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EAT - Q2 2020 Brinker International Inc Earnings Call

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OVERVIEW:

Co. reported 2Q20 total revenues of $869m and adjusted EPS of $1.01. Expects FY20 EPS, excluding special items, to be $4.25-4.45.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International Q2 Fiscal 2020 Earnings Call. (Operator Instructions)

It is now my pleasure to turn the floor over to your host, Mika Ware. Ma'am, the floor is yours.

Mika Ware - *Brinker International, Inc. - VP of Finance & IR*

Thank you, Paul, and good morning, everyone. Welcome to the earnings call for Brinker International's Second Quarter of Fiscal Year 2020. With me today on the call are Wyman Roberts, Chief Executive Officer and President; and Joe Taylor, our Chief Financial Officer.

Results for the quarter were released earlier this morning and are available on our website at brinker.com. Wyman and Joe will first make prepared comments related to our operating performance and strategic initiatives, then we will open the call for your questions.

Before beginning our comments, I must remind everyone of our safe harbor regarding forward-looking statements. During our call, management may discuss certain items, which are not based entirely on historical facts. Any such items should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All such statements are subject to risks and uncertainties, which could cause actual results to differ from those anticipated. Such risks and uncertainties include factors more completely described in this morning's press release and the company's filing with the SEC. And of course, on the call, we may refer to certain non-GAAP financial measures that management uses in its review of the business and believes will provide insight into the company's ongoing operations.

And with that said, I will turn the call over to Wyman.

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

Thanks, Mika. Good morning, everyone, and thank you for joining us. Q2 was a great quarter for Brinker. We delivered $1.01 in adjusted earnings, a 13% improvement over prior year, which was driven primarily through strong core execution in our restaurants. This level of organic growth demonstrates the effectiveness of our strategy and the ability of our operators to deliver for our shareholders. As we outlined in this morning's press release, the ongoing momentum in our business has enabled us to raise guidance for the year, which Joe will detail for you in just a few minutes.

Our success starts with our positive comp sales trends. Brinker came in up 1.5% for the quarter, and Chili's was up 2%, our seventh consecutive quarter of positive comp sales. Maggiano's had a softer quarter, but finished strong with one of our best holiday seasons as 37 of our 52 locations set new holiday sales record.

Off-premise was once again the primary sales driver at Chili's with takeout, third-party delivery and now delivery options on our app and website, all contributing. And Q2 was the eighth quarter in a row, Chili's outperformed the category in traffic. We're really pleased with this trend, as it demonstrates our ability to meet the consumers' increasing needs for convenience, value and consistency at a level matched by few other brands. And once again, our operator set new all-time highs in our guest satisfaction metrics proving we can drive the business, while delivering a better guest experience.

We believe this strategy will continue to perform well into the future, and we will uphold our commitment to our operators to provide best-in-class systems and to keep our operations model simple, so they can stay focused on strong core execution. While our operators remain focused on running great shifts, our support teams are hard at work on exciting innovation to ensure our long-term success.

We're testing new initiatives that allow us to enhance our value proposition, improve our operating systems and increase efficiencies to holistically strengthen the Brinker business model and further separate us from those competitors that can't keep up with those of us performing at these higher levels.

For example, this quarter, we began replacing our original table-top system with new, more advanced system. We're in the first -- we were the first major chain to put technology on the table, and it's made significant improvements to our guest experience and the efficiencies of our model. With the new upgraded system, we'll continue to leverage the operational advantages like customer payment and real-time feedback as well as the marketed advantages like direct login for activation and engagement in our loyalty program. And just like any new technology, this system is more reliable and offers more advanced features like near-field communication, which allows us to create an even more personal marketing relationship and further enhance our ability to leverage our powerful consumer database.

Investments back into the business like this are an important component in continuing our share gains and financial growth. Our Midwest investment is also playing out well for us. These 116 restaurants are transitioning smoothly. They're in the process of converting over to the Brinker systems, which should be completed by the end of this fiscal year, and we anticipate seeing a more significant bottom line impact to the Brinker P&L during the higher volume in back half of our fiscal year.

Our remodel and new restaurant development programs continue to perform well. Through January, we've opened 6 new restaurants, each well above hurdle with as many as 7 more new and relocated restaurants to open this fiscal year. This is an area we think we can accelerate as we have fertile trade areas now available for development that were previously held by franchisees.

All in all, it was a great second quarter for Brinker. We believe in our brands and in owning great restaurants at a scale that enables us to continue to take share and win in this category. We're excited about our line of sight into the balance of the year and longer term. And while we typically don't share inter-period results, we are off to a strong start in Q3, with sales at Chili's up over 4% in January.

And now I'll turn the call over to Joe to walk you through the numbers. Joe?

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

Hey, thanks, and good morning, everyone. Before jumping into my overview related to the second quarter, let me pick up on Wyman's last comment regarding our current quarter performance. During the 5-week January period, which ends today, both brands built on their momentum coming out of the holiday, recording positive comp sales performance compared to prior year.

A particular note, Chili's net comp sales quarter-to-date is above 4%. This quarter, as we implemented our plan move back to messaging around value and layered on new news with stake in our Patron margarita, our guests have responded. I would note this performance laps a 4.5% comp sales recorded in January of last fiscal year and sets up the quarter nicely for very solid top line organic growth.

Moving back to the second quarter, as demonstrated by the results reported this morning, the strategy has and we believe will continue to produce solid organic top line growth, improve restaurant level margins and adjusted EPS growth squarely in our target range of 10% to 15% annually.

At the top of the P&L, total revenues in the second quarter were $869 million, a 9.9% increase versus prior year. This was driven by comp sales growth at Brinker of 1.5% and a full quarter of capacity approximately $71 million from the Midwest restaurants acquired in early September.

Off-premise sales in the quarter grew in excess of 31% year-over-year. Off-premise sales, both to go and delivery, now represent approximately 17% of total sales.

At the brand level, Chili's continued its top line momentum, reporting quarterly net comp sales of 2%, nicely lapping a positive 2.9% from the prior year. This results in a 2-year stack of 4.9% for each of the last 2 quarters.

Traffic was positive for the quarter and also positive to the industry by approximately 300 basis points.

Our Maggiano's brand posted net comps of minus 1.4% for the quarter. We're disappointed in these top line results for the quarter. That being said, performance did improve throughout the quarter, and the brand ended December with a very solid holiday season. Our Maggiano's team has now worked through the transition to DoorDash exclusivity, which was a drag early in the quarter as they gave up other established third-party delivery business. Despite a weaker top line than expected, the brand managed its P&L effectively and contributed well to the overall success of the Brinker bottom line for the quarter.

Capacity growth and effective utilization by our restaurant teams of our operating tools and systems combined to increase Brinker's restaurant operating margin by 30 basis points as compared to the second quarter last year.

Taking a more detailed look in the margins. Cost of sales was favorable 10 basis points to last year as pricing of 1.4% offset a low level of mix shift and slight commodity inflation, primarily driven by beef and dairy.

Our top-quality supply chain team continues to manage our sourcing effectively, avoiding inflationary impacts to our specific basket. As we previously stated, we have established higher levels of commodity contracting to protect ourselves against volatility for key products. We are now 93% contracted through the end of the fiscal year and more than 50% contracted through the first half of next fiscal year.

Labor was 20 basis points unfavorable versus prior year for the quarter. Hourly wage rates were up again in the mid-3% range. Our operators' focus on our labor tools and sales leverage helped to mitigate the inflationary pressures in this area. As expected, the positive impact of the top line capacity growth is meaningfully evident in our restaurant expense line, favorable 40 basis points compared to prior year.

As previously discussed, growing cash flow is an important part of our strategy, and our operating performance so far this year has set us on a path to achieving our growth targets for the year. After first half capital expenditures of approximately $51 million, our free cash flow for the first half of the fiscal year totaled $90 million, an increase of nearly $46 million through the 6-month period.

We're using our strong cash generation to differentiate our performance by investing across the breadth of our business, while moving forward with repayment of incremental debt associated with our recent acquisition.

As it relates to guidance, our year-to-date results and expected performance in the second half of the fiscal year enabled us to increase several pieces of our guidance. Specifically, earnings per share, excluding special items, is now estimated to be in the range of $4.25 to $4.45. Restaurant operating margin is expected to be flat compared to fiscal 2019. And the expected range for free cash flow is increased to $175 million to $190 million. We also reaffirm the other aspects of our fiscal 2020 financial guidance, as previously communicated on our August 13, 2019 earnings call.

As many of you are also starting to focus on modeling for our next fiscal year, fiscal year 2021, please be aware, it will include a 53rd week, with that additional week landing in the fourth quarter.

In summary, our strategy to focus on core execution, value and convenience is delivering on both the top and bottom line and further differentiating Chili's as one of the top-performing brands in casual dining. We continue to demonstrate our ability to consistently win by driving an improved guest experience and incremental traffic.

With our comments now complete, Paul, let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is coming from Jeff Farmer.

Jeffrey Daniel Farmer - *Gordon Haskett Research Advisors - MD & Senior Analyst of Restaurants*

Gordon Haskett. You shared your January same-store sales trends, but is that solid performance is a function of stronger segment trends? Or has Chili's seen its relative performance improved versus the peer group in that month of January?

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

Jeff, a little both. So I think we're excited about the absolute movement that we've seen in our business. And it really comes from a focus back into a restaurant message. So really, for the first half, we primarily focused on communicating and building our delivery and takeout messaging, didn't bring any new news or innovation to the marketplace or into the operations as we let them focus on the increased shift in that channel. And then at the start of January, we got back on the air and back into the -- on the air with stake on 3 for $10 and that -- that had a significant impact in changing the trends. And we're -- that's our plan as we move through the rest of the year is to continue to find a balance between communicating innovation and new news and excitement about in-restaurant as well as outside the restaurant opportunities.

Jeffrey Daniel Farmer - *Gordon Haskett Research Advisors - MD & Senior Analyst of Restaurants*

All right. And just a quick follow-up on delivery. Are you able to provide an update on any of those metrics that you first shared at your Investor Day across the delivery orders per day, average check incrementality, anything you guys are able to share we would love to hear.

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

Jeff, they're really consistent with what we talked about at the August meeting. You're seeing that check about $25 on average. Slightly higher check as we move to the white label. The orders per day are holding in right where we expected them, moved up a tick with the seasonality. You start to see, really as you kind of move through the winter, a seasonal build and delivery too, and so we are experiencing that.

And incrementality, the way we're looking at incrementality, it's holding in right where we expected it to, particularly, as you move through the first year of this delivery operation.

Operator

The next question is coming from David Palmer.

David Sterling Palmer - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Evercore ISI. I guess a follow-up there on the marketing. As you went through that December quarter, probably also for the entire first half, it looked like you were really channeling one thing that was delivery. And here, we've dipped our toe into supporting another channel into people's brains here with the 3 for $10 and adding stake to that. I'm just wondering as you audit, what has happened and perhaps saw the incrementality and how that played out in that fiscal second quarter and what's happened today? How are you going to basically navigate going forward? And are you going to think about new menu news because it looks like you just did value news here, but the new menu part has not really been a part of that. It's been sort of the same old favorites being put on to value. So just a menu strategy and then the separate thing.

Two, is it feels like there's these flare-ups of discounting out there? And even Darden was talking about how that's causing some volatility. Could you talk about the discounting that's happened? And are you seeing tremors in your own results and swings based upon one desperate competitor here or there doing some stuff that may not be sustainable?

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

David, yes. I mean, first on the strategy itself, I think -- and the incrementality of delivery, I think everything is pretty much falling in line with -- as we expected it would. I think one of the things that I'm just surprised a little bit about is how independent delivery can work. It's -- once you get out in that environment, it doesn't probably require as much of our support to keep that business moving as we may have thought and that it has its own kind of organic marketing world that it can play into. And so we will now, as we had always planned, but I think very comfortably, move back into a balanced marketing approach that has as much, if not more, energy focused on in-restaurant opportunities as well as continuing to remind people about our convenience options.

With regard to the kind of flare-up, as you say, with various competitors and what's going on in the space, I think there's nothing really new. I mean, I think you find people that may be a little bit out of desperation to turn the trend around, throw something out there that's really not sustainable. For the most part, we haven't felt the -- that impact us in a dramatic way, and we continue to not chase. We continue to want to run our race, put the value and the innovation and the consistency and quality components together for our restaurants and our operators to deliver to our guests on a day in, day out basis. So that's kind of how we deal with that.

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

And David, I would add, too, on the stake side of the equation, as you've seen and heard us talk about the 3 for $10 with stake on it, but it's a broader stake play too when you come back into being able to talk about that protein because we have feature cards in the restaurants with a couple of very nice stake offerings that are also doing well. So you get the value play and you get kind of a premium approach and lift the entire segment of stakes as you kind of move through that window.

Operator

The next question is coming from Chris O'Cull.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

Stifel. Wyman, I know part of the improvement in comps have also come just from some improvements you've made to the food quality or to the specs of certain items. Do you have plans to make any additional improvements to the menu this year? And then I had a follow-up.

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

Yes, Chris. I mean, I guess, in general, just our overall strategy is to consistently upgrade the quality of the experience, that -- whether it's atmosphere, service or food. And we are constantly looking for ways to do that in a way that the consumer gives us credit for it and significantly changes kind of their approach. We absolutely are not looking at any opportunities to save costs and reduce the quality of the product. So to answer your question, yes, we're -- we continue to have work being done in the culinary center to bring us ideas on how we can upgrade the quality of the products. I think our chicken sandwich that we talked about last time, this is another good example that a pounded hand breaded chicken product relative to kind of the alternatives that we were looking at before is just significantly better product. Now does it turn the business around overnight or might have a huge impact immediately? No. But over the long haul, we're seeing that impact, and it's all showing up in better guest satisfaction metrics, right? So our food scores that our guests give us are at all-time highs. And we continue to see that happen because of the changes in the menu as well as our operators executing more consistently to standards.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

Great. And then, Joe, does the updated restaurant margin guidance reflect upside to your internal expectations for the second quarter? Or is it more of a -- just an improved view on the outlook in the back half of the year? And then also, if you could just give us an update on the commodity basket, in particular, what you may have locked already for fiscal '21?

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

It's a combination of both as it relates to margins. Again, I think seeing the level of execution and the improvement at the restaurant level from an operational standpoint, because there's not any one thing, both in the second quarter or my expectations going forward is performing across that restaurant level P&L that is starting to make a difference on that flow-through, which we're very appreciative of the operators and their performance there.

Threats to the commodities, one of the largest locks we have put in place that goes pretty much through most of '21 is chicken, which is one of our largest, obviously, protein buys. And we have extended our contracts out well into the second half of the fiscal '21 in that regard. A lot of our baked and product ribs, things of that, we have locked in through the end of the calendar year and are actually looking at taking advantage of some of the improvements you've seen in some of those pork-related markets in December to probably extend that coverage a little bit farther in the year. So we're trying to be very opportunistic. Our supply chain is extremely experienced in this regard. They've been there, done that. They've seen the cycles and understand how to work around those cycles and work within those cycles and are making all the appropriate moves to reduce that volatility.

Operator

The next question is coming from Nicole Miller.

Nicole Miller Regan - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Piper Sandler. I wanted to understand a little bit more about Chili's, specifically. And then if this question is to maybe for all of casual dining, but I'm inclined to believe that with your progress in same-store sales, is that -- it's good to have a rifle-shot approach in terms of a very focused menu? And it just feels like maybe you had broaden horizons and now come back full circle, 2 ribs, 2 fajitas, 2 margaritas. It's being focused is right, why is that? And then how does mix shift look today when customers come in versus maybe what it looked at in prior periods where comps weren't as strong as they are today?

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

Nicole, I think our belief and our strategy has really been laid out now probably into our third year of focused menu execution. So to your point -- from a consumer standpoint, if you ask a consumer, they'll always want more. I mean, listen, give me a menu with everything that I could possibly ever want on it. And the challenge with that, obviously, is executing those items at a high level of consistency with the expertise you need to deliver a great in-restaurant experience. And so we've found that to stay focused on those core menu items is really critical for us, but to also bring innovation in new news to them to kind of keep them fresh, but to not get caught up in kind of an arms race for new items and new initiatives around the menu, especially getting a kitchen to execute under high-volume Fridays and Saturday nights, your menu consistently is not an easy thing. And so we've committed to our operators to only bring them changes to the menu when it really makes a difference, when consumers are really excited about it and not just because it may chase some short-term trend or provide a category or an item that a small group of people are maybe a little bit excited about for a short period of time. So we are totally onboard with focus does make a difference. And we're seeing that, again, as I've mentioned, in all of our results. It also allows you to be a little more efficient because people have that muscle memory.

Nicole Miller Regan - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So it sounds like discipline matters. And I do recall in the past from Maggiano's, you've had some good direct interactions, and you've talked about those from catering and how that could maybe extend into delivery across Chili's. So is there any update on best practices on how you as a brand, how casual dining as a brand can go direct to the customer, still utilize the third-party marketplace, but capture the data and capture the relationship directly with the consumer in terms of delivery, specifically?

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

Well, with Maggiano's, we obviously do have our own catering teams in every restaurant with vehicles. And so we do delivery ourselves as well as use third parties.

With regard to Chili's, we don't anticipate delivering ourselves. We just think that the model doesn't work as well in that case. I think the key there is working with our partner, and we're very excited and happy to have DoorDash as a partner and making sure that we're helping each other leverage the marketing opportunities for in-restaurant and out-of-restaurant experiences. And so again, it has a lot to do with how do we partner on databases, on building each other's businesses, if you will, through the strength of the scale that we both bring into the partnership.

Operator

The next question is coming from Brian Vaccaro.

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

Raymond James. I just want to appreciate the January comments, but could you also speak to the cadence you saw in fiscal Q2? It seems like your relative gap to the industry may have narrowed, is that right? And if so, what would you attribute that to? Is that the value environment, maybe day part specific or anything else you can shed some light on?

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

Yes, Brian, it's really easy. If you look at our Q1 performance, our price/mix was at 2.9%. I'm sorry, it was -- I'm sorry, yes, 2.9%. And so we told -- I think we communicated to the Street at that time that 2.9% was a high end for us. We've always been pretty clear that our price strategy is 1.5% to 2%. And that given timing of when you take a price increase, a quarter, maybe a little high one, maybe a little low, they don't always line up exactly and then we may have some mix shifts. But in general, that 1.5% to 2% range is what we kind of planned for. And so we were a little bit on the high end in Q1. And in Q2, we came in right in what we expected at 1.9% with things kind of more leveling out to our expectations. So I think that we were pretty much onboard with exactly the way the results came in. If anything we were a little bit more aggressive, just based on timing of some menu pricing in Q1, then we would have normally expected. That's how we communicated that, but sometimes that gets lost in the mix. Overall, we continue to focus on a traffic-driving strategy, and this is our eighth quarter in a row of beating traffic trends for the industry and not by small numbers. We're not -- we're consistently beating by 2 and 3 points now, and we want to continue that approach. Keeping the restaurants busy through traffic is the key to success, we think, in leveraging the business.

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

And that gap to the industry actually increased second quarter to first quarter, too.

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

Okay. And the pricing in January, I guess, or the traffic performance in January, could you speak to either of those? Have you taken pricing relative to where you were in the fiscal second quarter here in January? And also, how should we think about second half pricing, Joe, just setting expectations for average check growth?

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

Yes, in the second half, again, we -- what we've guided all along is that we will bring pricing. It is now back down into that range of 1.5% to 2%, and we'll maintain it in that range as we kind of move through the second half of the year.

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

And we didn't do any pricing in January yet. So those results are really just a function of what we talked about getting more focused on driving traffic back into the restaurant through messaging that really is only available in the restaurant. 3 for $10, as you know, is not available in the delivery channel. So when we talk about stake on 3 for $10, if you want to take advantage of that opportunity of that offer, you got to come into the restaurant to get.

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

Yes. And from a color standpoint, it's Joe, I think, Brian, you'd expect to see us with a menu pricing towards the upper end of that range, but it will definitely be in the range, but I want you to air towards the top end, not the bottom end.

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

Upper end of the pricing range, rest of this year.

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

Correct.

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

Okay. That's helpful. Very helpful color. And just to shift gears, one quick follow-up, and sorry if I missed it, I think it will be in the 10-Q. But what was delivery sales mix at Chili's in the quarter? And can you help us frame how much is coming from third-party versus the direct channels, the app and the website?

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

Yes, third party, the marketplace, as we call it, continues to be the lion's share of that effort. It's generating of the delivery piece of the equation. It's in the mid-80s from a percentage standpoint. And how much is coming out of the marketplace, again, still early on in the white label side of the equation, having started that in October. So we'll watch that closely, but marketplace has a wide, broad presence and a great incrementality that comes from that.

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

The thing that's encouraging, Brian, is we are moving to the third year of kind of emphasis on our takeout business and takeout is continuing to grow. And so this quarter, we continued to see growth in takeout after some really nice growth in the prior year. So it's not all about third party. We're continuing to see growth in our takeout business as well, which I think, again, encourages us that as we kind of lap and move through this business, we will continue to be able to grow it in all the channels.

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

Okay. And I think that the delivery was 3.1% memory serves in Q1. Can you share what that was in Q2?

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

Yes, at the breaker level, it's a little above 4% now. It's a higher level at Chili's is pushing towards 5% of their total. And again, as I said, total off-premise is pushing at 17% now of total sales as you continue to also see a little bit of growth coming out of the to-go side of the equation, too. And so...

Operator

And the next question is coming from Stephen Anderson.

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

From Maxim Group. I wanted to turn to Maggiano's as is a major competitor in that upscale talent space, just also announced another batch of closures lately. I just wanted to ask if you are seeing signs or any kind of a pickup of market share, maybe some -- for some of the competitors that have closed in that space?

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

I think it's probably a little early for that to kind of all flow-through, Stephen, but we'll -- I mean Maggiano's is doing a great job focusing on continuing to deliver great guest experience, working on making the brand kind of as relevant as it needs to be in today's world. It continues to be one of the premier brands in the industry. No matter what guest or consumer survey you look at, Maggiano's always ranks right at the top. So we've got a really powerful brand that does a great job. And now we're focused on just kind of enhancing that experience. We probably need to put a little bit of investment back into the brand to kind of update some of the relevancy of elements, but we haven't seen any specific to what you're asking about, but we haven't really been looking either. We're just kind of more focused on ourselves and how to grow that business, and we're excited about what that team is pulling together.

Operator

And the next question is coming from John Ivankoe.

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

With JPMorgan. I was just curious about some of the monthly sales trends that Chili's is seeing. It does seem like September and October a little bit better. November and December maybe slowed down a little bit only to reaccelerate into January. Wyman, you obviously have a lot of experience with the Chili's brand, specifically, but obviously, the industry overall. Does that kind of monthly volatility for the lack of a better word, or just kind of some monthly unevenness and year-over-year sales performance surprised you, I guess, at this point in the cycle? And do you think, especially for the sake of the operators and overall staffing levels that you can kind of achieve a more predictable and stable kind of month-to-month, year-over-year sales performance given your current economic and competitive environment?

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

Yes, John, I think there are some factors that are contributing to it, looking maybe a little more volatile than it is. The way the holiday played out, especially with a lot of our calendars through, might have thrown Thanksgiving out of one month into the next and that had a pretty dramatic impact. Obviously, the holiday shopping period this year versus last, you went from the longer period to the shortest kind of consolidated or compressed time period. So those kind of things kind of played into it. But overall, when you kind of shift through some of that, it's not that dramatic. It's moving a point here or there. And at the restaurant level, that's manageable. The good news for us, and I think for the industry, is it's moving in the right direction. And that's encouraging. And I think that's a sign of a lot of things happening, both primarily at what we're doing here at Chili's, but also in the category maybe to become more competitive.

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

Okay. It was my impression, and correct me if I'm wrong, that kind of the run rate in September and October was stronger than what you actually reported for the quarter, but maybe I could have misinterpreted some of the conference call comments that you made 3 months ago, but we can follow up with that online if you don't want to know.

And if I may, just in terms of a slightly different question. Wyman, you did mention in your prepared remarks, maybe looking at some more new unit development, specifically, at Chili's and acquired franchise markets. I know at the Analyst Day, we talked about beginning to look at some packages for remodels of Maggiano's as some of those bigger units haven't been touched. As you begin to kind of think about the '21 plan, as you rightly pointed out, we certainly are focused on the '21 and '22 in our models, what does that say in terms of future CapEx? I mean where do those numbers shift, if at all, for those 2 reasons?

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

Again, I think we are to expect to see a fairly consistent level of CapEx as you think about those next couple of years. I mean, again, we'll update that officially as we get to the guidance side of the equation. But I think the pace that we're seeing, the acceleration of cash flows, as we look at our capital models and needs and move between the different buckets, I would expect to see a similar range for the next couple of years. We have a couple more years of reimaging work on the Chili's side of the equation, and then we'll start to also sequence in what we think where the opportunities lie or relates to Maggiano's in that time frame also.

Operator

And the next question is coming from Katherine Fogertey.

Katherine Irene Fogertey - *Goldman Sachs Group Inc., Research Division - VP & Derivatives Research Strategist*

It's Goldman Sachs. I have a few questions here. So first of all, I mean, we've touched on it a little bit. But for the broader industry, the tips that we're getting, are that trends improved in January? From the consumer standpoint, kind of boots on the ground, do you think that, that's more of a mix of better consumer spending? Do you attribute some of it to weather? Anything outside of the overall strength that you're seeing in 3 for $10 and delivery that would kind of help explain a more constructive backdrop?

And then you've referenced the new table tops that you're putting in. I know it's still kind of early days on that, but could you kind of help us understand whether it's the engagement on the loyalty side or the ticket or speed of service, anything that we can understand how that rollout is helping to accelerate your business?

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

Sure. Yes, Katie. So I mean, again, from an industry standpoint, I'm not going to kind of spend a lot of time speculating on what could be driving some of that performance. I do think there has been, as mentioned on a previous question, maybe a little more aggressive shorter-term marketing initiatives by certain players. There may be a little bit of weather in there. All the components kind of come in. But at the end of the day, I think the thing that's interesting is I think we're going to start to see strength in the casual dining segment relative to the other segments. And that's a nice trend to see. And I think that really gets back to specifically what we're doing, making ourselves a better competitor, whether it's in our restaurants or whether it's through delivery channels to other options out there, whether they be fast food or fast casual. And again, with delivery, you open yourself up to occasions that people may not have considered us for -- before that they only considered other categories. So those are the kind of things that are exciting to us and that we're leaning into better understanding as we continue to expect and are excited about our opportunity to continue to grow sales and traffic.

With regard to table tops and the new table-top device, we opened up that whole category for the industry in casual dining, for sure, over 6 years ago. And so the equipment needed to be replaced. You can't run a computer with the kind of stress we put those computers under our volumes forever. So we knew we needed to replace. We've gone to a system that does a couple of things better for us. So what are the wins for us? It's a more dependable system, less moving parts. So that's a good thing for our operators and our team members because if they can count on the equipment to work every time, then they will get our guests to use it and they'll lean into it. And that does a couple of things. It gets people to handle the payment on their own. And so our pay at the table, as we call, the metric is high. And that's important because that gives servers freeze-up server time to do other things rather than run checks back and forth. It also has implications to credit card and bad debt because if there -- those new machines all have chip readers that eliminate some of that expense. And it is really most powerful for us from the standpoint of engaging our guests in our loyalty programs. So it becomes very easy for them to login and participate in loyalty. We also have now the capability, we haven't turned it on yet to ask them if they want to start to communicate more -- kind of more automatically. They can walk in, they've set their phone up, we can just start talking to them without even having them login. And those are the kind of things that we're going to continue to push forth as we aggressively grow our database. So we are, right now, pushing and growing the database at a nice clip. We will continue to grow that and see that as a really competitive advantage to us in the future as we are getting smarter and smarter about how to use that database to market to individual consumers in unique ways that drive incrementality.

Katherine Irene Fogertey - *Goldman Sachs Group Inc., Research Division - VP & Derivatives Research Strategist*

Okay. And I just also have a follow-up on [thermalling] on the 3 for $10 and kind of pushing stake more. Is there anything from a margin perspective that we need to consider? Or is that pretty comparable to the margins on the other offerings on 3 for $10?

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

It's in the ballpark. It's a little premium. It's not -- again, it's not going to be there forever. It's -- it will be on 3 for $10 platform for a period of time, and then it will go away. And in that time period, as Joe mentioned, we're pushing -- so we may give up a little margin on the 3 for $10 platform a stake. But we're also pushing our whole stake portfolio, if you will, and we've added some new items to that portfolio and they're doing well, and those items actually have better-than-average margins. And so the trade-off is definitely manageable.

Operator

And the next question is coming from Jeffrey Bernstein.

Jeffrey Andrew Bernstein - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

From Barclays. 2 questions. Just one, kind of looking back at the January improvement, I mean, the fact that it upticked as much as it did and the comparison seemingly was a lot more difficult. I was just hoping to contextualize, your understanding is, at this point, that the greatest driver of that was the switchback in advertising to the 3 for $10 with stake, but it seems like you're acknowledging that the industry got better as well. So I'm just trying to understand, one, what you believe the primary driver was, if it was the stake addition? And then maybe if you can contextualize how Chili's has performed versus the industry maybe versus past months just to kind of get a feel for how much of it is just a rising tide lifting all boats?

And if that number is sustainable, which it sounds like you guys feel good about the momentum, how you think about the fiscal '20 guide? Because it would seem like your comp guidance would, therefore, would be quite conservative.

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

Hey, Jeff. So let me just talk to what's going on within Chili's. So again, we talked about getting back on air in January with a more compelling message that drives traffic into the restaurants. And we've seen -- the way we measure success usually on something like that is how many people came in and ate the item we're talking about. And we've seen really good pickup on stake on 3 for $10, as you would expect, and that was consistent with the trend change for us from an absolute perspective.

Additionally, we were -- our margarita of the month program is unbelievably powerful. Again, this is a program that will start our third year of next month. And every year has gotten stronger and continues to get better with regard to driving incrementality in that aspect of our business. And we had our most successful margarita of the month in ever in January with the Patron margarita that just blew it out of the park. So again, it lines up with our strategy to deliver quality products at a great value, but not be the lowest possible price point out there, not to necessarily go to the very bottom of the well, if you will, but to really put compelling value out there linked with quality products. That's what -- that's strategically what we're doing and that's what's winning and that's kind of what we saw a trend change our trends.

With regard to the rest of the industry, it's a little bit -- again, I'm not an expert on exactly what's going on with the rest of the industry. There have been some other weather changes. There have been some people that have been pushing a little more aggressively. And so again, it's just nice to see the whole category move a little bit in a positive direction after what's been relatively a soft first half for our fiscal year for the category. But that said, we're absolutely encouraged and optimistic about what we're doing, both relative and absolute.

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

Yes, Jeff, as it relates to the comp guidance, we're very comfortable with the comp guidance we provided and the range that you have right now. And that's in the context of the first half of the year, where as Wyman said, where we've had a industry underperformance versus what we baked in to our expectations. So an improving industry is only going to bolster confidence even more as we kind of move into the second half of the year. But I think we're solidly in that guidance range. And I'm very comfortable with where we expect to come out by the end of the year.

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

Yes.

Jeffrey Andrew Bernstein - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Got it. And then my follow-up was just on the value messaging, and I know you talked about occasionally competitors get more aggressive and whatnot in terms of value offerings. But I think in your prepared remarks, you talked about even specific to Chili's, there are some new initiatives to enhance the value proposition. Just wondering what that might entail. And when you think about your value proposition, where you guys are currently sitting as a mix as a percentage of the menu? Is it still kind of in that 25-plus percent range as a percentage of sales? Or how do you think about that mix?

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

Yes. Again, it depends on what you would consider our value platforms. When you think about 3 for $10, which is absolutely a value platform, we're in the high teens and that's the driver. And those are -- that's the primary platform we've been leveraging for a little while now, and we will continue to. And we see opportunities to bring new news into that platform. It's a compelling platform. It's built into our margin structure now. And as you can see, our margins look good, so we have room to continue to lean into that. The fact that we're not offering that in the delivery channel, kind of, gives us another kind of buffer, if you will, and between those pieces of the business, and we like that. And so between innovation that we can bring to that platform as an example and then what we're doing with our database, we're excited about the opportunity we have to continue to drive traffic, both inside and outside the restaurants.

Operator

And the next question is coming from John Glass.

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

It's Morgan Stanley. If I could just go back to the dynamics in the second quarter on the comp and, particularly, delivery versus the rest of the business, if you looked at traffic and mix, they're relatively stable versus first quarter to second quarter. So is it the right way to look at it is that delivery performed well or maybe outperformed what you did, the rest of the business underperformed because you didn't have news so that delivery is still contributing what you thought? And does that raise the challenge if you go into a period like you are now, where you're focusing on a dine-in offer that you can't get in delivery? Does that hurt delivery sales? Is there a balance you need to figure out how to strike, so you can drive both delivery as well as the dining business?

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

No, hey, John, it's a great observation, right? So I think, first off, we're 6 months into delivery. So we're learning exactly how this business plays on a scale, right? I mean, obviously, we did delivery, but it didn't -- it was a relatively small and -- piece of the business. And now as it becomes a bigger piece of the business, we're getting smarter about it, okay, how does -- how do you -- how much do you have to market to it? How much of that gets carried by your third-party partner? And how much do you have to -- how do you optimize it with regard to the promotional aspect of it? And we've been very hesitant to promote. I mean we haven't done a lot of discounting within that space, not as much as others. So that's always an opportunity for us. We've probably put more external emphasis on it with regard to our marketing messaging than in hindsight, we probably need it. It looks like a lot of that gets carried more third party, and that's great news because that's not an incremental cost we have to deal with as much. And so we don't have to make those trade-offs. And that's what we're going to lean into now as we are comfortable now that the delivery aspect of the business is kind of working on its own, and it doesn't require a whole lot of our support from a marketing messaging. And we will put our focus more on kind of the in-restaurant opportunities.

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

And then, Joe, on ERJ, how much of that contribute to this quarter from an earnings perspective? And is part of your increased guidance, you've got better visibility on better accretion than you initially thought from that acquisition?

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

It contributed really at the level we expected to, but our expectation along is we built the annual model was for greater contribution from the acquisition in the last 2 quarters. As you see us just normally make more money in the last 2 quarters as those are the higher volume businesses, so we performed as expected. We're on the path that we would continue to see that performance play out. And so it will contribute at a higher level, both of the last 2 quarters, in line or with the expectations of how we built that model. So again, not making any great changes to the specific accretion from it, but we're very pleased in what we have seen in the direction of where that piece of the business is going.

I would note, too, that one of the things that's interesting about the current performance that we talked about earlier. And this in this first part of the quarter is, remember, Midwest is not in those numbers because they are non-comp restaurants of the first year. And we're pretty excited about the performance we've seen coming out of those restaurants too is they also write some of the benefits that we're bringing to the equation this quarter.

Operator

And the next question is coming from Sara Senatore.

Sara Harkavy Senatore - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

Bernstein. I just wanted to follow up on margins, the messaging back to value. I was wondering if that is implications from margins or mix. And specifically in the context of guidance where you took up EPS and cash flow, but not comp, even though, of course, the January churn is quite strong, and you're already kind of running at the high end of your comp guide. So just trying to understand if there are any implications about sort of margin top line trade-off? Or how you think about that playing out through the rest of the year notwithstanding the January top line?

And related question, could you just talk a little bit more about the margin implications to go, I think we've said is the same or higher than in-store deliveries, maybe a little bit lower? Although as you pointed out, kind of what's offered on the delivery channel may dictate a little bit what happens, but just remind me kind of how those different channels look from a margin perspective.

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

Sara, let me just talk about the first question. With regard to the impact of -- on cost of sales and margins relative to these offers, it's not significant, and it's obviously what we planned for. The bigger opportunity is the leverage we get from higher sales. And that more than offsets any kind of downside margin, and that's what you're seeing, right? As we continue to show positive comp sales, our ability to flow that through our operators run really great restaurants and are very much aligned with how to maintain a cost structure. And so those dollars flow through at a pretty predictable and a high level. So -- but Joe talked to it.

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

Yes. And again, I think as it relates to, particularly cost of sales that you mentioned. I mean our supply chain is working hand-in-hand with the marketing teams and they operates under -- so there's great line of sight as where we're going from a marketing standpoint that is built into how they approach the markets, the contracting we do. So there's not -- again, when you think about the positions we've taken and the protections we put in place, that is with total line of sight as to what we're expecting to do on the marketing side of the equation. So I don't expect any surprises coming out of that piece of the equation.

As it relates to margins in the different channels, they do have different margin characteristics, but not radically different. So I think as Wyman mentioned earlier, on the delivery side of the equation, when you don't have the 3 for $10 opportunity within marketplace, that's one of the ways that you manage that overall manage -- that margin perspective for that channel. So clearly, the in-dining, which is the dominant part of our business, clearly above 80% of the business has slightly larger margins across those channels, followed by delivery and to go based on some of those dynamics. Yes.

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

And again, Sara, we're getting smarter about this new kind of delivery business and how to optimize it and find the efficiencies in it, and we'll -- we're pretty good at that. We have a great team that's constantly looking at, "Hey, where can we find some efficiencies that don't impact the guest experience?"

Operator

And the next question is coming from Andrew Strelzik.

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

BMO. My question is on the loyalty program, which is an initiative that's had fits and starts over time. But I'm just curious for an update there. In terms of -- are you continuing to see the membership grow? I know you've been kind of optimistic about the ability to lean in with the personalized offers there. Have you really started to lean in or is that an opportunity that's still upfront?

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

Hey, Andrew. First, we are growing the database, and we're looking to even grow it more aggressively. So our -- which just kind of falls into the camp that we are totally bought into this approach towards marketing for the future, that is, direct-to-consumer marketing getting leveraging your database, leveraging our scale to use technology in a way that maybe others can't to get really smart about how we market to our guests and our potential guests is a way we're going to win. So yes, we're absolutely growing it, and we're committed to it, and we're excited about it. And we are using customization to a certain degree, but we see opportunities to take that up to the next level as we continue to bring some of the new technology into the restaurant, like we just talked about with table tops that opens up some avenues for us and as we just get smarter with the database over time.

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

That's helpful. And my other question is, from a turnover -- the labor efficiencies have been impressive, certainly, in the last couple of quarters. And you've talked about some of the drivers, but I'm curious on turnover. I mean how much has improvement there with the performance and kind of some easing of the operations and the training and all of those things? How much has that contributed to some of the efficiencies on the labor side?

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

Not a lot. Right now, our hourly turnover number, again, it continues to be much better than the industry, but still an opportunity for us. And our operators and everyone in the organization is focused on understanding how we can stabilize some of that even more, because we do believe that's an important metric for us. At the management level, we have seen some stability or some lower turnover numbers, and we think that's, again, something we look to continue as we move forward with the better systems for our managers and better metrics to help them understand kind of how they're performing. So it's not been a big component of it, but we do see opportunity as we move down the road to leverage turnover.

Operator

And the next question is coming from Jon Tower.

Jon Michael Tower - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Wells Fargo. Just a quick longer-term question on the business. Operating margins have been contracting really since fiscal -- excuse me, fiscal '16, and there's been some accounting pressures on that. So it's not truly an operating function. But I am curious if you could kind of outline how you think about this business going forward over the next 3 to 5 years? How we should think about EPS growth or the components of EPS growth, specifically, restaurant level margins? Should those stay flattish? Or do you expect those to expand in future periods and then leveraging or kind of keeping G&A growth flattish and, therefore, the components of the impact on operating income over time?

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

Yes, I think it's a combination, Jon, of all those. And the key is really the top line growth side of the equation. You're seeing great evidence this last quarter of the capacity growth, both from comp sales and from the acquisition. That's obviously a dynamic that will continue, particularly that capacity addition from the acquisition over the course of really the next 3 quarters, and you get a strengthening of that capacity growth in the second half of this fiscal year. So that top line, again, we go back to the long-term outline that we talked about at the Investor Day that our ability to drive towards a 2% comp area should have the opportunity for margin management in that regard. And you can get there, obviously, with that 1.5% to 2% price kind of maintain a consistent traffic perspective and flex mix when you have those opportunities to do that and flow through that price side of the equation.

But I think our belief, and again, we've always been effective management on the cost side of the equation, all the way down the P&L and including the G&A side of the equation. So again, growing that top line, adding capacity on a new restaurant development side and maintaining that 2-ish percent comp range does give us that opportunity to manage our margins.

Operator

And the final question is coming from Gregory Francfort.

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

I had 2. The first is for Joe. Just in terms of the contracting on the commodity side, how does that work? Are those fixed-price contracts, are they volume contracts or some blend of the 2? And my other question was for Wyman. As you look at the economics of the third-party delivery to you and then also your third party, I mean, is that how you are thinking about it? And as we try to gauge what seems like it's changing dynamics in the aggregator VC world, as you look at Chili's delivered order, is it a higher profitability than other delivered orders and that's why you believe VC will shift towards casual dining in Chili's? Or how do you think about that dynamic?

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

Greg, the short answer to your first part of your question is yes, yes and yes. It depends on the product that you're talking about. It depends on how the product equates to what we're doing in the restaurant from a marketing standpoint. So it can be a combination of all of what you mentioned.

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

Yes. I mean, again, I think the basket is fairly well locked though. And so that gives us absolute coverage.

With regard to the third-party delivery, I'm not exactly sure, Greg, of the question, but the economics we think are pin to the incrementality, right? And so we feel good about the incrementality. And based on the cost structure and the incrementality combined, it makes delivery a really nice piece of business for us and one we think we can continue to grow and grow profitably. And so when we look at delivery, we look at it from a totality of the business. And so the incrementality is important. We feel good about that and with that incrementality, how are the absolute margins and they're solid. So are they as good as if somebody were to walk right in our front door? Probably not, because you're paying for that delivery component. But it is a good piece of business and one well worth going after and when the consumer is going to demand. I mean, again, we think convenience is something that consumers are demanding. So rather than fight that, we're going to lean into it and do it in a way that we feel good about delivering a quality product and a business model that works for us. So that's kind of how we're looking at third-party delivery.

Mika Ware - *Brinker International, Inc. - VP of Finance & IR*

Okay. So that concludes our call for today. So we appreciate everyone joining us on the call and look forward to updating you on our third quarter results in April. So, everyone, have a wonderful day.

Operator

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