RED ROBIN GOURMET BURGERS INC
Form 10-Q
August 11, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended July 9, 2006

or

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

For the transition period from to

Commission File Number: 0-49916

RED ROBIN GOURMET BURGERS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1573084**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6312 S. Fiddler s Green Circle, Suite 200N **Greenwood Village, CO**	**80111**
(Address of principal executive offices)	(Zip Code)

(303) 846-6000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at August 9, 2006**
Common Stock, $0.001 par value per share	16,553,730 shares

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PART I FINANCIAL INFORMATION

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RED ROBIN GOURMET BURGERS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

(Unaudited)

	July 9, 2006	December 25, 2005
Assets:		
Current Assets:		
Cash and cash equivalents	$ 5,609	$ 3,340
Accounts receivable, net	2,958	3,589
Inventories	6,981	6,485
Prepaid expenses and other current assets	3,537	5,340
Income tax refund receivable		1,516
Deferred tax asset	2,571	2,046
Restricted current assets marketing funds	900	1,548
Total current assets	22,556	23,864
Property and equipment, net	310,661	270,279
Deferred tax asset	4,884	4,129
Goodwill and intangible assets, net	32,904	33,092
Other assets, net	3,186	3,057
Total assets	$ 374,191	$ 334,421
Liabilities and Stockholders Equity:		
Current Liabilities:		
Trade accounts payable	$ 5,652	$ 5,675
Construction related payables	16,976	8,340
Accrued payroll and payroll related liabilities	21,661	17,459
Unredeemed gift certificates	4,680	7,273
Accrued liabilities	12,045	10,137
Accrued liabilities marketing funds	900	1,548
Current portion of long-term debt and capital lease obligations	1,562	2,861
Total current liabilities	63,476	53,293
Deferred rent	16,570	15,331
Long-term debt and capital lease obligations	64,271	55,663
Other non-current liabilities	5,456	5,275
Total liabilities	149,773	129,562
Commitments and contingencies		
Stockholders Equity:		
Common stock; $0.001 par value: 30,000,000 shares authorized; 16,534,127 and 16,474,224 shares issued and outstanding, respectively	17	16
Preferred stock, $0.001 par value: 3,000,000 shares authorized; no shares issued and outstanding		
Treasury stock, 11,517 shares, at cost	(83)	(83)
Paid-in capital	142,312	137,294
Accumulated other comprehensive income, net of tax		9
Retained earnings	82,172	67,623

Total stockholders equity	224,418	204,859
Total liabilities and stockholders equity	$ 374,191	$ 334,421

See notes to condensed consolidated financial statements.

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RED ROBIN GOURMET BURGERS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Twelve Weeks Ended		**Twenty-eight Weeks Ended**	
	July 9, 2006	**July 10, 2005**	**July 9, 2006**	**July 10, 2005**
Revenues:				
Restaurant revenue	$ 132,071	$ 110,832	$ 297,722	$ 247,815
Franchise royalties and fees	3,751	3,210	8,547	7,287
Rent revenue	38	62	124	211
Total revenues	135,860	114,104	306,393	255,313
Costs and expenses:				
Restaurant operating costs:				
Cost of sales	29,781	26,113	67,876	58,593
Labor (includes $201, $0, $478 and $0 of stock-based compensation expense, respectively)	45,649	37,567	103,189	83,468
Operating	20,177	16,318	45,510	36,927
Occupancy	7,858	6,789	17,931	15,640
Depreciation and amortization	7,381	5,957	16,503	13,243
General and administrative (includes $1,168, $59, $2,808 and $72 of stock-based compensation expense, respectively)	11,382	8,296	27,229	19,520
Pre-opening costs	1,912	992	4,155	2,812
Total costs and expenses	124,140	102,032	282,393	230,203
Income from operations	11,720	12,072	24,000	25,110
Other expense (income):				
Interest expense, net	937	704	2,007	1,519
Other	(19)	18	16	63
Total other expenses	918	722	2,023	1,582
Income before income taxes	10,802	11,350	21,977	23,528
Provision for income taxes	3,608	3,927	7,428	8,142
Net income	$ 7,194	$ 7,423	$ 14,549	$ 15,386
Earnings per share:				
Basic	$ 0.44	$ 0.46	$ 0.88	$ 0.95
Diluted	$ 0.43	$ 0.45	$ 0.87	$ 0.93
Weighted average shares outstanding:				
Basic	16,522	16,255	16,509	16,199
Diluted	16,727	16,679	16,719	16,619

See notes to condensed consolidated financial statements.

RED ROBIN GOURMET BURGERS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Twenty-eight Weeks Ended July 9, 2006	July 10, 2005
Cash Flows From Operating Activities:		
Net income	$ 14,549	$ 15,386
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,503	13,243
Stock-based compensation expense	3,286	72
Income tax benefit from exercise of stock options		1,791
Other, net	(990)	865
Changes in operating assets and liabilities	9,201	6,034
Cash provided by operating activities	42,549	37,391
Cash Flows From Investing Activities:		
Changes in marketing fund restricted cash	(707)	(145)
Purchases of property and equipment	(47,747)	(39,377)
Cash used in investing activities	(48,454)	(39,522)
Cash Flows From Financing Activities:		
Borrowings of long-term debt	12,638	9,301
Payments of long-term debt	(4,491)	(8,842)
Repayment of stockholders/officers notes		3,600
Proceeds from exercise of stock options and employee stock purchase plan	1,067	2,901
Excess tax benefit related to exercise of stock options	242	
Debt issuance costs	(446)	
Payments of other debt and capital lease obligations	(836)	(2,779)
Cash provided by financing activities	8,174	4,181
Net change in cash and cash equivalents	2,269	2,050
Cash and cash equivalents, beginning of period	3,340	4,980
Cash and cash equivalents, end of period	$ 5,609	$ 7,030
Supplemental Disclosure of Cash Flow Information:		
Income taxes paid	$ 5,974	$ 5,696
Interest paid, net of amounts capitalized	1,710	1,330
Supplemental Disclosure of Non-Cash Items:		
Purchases of property and equipment on account	$ 8,636	$ 1,760

See notes to condensed consolidated financial statements.

RED ROBIN GOURMET BURGERS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Recent Accounting Pronouncements

Red Robin Gourmet Burgers, Inc. (Red Robin or the Company), a Delaware corporation, develops and operates casual-dining restaurants. At July 9, 2006, the Company operated 180 company-owned restaurants located in 22 states. The Company also sells franchises, of which there were 142 restaurants in 25 states and two Canadian provinces as of July 9, 2006. The Company operates its business as one reportable segment.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Red Robin and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation. The Company s financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates included in the preparation of these financial statements pertain to impairment of long-lived assets, fixed asset lives, impairment of goodwill, estimated useful lives of other intangible assets, bonuses, self-insurance liabilities, stock-based compensation expense and income taxes. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of results for the full year. For further information, refer to the consolidated financial statements and notes included in the Company s annual report on Form 10-K for the year ended December 25, 2005.

The Company s quarter which ended July 9, 2006, is referred to as second quarter 2006, or the twelve weeks ended July 9, 2006; the first quarter ended April 16, 2006, is referred to as first quarter 2006, or the sixteen weeks ended April 16, 2006; and, together the first and second quarters of 2006 are referred to as the twenty-eight weeks ended July 9, 2006. The Company s quarter which ended July 10, 2005, is referred to as second quarter 2005, or the twelve weeks ended July 10, 2005; the first quarter ended April 17, 2005, is referred to as first quarter 2005, or the sixteen weeks ended April 17, 2005; and, together the first and second quarters of 2005 are referred to as the twenty-eight weeks ended July 10, 2005.

Reclassifications

Certain reclassifications have been made to prior year amounts in the Condensed Consolidated Statements of Cash Flows to conform to the current year presentation of changes in marketing fund restricted cash.

Stock Based Compensation

Effective December 26, 2005, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, (SFAS 123R), a revision of SFAS 123, *Accounting for Stock-Based Compensation*, (SFAS 123), using the modified prospective transition method and therefore has not retrospectively adjusted results for prior periods. Under this transition method, stock-based compensation expense for fiscal year 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of December 26, 2005, based on the grant date fair value estimated in accordance with the original provision of SFAS 123. Stock-based compensation expense for all stock-based compensation awards granted after December 26, 2005 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs on a graded vesting basis over the requisite service period of the award, which is generally the weighted option vesting term of three years. Prior to the adoption of SFAS 123R, the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R. See Note 2 to the Condensed Consolidated Financial Statements for a further discussion on stock-based compensation.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board s (FASB) issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a comprehensive financial statement model of how a company should recognize, measure, present, and disclose uncertain tax positions that the company has taken or expects to take in its income tax returns. FIN 48 requires that only income tax benefits that meet the more likely than not recognition threshold be recognized or continue to be recognized on the effective date. Initial derecognition amounts would be reported as a cumulative effect of a change in accounting principle. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is assessing the impact of the new guidance on all of our open tax positions and it is not expected to have a material impact on earnings, financial condition or cash flows.

In March 2006, the FASB Emerging Issues Task Force (EITF) issued Issue 06-3, *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* (EITF 06-3). A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. The Company presents sales net of sales taxes. EITF 06-3 will not impact the method for recording these sales taxes in the consolidated financial statements.

2. Stock-Based Compensation

The Company has four stock based compensation plans: the 1996 Stock Option Plan (the 1996 Stock Plan), the 2000 Management Performance Common Stock Option Plan (the 2000 Stock Plan), the 2002 Incentive Stock Option Plan (2002 Stock Plan) and the 2004 Performance Incentive Plan (the 2004 Stock Plan).

As of July 9, 2006, there are no remaining options authorized for grant under the 1996, 2000 or 2002 Stock Plans. In general, options granted under these plans were issued at the estimated fair market value at the date of grant. Vesting of awards under these plans were time based over a period of one to four years; however, in some cases, options under these plans vested based on the attainment of certain financial results. Options granted under these plans expire within ten years from the date of grant.

In 2004, stockholders approved the 2004 Stock Plan which authorizes stock options, stock appreciation rights, restricted stock, stock bonuses and other forms of awards granted or denominated in the Company s common stock or units of the Company s common stock, as well as cash bonus awards pursuant to the plan. Persons eligible to receive awards under the 2004 Stock Plan include officers or employees of the Company or any of the Company s subsidiaries, directors of the Company, and certain consultants and advisors to the Company or any of its subsidiaries. The maximum number of shares of the Company s common stock that may be issued or transferred pursuant to awards under the 2004 Stock Plan is equal to 2,697,613 shares. Vesting of the awards under the 2004 Stock Plan is determined at the date of grant by the plan administrator. Each award granted under the 2004 Stock Plan may, at the discretion of the plan administrator, become fully vested, exercisable, and/or payable, as applicable, upon a change in control event if the award will not be assumed or substituted for or otherwise continued after the event. Each award expires on such date as shall be determined at the date of grant, however, the maximum term of options, SARs and other rights to acquire common stock under the plan is ten years after the initial date of the award, subject to provisions for further deferred payment in certain circumstances. Any shares subject to awards under the 1996 Stock Plan, the 2000 Stock Plan, the 2002 Stock Plan and the 2004 Stock Plan that are not paid or exercised before they expire or are terminated will become available for other award grants under the 2004 Stock Plan. The 2004 Stock Plan terminates on April 12, 2014, if not sooner terminated by the Company s board of directors. Options are the only types of awards currently outstanding under the 2004 Stock Plan.

Effective December 26, 2005, the beginning of the first quarter of fiscal 2006, the Company adopted the fair value recognition provisions of SFAS 123R using the modified prospective transition method and, therefore, has not retrospectively adjusted prior periods results. Under this transition method, stock-based compensation expense in fiscal 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of, December 26, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all stock-based payment awards granted after December 26, 2005 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes these compensation costs net of a forfeiture rate and recognizes the compensation costs for only those shares expected to vest on a graded vesting basis over the requisite service period of the award, which is generally the weighted option vesting term of three years. The Company estimated the forfeiture rate based on its historical experience during the preceding four fiscal years.

Prior to December 26, 2005, the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), as if the fair value method defined by SFAS 123 had been applied to its stock-based compensation.

For the prior year s disclosure under SFAS 123, for the twelve and twenty-eight weeks ended July 10, 2005, the Company determined compensation costs based on the fair value at the date of grant for its stock options, net income and earnings per share reflected the following pro forma amounts (in thousands, except per share data):

	Twelve Weeks Ended July 10, 2005	**Twenty-eight Weeks Ended July 10, 2005**
Net income, as reported	$ 7,423	$ 15,386
Add: Stock-based employee compensation costs included in reported net income, net of tax benefit	39	47
Deduct: Stock-based employee compensation costs based on fair value method, net of tax benefit	(739)	(1,396)
Pro forma net income	$ 6,723	$ 14,037
Basic earnings per share:		
As reported	$ 0.46	$ 0.95
Pro forma	$ 0.41	$ 0.87
Diluted earnings per share:		
As reported	$ 0.45	$ 0.93
Pro forma	$ 0.40	$ 0.84

At July 9, 2006, the Company recognized total compensation expense related to all stock-based payment awards made to our employees and directors including employee stock option awards and employee stock purchases made under our Employee Stock Purchase Plan (ESPP) of $1.4 million and $3.3 million for the twelve and twenty-eight weeks ended July 9, 2006, respectively. Stock-based compensation capitalized as part of fixed assets was $122,000 and $151,000 for the twelve and twenty-eight weeks ended July 9, 2006. Prior to December 26, 2005, the Company accounted for those awards under the recognition and measurement provisions of APB 25. Accordingly, the Company generally recognized compensation expense only when it granted options with a discounted exercise price. Any resulting compensation expense was recognized ratably over the associated service period, which was generally the option vesting term.

The table below summarizes the status of the Company s stock based compensation plans:

	Shares (in thousands)	**Weighted Average Exercise Price**	**Weighted Average Remaining Years of Contractual Life**	**Aggregate Intrinsic Value (in thousands)**
Outstanding, as of December 25, 2005	1,110	$ 34.11		
Awards granted	324	41.78		
Awards forfeited or expired	(43)	42.53		
Awards exercised	(36)	12.97		
Outstanding, as of April 16, 2006	1,355	$ 36.24	8.39	$ 12,726
Awards granted	73	42.49		
Awards forfeited or expired	(19)	41.05		
Awards exercised	(18)	18.91		
Outstanding, as of July 9, 2006	1,391	$ 36.72	8.27	$ 12,263

Exercisable as of July 9, 2006	514	$	27.89	7.05	$	8,886
Vested and expected to vest as of July 9, 2006	1,278	$	36.15	8.19	$	11,973

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The weighted-average Black-Scholes fair value of options at their grant date during the twelve and twenty-eight weeks ended July 9, 2006 and July 10, 2005, where the exercise price equaled the market price on the grant date was $10.36, $11.20, $18.80 and $18.67, respectively. The total intrinsic value of options exercised during the twelve weeks ended July 9, 2006 and July 10, 2005 was $1.1 million and $3.7 million, respectively. For the twenty-eight weeks ended July 9, 2006 and July 10, 2005, the total intrinsic value of options exercised was $2.1 million and $5.0 million, respectively. As of July 9, 2006, there was $8.4 million of total unrecognized compensation cost, excluding estimated forfeitures, related to nonvested options granted under the Company s stock-based compensation plans. That cost is expected to be recognized over a weighted-average period of 1.4 years.

The estimated fair value of each option grant is calculated using the Black-Scholes multiple option-pricing model. The assumptions used in the model were as follows:

	Twelve Weeks Ended		Twenty-Eight Weeks Ended	
	July 9, 2006	July 10, 2005	July 9, 2006	July 10, 2005
Risk-free interest rate	5.1 %	3.8 %	4.8 %	4.0 %
Expected years until exercise	3.0	5.5	3.0	5.5
Expected stock volatility	38.2 %	30.3 %	36.2 %	31.2 %
Dividend yield	0.0 %	0.0 %	0.0 %	0.0 %

The risk-free interest rate was based on the rate for zero coupon U.S. Government issues with a remaining term similar to the expected life. The expected life of the options represents the period of time the options are expected to be outstanding and is based on historical trends. The expected stock price volatility represents an average of the Company s historical volatility measured over a period approximating the expected life. The dividend yield assumption is based on the Company s history and expectations of dividend payouts.

3. Borrowings

Borrowings at July 9, 2006 and December 25, 2005 are summarized below (in thousands):

	July 9, 2006	December 25, 2005
Revolving credit agreement	$ 50,211	$ 42,329
Capital lease obligations	10,102	10,064
Collateralized notes payable	5,520	6,131
	65,833	58,524
Current portion	(1,562)	(2,861)
Long-term debt	$ 64,271	$ 55,663

As of July 9, 2006 and December 25, 2005, borrowings under the revolving credit agreement bore interest at approximately 5.9% and 5.4%, respectively. Subsequent to July 9, 2006, the Company borrowed approximately $33.5 million in connection with the acquisition of 11 franchised Red Robin® restaurants in the state of Washington on July 10, 2006. See the discussion in Note 8.

The Company maintains an outstanding letter of credit to back the Company s self-insured workers compensation program. This letter of credit reduces the amount of future borrowings available under the revolving credit agreement. The amount outstanding under this letter of credit was $3.6 million at July 9, 2006 and December 25, 2005.

4. Earnings Per Share

Basic earnings per share amounts are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share amounts are calculated based upon the weighted-average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive shares are excluded from the computation in periods in which they have an anti-dilutive effect. Diluted earnings per share reflect the potential dilution that could occur if holders of options exercised their options into common stock. During the twelve and twenty-eight weeks ended July 9, 2006, respectively, approximately 847,000 and 741,000 stock options outstanding were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the period presented. During the twelve and twenty-eight weeks ended July 10, 2005, a total of 27,000 and 124,000 stock options outstanding were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the period presented. The Company uses the treasury stock method to calculate the impact of outstanding stock options. The computations for basic and diluted earnings per share are as follows (in thousands, except per share data):

	Twelve Weeks Ended		**Twenty-eight Weeks Ended**	
	July 9, 2006	**July 10, 2005**	**July 9, 2006**	**July 10, 2005**
Net income	$ 7,194	$ 7,423	$ 14,549	$ 15,386
Basic weighted-average shares outstanding	16,522			