

DARDEN RESTAURANTS INC

Form 10-Q

September 28, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 26, 2007

or

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

For the transition period from _____ to _____

1-13666

Commission File Number

DARDEN RESTAURANTS, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of incorporation or organization)

59-3305930

(I.R.S. Employer Identification No.)

5900 Lake Ellenor Drive,

Orlando, Florida

32809

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(Address of principal executive offices)

407-245-4000

(Zip Code)

(Registrant's telephone number, including area code)

Not Applicable

(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 No

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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares of common stock outstanding as of September 14, 2007: 141,894,388 (excluding 136,237,463 shares held in our treasury).

Table of Contents

DARDEN RESTAURANTS, INC.

TABLE OF CONTENTS

| | Page |
|---|-------------|
| Part I - <u>Financial Information</u> | |
| Item 1. <u>Financial Statements (Unaudited)</u> | 3 |
| <u>Consolidated Statements of Earnings</u> | 3 |
| <u>Consolidated Balance Sheets</u> | 4 |
| <u>Consolidated Statements of Changes in Stockholders' Equity and Accumulated Other Comprehensive Income (Loss)</u> | 5 |
| <u>Consolidated Statements of Cash Flows</u> | 6 |
| <u>Notes to Consolidated Financial Statements</u> | 7 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 14 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 24 |
| Item 4. <u>Controls and Procedures</u> | 24 |
| Part II - <u>Other Information</u> | |
| Item 1. <u>Legal Proceedings</u> | 25 |
| Item 1A. <u>Risk Factors</u> | 25 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 31 |
| Item 5. <u>Other Information</u> | 32 |
| Item 6. <u>Exhibits</u> | 32 |
| <u>Signatures</u> | 33 |
| <u>Index to Exhibits</u> | 34 |

Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****DARDEN RESTAURANTS, INC.****CONSOLIDATED STATEMENTS OF EARNINGS****(In millions, except per share data)****(Unaudited)**

| | Quarter Ended | |
|--|--------------------|--------------------|
| | August 26, 2007 | August 27, 2006 |
| Sales | \$ 1,467.5 | \$ 1,359.6 |
| Costs and expenses: | | |
| Cost of sales: | | |
| Food and beverage | 423.8 | 385.9 |
| Restaurant labor | 471.6 | 435.7 |
| Restaurant expenses | 216.9 | 204.7 |
| Total cost of sales, excluding restaurant depreciation and amortization of \$47.5 and \$45.7, respectively | \$ 1,112.3 | \$ 1,026.3 |
| Selling, general and administrative | 143.0 | 133.7 |
| Depreciation and amortization | 50.6 | 49.9 |
| Interest, net | 9.7 | 10.3 |
| Total costs and expenses | \$ 1,315.6 | \$ 1,220.2 |
| Earnings before income taxes | 151.9 | 139.4 |
| Income taxes | (45.3) | (46.1) |
| Earnings from continuing operations | 106.6 | 93.3 |
| Losses from discontinued operations, net of tax benefit of \$0.5 and \$4.1, respectively | (0.7) | (4.8) |
| Net earnings | \$ 105.9 | \$ 88.5 |
| Basic net earnings per share: | | |
| Earnings from continuing operations | \$ 0.76 | \$ 0.64 |
| Losses from discontinued operations | (0.01) | (0.03) |
| Net earnings | \$ 0.75 | \$ 0.61 |
| Diluted net earnings per share: | | |
| Earnings from continuing operations | \$ 0.73 | \$ 0.62 |
| Losses from discontinued operations | (0.01) | (0.03) |
| Net earnings | \$ 0.72 | \$ 0.59 |

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| | | |
|--|-------|-------|
| Average number of common shares outstanding: | | |
| Basic | 140.8 | 144.9 |
| Diluted | 146.2 | 150.3 |

See accompanying notes to consolidated financial statements.

Table of Contents

DARDEN RESTAURANTS, INC.
CONSOLIDATED BALANCE SHEETS

(In millions)

| | August 26, 2007 (Unaudited) | May 27, 2007 |
|---|--------------------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 47.3 | \$ 30.2 |
| Receivables, net | 31.3 | 46.4 |
| Inventories, net | 226.5 | 209.6 |
| Prepaid expenses and other current assets | 34.1 | 33.5 |
| Deferred income taxes | 72.6 | 81.7 |
| Assets held for sale | 140.8 | 144.0 |
| Total current assets | \$ 552.6 | \$ 545.4 |
| Land, buildings and equipment, net | 2,221.3 | 2,184.4 |
| Other assets | 152.7 | 151.0 |
| Non-current deferred income taxes | 5.2 | |
| Total assets | \$ 2,931.8 | \$ 2,880.8 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 210.2 | \$ 178.0 |
| Short-term debt | 179.5 | 211.4 |
| Accrued payroll | 95.5 | 108.5 |
| Accrued income taxes | 41.5 | 75.9 |
| Other accrued taxes | 44.4 | 43.4 |
| Unearned revenues | 93.4 | 109.9 |
| Other current liabilities | 294.1 | 305.0 |
| Liabilities associated with assets held for sale | 36.5 | 42.3 |
| Total current liabilities | \$ 995.1 | \$ 1,074.4 |
| Long-term debt, less current portion | 491.0 | 491.6 |
| Deferred income taxes | | 25.8 |
| Deferred rent | 128.6 | 127.1 |
| Other liabilities | 127.0 | 67.4 |
| Total liabilities | \$ 1,741.7 | \$ 1,786.3 |
| Stockholders' equity: | | |
| Common stock and surplus | \$ 1,926.7 | \$ 1,904.3 |
| Retained earnings | 1,900.2 | 1,820.4 |
| Treasury stock | (2,583.2) | (2,576.5) |
| Accumulated other comprehensive income (loss) | (33.5) | (32.8) |
| Unearned compensation | (19.9) | (20.6) |
| Officer notes receivable | (0.2) | (0.3) |
| Total stockholders' equity | \$ 1,190.1 | \$ 1,094.5 |
| Total liabilities and stockholders' equity | \$ 2,931.8 | \$ 2,880.8 |

See accompanying notes to consolidated financial statements.

Table of Contents**DARDEN RESTAURANTS, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND****ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)****For the three months ended August 26, 2007 and August 27, 2006****(In millions)****(Unaudited)**

| | Common Stock And Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Unearned Compensation | Officer Notes Receivable | Total Stockholders Equity |
|--|-----------------------------------|----------------------|-------------------|---|--------------------------|--------------------------------|---------------------------------|
| Balance at May 27, 2007 | \$ 1,904.3 | \$ 1,820.4 | \$ (2,576.5) | \$ (32.8) | \$ (20.6) | \$ (0.3) | \$ 1,094.5 |
| Comprehensive income: | | | | | | | |
| Net earnings | | 105.9 | | | | | 105.9 |
| Other comprehensive income (loss): | | | | | | | |
| Foreign currency adjustment | | | | 1.0 | | | 1.0 |
| Change in fair value of derivatives, net of tax of \$0.9 | | | | (2.6) | | | (2.6) |
| Amortization of unrecognized net actuarial loss, net of tax of \$0.6 | | | | 0.9 | | | 0.9 |
| Total comprehensive income | | | | | | | 105.2 |
| Adjustment related to adoption of FIN 48, net of tax of \$0.4 | | (0.7) | | | | | (0.7) |
| Cash dividends declared | | (25.4) | | | | | (25.4) |
| Stock option exercises (0.4 shares) | 7.6 | | 0.6 | | | | 8.2 |
| Stock-based compensation | 7.5 | | | | | | 7.5 |
| ESOP note receivable repayments | | | | | 0.7 | | 0.7 |
| Income tax benefits credited to equity | 5.8 | | | | | | 5.8 |
| Purchases of common stock for treasury (0.2 shares) | | | (7.6) | | | | (7.6) |
| Issuance of treasury stock under Employee Stock Purchase Plan and other plans (0.1 shares) | 1.5 | | 0.3 | | | | 1.8 |
| Repayment of officer notes | | | | | | 0.1 | 0.1 |
| Balance at August 26, 2007 | \$ 1,926.7 | \$ 1,900.2 | \$ (2,583.2) | \$ (33.5) | \$ (19.9) | \$ (0.2) | \$ 1,190.1 |

| | Common Stock And Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Unearned Compensation | Officer Notes Receivable | Total Stockholders Equity |
|-----------------------------|-----------------------------------|----------------------|-------------------|---|--------------------------|--------------------------------|---------------------------------|
| Balance at May 28, 2006 | \$ 1,806.4 | \$ 1,684.7 | \$ (2,211.2) | \$ (5.5) | \$ (44.2) | \$ (0.4) | \$ 1,229.8 |
| Comprehensive income: | | | | | | | |
| Net earnings | | 88.5 | | | | | 88.5 |
| Other comprehensive income: | | | | | | | |
| Foreign currency adjustment | | | | (0.1) | | | (0.1) |

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| | | | | | | | | |
|--|-------------------|-------------------|---------------------|-----------------|------------------|-----------------|-----------|-------------------|
| Change in fair value of derivatives, net of tax of \$0.8 | | | | 0.7 | | | | 0.7 |
| Total comprehensive income | | | | | | | | 89.1 |
| Stock option exercises (0.8 shares) | 8.3 | | 0.6 | | | | | 8.9 |
| Reclassification of unearned compensation due to adoption of SFAS No. 123(R) | (20.2) | | | | 20.2 | | | |
| Stock based compensation | 8.6 | | | | | | | 8.6 |
| ESOP note receivable repayments | | | | | 0.9 | | | 0.9 |
| Income tax benefits credited to equity | 9.0 | | | | | | | 9.0 |
| Purchases of common stock for treasury (2.3 shares) | | | (83.2) | | | | | (83.2) |
| Issuance of treasury stock under Employee Stock Purchase Plan and other plans (0.1 shares) | 1.2 | | 0.3 | | | | | 1.5 |
| Balance at August 27, 2006 | \$ 1,813.3 | \$ 1,773.2 | \$ (2,293.5) | \$ (4.9) | \$ (23.1) | \$ (0.4) | \$ | \$ 1,264.6 |

See accompanying notes to consolidated financial statements.

Table of Contents**DARDEN RESTAURANTS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In millions)****(Unaudited)**

| | Quarter Ended | |
|--|----------------------------|----------------------------|
| | August 26, 2007 | August 27, 2006 |
| Cash flows operating activities | | |
| Net earnings | \$ 105.9 | \$ 88.5 |
| Losses from discontinued operations, net of tax benefit | 0.7 | 4.8 |
| Adjustments to reconcile net earnings to cash flows: | | |
| Depreciation and amortization | 50.6 | 49.9 |
| Asset impairment, net | | 0.5 |
| Amortization of loan costs | 0.4 | 0.4 |
| Stock-based compensation expense | 8.4 | 8.4 |
| Change in current assets and liabilities | 21.4 | (32.9) |
| Contributions to postretirement plan | (0.2) | (0.2) |
| (Gain)/loss on disposal of land, buildings and equipment | 0.8 | 0.7 |
| Change in cash surrender value of trust owned life insurance | 1.7 | 0.1 |
| Deferred income taxes | (21.0) | (7.0) |
| Change in deferred rent | 1.5 | (5.3) |
| Change in other liabilities | (9.9) | (1.9) |
| Other, net | 0.8 | 1.6 |
| Net cash provided by operating activities of continuing operations | \$ 161.1 | \$ 107.6 |
| Cash flows investing activities | | |
| Purchases of land, buildings and equipment | (86.7) | (92.4) |
| Proceeds from disposal of land, buildings and equipment | 0.2 | 12.6 |
| Increase (decrease) in other assets | (5.5) | 0.4 |
| Net cash used in investing activities of continuing operations | \$ (92.0) | \$ (79.4) |
| Cash flows financing activities | | |
| Proceeds from issuance of common stock | 10.0 | 10.4 |
| Dividends paid | (25.4) | |
| Purchases of treasury stock | (7.6) | (83.2) |
| Income tax benefits credited to equity | 5.8 | 9.0 |
| (Payments) proceeds from issuance of short-term debt, net | (31.9) | 36.0 |
| ESOP note receivable repayment | 0.7 | 0.9 |
| Repayment of long-term debt | (0.7) | (0.9) |
| Net cash used in financing activities of continuing operations | \$ (49.1) | \$ (27.8) |
| Cash flows discontinued operations | | |
| Net cash (used in) provided by operating activities of discontinued operations | (2.6) | 5.9 |
| Net cash used in investing activities of discontinued operations | (0.3) | (3.1) |
| Net cash (used in) provided by discontinued operations | \$ (2.9) | \$ 2.8 |

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| | | |
|--|---------|-----------|
| Increase in cash and cash equivalents | 17.1 | 3.2 |
| Cash and cash equivalents beginning of period | 30.2 | 42.3 |
| Cash and cash equivalents end of period | \$ 47.3 | \$ 45.5 |
| Cash flows from changes in current assets and liabilities | | |
| Receivables, net | 14.6 | 8.2 |
| Inventories, net | (16.8) | (10.1) |
| Prepaid expenses and other current assets | (0.7) | (8.0) |
| Accounts payable | 32.2 | (16.4) |
| Accrued payroll | (13.0) | (27.8) |
| Accrued income taxes | 31.2 | 32.1 |
| Other accrued taxes | 1.0 | 1.8 |
| Unearned revenues | (16.5) | (14.2) |
| Other current liabilities | (10.6) | 1.5 |
| Change in current assets and liabilities | \$ 21.4 | \$ (32.9) |

See accompanying notes to consolidated financial statements.

Table of Contents

DARDEN RESTAURANTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

Darden Restaurants, Inc. (we, our or the Company) owns and operates casual dining restaurants in the United States and Canada under the trade names Red Lobster®, Olive Garden®, Bahama Breeze®, Smokey Bones Barbeque & Grill® and Seasons 52®. We have prepared these consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. They do not include certain information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the quarter ended August 26, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending May 25, 2008.

These statements should be read in conjunction with the consolidated financial statements and related notes to consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007. The accounting policies used in preparing these consolidated financial statements are the same as those described in our Form 10-K.

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements requires us 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 sales and expenses during the reporting period. Actual results could differ from those estimates.

During the fourth quarter of fiscal 2007, we announced our intent to close or hold for sale all Smokey Bones and Rocky River Grillhouse restaurants and, additionally, closed nine Bahama Breeze restaurants. Consistent with the discontinued operations reporting provisions of Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets and Emerging Issues Task Force Issue No. 03-13, Applying the Conditions in Paragraph 42 of SFAS No. 144 in Determining Whether to Report Discontinued Operations, we determined that we have discontinued or will discontinue all significant cash flows and continuing involvement with respect to these Smokey Bones, Rocky River Grillhouse and Bahama Breeze operations noted above and consider these to be discontinued operations. Therefore, for the quarters ended August 26, 2007 and August 27, 2006, all impairment charges and disposal costs, along with the sales, costs and expenses and income taxes attributable to these restaurants, have been aggregated in a single caption entitled Losses from discontinued operations, net of tax on our accompanying consolidated statements of earnings. We have not allocated any general corporate overhead to amounts presented in discontinued operations, nor have we elected to allocate interest costs. Assets and liabilities associated with these restaurants that are considered held for sale, have been segregated from continuing operations and presented as assets and liabilities held for sale on our accompanying consolidated balance sheets. See Note 3 Discontinued Operations for additional information.

Unless otherwise noted, amounts and disclosures throughout our Notes to Consolidated Financial Statements relate to our continuing operations.

Note 2. Acquisition of RARE Hospitality International, Inc.

On August 16, 2007, we announced that we had entered into an agreement to purchase the common stock of RARE Hospitality International, Inc. (RARE) through a tender offer for \$38.15 per share in cash, to be followed by a merger in which the remaining RARE shareholders would each receive \$38.15 per share in cash, or approximately \$1.4 billion in total purchase price, including payments to the holders of RARE's 2.5 percent convertible notes of approximately \$136.4 million (Acquisition). The Acquisition, which is subject to the satisfaction of customary closing conditions, including the condition that no less than a majority of the outstanding common stock of RARE be tendered, received unanimous approval by the boards of directors of both companies. The tender offer period commenced on August 31, 2007 and is expected to end on September 28, 2007, but may be extended under certain conditions. The merger is expected to be completed shortly thereafter. On September 13, 2007, Darden and RARE received notification from the Federal Trade Commission that it had granted early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

Table of Contents

DARDEN RESTAURANTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

To fund the Acquisition, on September 20, 2007, we entered into (i) a \$750.0 million revolving Credit Agreement dated as of September 20, 2007 (the New Revolving Credit Agreement) with Bank of America, N.A. (BOA), as administrative agent, and the lenders (the Revolving Credit Lenders) and other agents party thereto, and (ii) a \$1.15 billion 364-Day Credit Agreement dated as of September 20, 2007 (Interim Credit Agreement, and together with the New Revolving Credit Agreement, the New Credit Agreements) with BOA, as administrative agent, and the lenders party thereto. The New Credit Agreements are senior unsecured debt obligations of the Company. Both of the New Credit Agreements contain customary representations, affirmative and negative covenants (including limitations on liens and subsidiary debt, and a maximum consolidated lease adjusted total debt to total capitalization ratio of 0.75 to 1.00) and events of default usual for credit facilities of this type.

The Interim Credit Agreement requires mandatory prepayments in the event of asset sales or debt issuances, subject to certain exceptions and thresholds. The Interim Credit Agreement matures 364 days from the closing date. Up to the full amount of the Interim Credit Agreement may be converted into a revolving credit facility in order to support commercial paper issued to reduce the outstanding amount of the Interim Credit Agreement. Proceeds of the Interim Credit Agreement may only be used to finance the Acquisition and related fees and expenses, to repay certain existing debt and to support commercial paper issuances used to repay loans under the Interim Credit Agreement.

The New Revolving Credit Agreement matures on September 20, 2012, and the proceeds may be used for commercial paper back-up, working capital and capital expenditures, the refinancing of certain indebtedness, the partial financing of the Acquisition as well as general corporate purposes. The New Revolving Credit Agreement also contains a sub-limit of \$150.0 million for the issuance of letters of credit. The borrowings and letters of credit obtained under the New Revolving Credit Agreement may be denominated in U.S. Dollars, Euro, Sterling, Yen, Canadian Dollars and each other currency approved by the Revolving Credit Lenders. The Company may elect to increase the commitments under the New Revolving Credit Facility by up to \$250.0 million (to an aggregate amount of up to \$1.0 billion), subject to the Company obtaining commitments from new and existing lenders for the additional amounts.

The loans under the New Credit Agreements will bear interest at a rate of LIBOR plus a margin determined by reference to a ratings-based pricing grid, or the base rate (which is defined as the higher of the BOA prime rate and the Federal Funds rate plus 0.50 percent). We may also request that loans under the New Revolving Credit Agreement be made at interest rates offered by one or more of the Revolving Credit Lenders, which may vary from the LIBOR or base rate, for up to \$100.0 million of borrowings. Assuming a BBB equivalent credit rating level, the applicable margin under the Interim Credit Facility will be 0.32 percent, and the applicable margin under the Revolving Credit Facility will be 0.35 percent. The New Credit Agreements require that we pay a facility fee on the total amount of such facility (ranging from 0.070 percent to 0.175 percent, based on our ratings) and, in the event that the outstanding amounts under the applicable New Credit Agreement exceed 50 percent of such New Credit Agreement, a utilization fee on the total amount outstanding under such facility (ranging from 0.050 percent to 0.150 percent, based on our ratings). As of September 20, 2007, \$175.0 million was outstanding under the New Revolving Credit Agreement. The Interim Credit Agreement will become available to us upon the consummation of (and will be used to fund the purchase of shares pursuant to) the tender offer that is part of the Acquisition. The New Revolving Credit Agreement replaced our Prior Credit Agreement, which was terminated effective September 20, 2007.

Note 3. Discontinued Operations

On April 28, 2007, we closed nine under-performing Bahama Breeze restaurants to focus more on the profitable locations and position the concept for new unit growth. On May 5, 2007, we announced the closure of 54 Smokey Bones and two Rocky River Grillhouse restaurants as well as our intention to offer for sale the remaining 73 operating Smokey Bones restaurants.

For the quarters ended August 26, 2007 and August 27, 2006, all impairment charges and disposal costs, along with the sales, costs and expenses and income taxes attributable to these restaurants, have been aggregated in a single caption entitled Losses from discontinued operations, net of tax on our consolidated statements of earnings for all periods presented. Losses from discontinued operations, net of tax on our accompanying consolidated statements of earnings are comprised of the following:

Table of Contents**DARDEN RESTAURANTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

| (in millions) | Quarter Ended | |
|---|-----------------|-----------------|
| | August 26, 2007 | August 27, 2006 |
| Sales | \$ 52.9 | \$ 96.3 |
| Losses before income taxes | \$ (1.2) | \$ (8.9) |
| Income tax benefits | 0.5 | 4.1 |
| Losses from discontinued operations, net of tax | \$ (0.7) | \$ (4.8) |

The following is a detail of the assets and liabilities associated with the restaurants reported as discontinued operations and classified as held for sale on our accompanying consolidated balance sheets as of August 26, 2007 and May 27, 2007 at fair value:

| (in millions) | August 26, 2007 | May 27, 2007 |
|------------------------------------|-----------------|--------------|
| Current assets | \$ 41.3 | \$ 44.6 |
| Land, buildings and equipment, net | 97.2 | 97.1 |
| Other assets | 2.3 | 2.3 |
| Total assets | \$ 140.8 | \$ 144.0 |
| Current liabilities | \$ 31.2 | \$ 37.1 |
| Other liabilities | 5.3 | 5.2 |
| Total liabilities | \$ 36.5 | \$ 42.3 |

The following is a reconciliation of accrued exit and disposal costs from May 27, 2007 to August 26, 2007, which are included in liabilities held for sale on the accompanying consolidated balance sheets and are expected to be paid in fiscal 2008:

| (in millions) | Balance at | | | Balance at August 26, 2007 |
|-------------------------|--------------|----------|-------------|-------------------------------|
| | May 27, 2007 | Payments | Adjustments | |
| Lease termination costs | \$ 6.2 | \$ | \$ (1.2) | \$ 5.0 |
| Other exit costs | 1.0 | | (0.2) | 0.8 |
| | \$ 7.2 | \$ | \$ (1.4) | \$ 5.8 |

Note 4. Consolidated Statements of Cash Flows

During the quarter ended August 26, 2007, we paid \$12.9 million for interest (net of amounts capitalized) and \$28.8 million for income taxes. Interest income of \$0.1 million associated with our cash and cash equivalents was recognized in earnings as a component of interest, net, during the quarter ended August 26, 2007. During the quarter ended August 27, 2006, we paid \$11.6 million for interest (net of amounts capitalized) and \$8.6 million for income taxes. Interest income of \$0.1 million associated with our cash and cash equivalents and short-term investments was recognized in earnings as a component of interest, net, during the quarter ended August 27, 2006.

Note 5. Stock-Based Compensation

Effective May 29, 2006, we adopted the provisions of SFAS No. 123(R), Share-Based Payment, which requires companies to recognize in the financial statements the cost of employee services received in exchange for awards of equity instruments based on the grant date fair value of those awards. We adopted SFAS No. 123(R) according to the modified prospective transition method and use the Black-Scholes option pricing model to estimate the fair value of awards. Under the modified prospective transition method, we recognize compensation expense on a straight-line basis over the remaining employee service period for new awards granted after the effective date of SFAS No. 123(R) and for unvested awards granted prior to the effective date of SFAS No. 123(R). In accordance with the modified prospective transition method, financial statements issued for periods prior to the adoption of SFAS No. 123(R) in fiscal 2007 have not been restated.

Table of Contents**DARDEN RESTAURANTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The weighted-average fair value of options granted and the related assumptions used in the Black-Scholes option pricing model as of August 26, 2007 and August 27, 2006 were as follows:

| | Stock Options Granted | |
|------------------------------|--------------------------------------|------------------------|
| | During the Three Months Ended | |
| | August 26, 2007 | August 27, 2006 |
| Weighted-average fair value | \$ 14.84 | \$ 13.72 |
| Risk-free interest rate | 4.63% | 5.08% |
| Expected volatility of stock | 32.6% | 34.5% |
| Dividend yield | 1.59% | 1.30% |
| Expected option life | 6.4 years | 6.4 years |

The following table presents a summary of our stock-based compensation activity for the quarter ended August 26, 2007:

| (in millions) | Options | Restricted Stock/ Restricted Stock Units | Darden Stock Units | Performance Stock Units |
|---------------------------------|----------------|---|-------------------------------|------------------------------------|
| Outstanding beginning of period | 16.1 | 1.2 | 1.0 | 0.3 |
| Awards granted | 1.3 | 0.1 | 0.2 | 0.3 |
| Awards exercised | (0.4) | (0.2) | | (0.1) |
| Awards cancelled | (0.2) | (0.1) | | |
| Outstanding end of period | 16.8 | 1.0 | 1.2 | 0.5 |

During the quarters ended August 26, 2007 and August 27, 2006, we recognized expense from stock-based compensation as follows:

| (in millions) | Quarter Ended | |
|---|------------------------|------------------------|
| | August 26, 2007 | August 27, 2006 |
| Stock Options | \$ 3.2 | \$ 4.2 |
| Restricted Stock/Restricted Stock Units | 1.1 | 1.5 |
| Darden Stock Units | 1.4 | 0.3 |
| Performance Stock Units | 2.3 | 2.1 |
| Employee Stock Purchase Plan/Other | 0.4 | 0.3 |
| | \$ 8.4 | \$ 8.4 |

Note 6. Income Taxes

The effective income tax rate for the quarter ended August 26, 2007 was 29.8 percent compared to an effective income tax rate of 33.1 percent for the quarter ended August 27, 2006. The decrease in the effective tax rate in fiscal 2008 is primarily attributable to a decrease in our state and federal effective income tax rates during the first quarter of fiscal 2008 resulting from the favorable resolution of prior year tax matters expensed

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in prior years. Additionally, our state effective income tax rate decreased from the first quarter of fiscal 2007 to the first quarter of fiscal 2008 because of an increase in state income tax liabilities during the first quarter of fiscal 2007 related to uncertain income tax positions.

Effective May 28, 2007 we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 requires that a position taken or expected to be taken in a tax return be recognized (or derecognized) in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

Upon adoption, we recognized an additional liability of \$1.1 million (\$0.7 million after tax) for uncertain tax positions, including interest, which was accounted for as a cumulative decrease to the balance of beginning retained earnings. As of the date of, and after recognizing the impact of, the adoption of FIN 48, we had gross unrecognized tax benefits, which represent the aggregate tax effect of differences between tax return positions and

Table of Contents

DARDEN RESTAURANTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

benefits recognized in our consolidated financial statements, totaling \$64.1 million, which were reclassified from income taxes payable to other non-current liabilities upon adoption of FIN 48. Of this total, approximately \$39.6 million, after considering the federal impact on state issues, would favorably affect the effective tax rate if resolved in our favor.

We recognize accrued interest related to unrecognized tax benefits in interest expense. Penalties, if incurred, would be recognized in income tax expense. The Company had approximately \$5.1 million for the payment of interest accrued as of the date of adoption and after recognizing the impact of FIN 48. No amounts have been accrued for the payment of penalties.

The major jurisdictions in which the Company files income tax returns include the U.S. federal jurisdiction, Canada, and most states in the U.S. that have an income tax. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for fiscal years prior to 2004 and, with a few exceptions, state and local, or non-U.S. income tax examinations by tax authorities for fiscal years prior to 1999.

Included in the balance of unrecognized tax benefits at May 28, 2007 is \$6.4 million related to tax positions for which it is reasonably possible that the total amounts could materially change during the next twelve months based on the outcome of examinations, or as a result of the expiration of statute of limitations for specific jurisdictions.

Note 7. Long-Term Debt

Until September 20, 2007, we maintained a credit facility under a Credit Agreement dated August 16, 2005 (Prior Credit Agreement) with a consortium of banks under which we could borrow up to \$500.0 million. As part of the Prior Credit Agreement, we could request issuance of up to \$100.0 million in letters of credit, the outstanding amount of which reduced the net borrowing capacity under the agreement. The Prior Credit Agreement allowed us to borrow at interest rates that varied based on a spread over (i) LIBOR or (ii) a base rate that was the higher of the prime rate or one-half of one percent above the federal funds rate, at our option. The interest rate spread over LIBOR was determined by our debt rating. We could also request that loans be made at interest rates offered by one or more of the banks, which may have varied from the LIBOR or base rate. The Prior Credit Agreement supported our commercial paper borrowing program and would have expired on August 15, 2010, but was terminated on September 20, 2007 in connection with the new credit arrangements described below. We were required to pay a facility fee of 10 basis points per annum on the average daily amount of loan commitments by the consortium. The amount of interest and annual facility fee were subject to change based on our maintenance of certain debt ratings and financial ratios, such as maximum debt to capital ratios. Advances under the Prior Credit Agreement were unsecured. As of August 26, 2007 we had borrowings of \$100.0 million outstanding under the Prior Credit Agreement. At May 27, 2007, no borrowings under the Prior Credit Agreement were outstanding. As of August 26, 2007, there was \$79.5 million of commercial paper and no letters of credit outstanding, which were backed by this facility. As of August 26, 2007, we were in compliance with all covenants under the Prior Credit Agreement.

To fund the Acquisition, we have entered into the New Credit Agreements discussed in Note 2 Acquisition of RARE Hospitality International, Inc., consisting of a revolving line of credit of \$750.0 million that replaced the Prior Credit Agreement, and a \$1.15 billion interim financing facility to be funded upon consummation of the tender offer. Following the Acquisition, we intend to refinance the interim financing facility with proceeds from one or more offerings of long-term notes. In September 2007, we entered into treasury-lock derivative instruments with \$300.0 million of notional value to hedge the risk of changes in the benchmark interest rate prior to the issuance of these notes, as changes in the benchmark interest rate will cause variability in our forecasted interest payments. See Note 2 for additional information regarding the Acquisition and the New Credit Agreements.

Note 8. Net Earnings per Share

Outstanding stock options and restricted stock granted by us represent the only dilutive effect reflected in diluted weighted average shares outstanding. Options and restricted stock do not impact the numerator of the diluted net earnings per share computation. Options to purchase 2.3 million and 3.2 million shares of our common stock were excluded from the calculation of diluted net earnings per share for the quarters ended August 26, 2007 and August 27, 2006, respectively, because the effect would have been anti-dilutive.

Table of Contents**DARDEN RESTAURANTS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Note 9. Stockholders' Equity**

Pursuant to the authorization of our Board of Directors to repurchase up to 162.4 million shares of our common stock in accordance with applicable securities law, we repurchased 0.2 million shares of our common stock for \$7.6 million during the quarter ended August 26, 2007, resulting in a cumulative repurchase of 142.1 million shares as of August 26, 2007.

Note 10. Retirement Plans

Components of net periodic benefit cost are as follows:

| (in millions) | Defined Benefit Plans Quarter Ended | | Postretirement Benefit Plan Quarter Ended | |
|---|--|--------------------|--|--------------------|
| | August 26, 2007 | August 27, 2006 | August 26, 2007 | August 27, 2006 |
| Service cost | \$ 1.5 | \$ 1.5 | \$ 0.1 | \$ 0.1 |
| Interest cost | 2.4 | 2.2 | 0.3 | 0.3 |
| Expected return on plan assets | (3.7) | (3.4) | | |
| Amortization of unrecognized prior service cost | | | | |
| Recognized net actuarial loss | 1.1 | 1.4 | 0.1 | 0.1 |
| Net periodic benefit cost | \$ 1.3 | \$ 1.7 | \$ 0.5 | \$ 0.5 |

Note 11. Commitments and Contingencies

As collateral for performance on contracts and as credit guarantees to banks and insurers, we are contingently liable pursuant to guarantees of subsidiary obligations under standby letters of credit. As of August 26, 2007 and May 27, 2007, we had \$58.1 million and \$75.0 million, respectively, of standby letters of credit related to workers' compensation and general liabilities accrued in our consolidated financial statements. As of August 26, 2007 and May 27, 2007, we also had \$9.6 million and \$10.4 million, respectively, of standby letters of credit related to contractual operating lease obligations and other payments. All standby letters of credit are renewable annually.

We are subject to private lawsuits, administrative proceedings and claims that arise in the ordinary course of our business. A number of these lawsuits, proceedings and claims may exist at any given time. These matters typically involve claims from guests, employees and others related to operational issues common to the restaurant industry and can also involve infringement of, or challenges to, our trademarks. While the resolution of a lawsuit, proceeding or claim may have an impact on our financial results for the period in which it is resolved, we believe that the final disposition of the lawsuits, proceedings and claims in which we are currently involved, either individually or in the aggregate, will not have a material adverse effect on our financial position, results of operations or liquidity. The following is a brief description of the more significant of these matters. In view of the inherent uncertainties of litigation, the outcome of any unresolved matters described below cannot be predicted at this time, nor can the amount of any potential loss be reasonably estimated.

Like other restaurant companies and retail employers, we have been faced in a few states with allegations of purported class-wide wage and hour violations. In January 2004, a former food server filed a purported class action in California state court alleging that Red Lobster's server banking policies and practices (under which servers settle guest checks directly with customers throughout their shifts, and turn in collected monies at the shift's end) improperly required her and other food servers and bartenders to make up cash shortages and walkouts in violation of California law. The case was ordered to arbitration. As a procedural matter, the arbitrator ruled that class-wide arbitration is permissible under our dispute resolution program. We have filed a petition opposing the arbitrator's decision; no decision on the petition has yet been rendered and no class has been certified. In January 2007, plaintiffs' counsel filed in California state court a second purported class action lawsuit on behalf of servers and

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bartenders alleging that Olive Garden's server banking policy and its alleged failure to pay split shift premiums violated California law. We believe that our policies and practices were lawful and that we have strong defenses to both cases.

In August 2007, an action was filed in California state court by a former Olive Garden server alleging that Olive Garden's scheduling practices resulted in failure to properly pay reporting time (minimum shift) pay as well as to pay minimum wage, to provide itemized wage statements, and to timely pay employees upon the termination of

Table of Contents

DARDEN RESTAURANTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

their employment. The complaint seeks to have the suit certified as a class action; however, no class has been certified to date. We intend to defend ourselves vigorously against this claim and have removed the case to federal court, and filed motions to dismiss the case.

Note 12. Application of New Accounting Standards

In September 2006, the FASB issued SFAS No. 157, Fair Value Measures. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, which will require us to adopt these provisions in fiscal 2009. We are currently evaluating the impact SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, which will require us to adopt these provisions in fiscal 2009. We are currently evaluating the impact SFAS No. 159 will have on our consolidated financial statements.

Note 13. Subsequent Event

On September 14, 2007, the Board of Directors declared a cash dividend of eighteen cents per share to be paid November 1, 2007 to all shareholders of record as of the close of business on October 10, 2007.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The discussion and analysis below for the Company should be read in conjunction with the unaudited financial statements and the notes to such financial statements included elsewhere in this Form 10-Q. The discussion below contains forward looking statements which should be read in conjunction with Forward-Looking Statements included elsewhere in this Form 10-Q. The following table sets forth selected operating data as a percent of sales for the periods indicated. All information is derived from the consolidated statements of earnings for the quarters ended August 26, 2007 and August 27, 2006.

| | Quarter Ended | |
|--|--------------------|--------------------|
| | August 26, 2007 | August 27, 2006 |
| Sales | 100.0% | 100.0% |
| Costs and expenses: | | |
| Cost of sales: | | |
| Food and beverage | 28.9 | 28.4 |
| Restaurant labor | 32.1 | 32.0 |
| Restaurant expenses | 14.8 | 15.0 |
| Total cost of sales, excluding restaurant depreciation and amortization of 3.2% and 3.4%, respectively | 75.8% | 75.4% |
| Selling, general and administrative | 9.7 | 9.8 |
| Depreciation and amortization | 3.5 | 3.7 |
| Interest, net | 0.7 | 0.8 |
| Total costs and expenses | 89.7% | 89.7% |
| Earnings before income taxes | 10.3 | 10.3 |
| Income taxes | (3.1) | (3.4) |
| Earnings from continuing operations | 7.2 | 6.9 |
| Losses from discontinued operations | | (0.4) |
| Net earnings | 7.2% | 6.5% |

OVERVIEW OF OPERATIONS

Our sales from continuing operations were \$1.47 billion for the first quarter of fiscal 2008, compared to \$1.36 billion for the first quarter of fiscal 2007. The 7.9 percent increase in sales for the first quarter of fiscal 2008 were driven primarily by increased U.S. same-restaurant sales at Olive Garden and Red Lobster and a net increase of 36 company-owned restaurants since the first quarter of fiscal 2007, excluding restaurants reported as discontinued operations. For the first quarter of fiscal 2008, our net earnings from continuing operations were \$106.6 million compared to \$93.3 million for the first quarter of fiscal 2007, a 14.2 percent increase, and our diluted net earnings per share from continuing operations were \$0.73 for the first quarter of fiscal 2008 compared to \$0.62 for the first quarter of fiscal 2007, a 17.7 percent increase.

Olive Garden reported its 52nd consecutive quarter of U.S. same-restaurant sales growth during the first quarter of fiscal 2008, with a 4.8 percent increase. Olive Garden has opened 37 net new restaurants since the first quarter of fiscal 2007, while increasing U.S. same-restaurant sales. Red Lobster's U.S. same-restaurant sales for the first quarter of fiscal 2008 increased 7.0 percent. Red Lobster continued to improve many aspects of its business as they prepared to increase new restaurant growth. Bahama Breeze's same-restaurant sales decreased 1.3 percent in the first quarter of fiscal 2008. Bahama Breeze continues to build its site pipeline for new restaurant growth.

On August 16, 2007, we announced that we had entered into an agreement to purchase the common stock of RARE Hospitality International, Inc. (RARE) through a tender offer for \$38.15 per share in cash, to be followed by a merger in which the remaining RARE shareholders would each receive \$38.15 per share in cash, or approximately \$1.4 billion in total purchase price, including payments to the holders of RARE's 2.5 percent convertible notes of

Table of Contents

approximately \$136.4 million. The acquisition, which is subject to the satisfaction of customary closing conditions, including the condition that no less than a majority of the outstanding common stock of RARE be tendered, received unanimous approval by the boards of directors of both companies. The tender offer period commenced on August 31, 2007 and is expected to end on September 28, 2007, but may be extended under certain conditions. The merger is expected to be completed shortly thereafter. On September 13, 2007, Darden and RARE received notification from the Federal Trade Commission that it had granted early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

To fund the acquisition, we have entered into a revolving line of credit of \$750.0 million that replaced our prior \$500.0 million revolving line of credit, and a \$1.15 billion interim financing facility to be funded upon consummation of the tender offer, as discussed in the Liquidity and Capital Resources section below. Following the acquisition, we intend to refinance the interim financing facility with proceeds from one or more offerings of long-term notes. In September 2007, we entered into treasury-lock derivative instruments with \$300.0 million of notional value to hedge the risk of changes in the benchmark interest rate prior to the issuance of these notes, as changes in the benchmark interest rate will cause variability in our forecasted interest payments.

SALES

Sales from continuing operations were \$1.47 billion and \$1.36 billion for the quarters ended August 26, 2007 and August 27, 2006, respectively. The 7.9 percent increase in sales for the first quarter of fiscal 2008 was primarily due to increased U.S. same-restaurant sales at Red Lobster and Olive Garden and a net increase of 36 company-owned restaurants since the first quarter of fiscal 2007. Olive Garden's sales of \$749.9 million were 9.6 percent above last year's first quarter, driven primarily by a 4.8 percent increase in U.S. same-restaurant sales and its 37 net new restaurants in operation since the first quarter of last year. Olive Garden achieved its 52nd consecutive quarter of U.S. same-restaurant sales growth primarily as a result of a 3.4 percent increase in average check and a 1.4 percent increase in same-restaurant guest counts. Red Lobster's sales of \$669.5 million were 6.3 percent above last year's first quarter, which resulted primarily from a 7.0 percent increase in U.S. same-restaurant sales, partially offset by a net decrease of three company-owned restaurants since the first quarter of last year. The increase in U.S. same-restaurant sales resulted primarily from a 3.6 percent increase in average check, and a 3.4 percent increase in same-restaurant guest counts. Bahama Breeze sales of \$37.2 million decreased \$0.5 million compared to last year's first quarter, driven by a 1.3 percent decrease in same-restaurant sales.

COSTS AND EXPENSES

Total costs and expenses were \$1.32 billion and \$1.22 billion for the quarters ended August 26, 2007 and August 27, 2006, respectively. As a percent of sales, total costs and expenses remained flat in the first quarter of fiscal 2008 as compared to the first quarter of fiscal 2007.

Food and beverage costs were \$423.8 million during the first quarter of fiscal 2008, an increase of \$37.9 million, or 9.9 percent, from food and beverage costs of \$385.9 million during the first quarter of fiscal 2007. As a percent of sales, food and beverage costs increased in the first quarter of fiscal 2008 primarily as a result of menu mix changes related to the timing of Olive Garden and Red Lobster promotions and costs associated with the introduction of non-trans fat oils in our restaurants. Restaurant labor costs were \$471.6 million during the first quarter of fiscal 2008, an increase of \$35.9 million, or 8.2 percent, from restaurant labor costs of \$435.7 million during the first quarter of fiscal 2007. As a percent of sales, restaurant labor costs increased in the first quarter of fiscal 2008 primarily as a result of an increase in wage rates and manager compensation. Restaurant expenses (which include lease, property tax, maintenance, credit card, utility, workers' compensation, insurance, new restaurant pre-opening and other restaurant-level operating expenses) were \$216.9 million during the first quarter of fiscal 2008, an increase of \$12.2 million, or 6.0 percent, from restaurant expenses of \$204.7 million during the first quarter of fiscal 2007. As a percent of sales, restaurant expenses decreased in the first quarter of fiscal 2008 primarily as a result of lower workers' compensation and public liability expenses compared to last year resulting from our improved safety performance in the restaurants and increased sales leverage at Olive Garden and Red Lobster.

Selling, general and administrative expenses were \$143.0 million during the first quarter of fiscal 2008, an increase of \$9.3 million, or 7.0 percent, from selling, general and administrative expenses of \$133.7 million during the first quarter of fiscal 2007. As a percent of sales, selling, general and administrative expenses decreased slightly in the first quarter of fiscal 2008 primarily as increased sales leverage at Olive Garden and Red Lobster was partially offset by an increase in general and administrative expenses.

Table of Contents

Depreciation and amortization expense was \$50.6 million during the first quarter of fiscal 2008, an increase of \$0.7 million, or 1.4 percent, from depreciation and amortization expense of \$49.9 million during the first quarter of fiscal 2007. As a percent of sales, depreciation and amortization expense decreased slightly between the first quarter of fiscal 2008 and the first quarter of fiscal 2007 as new restaurant activity was offset by increased sales leverage at Olive Garden and Red Lobster.

Net interest expense was \$9.7 million during the first quarter of fiscal 2008, a decrease of \$0.6 million, or 5.8 percent, from interest expense of \$10.3 million during the first quarter of fiscal 2007. As a percent of sales, net interest expense decreased between the first quarter of fiscal 2008 and the first quarter of fiscal 2007 due mainly to increased sales leverage and lower interest expense.

INCOME TAXES

The effective income tax rate for the first quarter of fiscal 2008 was 29.8 percent compared to an effective income tax rate of 33.1 percent in the first quarter of fiscal 2007. The rate decrease in fiscal 2008 was primarily attributable to a decrease in our effective state and federal effective income tax rates during the first quarter of fiscal 2008 resulting from the favorable resolution of prior year tax matters expensed in prior years. Additionally, our state effective income tax rate decreased from the first quarter of fiscal 2007 to the first quarter of fiscal 2008 because of an increase in state income tax liabilities during the first quarter of fiscal 2007 related to uncertain income tax positions.

NET EARNINGS AND NET EARNINGS PER SHARE FROM CONTINUING OPERATIONS

For the first quarter of fiscal 2008, our net earnings from continuing operations were \$106.6 million compared to \$93.3 million in the first quarter of fiscal 2007, a 14.2 percent increase, and our diluted net earnings per share from continuing operations were \$0.73 compared to \$0.62 in the first quarter of fiscal 2007, a 17.7 percent increase. At Olive Garden, increased sales and lower selling, general and administrative expenses and depreciation and amortization expenses as a percent of sales partially offset increased food and beverage costs, restaurant labor costs and restaurant expenses as a percent of sales. As a result, operating profit increased for Olive Garden in the first quarter of fiscal 2008, although, as a percent of sales, operating profit decreased from fiscal 2007. At Red Lobster, increased sales and lower restaurant labor costs, restaurant expenses and depreciation and amortization expenses as a percent of sales more than offset higher food and beverage costs and selling, general and administrative expense as a percent of sales. As a result, Red Lobster had an operating profit increase in the first quarter of fiscal 2008 compared to the first quarter of fiscal 2007. The increase in both our net earnings and diluted net earnings per share for the first quarter of fiscal 2008 was primarily due to increased U.S. same-restaurant sales at Red Lobster and Olive Garden, new restaurant growth and decreases in our consolidated restaurant expenses, selling, general and administrative expenses, depreciation and amortization expenses and net interest expense as a percent of sales, which more than offset increased food and beverage costs and restaurant labor costs as a percent of sales.

LOSSES FROM DISCONTINUED OPERATIONS

On an after-tax basis, losses from discontinued operations for the first quarter of fiscal 2008 were \$0.7 million (\$0.01 per diluted share) compared with losses from discontinued operations for the first quarter of fiscal 2007 of \$4.8 million (\$0.03 per diluted share). During the first quarter of fiscal 2007, we recorded \$4.1 million of long-lived asset impairment charges related to three Smokey Bones restaurants.

SEASONALITY

Our sales volumes fluctuate seasonally. During fiscal 2007, 2006 and 2005, our sales were highest in the spring and winter, followed by the summer, and lowest in the fall. Holidays, severe weather and similar conditions may impact sales volumes in some operating regions. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

Table of Contents**NUMBER OF RESTAURANTS**

The following table details the number of restaurants currently reported in continuing operations that were open at the end of the first quarter of fiscal 2008, compared with the number open at the end of fiscal 2007 and the end of the first quarter of fiscal 2007.

| | August 26, 2007 | May 27, 2007 | August 27, 2006 |
|---------------------|-----------------|--------------|-----------------|
| Red Lobster USA | 651 | 651 | 652 |
| Red Lobster Canada | 29 | 29 | 31 |
| Total | 680 | 680 | 683 |
| Olive Garden USA | 615 | 608 | 578 |
| Olive Garden Canada | 6 | 6 | 6 |
| Total | 621 | 614 | 584 |
| Bahama Breeze | 23 | 23 | 23 |
| Seasons 52 | 7 | 7 | 5 |
| Total | 1,331 | 1,324 | 1,295 |

LIQUIDITY AND CAPITAL RESOURCES

Cash flows generated from operating activities provide us with a significant source of liquidity, which we use to finance the purchases of land, buildings and equipment, to pay dividends and to repurchase shares of our common stock. Since substantially all of our sales are for cash and cash equivalents and accounts payable are generally due in five to 30 days, we are able to carry current liabilities in excess of current assets. In addition to cash flows from operations, we use a combination of long-term and short-term borrowings to fund our capital needs.

We currently manage our business and our financial ratios to maintain an investment grade bond rating, which allows flexible access to financing at reasonable costs. Currently, our publicly issued long-term debt carries Baa3 (Moody's Investors Service), BBB+ (Standard & Poor's) and BBB (Fitch) ratings. Our commercial paper has ratings of P-3 (Moody's Investors Service), A-2 (Standard & Poor's) and F-2 (Fitch). The ratings are as of the date of the filing of this report and have been obtained with the understanding that Moody's Investors Service, Standard & Poor's and Fitch will continue to monitor our credit and make future adjustments to these ratings to the extent warranted. The ratings are not a recommendation to buy, sell or hold our securities, may be changed, superseded or withdrawn at any time and should be evaluated independently of any other rating.

Our commercial paper program serves as our primary source of short-term financing. To support our commercial paper program, until September 20, 2007, we maintained a credit facility under a Credit Agreement dated August 16, 2005 (Prior Credit Agreement) with a consortium of banks under which we could borrow up to \$500.0 million. As part of the Prior Credit Agreement, we could request issuance of up to \$100.0 million in letters of credit, the outstanding amount of which reduced the net borrowing capacity under the agreement. The Prior Credit Agreement allowed us to borrow at interest rates that varied based on a spread over (i) LIBOR or (ii) a base rate that was the higher of the prime rate or one-half of one percent above the federal funds rate, at our option. The interest rate spread over LIBOR was determined by our debt rating. We could also request that loans be made at interest rates offered by one or more of the banks, which may have varied from the LIBOR or base rate. The Prior Credit Agreement supported our commercial paper borrowing program and would have expired on August 15, 2010, but was terminated on September 20, 2007 in connection with the new credit arrangements described below. We were required to pay a facility fee of 10 basis points per annum on the average daily amount of loan commitments by the consortium. The amount of interest and annual facility fee were subject to change based on our maintenance of certain debt ratings and financial ratios, such as maximum debt to capital ratios. Advances under the Prior Credit Agreement were unsecured. As of August 26, 2007 we had borrowings of \$100.0 million outstanding under the Prior Credit Agreement. At May 27, 2007, no borrowings under the Prior Credit Agreement were outstanding. As of August 26, 2007, there was \$79.5 million of commercial paper and no letters of credit outstanding, which were backed by this facility. As of August 26, 2007, we were in compliance with all covenants under the Prior Credit Agreement.

Table of Contents

On September 20, 2007, we entered into (i) a \$750.0 million revolving Credit Agreement dated as of September 20, 2007 (the New Revolving Credit Agreement) with Bank of America, N.A. (BOA), as administrative agent, and the lenders (the Revolving Credit Lenders) and other agents party thereto, and (ii) a \$1.15 billion 364-Day Credit Agreement dated as of September 20, 2007 (Interim Credit Agreement, and together with the New Revolving Credit Agreement, the New Credit Agreements) with BOA, as administrative agent, and the lenders party thereto. The New Credit Agreements are senior unsecured debt obligations of the Company. Both of the New Credit Agreements contain customary representations, affirmative and negative covenants (including limitations on liens and subsidiary debt, and a maximum consolidated lease adjusted total debt to total capitalization ratio of 0.75 to 1.00) and events of default usual for credit facilities of this type.

The Interim Credit Agreement requires mandatory prepayments in the event of assets sales or debt issuances, subject to certain exceptions and thresholds. The Interim Credit Agreement matures 364 days from the closing date. Up to the full amount of the Interim Credit Agreement may be converted into a revolving credit facility in order to support commercial paper issued to reduce the outstanding amount of the Interim Credit Agreement. Proceeds of the Interim Credit Agreement may only be used to finance the acquisition of RARE and related fees and expenses, to repay certain existing debt and to support commercial paper issuances used to repay loans under the Interim Credit Agreement.

The New Revolving Credit Agreement matures on September 20, 2012, and the proceeds may be used for commercial paper back-up, working capital and capital expenditures, the refinancing of certain indebtedness, the partial financing of the RARE acquisition as well as general corporate purposes. The New Revolving Credit Agreement also contains a sub-limit of \$150.0 million for the issuance of letters of credit. The borrowings and letters of credit obtained under the New Revolving Credit Agreement may be denominated in U.S. Dollars, Euro, Sterling, Yen, Canadian Dollars and each other currency approved by the Revolving Credit Lenders. The Company may elect to increase the commitments under the New Revolving Credit Facility by up to \$250.0 million (to an aggregate amount of up to \$1.0 billion), subject to the Company obtaining commitments from new and existing lenders for the additional amounts.

The loans under the New Credit Agreements will bear interest at a rate of LIBOR plus a margin determined by reference to a ratings-based pricing grid, or the base rate (which is defined as the higher of the BOA prime rate and the Federal Funds rate plus 0.50 percent). We may also request that loans under the New Revolving Credit Agreement be made at interest rates offered by one or more of the Revolving Credit Lenders, which may vary from the LIBOR or base rate for up to \$100.0 million of borrowings. Assuming a BBB equivalent credit rating level, the applicable margin under the Interim Credit Facility will be 0.32 percent, and the applicable margin under the Revolving Credit Facility will be 0.35 percent. The New Credit Agreements require that we pay a facility fee on the total amount of such facility (ranging from 0.070 percent to 0.175 percent, based on our ratings) and, in the event that the outstanding amounts under the applicable New Credit Agreement exceed 50 percent of such New Credit Agreement, a utilization fee of the total amount outstanding under such facility (ranging from 0.050 percent to 0.150 percent, based on our ratings). As of September 20, 2007, \$175.0 million was outstanding under the New Revolving Credit Agreement. The Interim Credit Agreement will become available to us upon the consummation of (and will be used to fund the purchase of shares pursuant to) the tender offer that is part of the RARE acquisition. The New Revolving Credit Agreement replaced our Prior Credit Agreement, which was terminated effective September 20, 2007.

Following the acquisition, we intend to refinance the interim financing facility with proceeds from one or more offerings of long-term notes. In September 2007, we entered into treasury-lock derivative instruments with \$300.0 million of notional value to hedge a portion of the risk of changes in the benchmark interest rate prior to the issuance of these notes, as changes in the benchmark interest rate will cause variability in our forecasted interest payments.

At August 26, 2007, our long-term debt consisted principally of:

\$150.0 million of unsecured 4.875 percent senior notes due in August 2010;

\$75.0 million of unsecured 7.450 percent medium-term notes due in April 2011;

Table of Contents

\$100.0 million of unsecured 7.125 percent debentures due in February 2016;

\$150.0 million of unsecured 6.000 percent senior notes due August 2035; and

An unsecured, variable rate \$18.5 million commercial bank loan due in December 2018 that is used to support two loans from us to the Employee Stock Ownership Plan portion of the Darden Savings Plan.

A summary of our contractual obligations and commercial commitments at August 26, 2007, is as follows:

| (in millions) | Total | Payments Due by Period | | | More than 5 Years |
|--------------------------------------|-------------------|------------------------|-----------------|-----------------|-------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | |
| Contractual Obligations | | | | | |
| Short-term debt | \$ 179.5 | \$ 179.5 | \$ | \$ | \$ |
| Long-term debt ⁽¹⁾ | 853.6 | 33.5 | 215.5 | 119.6 | 485.0 |
| Operating leases | 441.0 | 82.9 | 138.4 | 99.7 | 120.0 |
| Purchase obligations ⁽²⁾ | 316.5 | 285.7 | 30.8 | | |
| Benefit obligations ⁽³⁾ | 277.0 | 26.3 | 39.9 | 48.3 | 162.5 |
| Unrecognized tax benefits | 69.2 | 6.4 | 60.1 | 2.7 | |
| Total contractual obligations | \$ 2,136.8 | \$ 614.3 | \$ 484.7 | \$ 270.3 | \$ 767.5 |

| | Total Committed | Amount of Commitment Expiration per Period | | | More than 5 Years |
|--|-----------------|--|---------------|---------------|-------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | |
| Other Commercial Commitments | | | | | |
| Standby letters of credit ⁽⁴⁾ | \$ 67.8 | \$ 67.8 | \$ | \$ | \$ |
| Guarantees ⁽⁵⁾ | 0.8 | 0.3 | 0.3 | 0.2 | |
| Total commercial commitments | \$ 68.6 | \$ 68.1 | \$ 0.3 | \$ 0.2 | \$ |

- 1) Includes interest payments associated with existing long-term debt, including the current portion. Variable-rate interest payments associated with the ESOP loan were estimated based on the interest rate in effect at August 26, 2007 (5.936 percent). Excludes issuance discount of \$2.4 million.
 - 2) Includes commitments for food and beverage items and supplies, capital projects and other miscellaneous commitments.
 - 3) Includes expected payments associated with our defined benefit plans, postretirement benefit plan and our non-qualified deferred compensation plan through fiscal 2016.
 - 4) Includes letters of credit for \$58.1 million of workers' compensation and general liabilities accrued in our consolidated financial statements, letters of credit for \$3.2 million of lease payments included in contractual operating lease obligation payments noted above and other letters of credit totaling \$6.4 million.
 - 5) Consists solely of guarantees associated with leased properties that have been assigned to third parties. We are not aware of any non-performance under these arrangements that would result in us having to perform in accordance with the terms of the guarantees.
- Our Board of Directors has authorized us to repurchase up to an aggregate of 162.4 million shares of our common stock. Net cash flows used in financing activities included our repurchase of 0.2 million shares of our common stock for \$7.6 million in the first quarter of fiscal 2008, compared to 2.3 million shares for \$83.2 million in the first quarter of fiscal 2007. As of August 26, 2007, we have repurchased a total of 142.1 million shares of our common stock. The repurchased common stock is reflected as a reduction of stockholders' equity.

Net cash flows provided by operating activities from continuing operations increased to \$161.1 million in the first quarter of fiscal 2008 from \$107.6 million in the first quarter of fiscal 2007 primarily as a result of an increase in net earnings from continuing operations and the timing of purchases of inventories and restaurant level services and payments made for income taxes.

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Net cash flows used in investing activities from continuing operations included capital expenditures incurred principally for building new restaurants, replacing equipment and technology initiatives. Capital expenditures were \$86.7 million in the first quarter of fiscal 2008, compared to \$92.4 million in the first quarter of

Table of Contents

fiscal 2007. The decreased expenditures in the first quarter of fiscal 2008 resulted primarily from decreased spending associated with restaurant replacement assets and technology initiatives. During the first quarter of fiscal 2007, we also received \$12.6 million in cash in connection with the sale and leaseback of our current Restaurant Support Center.

Net cash flows used in financing activities included \$25.4 million in dividends paid in the first quarter of fiscal 2008, compared to no dividends for the same period in fiscal 2007. On June 15, 2007, the Board of Directors declared a cash dividend of eighteen cents per share to be paid on August 1, 2007 to all shareholders of record as of the close of business on July 10, 2007. Based on this eighteen cent quarterly dividend declaration, our indicated annual dividend is seventy-two cents per share. In fiscal 2007, we paid semi-annual dividends of twenty-three cents per share. Cash flows used in financing activities for the first quarter of fiscal 2008 were greater than the cash flows used in financing activities for the first quarter of fiscal 2007 due to the repayment of \$31.9 million of short-term debt in the first quarter of fiscal 2008 compared to proceeds received from the issuance of short-term debt of \$36.0 million in the first quarter of fiscal 2007. These increased cash outflows were partially offset by the decrease in purchases of treasury stock from \$83.2 million in the first quarter of fiscal 2007 to \$7.6 million in the first quarter of fiscal 2008.

Except with respect to the RARE acquisition, we are not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, sales or expenses, results of operations, liquidity, capital expenditures or capital resources. Other than with respect to the RARE acquisition, we are not aware of any trends or events that would materially affect our capital requirements or liquidity. We believe that our New Credit Agreements and internal cash generating capabilities will be sufficient to finance our acquisition of RARE, ongoing capital expenditures, dividends, stock repurchase program and other operating activities through fiscal 2008.

FINANCIAL CONDITION

Our current assets totaled \$552.6 million at August 26, 2007, compared to \$545.4 million at May 27, 2007. The increase resulted primarily from an increase in cash and cash equivalents, which were \$47.3 million at August 26, 2007 compared to \$30.2 million at May 27, 2007, and an increase in inventories which were \$226.5 million at August 26, 2007 compared to \$209.6 million at May 27, 2007, principally due to seasonality, and were partially offset by a decrease in receivables, net due to proceeds received related to the sale of our Restaurant Support Center during the first quarter of fiscal 2007.

Our current liabilities totaled \$995.1 million at August 26, 2007, compared to \$1.07 billion at May 27, 2007. Accounts payable and short-term debt totaled \$210.2 million and \$179.5 million at August 26, 2007, respectively, compared to \$178.0 million and \$211.4 million at May 27, 2007, respectively, principally due to the timing and terms of seasonal inventory purchases, share repurchases, capital expenditures and related payments during the first quarter and the use of commercial paper to manage to desired debt leverage targets. Accrued payroll of \$95.5 million at August 26, 2007, decreased from \$108.5 million at May 27, 2007, principally due to the payout of fiscal 2007 incentive compensation during the first quarter of fiscal 2008, which is partially offset by the amounts accrued for fiscal 2008 incentive compensation. Unearned revenues of \$93.4 million at August 26, 2007 decreased from \$109.9 million at May 27, 2007 principally due to seasonal fluctuations in sales and redemptions of our gift cards. Accrued income taxes decreased to \$41.5 million at August 26, 2007 from \$75.9 at May 27, 2007 primarily due to a reclassification of gross unrecognized tax benefits to non-current liabilities in connection with the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), effective May 28, 2007. Other liabilities increased to \$127.0 million at August 26, 2007 from \$67.4 million at May 27, 2007 principally due to the FIN 48 reclassification noted above.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements requires us 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 sales and expenses during the reporting period (see Note 1, Summary of Significant Accounting Policies under Notes to Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data of our Annual Report on Form 10-K for the fiscal year ended May 27, 2007). Actual results could differ from those estimates.

Table of Contents

Critical accounting policies are those we believe are both most important to the portrayal of our financial condition and operating results and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Judgments and uncertainties affecting the application of those policies may result in materially different amounts being reported under different conditions or using different assumptions. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at cost less accumulated depreciation. Building components are depreciated over estimated useful lives ranging from seven to 40 years using the straight-line method. Leasehold improvements, which are reflected on our consolidated balance sheets as a component of buildings, are amortized over the lesser of the expected lease term, including cancelable option periods, or the estimated useful lives of the related assets using the straight-line method. Equipment is depreciated over estimated useful lives ranging from two to 10 years, also using the straight-line method.

Our accounting policies regarding land, buildings and equipment, including leasehold improvements, include our judgments regarding the estimated useful lives of these assets, the residual values to which the assets are depreciated or amortized, the determination of what constitutes expected lease term and the determination as to what constitutes enhancing the value of or increasing the life of existing assets. These judgments and estimates could produce materially different amounts of reported depreciation and amortization expense if different assumptions were used. As discussed further below, these judgments may also impact our need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized, or as our expectations of estimated future cash flows change.

Leases

We are obligated under various lease agreements for certain restaurants. We recognize rent expense on a straight-line basis over the expected lease term, including option periods as described below. Within the provisions of certain of our leases, there are rent holidays and/or escalations in payments over the base lease term, as well as renewal periods. The effects of the holidays and escalations have been reflected in rent expense on a straight-line basis over the expected lease term, which includes option periods we are reasonably assured to exercise because failure to exercise such options would result in an economic penalty to the Company. The lease term commences on the date when we have the right to control the use of the leased property, which is typically before rent payments are due under the terms of the lease. Many of our leases have renewal periods totaling five to 20 years, exercisable at our option, and require payment of property taxes, insurance and maintenance costs in addition to the rent payments. The consolidated financial statements reflect the same lease term for amortizing leasehold improvements as we use to determine capital versus operating lease classifications and in calculating straight-line rent expense for each restaurant. Percentage rent expense is generally based upon sales levels and is accrued at the point in time we determine that it is probable that such sales levels will be achieved.

Our judgments related to the probable term for each restaurant affect the classification and accounting for leases as capital versus operating, the rent holidays and escalation in payments that are included in the calculation of straight-line rent and the term over which leasehold improvements for each restaurant facility are amortized. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

Impairment of Long-Lived Assets

Land, buildings and equipment and certain other assets, including capitalized software costs and liquor licenses, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted net cash flows expected to be generated by the assets. Identifiable cash flows are measured at the lowest level for which they are largely independent of the cash flows of other groups of assets and liabilities, generally at the restaurant level. If these assets are determined to be impaired,

Table of Contents

the amount of impairment recognized is the amount by which the carrying amount of the assets exceeds their fair value. Fair value is generally determined by appraisals or sales prices of comparable assets. Restaurant sites and certain other assets to be disposed of are reported at the lower of their carrying amount or fair value, less estimated costs to sell. Restaurant sites and certain other assets to be disposed of are included in assets held for sale when certain criteria are met. These criteria include the requirement that the likelihood of disposing of these assets within one year is probable. For assets that meet the held for sale criteria, we separately evaluate whether those assets also meet the requirements to be reported as discontinued operations. Principally, if we discontinue cash flows and no longer have any significant continuing involvement with respect to the operations of the assets, we classify the assets and related results of operations as discontinued. We consider guest transfer (an increase in guests at another location as a result of the closure of a location) as continuing cash flows and evaluate the significance of expected guest transfer when evaluating a restaurant for discontinued operations reporting. To the extent we dispose of enough assets where classification between continuing operations and discontinued operations would be material to our consolidated financial statements, we utilize the reporting provisions for discontinued operations. Assets whose disposal is not probable within one year remain in land, buildings and equipment until their disposal is probable within one year.

The judgments we make related to the expected useful lives of long-lived assets and our ability to realize undiscounted cash flows in excess of the carrying am