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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brinker International Q4 Earnings Call. (Operator Instructions)

It is now my pleasure to turn the floor over to your host, Mika Ware, Vice President of Finance and Investor Relations. Ma'am, the floor is yours.

Mika Ware

Thank you, Kate. Again, this is Mika Ware, Vice President of Finance and Investor Relations. Welcome to the earnings call for Brinker International's fourth quarter of fiscal year 2018.

Results for the quarter were released earlier this morning and are available on our website at brinker.com. Wyman Roberts, Chief Executive Officer and President; and Joe Taylor, Chief Financial Officer, join me this morning here in Dallas. As is our practice, Wyman and Joe will first make prepared comments related to our operating performance and strategic initiatives. In addition, we will provide guidance for modeling fiscal year 2019 performance. We will then open the call for your questions.

Before beginning our comments, please let me remind everyone of our safe harbor regarding forward-looking statements. During our call, management may discuss certain items, which are not based entirely on historical facts. Any such items should be considered forward-looking statements with 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 commonly described in this morning's press release and the company's filings with the SEC.

And of course, on the call, we may refer to certain non-GAAP financial measures that management uses in its review of the business and believes will provide insight into the company's ongoing operations.

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

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

Thanks, Mika. Good morning, everyone. As you saw in this morning's press release, Brinker delivered solid fourth quarter results with earnings of $1.19, positive comp sales at 0.6% and positive comp traffic at 0.7%.

At Chili's, we are 3 quarters into our new strategy designed to drive sustainable sales and traffic growth, and I'm pleased with the brand's ongoing momentum. Fourth quarter reflected Chili's best performance in more than 3 years. As you recall, the strategy is focused on 4 critical areas of the guest experience: food quality; operational consistency; convenience, specifically around off-premise; and our value proposition. That's the journey we've been on. We remain committed to investing in and improving these 4 areas, and we continue to deliver sequential improvements to both sales and traffic.

Fourth quarter traffic outperformed the industry by more than 200 basis points, and we're seeing that trend to continue. The fourth quarter comp sales number reflects a significant investment, nearly 100 basis points, to grow the Chili's loyalty database. Joe will give you more details on the accounting, but during the quarter, we actively incented guests to join My Chili's Rewards Program, increasing our already substantial database by more than 25%. This gives us additional marketing leverage throughout the year to drive incremental visits for the sizable portion of our guest base. We saw a meaningful increase in the percentage of our guests who engage with us through this platform and will continue to expand our direct marketing capability to optimize the efficiency of those channels.

At Maggiano's, the brand delivered its third consecutive quarter of positive comp sales at plus 0.3%, and our global partners drove positive results in Latin America, while the Middle East continues to battle macroeconomic challenges. Our global partners opened 7 restaurants during the quarter for a total of 34 new restaurants in fiscal '18, bringing our international presence to 383 restaurants.

I'm proud of our performance during what was an important and pivotal year for our business, specifically at Chili's. We launched Chili's new strategy by simplifying operations to enable consistent execution. We reduced our menu by 40%, which enabled us to deliver hotter food faster and cut our longest ticket times in half. We coupled that with significant quality improvements and innovation around our burgers, ribs, fajitas and margaritas, and we strengthened our value proposition with our $5 margaritas and our 3 for $10 offering.

Finally, we improved convenience by elevating our technology platform and our execution of takeout, driving sequential improvement in our to-go business throughout the year, ending in double-digit growth in the fourth quarter. The strategy is working. Sales and traffic are both up, guests are telling us through their satisfaction scores that their experience is faster, the food is better and the value is best-in-class. And our team appreciates this back to our roots strategy and the commitment to simplify their experience. Engagement score is at all-time highs, and our employee turnover is significantly better than the industry.

Now as we enter fiscal '19, we'll keep working the Chili's strategy. Against a broad consumer base, we see a lot of opportunity to drive frequency with our guests. So we'll keep dialing in our effectiveness in these key areas as we look to grow the business. First, we'll continue to improve how we leverage our industry-leading technology platform. Second, we'll get even more aggressive with our direct marketing capabilities. Third, we'll optimize our value proposition. And finally, we'll continue to target multiple occasions inside and outside the restaurant.

We'll also leverage our capital to continue investing in the guest experience. As we shared before, we're pressing forward with our reimage program. We completed our first market, and we continue to be encouraged by the results. We're also investing in technology that enables speed and convenience and makes our team's jobs easier. And we're investing in our team to keep the operations simple and to help them focus on the most important person in the restaurant, our guest.

At Maggiano's, we're so pleased to welcome Kelly Baltes as the brand's new President. Kelly is a veteran in our industry with a proven track record for growing brands while enhancing the guest experience. We've got a great brand and a talented team at Maggiano's with significant potential, and Kelly is the right leader to help the team accelerate the brand's growth.

Our global team will continue working to develop successful partners and further expand our presence. This fiscal year, our focus is in Asia, especially in China and Vietnam, where we'll open our first restaurants. We expect our partners to open another 30-plus restaurants in fiscal '19, outpacing the category and marking the third consecutive year of more than 30 openings internationally.

I'm excited about the ample opportunity we see in fiscal '19 to accelerate momentum and grow the business. As you'll hear from Joe in a moment, our guidance is returning to positive comp sales and traffic. In a tough environment, our commitment to leverage our scale and our cash flow to invest in critical aspects of our business will put increasing pressure on our competition and help us capture market share from both chain and independents. Our entire team is passionate about getting better every day, every shift, for every guest, and we're committed to giving them everything they need to do just that.

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

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

Hey, thanks, Wyman. Good morning to everyone. Before I move to your questions, let me continue our prepared comments by covering a couple of topics. First, some additional insights related to our recent quarterly performance, then a summary of our sale leaseback financing, and finally, some context for our fiscal year '19 guidance detailed in this morning's press release.

Our fourth quarter ended fiscal year '18 in a positive fashion, with the company reporting both top line and EPS growth, most importantly driven by Chili's return to positive comp sales from continuing traffic improvements. This improvement in comp sales to positive 0.6% for the quarter underlined an increasing quarterly company sales to $791 million.

For the quarter, our adjusted earnings per share, excluding special items, increased by 9.2% to $1.19. For the fiscal year, we reported adjusted earnings per share at the high end of our guidance range of $3.50, a 9.4% increase over the prior year.

As it relates to Chili's quarterly comp sales performance, let me note a couple of items. Importantly, traffic continued its steady improvement and is now in positive year-over-year territory, reporting close to a 1% gain for the quarter. As we had noted earlier in the year, we intended to be less dependent on price to drive comp sales improvement and more focused on incremental traffic. This approach to driving improved top line performance will continue this fiscal year.

You likely noticed our comp sales for the quarter included a negative price impact of 1%. This reflects a year-over-year comp expense increase for our promotional direct marketing and loyalty efforts, which are accounted for as a reduction in price. Reiterating Wyman's earlier comment, reactivation of our loyalty program following the transition from Plenti heightened the level of this marketing activity in the quarter and we believe reduced net comp sales for the quarter by approximately 1%.

Our restaurant operating margin as a percent of company sales decreased in the quarter to 15.9%. While investing in areas impacting cost of sales such as food and value propositions contributed to this reduction, the primary driver of the margin decrease was higher restaurant bonus compensation and ongoing headwinds from hourly labor, much of which are related to increased guest traffic.

Our cash flow for the fiscal year remains strong with EBITDA of $412 million and free cash flow of a little more than $183 million, which was utilized to fund dividend and share repurchases. We also utilized our borrowing capacity during the quarter to increase the number of shares repurchased, buying over 3.1 million shares in total during the quarter. This brought our shares repurchased for the year to almost 7.9 million shares or approximately 16% of the shares outstanding at the beginning of the year. This repurchase activity did result in our lease-adjusted leverage increasing to 4.16x EBITDAR at year-end. However, the successful completion of our recently announced sale leaseback transactions allowed us to use the proceeds to repay a meaningful portion of our revolving credit borrowings. We expect our adjusted leverage this year to be in the 3.7 to 4x range.

Speaking of our sale leaseback financing, let me provide a quick summary. Over the course of the last several weeks, we entered into 3 separate purchase agreements for the sale of 143 restaurant properties to be leased back to us for 15-year terms with extension options. We have subsequently closed on all but a small number of the properties and anticipate wrapping up the additional few closings in the near future. The combined transactions have generated approximately $443 million of gross proceeds. We are pleased with the structure of the transactions, the ability to close the offerings in a timely manner and believe we unlocked significant value from these real estate holdings. The transaction will impact several expense items going forward, mainly increased rent expense, partially offset by lower depreciation expense, both of which are incorporated into our guidance for the current fiscal year.

Now with respect to guidance. Underlying our fiscal year 2019 guidance is a continuation of the strategy to drive traffic at our brands, to invest in improving the guest experience, the look and feel of our restaurants and the value we offer our guests. We're looking to improve our bottom line earnings through a better balance of organic growth and our capital allocation programs. Our full guidance, along with our guidance policy, can be found in this morning's press release in the Investor Relations area of our website, brinker.com. Here are several highlights.

For the fiscal year, we are currently forecasting comp sales growth of positive 0.75% to 1.75% and revenue growth of 1% to 2.25%. I would note that included in our revenue growth for this fiscal year are franchisee marketing contributions due to the adoption of the new revenue recognition rules. Without the inclusion of these marketing contributions, our range of revenue growth, not comp growth, revenue growth would be approximately 50 basis points lower.

We do expect a step-down in our restaurant operating margin for the fiscal year, primarily driven by the SLB rent and the previously mentioned change in franchise marketing contribution recognition, which was previously recognized as a credit to marketing expenses in the restaurant expense line. For the year, we are expecting restaurant operating margin to be down 1.6% to 1.8%. Without the sale leaseback financing impact and change in revenue recognition standards, our restaurant operating margin for the year would have been forecasted to be flat to slightly positive.

We are increasing our capital investment into our existing restaurant fleet and expect capital expenditures for the year of $140 million to $150 million. As Wyman mentioned earlier, we are now fully into our restaurant reimage program, which is the driver of increased CapEx spend for the year. The average reimage spend per restaurant is estimated between $210,000 and $230,000, and we are scheduled to complete approximately 250 restaurants by the end of this fiscal year. The overall project will take most of the next 3 fiscal years.

Free cash flow is estimated between $165 million and $175 million, leading to a forecasted weighted average shares outstanding for the year between 38 million and 40 million shares. Finally, our adjusted earnings per share guidance for fiscal year '19 is a range of $3.70 to $3.90.

With my comments now complete, let's open the call for your questions. Kate, I will turn it back to you to facilitate.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today is coming from Nicole Miller.

Nicole Miller Regan - *Piper Jaffray Companies, Research Division - MD & Senior Research Analyst*

Two quick questions. I just want to understand if you have it yet on the remodels the difference in guest satisfaction scores between your core base because I believe you had a remodel market done, I think, last month. What can you tease out and tell us that customers are saying now?

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

Nicole, Wyman. The feedback from the guests has been positive. Obviously, they really appreciate, and we see the biggest movement, as you would expect, in the atmosphere scores, the relevance, the cleanliness, and that's the piece of the project that gets the most playback. But we're also excited about the opportunity to give guests a better guest experience when they come in to the restaurants. And we're working very hard with all the operators to make sure when we make the investment in the market that the other aspects of the experience are also stepped up. So right now, the feedback and more importantly, what they're doing with their visitation and the frequency is very encouraging. And while we said we just finished our first market ahead -- been previously reimaged 7 years ago, and we're encouraged by how that market is playing out as well as what we've seen in the market I think you're referencing, which is up in the northeast that we had done but had never had the prior reimage.

Nicole Miller Regan - *Piper Jaffray Companies, Research Division - MD & Senior Research Analyst*

And I just want to say hi, Kelly, and I want to understand a little bit more about Maggiano's. Can you talk about why you're accelerating development now? Is this going to be the same box or a different unit-level economic model? Maybe a little bit about what the total addressable future of the brand is, and again, just why now for the acceleration.

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

Well, I think, first, we're excited to have Kelly on board. And to answer your questions really, we want to give Kelly that opportunity. So there isn't a specific prototype or development plan that we want to share with you right now. Kelly just got his feet on the ground. He's getting to know the team and the brand and very quickly will work towards putting his plan together for how to grow and develop Maggiano's, first, as a -- to strengthen it in the footprint that it has and then ideas for other potential growth. So that's where we're going.

Operator

Our next question today is coming from John Glass.

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

It's Morgan Stanley. First, Joe, just on the comments on the pricing being negative and as it relates to building up back your direct marketing program, is that something that continues -- do you forecast that throughout 2019? Or was that really just an upstart cost, if you will, and that it doesn't persist?

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

John, the answer to the question is really both. Again, embedded in our guidance to you, particularly as it relates to the comp sales, is an expectation of the marketing spend, which it really is just a reduction to price. But as I mentioned, we really had heightened the activity as we reinvigorated that program in the fourth quarter. So the incremental drag coming from that is kind of that 1%-ish range that we mentioned to you.

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

But just to be clear, does it stay at that level? Or is this sort of the peak and it sort of tails off as you -- spending tails off, if you will?

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

I think we will parse it in and out. I mean, again, it's a marketing tool we have to use. But I think the level was higher than you would normally expect to see it on an ongoing basis in the fourth quarter.

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

Okay. And then just on your restaurant margin guidance. So can you maybe just talk about why flat to up a little bit is feasible? Is that driven by the positive comps? Is there another element of it, particularly, as you highlighted, labor is still a headwind, and presumably, if you're planning on positive traffic, that would continue to be the case? And can you also just quantify specifically what the cost of the incremental lease expense is for 2019?

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

Yes, a couple of things there. First, on the flat to slightly positive without the adjustments. Much of that would be M&A from the top line growth and some of the leverage you get out of that environment. Obviously, we continue to look at opportunities for efficiencies at other places within the restaurant operating segment. We do look at a fairly benign still cost of sales environment, maybe a touch slight inflationary if you look across the broader basket there. But top line is the contributor in the biggest way. As far as the impact as it relates to the 2 items I gave you, which were the SLB rent expense and the shift in the revenue recognition for franchisee marketing contributions, on a combined basis, that's between $50 million and $55 million impact to that restaurant operating margin and actually roughly split relatively close between the 2 of them, a little bit more on the rent expense. And then you had a depreciation question?

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

No, but you can answer if you want.

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

Yes. Actually, the offset to that, too, remember, too, is we do have a decrease in depreciation related to the sale of those assets, and that offsets just under 1/4 of the rent expense.

Operator

Our next question today is coming from Jeffrey Bernstein.

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

Calling from Barclays. Couple of questions. One, maybe as you think about the guidance for fiscal '19 on comps, which was quite specific at 0.75% to 1.75%, I'm just wondering if you can give some insight into how you arrived at that. And I think you mentioned that assumes positive traffic, but in terms of the components that it adds up to that. And maybe how you think about that relative to the casual dining industry for fiscal '19. And then I had a follow-up.

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

Jeff, Wyman. Yes, I think the -- obviously, we build our plans from the base, and we're making assumption about the industry. We don't see it changing dramatically from where it's at given everything we know today. So kind of in that probably low 1% positive comp sales [to 2%]. So we see ourselves gaining share, specifically on traffic like we have kind of been doing the last few quarters, and we continue to see that throughout '19. And then from a sales perspective, taking share but significantly driving share gains from traffic.

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

Got it. And then you mentioned the off-premise. I think you said the fourth quarter had double-digit growth. I'm just wondering if you can maybe provide some update. Seems like you and all of your peers are aggressively pursuing it, so maybe what percentage of your mix is the to-go, how much of that maybe is delivery, average check, the margin, any kind of components around that to-go and delivery opportunity and where you are today?

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

Yes, Jeff, from a -- this is Joe. From a to-go standpoint, we're continuing to see our mix of to-go between 11.5% and 12%. Interestingly enough, one thing I would point out is the mix isn't moving as much because we are growing the whole pie. We see year-over-year mid-teens to upper teens growth on a very consistent basis in our to-go business. But we are growing both to-go and in-dining room operations, which gives a little less impact to the overall mix. We're real pleased with the direction there. Delivery continues to be a very small component of that, but we are going to be leaning more aggressively into delivery as we move throughout the fiscal year, and I would anticipate it having some impact on our ability to move the business forward, particularly in the second half of the fiscal year.

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

Got it. And just lastly, a factual clarification maybe on the leverage side of things. The long-term debt after the paydown, I know you gave us, I think, what you thought your leverage level would be. But how much absolute long-term debt are you thinking? And maybe what's the interest expense you're expecting within guidance for fiscal '19?

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

So we're -- again, I gave you the quarter ending is that 3.7 to 4x is what we would expect to see as we move throughout the year. We obviously will be investing into the business to things like our reimage program, so that will probably have a little bit of a delta as we move throughout the fiscal year, but we're comfortable at that. From an interest perspective, we're anticipating an increase in interest. It's going to be probably up in the $3.5 million, $4 million range, depending on interest rate increase and things of that nature, but we're comfortable in our ability to manage at that level.

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

$3.5 million to $4 million above your fiscal '18 actual?

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

Correct. We should be in that $4 million range, above.

Operator

Our next question today is coming from David Palmer.

David Sterling Palmer - *RBC Capital Markets, LLC, Research Division - MD of Food and Restaurants and Consumer Analysts*

RBC. Just a question about what you found -- what works marketing-wise and how will that shape your marketing into fiscal '19. And more specifically, about that 3 for $10, you introduced it, you pulled it only to return it lately. Was that a restaurant margin sacrifice in the quarter? And is that something that you're going to stick with in fiscal '19 and find some other ways to offset to keep those restaurant -- that underlying restaurant margin performance flat this fiscal year?

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

David, Wyman. I think a couple of things. One, we're going to be a little less specific on specific marketing tactics and their effectiveness and our thinking about them just from a competitive perspective. What I'll say is, in general, with regard to our marketing mix and our promotional strategy, the importance of nontraditional mediums is rising. So digital, social, direct, including our CRM and loyalty, are areas that we can measure, feel that we have a competitive advantage on and are things that the marketing team here is doing a really great job kind of leaning more into. And so from a tactical perspective, that's the -- those are some of the areas that the marketing team is, again, giving more focus on and how we're changing the mix a little bit. With regard to the specific offers and how we're going to dial in our value proposition, we're going to keep that a little closer to the vest. 3 for $10 has been a strong offering out there for us. We're excited about what it does for the business, both dayparts and however that works for us. And it's within our margin structure to make it work. And you've seen that in kind of the forecast we've laid out just for you.

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

And, David, I would add to that. Specific to the restaurant operating margin, when you look at some of those opportunities when you mentioned one, we understand some of them will have an impact, particularly if you think about cost of sales to the extent that they're impacting the mix dynamics. But obviously, we're looking at the overall comp opportunity and the traffic driving opportunities to come out of that activity. So that's typically where we would look at impact on costs but positive benefit and offsets driving top line.

Operator

Our next question today is coming from Sara Senatore.

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

Bernstein. And I have just really 2 follow-up questions. One is on the (inaudible) impact of the (inaudible) technique. In your last conference call, you implied (inaudible) digits. But when I back out the (inaudible)...

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

Sara, we're having some trouble -- we missed the first part of...

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

You're breaking up, Sara.

Mika Ware

Yes, you're breaking up.

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

I was just asking about the comps trajectory in the last quarter. And just the fact that if I back out the 1% negative pricing, you're kind of in line with the low single digits that you have been guiding to on the last conference call. Was this more investment than you had expected? Were you just sort of, at that point, kind of looking at the organic underlying? I'm just trying to understand how you're thinking about the returns on this pricing. Is there any color you can give on the loyalty members? And is it the kind of return you would expect to see? And then I'll have another question, please.

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

Yes, I think it was a decision we made to be more aggressive in the quarter than we had maybe originally planned. We're excited about the opportunity with the restart of the My Chili's after the kind of sunsetting of the Plenti program to get our loyalty and our CRM program back in 100% control and to grow it. And so that's what we did. It's an investment and a marketing strategy. If you think about it, that paid out over a longer period of time. So that investment will leverage those names and those relationships for months, if not years. So that's what that investment in the quarter did for us. It was one we wanted to make quickly with the reestablishment of My Chili's Rewards. And again, as we mentioned before, probably a little more aggressive than we'll do in the future, but it's a strategy and a tactic that we will continue to lean into. And we think we bring a competitive advantage to the category with our team and our insights.

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

As it relates to the return piece of the equation, from a marketing channel perspective, we do feel that direct marketing piece, particularly as we learn how to enhance it and perfect it, has some of the higher returning attributes compared to other marketing channels. So it's going to be well worth the investment and one that you can drive over an extended period of time.

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

Okay. Great. And then just on the sale leaseback. I guess my rough math that the cap rates are perhaps higher than what [you pay on] funded debt. Wonder, first of all, if I'm thinking about that right. And second of all then, what was the sort of underlying rationale for doing this sale leaseback if the rates are -- if you could argue lead to a better rate in terms of funded debt.

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

Well, one, Sara, we're very pleased with the structure of the transaction. The cap rates came in below our targets. When we looked at the transaction, we found our offerings to be very compelling in the market. So we're pleased with that. I mean, it is a long-term financing. So relative to the long-term financing market, so I think it's very compelling. It's also the ability to unlock the amount of value that we did. The impact on our leverage, when you do the adjusted 6x, is significantly below the amount of value we unlocked in that transaction. So I think the rates we paid are right in line and pleased with the transaction.

Operator

Our next question today is coming from Gregory Francfort.

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

I have 2 questions. The first is just on margin. Can you maybe help me understand the bridge from '18 to '19? I'm getting like 50 to 70 basis points on the rev rec and then like another 100 basis points on the incremental rent. And so I guess I'm just trying to get a sense, is that right? And then the other question I had was on kind of the leverage use of proceeds. You guys bought back a lot of stock with the revolver ahead of this deal. Why not just sort of delever the company from here? What was the reason to keep leverage at kind of 3.7 to 4x?

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

Greg, I think as you look at -- and then I'm assuming you're talking about the restaurant operating margin bridge is what you're referring to. You're right in the context of the bigger impacts are those higher rent and franchise marketing. There's obviously a number of different things that come into play. The manager bonus re-accrual, as we re-accrue back to target, comes into play. You have offsets impacting, the biggest offset being what we think we're going to do from a top line flow-through. So there's a number of other puts and takes throughout that restaurant operating margin. But top line benefits offset by the areas I just talked about are the really largest pieces of the equation. And again, down 1.6% to 1.8% is the guide. Without those changes, that would get you back to flat to slightly positive, so I think you can get the relative feel for those puts and takes. You're thinking about it the right way. As it relates to the leverage position, we're very comfortable at that leverage position that I guided you to. The cash flow dynamics of the company remains strong and more than capable of managing that level of leverage. If for some reason, for some unforeseen issue or market dynamics, we wanted to delever, we have the ability to do that in a fairly consistent manner. We also have cash flows that are improving from ongoing operations improvement and from the tax reform adjustments. So a number of dynamics that continue to keep us very comfortable at that leverage level.

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

Maybe just one follow-up. Is there a margin benefit from sort of losing the Plenti payments? And is that expected at all in next year's numbers?

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

The -- I mean, it's incorporated. The change in loyalty definitely is incorporated into the numbers for next year. There -- it's a shift in marketing expense, if you want to think about it from restaurant expense where Plenti was accounted for into the offset to price that we talked about earlier.

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

So just basically a margin to sales sort of flip.

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

Correct.

Operator

Our next question today is coming from Chris O'Cull.

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

It's Stifel. Joe, the comp growth you're targeting for fiscal '19 would seem to equate to maybe 40 basis points of leverage, but the impact of the promotional activities, impact on cost of sales, the labor cost pressures you guys have seen had been greater than that. So I'm just wondering if you can maybe give us a little bit more color as to how you maintain flat to slightly positive margin, excluding the sale leaseback and accounting changes.

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

Again, I think the biggest opportunity is that top line growth. When I look at the different puts and takes, it's a significant opportunity to leverage the fixed expenses that are throughout that piece of the margin. There is a little bit of benefit. It's a relatively smaller one compared to the other ones I talked about in that shift of the -- where the marketing expense is coming out of [raw] and into sales. We're going to be efficient as we've talked about in how we look at the other pieces of the equation like cost of sales and how we run the restaurant. So again, we think efficiency, combined with the ability to lever those fixed costs as we move throughout the year, is going to be an effective piece of that equation.

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

What kind of margin impact do you expect from a -- leverage impact do you expect from a 1% increase in comps? Is it greater than a 40% flow-through?

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

It has the potential being right in that range. Really, Chris, when you think about it, there's obviously a lot of puts and takes that come into play there. But...

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

And there is some price in there as well, so obviously, that will flow through at a better than your typical. So when you factor in that into the mix, you're able to get that net neutrality kind of position that we're looking for.

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

Can you help us understand, Wyman, what is the effective price increase, excluding all the accounting machinations? I mean, from the consumer's perspective, what kind of pricing are you expecting?

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

Yes, and we talked about this, I think, fairly extensively last call. We got a little aggressive in '17 and '18. We kind of backed ourselves back into where we want to be, which is in that 1% to 2%. But really, that 1.5% is kind of the sweet spot for us. We feel like based on everything we've seen that, that gives consumers enough leeway to kind of absorb the price without having to make significant changes in their visitations.

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

Okay. And then, Joe, I apologize if I misheard you, but did you say the interest expense would be up year-over-year in fiscal '19? Because I thought the company used the proceeds from the sale leaseback to repay debt.

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

We did use the proceeds from the sale leaseback to repay debt. Obviously, we are anticipating floating rate increases if you think through the rate curve, so we embed that thinking into our forecast. Obviously, we'll continue to make investments into the business such as the reimage. That could have some ramifications on the debt levels as we move forward. But I think that interest cost is very consistent with the 3.7 to 4.0 I gave you.

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

Okay. And just one last one. Are you including the amortization of gain from the sale leaseback transaction as a net in your rent expense?

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

From a GAAP perspective, it will be amortized over the life of those deals. But we intend to dial that out so that it will not have an impact to adjusted earnings on a go-forward basis.

Operator

Our next question today is coming from Robert Derrington.

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

Telsey Advisory. Wyman, I'm curious. I think most of us know that the Supreme Court recently changed the rules of the land as it relates to gaming. I'm just curious from your view, and you all have been typically pretty protective of the family environment within Chili's, but you're also spending $250,000 to update and renovate your bars, which, quite frankly, may offer you an opportunity. Have you given any consideration to that, ultimately trying to figure out is there some way that Chili's could participate within that?

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

Bob, not in a major way, not in a way that would reposition the Chili's brand. We're a family-oriented kind of very menu, bar and grill kind of mix. And there's not, I think, a positioning that would allow us to heavily lean into some gaming options. Obviously, there's others that are looking at that now. There are opportunities, and we will continue to explore on a smaller basis opportunities within the building that may allow us to take advantage of it or our franchisees to take advantage of some state and local opportunities that don't reposition the brand in a way that's significant but offer maybe some alternative revenue sources for them. So we're kind of exploring some of those, but nothing from a major brand positioning perspective that would embrace gaming at Chili's.

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

Okay. And then as a follow-up on the -- your delivery program and your to-go. Certainly, there's a big opportunity there, and I think the technology -- the improvement in your app, you probably got one of the easiest to use apps within the industry. Ultimately, do you foresee the ability to place a delivery order through your app? Or how do you see ultimately Chili's taking advantage of delivery, whether it's third party or through your own means?

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

Yes. Well, I think, again, this is where we can bring our technology and our scale to bear. I think the idea that we can take the benefit -- the consumer benefit that we see in our app, which is significant, we're seeing amazing growth in the use and the adoption of the app. The team's done a great job building that app and making the Chili's take-out experience about as seamless and convenient as it can be. And we like to use as much of that infrastructure with partners in a delivery idea, primarily so we keep it simple for the operators. When you walk into some of the restaurants and you see multiple tablets for multiple delivery people, you just have to really wonder about how easy it is and how consistent the operators are able to manage that information flow. And we are talking with partners and with suppliers to see how we can integrate delivery into the same technology platform so that we keep it simple for the operators, so that we make sure that everything we do supports their ability to deliver consistent guest experience, whether it's in the restaurant, picked up or delivered.

Operator

Our next question today is coming from Stephen Anderson.

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

From Maxim Group. A couple of questions. First, within your guidance of 0.75% to 1.25%, can you look at something that's a little bit your quarterly cadence, keeping in mind that the first half of the fiscal year, you are lapping the effects of Hurricanes Harvey and Irma? And I have a follow-up.

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

Yes, Steve, obviously, there -- those events are coming up here fairly quickly, and we'll lap on those and we anticipate getting some boost from that wrap and from our -- let's hope that the hurricane season stays fairly benign. The -- we're 3 quarters into the strategy at Chili's, and obviously, we've seen sequential growth throughout '18. And as -- we would expect that to continue and maybe be a little tougher lap as we get to the back end of '19. But we see consistent growth through the year.

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

Okay. And my other follow-up question is I noticed like on your dividends, the first time we've seen in quite some time that you haven't increased the quarterly dividend. Usually, it's done at the end of the fiscal year. Is that -- are you signaling some way, some shift in how you view your use of cash? Or is that you are still committed to dividend?

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

Well, obviously, we -- the board approved a dividend payout as part of this quarterly announcement, so that commitment continues. We're comfortable with the dividend payout from both the payout ratio and the yield that it is -- had been generating. So I think the dividend speaks for itself from that commitment level. I don't think it is signaling anything of any significance in that regard, Steve.

Operator

Our next question today is coming from Karen Holthouse.

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

Goldman Sachs. One quick one. Did I miss in prepared remarks, did you give what commodity inflation was in the quarter?

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

We didn't say it, Karen, in the prepared remarks, but for the fourth quarter, is that your ask?

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

Yes.

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

We haven't disclosed that. There isn't a major delta as it relates -- it's a fairly benign flattish kind of market year-over-year. And frankly, going forward, we -- I think I mentioned, we anticipate that environment is going to stay there maybe slightly inflationary as you look over the broad reach of the supply chain.

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

Okay. And then one other quick modeling one. On -- for margins, you mentioned the manager bonus re-accrual is a headwind next year. How should we think about that cadence of that through the year, particularly given the improving sales trajectory through the year?

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

It will impact throughout the year, particularly on the manager bonus side of the equation. The -- [ended] the performance this last year had higher manager bonus, as I mentioned, in the fourth quarter, so the impact of that cadence is probably greater in the front half and a little bit in -- as we move into the third quarter. I can tell you that from a dollar perspective, if you look across the scope of all of our incentive compensation programs, both within the restaurant and the RSC, the re-accruals as it relates to all of these programs is right about $18 million year-over-year.

Operator

Our next question today is coming from Andrew Strelzik.

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

BMO. So my question is about the same-store sales guidance. So over the last 12 months or so, casual dining industry has been a bit stronger than it has been prior to that. And you've talked about kind of your rates of outperformance over the last couple of quarters. And as you're looking for an acceleration now in 2019, are you anticipating that the industry stays at those better levels? Or do you think that you can accelerate the comp trajectory even if the industry were to kind of return to where we've been?

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

Yes, Andrew, we see it kind of staying in that same range. I mean, again, accelerated, it's plus or minus a point, right? It's not been tremendously dramatic, although sometimes the response is. But yes, we see it being in that range.

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

Okay. And my other question was on the CapEx trajectory. You've said previously with respect to the remodels that you wouldn't return to kind of the prior peaks of CapEx. So is this kind of the high point from CapEx when we see it hold here for the next couple of quarters as that program goes forward? Or does it -- I'm just wondering about the trajectory over the next couple of years from a CapEx perspective.

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

Yes, Andrew, the reimage program, obviously, is driving the delta of that, and it is designed to be pretty consistent over those 3 years. It's -- the pacing is going to be relatively similar year-over-year.

Operator

Our next question today is coming from Brian Vaccaro.

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

Raymond James. Just back to the menu pricing. If you exclude the 100 bps impact of the loyalty impact you called out in the quarter, it looks like pricing was flat. Is that the right way to be thinking about pricing currently in the menu? And, Wyman, you spoke to a target getting back into sort of the mid-1s. When do you expect to get back to that level?

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

Brian, let me answer the first piece, and then Wyman can talk to the second. So about -- it was about -- menu pricing in the fourth quarter was about 90 basis points. So it was there but significantly lower than we had seen in previous quarters as we, again, try to maintain that price discipline.

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

And we should be close to that going forward. We're targeting that 1.5% range. And I think, give or take, some fluctuations and just timing of menu rollouts, we should be there pretty much first quarter on.

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

Okay. And sorry if I missed it, but what was wage inflation in the fiscal fourth quarter? And what's your expectation around wage inflation into fiscal '19?

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

Brian, you didn't miss it, but I will tell you. It was about 3% in the quarter. We expect wage price inflation to be in that 3% to 3.5% range as we kind of move through this year.

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

Okay, great. And then just one last one. [Affected] delivery at Chili's, can you remind us how many of the system units are currently covered by delivery and how many might be covered by the end of fiscal '19?

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

No, we don't have that level of detail for you, Brian. I'll just say we're actively testing in many restaurants with most of the major players. And then we support a lot of the major and minor players in restaurants as well, but we're actively learning from tests with the big players to understand, first, guest issues and acceptance and then business impacts. And we anticipate having a much better understanding, what is this -- where is delivery really mean, especially for Chili's. And we're talking about Chili's. Again, the Maggiano's delivery store is much more developed. It's a bigger part of the business. And we just need to get that level of understanding both from a guest and a business perspective. And we're working very aggressively to understand that in the next quarter or 2.

Operator

Our next question today is coming from John Ivankoe.

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

With JPMorgan. I wanted to try to piece together, I think, a couple of different things that were set on the call. Hopefully, I have the context right here. Wyman, in your prepared remarks, I think I heard you say that trends were continuing into the current quarter, and by that, you meant traffic outperformance relative to peers?

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

Correct.

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

Okay. And then looking at that first quarter, I mean, your nominal comparison, especially on a traffic basis, looked very, very easy. And certainly, hurricanes is playing part of that, but it was before you had really put together all the brand work, major promotional changes, loyalty changes, what have you. But did you say at another -- during another question that you expected same-store sales trends to be relatively consistent throughout the year? Did I hear that correctly?

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

No. We said, obviously, the first quarter where you're lapping some very significant weather impacts, you probably got a little bit of upside there. But then we do anticipate or project that we can continue to grow comp sales and traffic throughout the year.

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

Okay. So maybe first quarter above the annual range. I mean, I know we haven't lapped the hurricanes yet, but I guess something has to be above average, and presumably, that would be the first quarter given that comparison. What is your insight of what's happening with Texas and the other oil states that are around it? I know Malcolm will publish that Texas numbers now on a monthly basis considering they're so strong. But what is your insight into these markets? In particular, are there laps beyond the hurricanes that we should be sensitive to of coming into much more difficult numbers later in the year?

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

Yes, I think our experience with the oil markets is they have rebounded. Obviously, we were -- we're very well represented in those markets, and we're encouraged by the rebound that we're seeing in the markets and in our concepts in those markets. So I don't think that -- I think that, that -- they'll start to lap and settle in, but we're also seeing some pretty broad strength throughout the country, frankly. So we're not concerned about what happens when oil laps. It's not the only thing carrying our momentum, and we're excited about, actually, what we're seeing in other parts of the country as well.

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

And oftentimes, the best-performing restaurant markets, especially those without very high labor costs, are what's going to attract competition, well-branded, well-executed kind of small chain independent type of competition. I can think some of your markets have several of those. But what is your view on the level of competitive activity as it relates to new restaurant construction year-over-year, the viability of independents in some of your core markets?

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

Well, it's interesting. And I think, John, as you guys try and decipher kind of the macro numbers from Malcolm and from Black Box and then you evaluate the various earnings calls from the publicly traded large companies, I think you're seeing it the way I see it. It seems like on net, the large national brands are doing better than the basic, than the industry as represented in those -- at least in those 2 major trackers in casual dining. So I think the independents are -- they're struggling a little more than some people would actually like to acknowledge. And there's always going to be the hot item and the hot concept in whatever town you're in. But there's a lot of pressure on a lot of those smaller independents. And in the bar and grill category, they continue to make up a big piece of the industry. And they're not all the hot new sexy thing, and they're struggling, I think, with a lot of the headwinds that the industry is facing. And they don't have the leverage, the scale, the insight to deal with it. And I think we're putting a little bit pressure on them.

Operator

Our next question today is coming from Will Slabaugh.

Hugh Gordon Gooding - *Stephens Inc., Research Division - Research Associate*

Stephens. This is actually Hugh on for Will this morning. And going off of that last question, first, I was hoping you could give us some more color on the comp progression in 4Q. And then going back to that last question, just the insight on the quarter-to-date period. I know you said that traffic was outperforming versus peers early in the quarter, but realizing the broader industry looks to have slowed somewhat in the first month of the quarter-to-date period, it sounds like you really haven't seen this. I was just wondering if you felt that was more of your exposure to stronger markets or just these initiatives gaining traction?

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

I'll just in say, in general, you're probably asking for a level of detail that we're just probably not going to give with inter-period stuff. I mean, in general, we felt good about the continued kind of sequential improvement in the plans throughout the year quarter-by-quarter, improved traffic, improved sales at Chili's, especially the traffic momentum. And as we walk into this quarter, we continue to feel good about the progress we're seeing in the brand and the progression we're seeing. So the month-to-month, just not going to get into that level of detail.

Hugh Gordon Gooding - *Stephens Inc., Research Division - Research Associate*

Got it. And then just stepping back a little bit, when you look at the additional focus on value, the investments in food quality, kind of leveraging that growing loyalty base in the off-premise piece, what do you believe has been the earliest contributor to the same-store sales improvement at this point? And where do you see kind of the largest opportunity over the course of 2019?

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

Well, we've laid out kind of -- without giving you and anyone else, it could be seen a competitively too much insight, we're excited about the things that we've kind of put out there in terms of the base experience at Chili's, focusing on simplification, delivering a better guest experience, getting the food out hotter faster and then improving the recipes. We know that makes a difference in the quality of experience, and that's fundamental to anything we do moving forward. On top of that, we're very excited about the work that's been done and the momentum we're seeing in take-out. And we anticipate that we can continue to grow that business. And as I mentioned, it ended the quarter in double digits. So that and then the value proposition and how we bring that to the table and our ability to then market using all the different mediums or the things that we're excited about that the team is working hard to continue to leverage and differentiate relative to some of the competitors we're seeing out there.

Operator

We have no further questions in the queue.

Mika Ware

All right. Great. Thank you, Kate. We appreciate everyone joining us for the call today, and we look forward to updating you on our first quarter results in October. Have a wonderful day. Bye-bye.

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

Thanks, everyone.

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

Thanks.

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.
