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

NET EARNINGS AND NET EARNINGS PER SHARE

Net earnings for fiscal 2004 were $231 million ($1.36 per diluted share) compared with net earnings for fiscal 2003 of $232 million ($ 1.31 per diluted share) and net earnings for fiscal 2002 of $238 million ($ 1.30 per diluted share).

Net earnings for fiscal 2004 decreased 0.3 percent and diluted net earnings per share increased 3.8 percent compared to fiscal 2003. The decrease in net earnings was primarily due to the $38 million pre-tax ($23 million after-tax) asset impairment and restructuring charges recognized during fiscal 2004 related to the closing of six Bahama Breeze restaurants and write-down of another four Bahama Breeze restaurants, one Olive Garden restaurant, and one Red Lobster restaurant. Net earnings were also impacted by decreases in food and beverage costs as a percent of sales, which were only partially offset by increases in restaurant labor, restaurant expenses, selling, general, and administrative expenses, and depreciation and amortization expense as a percent of sales. The increase in diluted net earnings per share is due to a reduction in the average diluted shares outstanding from fiscal 2003 to fiscal 2004 because of our continuing repurchase of our common stock.

Net earnings for fiscal 2003 decreased 2.3 percent and diluted net earnings per share increased 0.8 percent, compared to fiscal 2002. The decrease in net earnings was primarily due to increases in restaurant labor, restaurant expenses, and depreciation and amortization expenses as a percent of sales, which were only partially offset by decreases in food and beverage costs and selling, general, and administrative costs as a percent of sales. The increase in diluted net earnings per share was due to a reduction in the average diluted shares outstanding from fiscal 2002 to fiscal 2003 because of our continuing repurchase of our common stock.

SEASONALITY

Our sales volumes fluctuate seasonally. During fiscal 2004, 2003, and 2002, our sales were highest in the spring, lowest in the fall, and comparable during winter and summer. Holidays, severe weather, and similar conditions may impact sales volumes seasonally 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.

IMPACT OF INFLATION

We do not believe inflation had a significant overall effect on our operations during fiscal 2004, 2003, and 2002. We believe we have historically been able to pass on increased operating costs through menu price increases and other strategies.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. 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.

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 lease term 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. Accelerated depreciation methods are generally used for income tax purposes.