federal	\$ 16,971	\$ 13,916	\$ 2,232
State	3,089	2,400	394
Total current	20,060	16,316	2,626
<b>Deferred:</b>			
Federal	(613 )	(21 )	3,960
State	(66 )	(3 )	573
Total deferred	(679 )	(24 )	4,533
Income tax provision	\$ 19,381	\$ 16,292	\$ 7,159

A reconciliation of the statutory federal income tax rate to the Company's effective tax rate for December 26, 2006, December 27, 2005 and for the period from October 8, 2004 through December 28, 2004 are as follows:

	December 26, 2006	December 27, 2005	October 8, 2004 through December 28, 2004
Tax at statutory federal rate	35.0 %	35.0 %	34.0 %
State and local tax, net of federal benefit	3.1	3.1	3.4
Federal tax credits	(5.2 )	(3.5 )	(4.2 )
Incentive stock options	2.2		
EITF 04-1 charge relating to acquisition	0.6		
Other	0.6	0.3	0.4
Total	36.3 %	34.9 %	33.6 %

Components of deferred tax assets (liabilities) are as follows:

	December 26, 2006	December 27, 2005
<b>Deferred tax assets:</b>		
Insurance reserves	\$ 1,294	\$ 1,523
Other reserves	26	26
Deferred rent	1,367	1,090
Share-based compensation	1,174	
Other assets and liabilities	838	423
Total deferred tax asset	4,699	3,062
<b>Deferred tax liabilities:</b>		
Depreciation and amortization	(11,456 )	(9,120 )
Total deferred tax liability	(11,456 )	(9,120 )
Net deferred tax liability	\$ (6,757 )	\$ (6,058 )
Current deferred tax asset	\$ 1,066	\$ 621
Noncurrent deferred tax liability	(7,823 )	(6,679 )
Net deferred tax liability	\$ (6,757 )	\$ (6,058 )

See notes 3 and 8 for 2006 and 2005 deferred tax adjustments of approximately \$1.4 million and \$1.5 million, respectively, due to acquisitions.

The Company has not provided any valuation allowance as it believes the realization of its deferred tax assets is more likely than not.

**(11) Preferred Stock**

The Company's board of directors is authorized, without further vote or action by the holders of Class A common stock, to issue from time to time up to an aggregate of 1,000,000 shares of preferred stock in one or more series. Each series of preferred stock will have the number of shares, designations, preferences, voting powers, qualifications and special or relative rights or privileges as shall be determined by the board of directors, which may include, but are not limited to, dividend rights, voting rights, redemption and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights. There are no shares of preferred stock outstanding at December 26, 2006 and December 27, 2005.

**(12) Stockholders' Equity**

On December 28, 2005, in conjunction with the acquisitions of 11 franchise restaurants, the Company issued an aggregate of 2,478,530 shares of the Company's Class A common stock at \$15.84 per share. See note 3.

On July 5, 2005, the Company issued 700,000 shares as part of a follow-on Class A common stock offering and received net offering proceeds of \$11.0 million, net of \$1.2 million of offering expenses.

On October 8, 2004, the Company sold 13,162,962 shares of Texas Roadhouse, Inc. Class A common stock as part of its initial public offering for an aggregate purchase price of \$115.2 million. In connection with this offering, the Company undertook a series of transactions that resulted in Holdings, its wholly owned and majority-owned restaurants, and the other entities under common control being consolidated under Texas Roadhouse, Inc. Concurrently with this merger, the Company acquired the remaining equity interest of TRDC and Texas Roadhouse Management Corp. through mergers of those companies with wholly-owned subsidiaries of the Company. The Company acquired the remaining equity interests in all 31 of its majority-owned or controlled company restaurants, and the entire equity interest in one franchise restaurant, through mergers of those 32 companies with wholly-owned subsidiaries of the Company. The Company issued 6,178,160 shares of Class A common stock to the equity owners of the merged companies. These shares were calculated using predetermined acquisition formulas as required by each entity's operating, partnership or franchise agreement.

Under the terms of an agreement associated with the formation of Texas Roadhouse, Inc., W. Kent Taylor contributed all of his interests in WKT (1,000 shares), which owned 356,250 common shares of Holdings and the right to receive a one percent distribution on all sales of company and license Texas Roadhouse restaurants, in exchange for 356,250 shares of Texas Roadhouse, Inc. Class A common stock and 5,265,376 shares of Texas Roadhouse, Inc. Class B common stock.

Mr. Taylor also received 3,509,062 shares of Texas Roadhouse, Inc. Class A common stock in exchange for his 450 shares in TRDC, and 1,342,178 shares of Texas Roadhouse, Inc. Class A common stock in exchange for his 73,302 shares in the six license restaurants and three franchise restaurants.

The Class B common stock is identical in all respects to Class A common stock, except with respect to voting and conversion rights. Class A common stock and Class B common stock will vote together as a single class on all matters presented to a vote of stockholders, including the election of directors. Each holder of Class B common stock is entitled to ten votes to each share held of record on the applicable record date for all of these matters. The Class B common stock is convertible to one share of Class A common stock. W. Kent Taylor, or other entities controlled by him, will be the only holders of shares of

## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

Class B common stock. Earnings per share calculations included in the accompanying consolidated financial statements and notes thereto are calculated using the total of Class A and Class B common stock.

The Company made a distribution of \$31.2 million to members of its predecessor company, Holdings, in redemption of its preferred shares representing undistributed net income for periods through October 8, 2004. This distribution was paid in the second quarter of 2005.

### (13) Earnings Per Share

The 2006 and 2005 share and net income per share data and 2004 pro forma share and net income per share data 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 awards outstanding from the Company's equity incentive plan as discussed in note 16. The Company adopted SFAS 123R in the first quarter of 2006 as discussed in note 2. For the years ended December 26, 2006 and December 27, 2005, options to purchase 1,869,708 and 387,136 shares, respectively, were outstanding but not included in the computation of diluted net income per share because their inclusion would have had an anti-dilutive effect.

The following table sets forth the calculation of weighted average and pro forma weighted average shares outstanding (in thousands) as presented in the accompanying consolidated statements of income:

	<b>Fiscal Year Ended December 26, 2006</b>	<b>December 27, 2005</b>	<b>December 28, 2004</b>
Net income, 2004 adjusted for pro forma income taxes	\$ 34,009	\$ 30,322	\$ 13,832
Weighted-average common shares outstanding:			
Shares basic	73,876	68,677	51,890
Shares assumed issued on exercise of dilutive share equivalents	5,399	8,183	9,016
Shares assumed purchased with proceeds of dilutive share equivalents	(2,755 )	(4,295 )	(4,392 )
Shares applicable to diluted earnings	76,520	72,565	56,514
Basic EPS	\$ 0.46	\$ 0.44	\$ 0.27
Diluted EPS	\$ 0.44	\$ 0.42	\$ 0.24

### (14) Commitments and Contingencies

The estimated cost of completing capital project commitments at December 26, 2006 and December 27, 2005 was approximately \$81.0 million and \$42.4 million, respectively.

The Company entered into real estate lease agreements for franchise restaurants located in Everett, MA, Longmont, CO, Montgomeryville, PA and Fargo, ND before granting franchise rights for those restaurants. The Company has subsequently assigned the leases to the franchisees, but remains contingently liable if a franchisee defaults, under the terms of the lease. The Longmont lease was assigned in October 2003 and expires in May 2014, the Everett lease was assigned in September 2002 and expires in February 2018, the Montgomeryville lease was assigned in October 2004 and expires in March 2021 and the Fargo lease was assigned in February 2006 and expires in July 2016. As the fair value of the guarantees is not considered significant, no liability has been recorded.

The Company is involved in various claims and legal actions arising in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated results of operations, financial position or liquidity.

The Company currently buys most of its beef from four suppliers. Although there are a limited number of beef suppliers, management believes that other suppliers could provide similar product on comparable terms. A change in suppliers, however, could cause supply shortages and a possible loss of

sales, which would affect operating results adversely. The Company has no material minimum purchase commitments with its vendors that extend beyond a year.

**(15) Other Comprehensive Income**

The accumulated balances for each classification of other comprehensive income are as follows:

	December 26, 2006	December 27, 2005	December 28, 2004
Unrealized gain on security	\$	\$ 3	\$
Unrealized gain (loss) on derivative instruments			107
	\$	\$ 3	\$ 107

**(16) Share-based Compensation**

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

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

*Summary Details for Plan Share Options*

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 27, 2005	7,403,522	\$ 6.66		
Granted	899,375	13.72		
Forfeited	(148,922 )	13.69		
Exercised	(1,220,739 )	3.53		
Outstanding at December 26, 2006	6,933,236	\$ 7.98	6.81	\$ 34,809
Exercisable at December 26, 2006	4,308,817	\$ 6.15	5.98	\$ 29,508

The weighted-average grant date fair value of options granted during the years ended December 26, 2006, December 27, 2005 and December 28, 2004 was \$5.12, \$6.24 and \$3.45, respectively, using the Black Scholes option pricing model with the following weighted-average assumptions:

	Fiscal Year Ended		
	December 26, 2006	December 27, 2005	December 28, 2004
Risk-free interest rate	4.80 %	4.05 %	3.42 %
Expected term (years)	3.0 - 5.0	4.0	4.0
Expected dividend yield	0.0 %	0.0 %	0.0 %
Volatility	41 %	44 %	44 %

In connection with its adoption of SFAS 123R, the Company determined that it was appropriate to group stock option grants into three homogeneous groups when estimating expected term. These groups



consist of grants made primarily to executives, grants made primarily to restaurant-level employees and grants made to corporate office employees.

Prior to the adoption of SFAS 123R, the Company used a four-year term as the expected term of all stock option grants. In connection with its adoption of SFAS 123R and the increasing amount of historical data the Company now possesses with regard to stock option exercise activity, the Company re-evaluated its expected term assumptions. Based on historical exercise and post-vesting employee termination behavior, the expected life for options granted to its executives is approximately 5.0 years. For options granted to restaurant-level employees, the expected life is approximately 4.0 years. For options granted to its corporate office employees, the expected life is approximately 3.0 years. The Company based its expected volatility on the volatilities of similar entities for an appropriate period of time along with the volatility of the Company's stock since its stock began trading on October 5, 2004 in connection with its initial public offering. In accordance with Staff Accounting Bulletin No. 107, for grants issued after October 5, 2006, the Company based its expected volatility solely on the volatility of the Company's stock since its initial public offering.

The total intrinsic value of options exercised during the years ended December 26, 2006, December 27, 2005 and December 28, 2004 was \$14.3 million, \$36.2 million and \$1.4 million, respectively. As of December 26, 2006, with respect to unvested stock options, there was \$5.3 million of unrecognized compensation cost that is expected to be recognized over a weighted-average period of 1.5 years. The total grant date fair value of stock options vested during the years ended December 26, 2006 and December 27, 2005 was \$6.6 million and \$23.7 million, respectively.

For the years ended December 26, 2006 and December 27, 2005, cash received from options exercised was \$3.9 million and \$5.8 million, respectively. The excess tax benefit realized from tax deductions associated with options exercised for the year ended December 26, 2006 was \$3.8 million.

In the fourth quarter of 2006, the Company awarded 36,000 shares of restricted stock, at a weighted-average price of \$14.55 per share, to two corporate office employees under the terms of the Plan. The restricted shares vest after three years. At December 26, 2006, the unrecognized compensation expense related to the restricted stock grants totaled approximately \$0.5 million and will be recognized over the three year vesting period. There were no restricted stock awards prior to fiscal 2006.

F-24

---

**(17) Stock Split**

On August 18, 2005, the Company declared a two-for-one stock split of the Company's Class A and Class B common stock to stockholders of record as of the close of business on September 6, 2005. The stock split was effected in the form of a 100% stock dividend on September 23, 2005. All fiscal 2005 and 2004 share and per share information included in the accompanying Consolidated Financial Statements for all periods presented have been adjusted to retroactively reflect the stock split.

**(18) Noncash Compensation Expense**

Prior to October 8, 2004, some of the Company's executive officers earned compensation at rates significantly below market levels and the Company paid no salary or bonus compensation to W. Kent Taylor, the Company's founder and chairman. General and administrative expense includes an adjustment to record the difference between the actual salary and bonus compensation paid to these officers and the Company's estimate of the fair market value, based on industry analysis and competitive benchmarking, of the services rendered by these officers.

General and administrative expense was increased by approximately \$0.9 million for the period from December 31, 2003 through October 8, 2004.

**(19) Related Party Transactions**

Prior to October 8, 2004, W. Kent Taylor owned a substantial interest in Buffalo Construction, Inc., a restaurant construction business which provides services to the Company and other restaurant companies. From December 31, 2003 through October 8, 2004, the Company paid \$23.0 million to Buffalo Construction, Inc. The Company paid Buffalo Construction, Inc. amounts totaling \$15.0 million in 2003. In October 2004, W. Kent Taylor sold his interest in Buffalo Construction, Inc. Mr. Taylor received a promissory note in the amount of \$1.5 million from the purchaser of Buffalo Construction, Inc. in partial consideration of the purchase.

The Longview, Texas restaurant, which was acquired by the Company in connection with the completion of the initial public offering, leases the land and restaurant building from an entity controlled by Steven L. Ortiz, our Chief Operating Officer. The lease is for 15 years and will terminate in November 2014. The lease can be renewed for two additional periods of five years each. Rent is approximately \$16,000 per month and will increase by 5% on the 11th anniversary date of the lease. The lease can be terminated if the tenant fails to pay the rent on a timely basis, fails to maintain the insurance specified in the lease, fails to maintain the building or property or becomes insolvent. Total rent payments for 2006, 2005 and 2004 were approximately \$196,000, \$197,000 and \$186,000, respectively.

Prior to September 22, 2005, the Elizabethtown, Kentucky restaurant was leased from an entity owned by W. Kent Taylor and three other stockholders. On September 22, 2005, the Company purchased the land and building associated with the Elizabethtown, Kentucky restaurant for \$1.5 million. Rent expense for this restaurant was approximately \$0.1 million in each of the years 2004 and 2005. The lease was terminated upon the purchase of the land and building.

As of December 26, 2006, the Company has 14 license and franchise restaurants owned in whole or part by certain officers, directors and stockholders of the Company. These 14 entities paid the Company fees of \$2.0 million for the year ended December 26, 2006. As of December 27, 2005 and December 28, 2004, the Company had 13 license and franchise restaurants owned in whole or part by certain officers, directors and stockholders of the Company. These 13 entities paid the Company fees of \$1.7 million and \$1.5 million for the years ended December 27, 2005 and December 28, 2004, respectively.



## Edgar Filing: Texas Roadhouse, Inc. - Form 10-K

The Company employs Juli Miller Hart, the wife of G.J. Hart, the Company's Chief Executive Officer, as Director of Public Relations. Ms. Hart reports to W. Kent Taylor who conducts her performance reviews and determines her compensation.

From December 31, 2003 to May 27, 2004, WKT, which is owned by W. Kent Taylor, received royalties of \$1.3 million. WKT was entitled to receive these royalties as consideration for its contribution of the Texas Roadhouse operating system and concept to Holdings. After the completion of the Company's initial public offering, WKT no longer received such royalties. These royalties were classified as distributions in the Company's consolidated statement of stockholders' equity and comprehensive income.

John D. Rhodes, a stockholder, is a director and substantial stockholder of Confluent Inc., which provided certain business intelligence services to the Company through February 2004 for which it was paid an aggregate of \$0.1 million. Services included generating marketing analysis using their proprietary software program and data provided by the Company. After completion of the corporate reorganization and initial public offering on October 8, 2004, Dr. Rhodes is no longer a 5% stockholder of the Company.

### (20) Pro forma Adjustments (unaudited)

In connection with the reorganization as a C corporation, a pro forma income tax provision has been calculated as if the Company were taxable at an estimated consolidated effective income tax rate of 34.9% on income before taxes for the period from December 31, 2003 through October 8, 2004 and included in the accompanying calculation of pro forma provision for income tax.

The reconciliation of income tax computed at the federal statutory rate to income tax expense for the pro forma provision for income taxes for the year ended December 28, 2004 is as follows:

	<b>2004</b>
Effective federal tax rate	35.0 %
State and local tax	3.3 %
Federal tax credits	(3.8 )%
Other	.4 %
Combined effective federal and state tax rate	34.9 %

**(21) Selected Quarterly Financial Data (unaudited)**

	<b>2006</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	
Revenue	\$ 149,399	\$ 146,720	\$ 148,454	\$ 152,558	\$ 597,131
Total costs and expenses	\$ 135,302	\$ 132,439	\$ 134,213	\$ 140,808	\$ 542,762
Income from operations	\$ 14,097	\$ 14,281	\$ 14,241	\$ 11,750	\$ 54,369
Net income	\$ 8,182	\$ 8,831	\$ 9,150	\$ 7,846	\$ 34,009
Basic earnings per common share	\$ 0.11	\$ 0.12	\$ 0.12	\$ 0.11	\$ 0.46
Diluted earnings per common share	\$ 0.11	\$ 0.12	\$ 0.12	\$ 0.10	\$ 0.44

	<b>2005</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	
Revenue	\$ 111,067	\$ 115,757	\$ 114,327	\$ 117,633	\$ 458,784
Total costs and expenses	\$ 97,290	\$ 103,073	\$ 103,203	\$ 107,922	\$ 411,488
Income from operations	\$ 13,777	\$ 12,684	\$ 11,124	\$ 9,711	\$ 47,296
Net income	\$ 8,958	\$ 7,990	\$ 7,061	\$ 6,313	\$ 30,322
Basic earnings per common share	\$ 0.13	\$ 0.12	\$ 0.10	\$ 0.09	\$ 0.44
Diluted earnings per common share	\$ 0.12	\$ 0.11	\$ 0.10	\$ 0.09	\$ 0.42

The above financial data for 2006 includes \$6.2 million (\$5.0 million after-tax) relating to the expensing of share-based compensation in conjunction with the adoption of SFAS 123R at the beginning of fiscal 2006. The above financial data for 2006 also includes a charge of \$0.8 million (\$0.8 million after-tax) in conjunction with the application of EITF 04-1 relating to the acquisition of 11 franchise restaurants in the first quarter of 2006.

The above financial data for 2005 includes a \$0.8 million (\$0.5 million after-tax) adjustment to begin recording credit card fees in the month in which fees are incurred, rather than the month in which fees are paid.