

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Olive Garden sales of \$2.21 billion were 11.1 percent above last year. U.S. same-restaurant sales for Olive Garden increased 4.6 percent due to a 3.0 percent increase in average check and a 1.6 percent increase in same-restaurant guest counts. Average annual sales per restaurant for Olive Garden were \$4.1 million in fiscal 2004 (on a 52-week basis). Olive Garden has enjoyed 39 consecutive quarters of U.S. same-restaurant sales increases.

Bahama Breeze sales of \$176 million were 28 percent above last year. Bahama Breeze opened four new restaurants during fiscal 2004, including its new prototype restaurant in Pittsburgh, PA. Bahama Breeze also closed six restaurants during the fourth quarter of fiscal 2004 as a result of a comprehensive analysis performed during the fourth quarter of fiscal 2004 that examined restaurants not meeting our minimum return-on-investment thresholds and certain other operating performance criteria. Average annual sales per restaurant (excluding the six closed restaurants) were \$5.2 million (on a 52-week basis). Smokey Bones sales of \$174 million were 87 percent above last year. Average annual sales per restaurant were \$3.2 million (on a 52-week basis). Smokey Bones opened 30 new restaurants during fiscal 2004.

The 6.6 percent increase in company-wide sales for fiscal 2003 versus fiscal 2002 was primarily due to same-restaurant sales increases in the U.S. and a net increase of 60 company-owned restaurants since fiscal 2002. Red Lobster sales of \$2.43 billion were 4.1 percent above fiscal 2002. U.S. same-restaurant sales for Red Lobster increased 2.7 percent due to a 3.1 percent increase in average check, partially offset by a 0.4 percent decrease in same-restaurant guest counts. Average annual sales per restaurant for Red Lobster were \$3.7 million in fiscal 2003. Olive Garden sales of \$1.99 billion were 6.8 percent above fiscal 2002. U.S. same-restaurant sales for Olive Garden increased 2.2 percent due to a 3.7 percent increase in average check and a 1.5 percent decrease in same-restaurant guest counts. Average annual sales per restaurant for Olive Garden were \$3.9 million in fiscal 2003. Bahama Breeze opened five new restaurants during fiscal 2003 and generated sales that exceeded \$137 million. Smokey Bones opened 20 new restaurants during fiscal 2003 and generated sales of \$93 million.

### COSTS AND EXPENSES

Total costs and expenses were \$4.66 billion in fiscal 2004, \$4.31 billion in fiscal 2003, and \$4.00 billion in fiscal 2002. Total costs and expenses

in fiscal 2004 were 93.2 percent of sales, an increase from 92.5 percent of sales in fiscal 2003. The following analysis of the components of total costs and expenses is presented as a percent of sales.

Food and beverage costs increased \$78 million, or 5.4 percent, from \$1.45 billion to \$1.53 billion in fiscal 2004 compared to fiscal 2003. Food and beverage costs increased \$65 million, or 4.7 percent, from \$1.38 billion to \$1.45 billion in fiscal 2003 compared to fiscal 2002. As a percent of sales, food and beverage costs decreased from the prior year in fiscal 2004 and fiscal 2003 primarily as a result of pricing changes, and favorable changes in promotional and menu mix of sales, which was partially offset by higher seafood costs and by crab usage and additional plate accompaniments at Red Lobster during its crab promotion in the first quarter of fiscal 2004. Other commodity costs, such as chicken and shrimp, decreased modestly.

Restaurant labor increased \$116 million, or 7.8 percent, from \$1.49 billion to \$1.60 billion in fiscal 2004 compared to fiscal 2003. Restaurant labor increased \$112 million, or 8.1 percent, from \$1.37 billion to \$1.49 billion in fiscal 2003 compared to fiscal 2002. As a percent of sales, restaurant labor increased in fiscal 2004 primarily as a result of a modest increase in wage rates at Red Lobster and Olive Garden, and higher manager bonuses at Olive Garden as a result of their increased operating performance in fiscal 2004. These factors were only partially offset by the favorable impact of higher sales volumes and lower health insurance costs as a result of fewer claims. As a percent of sales, restaurant labor increased in fiscal 2003 primarily as a result of a modest increase in wage rates, higher promotional staffing levels, and increased sales volatility, which made it more difficult to predict staffing needs. These factors were only partially offset by the favorable impact of higher sales volumes.

Restaurant expenses (which include lease, property tax, credit card, utility, workers' compensation, insurance, new restaurant pre-opening, and other restaurant-level operating expenses) increased \$64 million, or 9.1 percent, from \$704 million to \$768 million in fiscal 2004 compared to fiscal 2003. Restaurant expenses increased \$75 million, or 11.9 percent, from \$629 million to \$704 million in fiscal 2003 compared to fiscal 2002. As a percent of sales, restaurant expenses increased in fiscal 2004 and fiscal 2003 primarily due to increased utility, workers' compensation, insurance, and new restaurant pre-opening costs. These cost increases were only partially offset by the favorable impact of higher sales volumes.