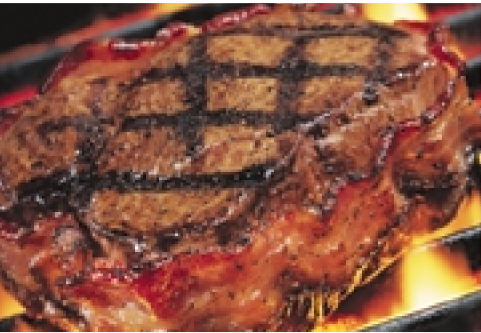
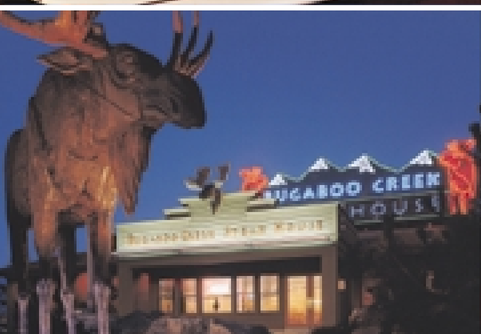




Building Loyalty Through Performance

2002 ANNUAL REPORT

ABOUT THE COMPANY

RARE Hospitality International, Inc. owns, operates and franchises 216 restaurants, including 177 LongHorn Steakhouse restaurants located primarily in the Eastern half of United States, 22 Bugaboo Creek Steak House restaurants located primarily in the Northeastern and Mid-Atlantic regions of the United States, and 15 The Capital Grille restaurants located in major metropolitan areas across the country.

FINANCIAL HIGHLIGHTS

(In thousands, except per share data)

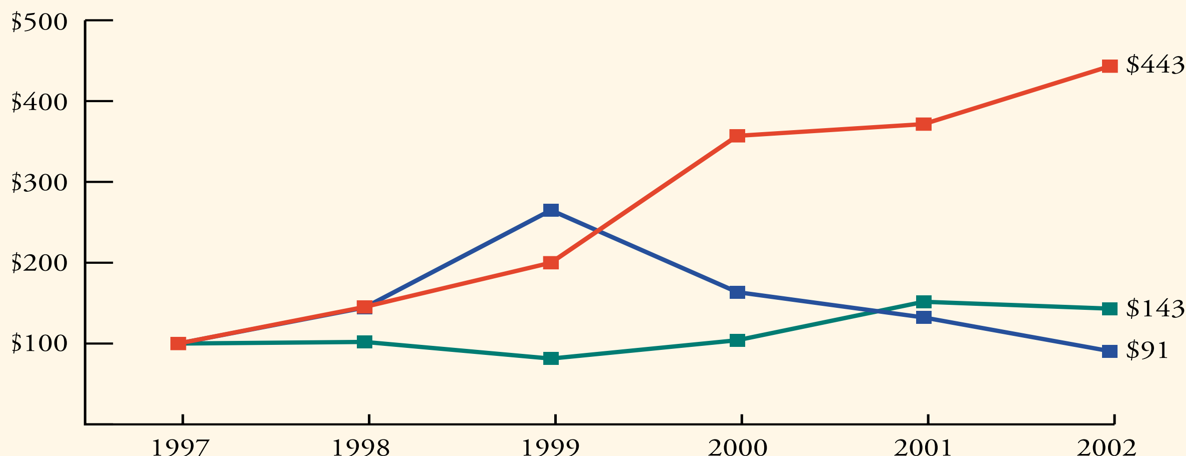
For the Fiscal Year		**2002**		2001
Revenues	**$**	**584,504**	$	520,326
Operating income, before nonrecurring items [1]	**$**	**53,591**	$	45,430
Net earnings, before nonrecurring items [1] [2]	**$**	**34,709**	$	28,577
Diluted earnings per share, before nonrecurring items [1] [2]	**$**	**1.52**	$	1.29
Weighted average common shares outstanding (diluted)		**22,845**		22,144

[1] Excludes nonrecurring expenses for fiscal 2002 of $495 ($309, or $0.01 per diluted share, after tax) and for fiscal 2001 of $2,802 ($1,737, or $0.08 per diluted share, after tax).

[2] Excludes nonrecurring expenses for fiscal 2002 of $1,540 ($961, or $0.05 per diluted share, after tax) and for fiscal 2001 of $1,100 ($682, or $0.03 per diluted share, after tax).

At Year End				
Cash and cash equivalents	**$**	**13,732**	$	25,979
Short-term investments		**17,735**		–
Total assets		**386,907**		352,456
Long-term debt		–		10,000
Obligations under capital leases, less current portion		**22,406**		20,867
Minority interest		**1,411**		1,329
Total shareholders' equity		**300,132**		256,530

RARE STOCK PERFORMANCE *Versus indices - 1997 - 2002*

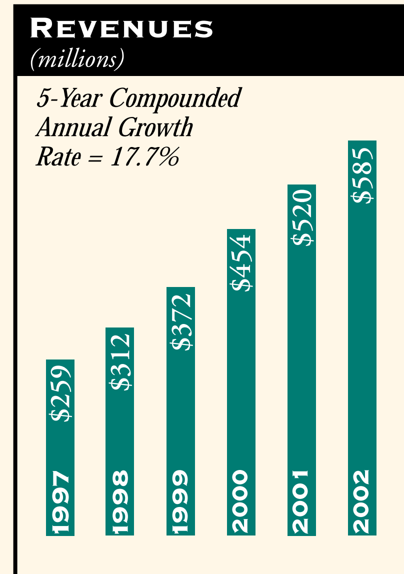


The above line-graph presentation compares cumulative shareholder returns of the Company (—■) with the Nasdaq Stock Market (—■) (U.S. Companies) and a Peer Index (—■) for the period beginning on December 26, 1997 (assuming the investment of $100 in the Company's Common Stock, the Nasdaq Stock Market (U.S. Companies), and the Peer Index on December 26, 1997 and reinvestment of all dividends).

LETTER TO SHAREHOLDERS

Fellow Shareholders:

Our Company enjoyed another year of substantial profitable growth in 2002, RARE's fifth consecutive year of improved operating and financial performance. When current senior management arrived at RARE just over five years ago, we recognized that in order to achieve long-term success, we needed to build the loyalty of our three primary constituencies – our **guests**, **team members** and **shareholders** – through substantial and continuing improvements in the Company's performance. While the meaning of "performance" is different for each of our constituencies, our results demonstrate the significant success we have achieved.



FOR OUR *GUESTS*, performance means superior execution of the RARE value proposition: providing great tasting, high quality food and outstanding service in a warm and friendly environment to build guest loyalty one guest at a time.

FOR OUR *TEAM MEMBERS*, performance means continuous investment in training and development to complement a strong focus on hiring the best people. This commitment has created one of the best restaurant teams in the industry and made RARE one of the industry's employers of choice.

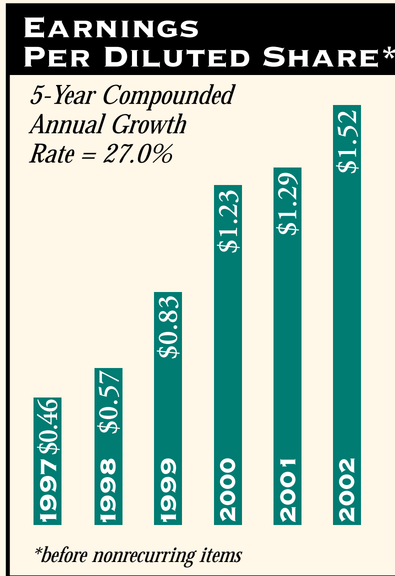
FOR OUR *SHAREHOLDERS*, performance has meant a 27.0% compounded annual growth rate in earnings per diluted share, before nonrecurring items, for the last five years, substantially above our long-term goal of 20%. RARE has achieved consistent expansion of our base of restaurants in operation, a long-term record of annual increases in same-store sales for each of our three concepts, and profit margin improvements that have driven profitable growth for over five years.

RARE's shareholder value has grown substantially, with 2002 marking the **fifth consecutive year of growth in our share price**. The compounded annual growth rate of our share price for the last five years is 35.7%. We believe the growth in our share price in 2002 reflects, among other things, the Company's enhanced ability to drive further profitable growth. With three strong restaurant concepts, with proven management and high quality restaurant teams, with effective growth and operating strategies, and with the substantial strengthening achieved in the Company's financial position, we are confident of RARE's continuing ability to build loyalty through performance.

2002: Compelling Performance in a Challenging Environment - Many of the difficult conditions we faced in 2001, including the substantial uncertainties related to the economy and world events, continued to affect the Company's and the industry's results for 2002. Within that context, however, we were pleased the Company's profitable growth for the year significantly exceeded our original expectations.

RARE's total revenues for 2002 increased 12.3% to $584.5 million, from $520.3 million for 2001. Net earnings, before nonrecurring items, rose 21.5% to $34.7 million for 2002, from $28.6 million for 2001, while earnings per diluted share, before nonrecurring items, were $1.52, up 17.8%, from $1.29 for 2001. After-tax nonrecurring charges, which were related both to the Company's review of the carrying amounts of long-lived assets and to the termination of interest rate swap agreements, totaled $1.3 million, or $0.06 per diluted share, for 2002 and $2.4 million, or $0.11 per diluted share, for 2001.

We attribute our revenue growth for 2002 primarily to the 10.0% expansion of the base of Company-owned restaurants in operation, as well as the full-year revenue impact of restaurants opened in 2001. During 2002, LongHorn Steakhouse opened 17 new locations, increasing its total restaurants by 10.4% to 170 at the end of 2002, from 154 at the end of 2001. We also

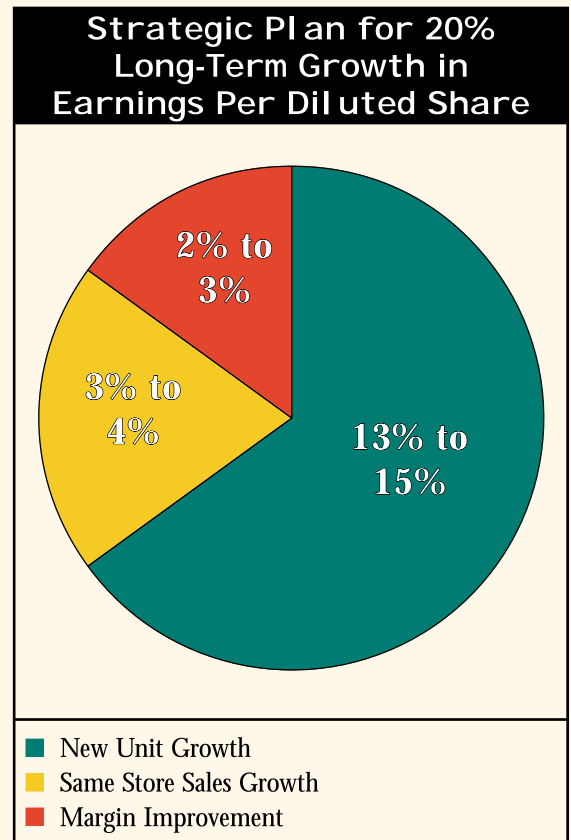


opened three Bugaboo Creek Steak House restaurants during 2002, expanding the concept's total restaurants at year end by 15.8% to 22, from 19 at the end of 2001. Having opened three new restaurants in 2001, The Capital Grille concept opened no additional restaurants in 2002.

2002 revenues also benefited from continued growth in same-store sales for each concept. We believe same-store sales growth is the key measure of the vitality of our restaurants, and we are proud of our team for producing an ever-expanding record of annual same-store sales growth. For 2002, LongHorn Steakhouse produced an increase in same-store sales of 2.7%, its ninth consecutive year of same-store sales growth; The Capital Grille's same-store sales increased 4.9%, its seventh consecutive year of growth; and Bugaboo Creek Steak House's same-store sales grew 1.9%, its fourth consecutive year of growth.

In addition to the favorable impact of higher revenues, RARE's earnings growth for 2002 is also attributable to increasing operating leverage. Our operating profit margin, before nonrecurring items, increased to 9.2% for 2002 from 8.7% for 2001, and our net profit margin, before nonrecurring items, increased to 5.9% from 5.5%. As another indication of the strong track record RARE has developed, 2002 represented the fifth consecutive year in which we have achieved improvement in our net profit margin, before nonrecurring items.

Pragmatic, Controlled Growth for 2003 – Due to our experience with, and confidence in, the business model of each concept, we continue to target long-term growth in earnings per diluted share at 20% per year. To achieve this goal consistently, we need to expand our number of restaurants in operation by 13% to 15% per year, achieve annual same-store sales growth of 3% to 4%, and drive 2% to 3% of the EPS growth rate through margin improvement. However, due primarily to the uncertain economic environment, our expectations for 2003 are slightly more conservative.

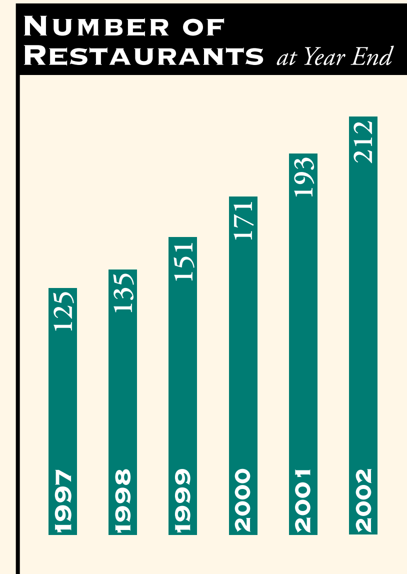


In 2003, we expect to open 20 to 21 LongHorn Steakhouse restaurants, one or two The Capital Grille restaurants and two or three Bugaboo Creek Steak House restaurants. We also target same-store sales growth of 2% to 3% for all three concepts. Our restaurant development and same-store sales assumptions for 2003, while stronger than those anticipated for 2002 in last year's annual report, reflect our focus on ensuring our existing operations are meeting our high standards before engaging in more aggressive new restaurant development.

There are **several factors** that support both our short-term and long-term growth expectations. First, we believe **industry fundamentals create compelling growth opportunities**. The increased disposable income of the baby boom generation has driven increasing restaurant visit frequency, especially as the pace and stress of modern life reduce time available for traditional family meals prepared at home. These trends are complemented by a reduced price differential between the cost of quality meals in restaurants compared with the cost of purchasing the same food in a supermarket. In addition, due to RARE's ongoing ability to expand its restaurant base, in contrast to casual dining industry trends, it is well positioned to continue to gain market share.

Second, we have **three growth concepts**. LongHorn Steakhouse pioneered the full-service western steakhouse concept over 20 years ago and has been building

a quality reputation ever since as the place to go for great food, friendly people and good times. The Capital Grille epitomizes elegant city dining and features an award-winning wine list. People know Bugaboo Creek Steak House as a friendly and comfortable place to meet friends for a drink or to bring the whole family for dinner, where they are guaranteed a wide selection of delicious entrees.



We are always working to strengthen our brands, first through superior performance for guests in each restaurant. This performance is thoroughly analyzed with both external and internal research so that each team knows how to improve. In addition, we engage in continuous initiatives to keep every aspect of our brands fresh. We regularly analyze and refine the design and décor of each concept. We obsess over the most appropriate evolution of menu items, plate presentations and taste profiles. We aggressively employ eye-catching promotions, innovative advertising and appealing in-store merchandising to attract new guests and to broaden the experience for our regular guests. As a result of this nonstop effort, we operate highly popular concepts that have proven easily exportable to new parts of the country.

Third, after five years of continuous success, we are confident that our **proven growth strategies** allow RARE ample opportunity to drive further expansion. For example, in terms of new restaurant development, the number of restaurants we operate in each concept represents only a fraction of the number the market will support. With regard to same-store sales, we are far from the limits of capacity, innovation and imagination that are essential for continued growth. We also see room for ongoing improvements in profit margins from leveraging fixed operating expenses and G&A, as well as from achieving further efficiencies in purchasing, marketing and restaurant operations.

Fourth, with a **strong financial position and substantial cash flow** from operations, we are increasingly able to finance our growth internally. At the end of 2002, we had no bank borrowings, and we had cash and short-term investments totaling $31 million. We assume our anticipated cash flow for 2002, combined with cash and short-term investments, will be adequate to finance our planned capital expenditures for 2003. In addition, we have a credit facility in place that allows us to borrow up to $100 million, if needed.

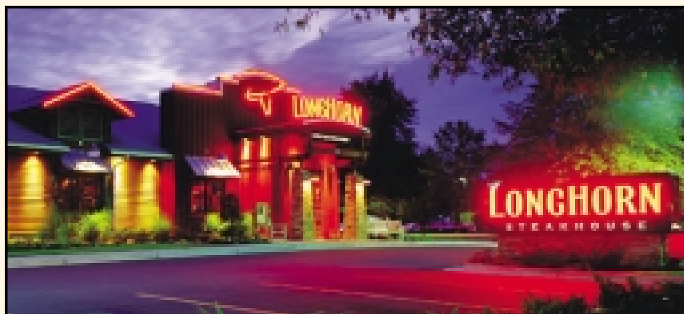
Summary – Those of you who have followed RARE over the past five years know of our focused efforts and continuous investment in building the best restaurant team in the industry. We recognize the extraordinary efforts of RARE's team members across the Company and thank them for their ongoing commitment to superior performance. It is through their performance that your Company was selected for inclusion in *BusinessWeek's* 2002 list of the Top 100 Hot Growth Companies and, for the second consecutive year, in the annual *Forbes* listing of the 200 Best Small Companies in America.

In the turbulent times we have witnessed since the new century began, our commitment to people – our guests, our team members and our shareholders – has become ever more important. Whether it is the warm, cheerful service that enhances the comfort and pleasure of our guests, the increased charitable giving that enables our Company to make an even bigger difference in people's lives, or the integrity our team members demand in every aspect of RARE's business dealings, we are confident that RARE's people will lead the Company to further success.

Sincerely,

Philip J. Hickey, Jr.
Chairman and Chief Executive Officer

Eugene I. Lee, Jr.
President and Chief Operating Officer



Through superior execution of each meal for each guest, LongHorn Steakhouse has produced nine consecutive years of growth in same-store sales.

Legendary Steaks
Our steaks are always fresh (never frozen) and hand cut from USDA, Midwestern corn-fed beef.

LONGHORN® STEAKHOUSE

LongHorn Steakhouse pioneered the western steakhouse concept and for 22 years has provided its guests great tasting food and great service.

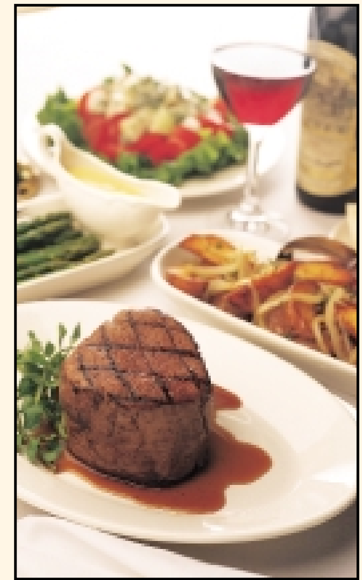
Bacon Cheese Burger
Juicy half pound burger topped with crisp bacon and Cheddar cheese.

LongHorn Steakhouse restaurants, which are located primarily in the Eastern half of the United States, are casual dining, full-service restaurants that serve lunch and dinner, in an attractive and inviting atmosphere. LongHorn Steakhouse restaurants offer a variety of top quality menu items, including signature steaks, as well as salmon, shrimp, chicken, ribs, pork chops and prime rib. The restaurants appeal to all ages with a unique combination of hospitable, attentive service, moderately priced, high-quality dishes and a comfortable atmosphere.

The LongHorn Steakhouse concept, with 170 Company-owned restaurants in operation at the end of 2002, is RARE's primary growth vehicle, accounting for more than 70% of total restaurant sales and total restaurant profits. Entering its 22nd year of business, LongHorn Steakhouse pioneered the western steakhouse concept. The current restaurant prototype includes approximately 5,100 square feet and 190 seats and is designed to produce an annual return on investment of 20% or higher. The Company expects to open 20 to 21 new LongHorn Steakhouse restaurants during 2003. While LongHorn Steakhouse will expand into several new markets in 2003, most of these restaurants are to be opened in markets with existing LongHorn Steakhouse restaurants, which enhances the concept's ability to supervise operations, improve marketing efficiency and distribute supplies.

LongHorn Steakhouse achieved its 9th consecutive year of same-store sales growth in 2002. RARE believes this performance is primarily attributable to superior execution on a daily basis by the staff in each restaurant. In addition, the Company focuses on consistent evolution in the menu to keep pace with the changing taste profiles of its core guests in the middle to upper income segment. While this strong and time-tested concept will continue to evolve, LongHorn Steakhouse will remain a concept focused on providing its guests great tasting food and great service in an attractive atmosphere.

THE CAPITAL® GRILLE



AVERAGE WEEKLY SALES PER RESTAURANT

(THOUSANDS)

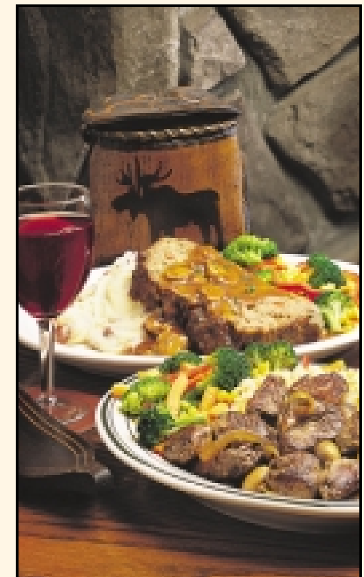
The Capital Grille, with 15 restaurants located in major metropolitan areas in the Eastern and Central United States, boasts an atmosphere of power dining, relaxed elegance and style. Acclaimed for dry aging steaks on the premises, The Capital Grille serves classic steak house offerings, such as chops, large North American lobsters and fresh seafood, and draws distinction by using only the highest quality ingredients, respectfully hand-crafted in grand portions. The restaurants feature an award-winning wine list offering over 300 selections, personalized service, comfortable club-like atmosphere and premiere private dining rooms.

The Capital Grille's sales are driven by business and special-occasion dining, and its ability to increase market share is dependent on highly personalized service and extraordinary food quality. Because of the concept's commitment to building guest loyalty by exceeding their expectations, the development of The Capital Grille's people is an absolute priority. In the same regard, The Capital Grille's site selection must be outstanding. As a result, RARE will continue a very deliberate pace of new restaurant development for The Capital Grille concept, with one or two additional restaurants under development for opening in 2003.

AVERAGE WEEKLY SALES PER RESTAURANT
(THOUSANDS)

Bugaboo Creek Steak House restaurants are designed as attractive, friendly establishments featuring moderately priced, flavorful food items and offering full liquor service. Primarily located in the Northeast and Mid-Atlantic regions of the United States, the 22 Bugaboo Creek Steak House restaurants attract guests of all ages with a rustic décor reminiscent of a Canadian Rocky Mountain lodge. Stressing a friendly and attentive service style, Bugaboo Creek Steak House restaurants offer a variety of menu selections, including signature seasoned steaks, prime rib, spit-roasted half chicken, smoked baby back ribs, grilled salmon and shrimp.

RARE has worked to refine the concept's economics and assure its exportability outside its traditional Northeastern and Mid-Atlantic markets. Among other changes, the Bugaboo Creek Steak House prototype has evolved in size to a 6,400 square-foot building to reduce development and operating costs and to improve return on investment. With the strengthening of the concept's management team and with the concept's having achieved its fourth consecutive year of same-store sales growth, RARE is confident that Bugaboo Creek Steak House has the demographic profile, the exportability and the sales volume to expand at a consistent pace. For 2003, RARE expects to open two or three additional Bugaboo Creek Steak House restaurants.



The Bugaboo Creek Steak House restaurants are casual dining restaurants designed to resemble a Canadian Rocky Mountain lodge.

SELECTED FINANCIAL DATA

Fiscal Years Ended	**December 29, 2002**	December 30, 2001	December 31, 2000	December 26, 1999	December 27, 1998
	(in thousands, except per share data)				
STATEMENT OF OPERATIONS DATA:					
Revenues:					
Restaurant sales	**$ 584,159**	$ 519,998	$ 453,284	$ 371,751	$ 311,938
Franchise revenues	**345**	328	380	195	–
Total revenues	**584,504**	520,326	453,664	371,946	311,938
Costs and expenses:					
Cost of restaurant sales	**211,006**	189,869	166,421	137,416	116,602
Operating expenses– restaurants	**257,252**	228,340	194,874	161,924	136,005
Provision for asset impairments, restaurant closings, and other charges	**495**	2,802	–	1,800	2,500
Depreciation and amortization–restaurants	**23,920**	21,248	17,022	15,249	17,636
Pre-opening expense	**3,802**	3,764	3,318	3,051	–
General and administrative expenses	**34,933**	31,675	30,723	25,547	22,049
Total costs and expenses	**531,408**	477,698	412,358	344,987	294,792
Operating income	**53,096**	42,628	41,306	26,959	17,146
Interest expense, net	**1,718**	2,128	4,159	3,866	2,939
Early termination of interest rate swap agreement	**1,540**	1,100	–	–	–
Provision for litigation settlement	–	–	1,000	–	–
Minority interest	**448**	639	1,407	1,609	1,334
Earnings before income taxes and cumulative effect of change in accounting principle	**49,390**	38,761	34,740	21,484	12,873
Income tax expense	**15,951**	12,603	11,480	7,060	4,120
Earnings before cumulative effect of change in accounting principle	**33,439**	26,158	23,260	14,424	8,753
Cumulative effect of change in accounting principle (net of tax benefit of $760)	–	–	–	1,587	–
Net earnings	**$ 33,439**	$ 26,158	$ 23,260	$ 12,837	$ 8,753
Basic earnings per common share before cumulative effect of change in accounting principle	**$ 1.54**	$ 1.25	$ 1.27	$ 0.80	$ 0.49
Cumulative effect per common share of change in accounting principle	–	–	–	0.09	–
Basic earnings per common share	**$ 1.54**	$ 1.25	$ 1.27	$ 0.71	$ 0.49
Diluted earnings per common share before cumulative effect of change in accounting principle	**$ 1.46**	$ 1.18	$ 1.20	$ 0.76	$ 0.48
Cumulative effect per common share of change in accounting principle	–	–	–	0.08	–
Diluted earnings per common share	**$ 1.46**	$ 1.18	$ 1.20	$ 0.68	$ 0.48
Weighted average common shares outstanding (basic)	**21,724**	21,002	18,271	18,048	18,006
Weighted average common shares outstanding (diluted)	**22,845**	22,144	19,416	18,819	18,149
BALANCE SHEET DATA:					
Working capital (deficit)	**$ 2,617**	$ (4,931)	$ (23,114)	$ (11,031)	$ 1,136
Total assets	**386,907**	352,456	295,381	237,118	218,862
Debt, net of current installments	–	10,000	51,000	40,000	48,000
Obligations under capital leases, net of current installments	**22,406**	20,867	20,925	9,732	9,732
Minority interest	**1,411**	1,329	1,469	3,982	2,610
Total shareholders' equity	**300,132**	256,530	167,257	137,584	120,618

MANAGEMENT'S DISCUSSION AND ANALYSIS
of financial condition and results of operations

GENERAL

The Company's revenues are derived primarily from restaurant sales from Company-owned and joint venture restaurants. The Company also derives a small percentage of its total revenue from franchise revenues from unaffiliated franchised restaurants. Cost of restaurant sales consists of food and beverage costs for Company-owned and joint venture restaurants. Restaurant operating expenses consist of all other restaurant-level costs. These expenses include the cost of labor, advertising, operating supplies, rent, and utilities. Depreciation and amortization includes only the depreciation attributable to restaurant-level capital expenditures.

General and administrative expenses include finance, accounting, management information systems, restaurant supervision expenses, and other administrative overhead related to support functions for Company-owned, joint venture, and franchise restaurant operations. Minority interest consists of the partners' share of earnings in joint venture restaurants.

The Company defines the comparable restaurant base to include those restaurants open for a full 18 months prior to the beginning of each fiscal quarter and are calculated using sales prior to being reduced for discounts, coupons, free products or services. Average weekly sales are defined as total restaurant sales divided by restaurant weeks. A "restaurant week" is one week during which a single restaurant is open, so that two restaurants open during the same week constitutes two restaurant weeks.

The Company's revenues and expenses can be affected significantly by the number and timing of the opening of additional restaurants. The timing of restaurant openings also can affect the average sales and other period-to-period comparisons.

The following table sets forth the percentage relationship to total revenues of the listed items included in the Company's consolidated statements of operations, except as indicated:

Fiscal Years Ended	**December 29, 2002**	December 30, 2001	December 31, 2000
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	**71.3%**	70.5%	70.6%
The Capital Grille	**15.2**	15.3	14.2
Bugaboo Creek Steak House	**12.2**	12.8	13.5
Other restaurants	**1.2**	1.4	1.6
Total restaurant sales	**99.9**	99.9	99.9
Franchise revenues	**0.1**	0.1	0.1
Total revenues	**100.0**	100.0	100.0
Costs and expenses:			
Cost of restaurant sales[1]	**36.1**	36.5	36.7
Operating expenses – restaurants[1]	**44.0**	43.9	43.0
Provision for asset impairments, restaurant closings, and other charges	**0.1**	0.5	–
Depreciation and amortization – restaurants[1]	**4.1**	4.1	3.8
Pre-opening expense – restaurants[1]	**0.7**	0.7	0.7
General and administrative expenses	**6.0**	6.1	6.8
Total costs and expenses	**90.9**	91.8	90.9
Operating income	**9.1**	8.2	9.1
Interest expense, net	**0.3**	0.4	0.9
Early termination of interest rate swap agreement	**0.3**	0.2	
Provision for litigation settlement	–	–	0.2
Minority interest	**0.1**	0.1	0.3
Earnings before income taxes	**8.5**	7.4	7.7
Income tax expense	**2.7**	2.4	2.5
Net earnings	**5.7%**	5.0%	5.1%

[1] *Cost of restaurant sales, restaurant operating expenses, depreciation and amortization and pre-opening expense are expressed as a percentage of total restaurant sales.*

RESULTS OF OPERATIONS

Year Ended December 29, 2002 Compared to Year Ended December 30, 2001

REVENUES

Total revenues increased 12.3% to $584.5 million for 2002, compared to $520.3 million for 2001.

LongHorn Steakhouse:
Sales in the LongHorn Steakhouse restaurants increased 13.8% to $416.9 million for 2002, compared to $366.5 million for 2001. The increase reflects a 10.2% increase in restaurant operating weeks in 2002 as compared to 2001, resulting from an increase in the restaurant base from 154 Company-owned and joint venture LongHorn Steakhouse restaurants at the end of 2001 to 170 restaurants at the end of 2002. Average weekly sales for all Company-owned and joint venture LongHorn Steakhouse restaurants in 2002 were $49,392, a 3.2% increase over 2001. Sales for the comparable LongHorn Steakhouse restaurants increased 2.7% in 2002 as compared to 2001. The increase in comparable restaurant sales for 2002 at LongHorn Steakhouse was attributable to an increase in average check and guest counts.

The Capital Grille:
Sales in The Capital Grille restaurants increased 10.6% to $88.6 million for 2002, compared to $80.1 million for 2001. The increase reflects a 5.3% increase in restaurant operating weeks in 2002 as compared to 2001, resulting from the full-year 2002 impact of the three The Capital Grille restaurants that opened in 2001. Average weekly sales for all The Capital Grille restaurants in 2002 were $113,637, a 5.1% increase from 2001. Sales for the comparable The Capital Grille restaurants increased 4.9% in 2002, as compared to 2001. The increase in comparable restaurant sales at The Capital Grille restaurants is attributable primarily to an increase in guest counts.

Bugaboo Creek Steak House:
Sales in the Bugaboo Creek Steak House restaurants increased 7.7% to $71.2 million for 2002, compared to $66.1 million for 2001. The increase reflects a 7.7% increase in restaurant weeks in 2002 as compared to 2001, resulting from an increase in the restaurant base from 19 Bugaboo Creek Steak House restaurants at the end of 2001 to 22 restaurants at the end of 2002. Average weekly sales for all Bugaboo Creek Steak House restaurants in 2002 were $68,609, a 2.5% increase from 2001. Sales for the comparable Bugaboo Creek Steak House restaurants increased 1.9% in 2002, as compared to 2001. The increase in comparable restaurant sales at Bugaboo Creek Steak House restaurants is attributable primarily to an increase in average check.

Franchise Revenue:
The Company has a Franchisee that operates three LongHorn Steakhouse restaurants in Puerto Rico. The Company's franchisee opened its third franchise LongHorn Steakhouse in 2000. The Company earned $345,000 and $328,000 in franchise revenue in 2002 and 2001, respectively.

COSTS AND EXPENSES

Cost of restaurant sales, as a percentage of restaurant sales, decreased to 36.1% in 2002 from 36.5% in 2001. Contract pricing on certain protein and other products during 2002 were favorable as compared to the prior year.

Restaurant operating expenses increased as a percentage of restaurant sales in 2002 to 44.0%, from 43.9% in 2001. This was due to an increase in restaurant management and hourly labor as a percentage of restaurant sales, partially offset by greater sales leverage of fixed and semi-fixed expenses (principally advertising and rent).

The provision for asset impairments, restaurant closings, and other charges of $495,000 in 2002 consisted of the write down of one LongHorn Steakhouse restaurant. The amount of the charge was determined under SFAS No. 144 by comparing discounted future cash flows to the carrying value of impaired assets.

Depreciation and amortization – restaurants increased to $23.9 million in 2002, from $21.2 million in 2001, due to the Company's new restaurant construction and depreciation of capital expenditures associated with the Company's remodeling of older restaurants.

Pre-opening expense remained flat at $3.8 million or 0.7% of total restaurant sales in both 2002 and 2001. The amounts charged to pre-opening expense in any year is dependent upon the number of restaurants opened and the restaurant concept.

General and administrative expenses increased to $34.9 million in 2002, from $31.7 million in 2001, but decreased as a percent of total revenues to 6.0% in 2002 from 6.1% in 2001. The increased costs in 2002 were primarily compensation related, associated with increased accruals for management bonuses, payroll and the cost of building the infrastructure necessary to support the Company's growth. General and administrative expenses, as a percent of total revenues, decreased principally due to greater leverage of fixed and semi-fixed expenses resulting from increased sales at existing restaurants and new restaurants.

Interest expense, net decreased to $1.7 million in 2002, from $2.1 million in 2001. The decrease in interest expense, net is due to the repayment of amounts outstanding under the Company's revolving credit facility and an increase in interest income in 2002.

Concurrent with amending and restating the Company's $100.0 million revolving credit agreement, the Company repaid all amounts outstanding under the credit agreement and terminated an associated interest rate swap agreement that had been accounted for as a hedge. The Company paid $1,540,000 resulting in an after-tax expense of $961,000 associated with terminating the interest rate swap agreement. The repayment of amounts outstanding under the credit agreement combined with the termination of the associated hedge created an ineffective hedge relationship, which resulted in the $1,540,000 charge to earnings in 2002.

Minority interest decreased to $448,000 in 2002, from $639,000 in 2001. This reflects a decrease in the number of joint venture restaurants in 2002 compared to 2001 resulting primarily from the purchase of the joint venture partner's interest in seven restaurants during 2002 and one joint venture restaurant during 2001.

Income tax expense in 2002 was 32.3% of earnings before income taxes. The Company's effective income tax rate differs from applying the statutory Federal income tax rate of 35% to earnings before income taxes primarily due to employee FICA tip tax credits partially offset by state income taxes.

Net income of $33.4 million in 2002, as compared to net income of $26.2 million in 2001, reflects the net effect of the items discussed above.

Year Ended December 30, 2001 Compared to Year Ended December 31, 2000

REVENUES

Total revenues increased 14.7% to $520.3 million for 2001, compared to $453.7 million for 2000. The Company's fiscal year is a 52- or 53-week year ending on the last Sunday in each calendar year. Each of the four quarters is typically made up of 13 weeks; however, since fiscal 2000 was a 53-week period, the first quarter of 2000 contained 14 weeks compared to 13 operating weeks in the first quarter of 2001. This differential in the number of operating weeks had an unfavorable effect on the Company's revenue comparisons and operating results for 2001 compared to 2000.

LongHorn Steakhouse:
Sales in the LongHorn Steakhouse restaurants increased 14.5% to $366.5 million for 2001, compared to $320.2 million for 2000. The increase reflects a 13.1% increase in restaurant operating weeks in 2001 as compared to 2000, resulting from an increase in the restaurant base from 135 Company-owned and joint venture LongHorn Steakhouse restaurants at the end of 2000 to 154 restaurants at the end of 2001. Total operating week comparisons were negatively affected by the additional week in the 2000 53-week operating period as compared to the 52-week operating period in 2001. Excluding the additional operating week in the 53-week fiscal year 2000, total restaurant operating weeks would have increased by 15.3% in 2001 as compared to the same period in 2000. Average weekly sales for all Company-owned and joint venture LongHorn Steakhouse restaurants in 2001 were $47,838, a 1.2% increase over 2000. Sales for the comparable LongHorn Steakhouse restaurants increased 1.8% in 2001 as compared to 2000. The increase in comparable restaurant sales for 2001 at LongHorn Steakhouse was attributable to an increase in average check.

The Capital Grille:
Sales in The Capital Grille restaurants increased 24.5% to $80.1 million for 2001, compared to $64.4 million for 2000. The increase reflects a 25.8% increase in restaurant operating weeks in 2001 as compared to 2000, resulting from an increase in the

restaurant base from 12 The Capital Grille restaurants at the end of 2000 to 15 restaurants at the end of 2001. Total operating week comparisons were negatively affected by the additional week in the 2000 53-week operating period as compared to the 52-week operating period in 2001. Average weekly sales for all The Capital Grille restaurants in 2001 were $108,139, a 1.0% decrease from 2000. This decrease in average weekly sales volume is due to the opening of three new The Capital Grille restaurants. The Capital Grille restaurants have historically opened at lower sales volumes and not experienced the drop off in sales after an initial honeymoon period commonly characteristic in the restaurant industry. Sales for the comparable The Capital Grille restaurants increased 1.8% in 2001, as compared to 2000. The increase in comparable restaurant sales at The Capital Grille restaurants is attributable primarily to an increase in average check. Excluding the additional operating week in the 53-week fiscal year 2000, total restaurant operating weeks would have increased by 28.2% in 2001 as compared to the same period in 2000.

Bugaboo Creek Steak House:
Sales in the Bugaboo Creek Steak House restaurants increased 7.7% to $66.1 million for 2001, compared to $61.4 million for 2000. The increase reflects a 3.2% increase in restaurant weeks in 2001 as compared to 2000, resulting from the operation of 19 Bugaboo Creek Steak House restaurants during all of 2001 compared to 2000 when the 19th Bugaboo Creek Steak House restaurant was opened in the fourth quarter. Total operating week comparisons were negatively affected by the additional week in the 2000 53-week operating period as compared to the 52-week operating period in 2001. Average weekly sales for all Bugaboo Creek Steak House restaurants in 2001 were $66,944, a 4.3% increase from 2000. Excluding the additional operating week in the 53-week fiscal year 2000, total restaurant operating weeks would have increased by 5.2% in 2001 as compared to the same period in 2000. Sales for the comparable Bugaboo Creek Steak House restaurants increased 2.9% in 2001, as compared to 2000. The increase in comparable restaurant sales at Bugaboo Creek Steak House restaurants is attributable primarily to an increase in average check and guest counts.

Franchise Revenue:
The Company has a Franchisee that operates three LongHorn Steakhouse restaurants in Puerto Rico. The Company's franchisee opened one franchise LongHorn Steakhouse in each of 2000, 1999 and 1998. The Company earned $328,000 and $380,000 in franchise revenue in 2001 and 2000, respectively.

COSTS AND EXPENSES

Cost of restaurant sales, as a percentage of restaurant sales, decreased to 36.5% in 2001 from 36.7% in 2000. Favorable pricing on certain non-red meat products during 2001 more than offset higher red meat costs during the year.

Restaurant operating expenses increased as a percentage of restaurant sales in 2001 to 43.9%, from 43.0% in 2000. This was due to an increase in restaurant management and hourly labor as a percentage of restaurant sales, and an increase in advertising and promotions expense, partially offset by greater sales leverage of fixed and semi-fixed expenses (principally rent).

The provision for asset impairments, restaurant closings, and other charges of $2.8 million in 2001 consisted primarily of the write down of five LongHorn Steakhouse restaurants. The amount of the charge was determined under SFAS No. 121 by comparing discounted future cash flows to the carrying value of impaired assets.

Depreciation and amortization – restaurants increased to $21.2 million in 2001, from $17.0 million in 2000, and as a percent of total restaurant sales due to the Company's new restaurant construction, capital lease accounting treatment associated with the three new The Capital Grille restaurants opened during 2001 and acceleration of the Company's remodeling programs.

Pre-opening expense increased to $3.7 million in 2001, from $3.3 million in 2000, principally due to the opening of 22 Company-owned restaurants in 2001 compared to the opening of 19 Company-owned restaurants in 2000.

General and administrative expenses increased to $31.7 million in 2001, from $30.7 million in 2000, but decreased as a percent of total revenues to 6.1% from 6.8% in 2000. The increased costs in 2001 were primarily payroll related, associated with building the infrastructure necessary to support the Company's growth partially offset by reduced accruals for management bonuses. General and administrative expenses, as a percent of total revenues, decreased principally due to greater leverage of fixed and semi-fixed expenses resulting from increased sales at existing restaurants and new restaurants.

Interest expense decreased to $2.1 million in 2001, from $4.2 million in 2000. The decrease in interest expense is principally due to the Company's common stock offering in February 2001, the proceeds of which were used to pay down borrowings under the Company's revolving credit facility. The Company's weighted average interest rate on borrowings, including the amortization of debt issue costs, under its revolving credit facility was approximately 8.6% in 2001 and 2000.

Concurrent with the completion of the February 2001 common stock offering, the Company amended its interest rate swap agreements to fix the interest rate on future amounts borrowed under the Company's credit facility. The Company paid $1.1 million resulting in an after-tax expense of $682,000 associated with amending the interest rate swap agreements to reduce the notional principal to amounts equal to the variable rate debt expected to be outstanding in the future under the Company's credit facility. The repayment of amounts outstanding under the credit agreement combined with the termination of the associated hedge resulted in the $1.1 million charge to earnings in 2001.

Minority interest decreased to $0.6 million in 2001, from $1.4 million in 2000. This reflects a decrease in the number of joint venture restaurants in 2001 compared to 2000 due to the purchase of a joint venture partner's interest in one restaurant during 2001 and 19 joint venture restaurants during 2000.

Income tax expense in 2001 was 32.5% of earnings before income taxes. The Company's effective income tax rate differs from applying the statutory Federal income tax rate of 35% to earnings before income taxes primarily due to employee FICA tip tax credits partially offset by state income taxes.

Net income of $26.2 million in 2001, as compared to net income of $23.3 million in 2000, reflects the net effect of the items discussed above.

LIQUIDITY AND CAPITAL RESOURCES

The Company requires capital primarily for the development of new restaurants, selected acquisitions and the refurbishment of existing restaurants. The Company's principal financing sources in 2002 were proceeds from cash flow from operations ($53.1 million), and proceeds from the exercise of employee stock options ($5.3 million). The primary uses of funds consisted of costs associated with expansion, principally leasehold improvements, equipment, land and buildings associated with the construction of new restaurants ($54.4 million) and the repayment of amounts outstanding under the Company's revolving credit facility ($10.0 million).

Since substantially all sales in the Company's restaurants are for cash, and accounts payable are generally due in seven to 30 days, the Company operates with little or negative working capital.

The increases in accounts receivable, inventory, prepaid expenses, and accrued expenses are principally due to the new restaurants which were opened during 2002 and the result of generally higher average unit volumes experienced during 2002. Further increases in current asset and liability accounts are expected as the Company continues its restaurant development program.

In November 2002, the Company amended and restated its $100.0 million revolving credit facility, including extending its maturity to November 2007. The terms of the revolving credit facility, as amended, require the Company to pay interest on outstanding borrowings at LIBOR plus a margin of 1.25% to 1.75% (depending on the Company's leverage ratio) or the administrative agent's prime rate of interest, at the Company's option, and pay a commitment fee of 0.3% to 0.4% (depending on the Company's leverage-ratio) per year on any unused portion of the facility. No amounts were outstanding under the Company's revolving credit agreement on December 29, 2002. As of December 29, 2002, interest on the revolving credit facility provided for interest to be accrued at LIBOR plus 1.25% or the prime rate. The Company was required to pay a commitment fee of 0.30% per year on any unused portion of the facility. The revolving credit facility contains various covenants and restrictions which, among other things, require the maintenance of stipulated leverage and fixed charge coverage ratios and minimum consolidated net worth, as defined, and also limit additional indebtedness in excess of specified amounts. The Company is currently in compliance with such covenants.

The $1,540,000 ($961,000 after-tax) separately stated expense associated with terminating the interest rate swap agreement resulted in an approximately $0.04 decrease in diluted earnings per share for the fourth quarter of 2002. At December 29, 2002, no amounts were outstanding and $100.0 million was available under the Company's $100.0 million revolving credit agreement.

The Company currently plans to open 20 to 21 Company-owned LongHorn Steakhouse restaurants, two or three Bugaboo Creek Steak House restaurants and one or two The Capital Grille restaurants in 2003. The Company estimates that its capital expenditures will be approximately $75.0 to $80.0 million in 2003. The capital expenditure estimate for 2003 includes the estimated cost of developing 23 to 26 new restaurants, ongoing refurbishment in existing restaurants, costs associated with obtaining real estate for year 2004 planned openings, installation of a new point of sale system in all existing restaurants and continued investment in improved management information systems. In September 2001, the Company's Board of Directors authorized the Company to use up to $15.0 million to purchase shares of its common stock through open market transactions, block purchases or in privately negotiated transactions. During the fourth quarter of 2002, the Company purchased 85,000 shares of its common stock for a total purchase price of $2,205,000 (average price of $25.96 per share).

The Company expects that available borrowings under the Company's revolving credit facility, together with cash on hand and cash provided by operating activities, will provide sufficient funds to finance its expansion and share repurchase plans through the year 2005.

OUTLOOK FOR FUTURE OPERATING RESULTS

Revenues: The Company plans to grow revenues by opening additional restaurants and increasing average unit volumes. The Company's new restaurant development plans for 2003 are summarized in the section entitled "LIQUIDITY AND CAPITAL RESOURCES." Based upon current economic conditions, the Company is targeting same store sales growth in 2003 of 2% to 3% for all three concepts, compared with 2002. The Company anticipates that the same store sales increase will be comprised of approximately equal percentage increases in average check and customer counts.

Cost of restaurant sales: The Company is anticipating flat to slightly favorable commodity prices in 2003 based primarily on favorable protein pricing. The Company is under a fixed price contract with its primary supplier for the majority of its anticipated purchases of protein products in 2003, however the Company pays market prices for other products, such as produce and fresh seafood. Accordingly, the Company does not expect its costs of goods sold to increase materially as a percentage of sales in 2003 as compared with 2002.

Operating expenses – restaurants: For the last several years, the Company has experienced wage rate pressure for both restaurant management and hourly positions, resulting from a tight labor market for skilled positions in the restaurant industry. Based upon labor market conditions that exist today, the Company expects this trend to continue in 2003. In addition, the Company expects that the cost of employee health insurance coverage will contribute to the upward pressure on labor costs as a percentage of restaurant sales. The Company also expects increased energy costs in 2003, as compared with 2002, particularly with respect to natural gas costs.

Pre-opening expense: Pre-opening costs are expensed as incurred and approximate $190,000 for each LongHorn Steakhouse restaurant, $214,000 for each Bugaboo Creek Steak House restaurant, and $358,000 for each The Capital Grille restaurant. Restaurant pre-opening expenses may vary materially from period to period depending on when restaurants open. As a result of the planned opening of more new restaurants in 2003, as compared to 2002, the Company anticipates that pre-opening expenses will be higher in 2003.

Depreciation and amortization – restaurants: The Company expects depreciation to increase as it invests in the development of new restaurants, the ongoing refurbishment in existing restaurants, and the installation of a new point of sale system in all existing restaurants. Due to greater leverage of this fixed expense resulting from expected sales increases in 2003, the Company expects depreciation and amortization – restaurants to remain flat as a percentage of restaurant sales.

General and administrative expenses: To support the Company's expected increase in the number of new restaurants in 2003, the Company plans to increase total general and administrative expenses by approximately 15% to 16%, compared with 2002. This percentage growth in general and administrative expense approximates the anticipated percentage growth in revenue.

Interest expense, net: Due to the repayment of all amounts outstanding under the Company's revolving credit facility, the Company expects net interest expense to decrease significantly in 2003 compared with 2002.

Income tax expense: The Company expects the effective income tax rate for 2003 to be approximately 32.5% of earnings before income taxes.

Earnings per share: Based upon the net effect of the items discussed above, the Company expects 2003 diluted earnings per common share in a range of $1.74 to $1.77.

The preceding discussion of liquidity and capital resources and outlook for future operating results contain certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements regarding the intent, belief or current expectations of the Company and members of its management team, as well as assumptions on which such statements are based. All forward-looking statements in this annual report are based upon information available to the Company on the date of this report. Forward-looking statements involve a number of risks and uncertainties, and in addition to the factors discussed elsewhere in this annual report, other factors that could cause actual results, performance or developments to differ materially from those expressed or implied by those forward-looking statements include the following: failure of facts to conform to necessary management estimates and assumptions; the Company’s ability to identify and secure suitable locations for new restaurants on acceptable terms, open the anticipated number of new restaurants on time and within budget, achieve anticipated rates of same store sales, hire and train additional restaurant personnel and integrate new restaurants into its operations; the continued implementation of the Company’s business discipline over a large restaurant base; unexpected increases in cost of sales or employee, pre-opening or other expenses; the economic conditions in the new markets into which the Company expands and possible uncertainties in the customer base in these areas; fluctuations in quarterly operating results; seasonality; changes in customer dining patterns; the impact of any negative publicity or public attitudes related to the consumption of beef; disruption of established sources of product supply or distribution; competitive pressures from other national and regional restaurant chains; business conditions, such as inflation or a recession, or other negative effect on dining patterns, or some other negative effect on the economy, in general, including (without limitation) war, insurrection and/or terrorist attacks on United States soil; growth in the restaurant industry and the general economy; changes in monetary and fiscal policies, laws and regulations; and the risks identified from time to time in the Company’s SEC reports, including the Company’s Annual Report on Form 10-K for 2002, registration statements and public announcements. The Company undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

The table below summarizes the Company’s significant contractual obligations, by maturity, as of December 29, 2002 *(in thousands)*:

	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Bank revolving credit facility	$ –	$ –	$ –	$ –	$ –
Capital lease obligations	51,268	2,096	4,393	4,576	40,203
Operating leases	113,008	15,679	29,932	24,041	43,356
Other purchase obligations	13,502	13,502	–	–	–
Total contractual cash obligations	$ 177,778	$ 31,277	$ 34,325	$ 28,617	$ 83,559

EFFECT OF INFLATION

Management believes that inflation has not had a material effect on earnings during the past several years. Inflationary increases in the cost of labor, food and other operating costs could adversely affect the Company’s restaurant operating margins. In the past, however, the Company generally has been able to modify its operations and increase menu prices to offset increases in its operating costs.

A majority of the Company’s employees are paid hourly rates related to federal and state minimum wage laws and various laws that allow for credits to that wage. Although the Company has been able to and will continue to attempt to pass along increases in the minimum wage and in other costs through food and beverage price increases, there can be no assurance that all such increases can be reflected in its prices or that increased prices will be absorbed by customers without diminishing, to some degree, customer spending at its restaurants.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). The Company adopted SFAS 142 effective as of the beginning of fiscal year 2002. SFAS 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. In the first quarter of fiscal 2002, the Company ceased amortization of goodwill and performed the required goodwill impairment testing. The impairment test required the Company to compare the fair value of each reporting unit to its carrying value to determine whether there is an indication that an impairment may exist. If an impairment of goodwill is determined to exist, it is measured as the excess of its carrying value over its fair value. Upon performing the initial test of the carrying value of the Company's goodwill, it was concluded that there was no current indication of impairment to goodwill. Accordingly, no impairment losses were recorded upon the initial adoption of SFAS 142.

As of the date of adoption, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million and $0.9 million for fiscal year 2001 and 2000, respectively. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for 2002. For the foreseeable future, management believes the only impact on the Company's consolidated financial statements from the adoption of SFAS 142 will be the elimination of goodwill amortization expense.

The proforma effects of the adoption of SFAS 142 on net earnings and basic and diluted earnings per share is as follows *(in thousands, except per share amounts)*:

	Year Ended		
	2002	2001	2000
Net earnings, as reported	**$ 33,439**	$ 26,158	$ 23,260
Goodwill amortization, net of tax benefit	–	679	549
Net earnings, pro forma	**$ 33,439**	$ 26,837	$ 23,809
Basic earnings per common share:			
Net earnings, as reported	**$ 1.54**	$ 1.25	$ 1.27
Goodwill amortization, net of tax benefit	–	0.03	0.03
Net earnings, pro forma	**$ 1.54**	$ 1.28	$ 1.30
Diluted earnings per common share:			
Net earnings, as reported	**$ 1.46**	$ 1.18	$ 1.20
Goodwill amortization, net of tax benefit	–	0.03	0.03
Net earnings, pro forma	**$ 1.46**	$ 1.21	$ 1.23

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets" ("SFAS 144"), which supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. SFAS 144 retains many of the provisions of SFAS 121, but addresses certain implementation issues associated with that statement. The Company adopted SFAS 144 effective as of the beginning of fiscal 2002. The adoption of SFAS 144 did not have a material impact on the Company's consolidated financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS Nos. 4 and 64 required gains and losses from extinguishment of debt to be classified as extraordinary items. SFAS 145 rescinds this requirement and stipulates that gains or losses on extinguishment of debt would have to meet the criteria of APB Opinion No. 30 to be classified as an extraordinary item. In addition, any extraordinary gains or losses on extinguishment of debt in prior periods presented would require reclassification. SFAS 145 is effective for fiscal years beginning after May 15, 2002. The Company is currently evaluating the impact of the adoption of SFAS 145.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). This statement requires that a liability for a cost associated with an exit or disposal activity be recognized only when the liability is incurred and measured at fair value. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the initial adoption of this statement to have a material impact on the Company's consolidated results of operations or financial position.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34." This interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on the Company's financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS 148"). SFAS 148 amends SFAS 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), and provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also amends the disclosure requirements of SFAS 123 to require more prominent and frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for financial statements issued for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company is currently evaluating SFAS 148 to determine if it will adopt SFAS 123 to account for employee stock options using the fair value method and, if so, when to begin transition to that method.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that the Company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective. The application of this Interpretation is not expected to have a material effect on the Company's financial statements.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

In the ordinary course of business, the Company has made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of its financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes that the following discussion addresses the Company's most critical accounting policies, the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions.

Property and Equipment:
Property and equipment is recorded at cost and is depreciated on a straight-line basis over the estimated useful lives of such assets. Changes in circumstances such as technological advances, changes to the Company's business model or changes in the Company's capital strategy can result in the actual useful lives differing from the Company's estimates. In those cases where the Company determines that the useful life of property and equipment should be shortened, the Company would depreciate the net book value in excess of the salvage value, over its revised remaining useful life thereby increasing depreciation expense. Factors such as changes in the planned use of fixtures or software or closing of facilities could also result in shortened useful lives.

The Company's accounting policies regarding property and equipment include judgments by management regarding the estimated useful lives of these assets, the residual values to which the assets are depreciated, and the determination as to what constitutes enhancing the value of or increasing the life of existing assets. These judgments and estimates may produce materially different amounts of depreciation and amortization expense than would be reported if different assumptions were used. As discussed further below, these judgments may also impact the Company's need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized.

Impairment of Long-Lived Assets:
Long-lived assets, including restaurant sites, fixed assets, intangibles and goodwill are reviewed by the Company for impairment whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. Expected cash flows associated with an asset is a key factor in determining the recoverability of the asset. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance. The Company's estimates of undiscounted cash flow may differ from actual cash flow due to, among other things, technological changes, economic conditions, changes to its business model or changes in its operating performance. If the sum of the undiscounted cash flows is less than the carrying value of the asset, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

Judgments made by the Company related to the expected useful lives of long-lived assets and the Company's ability to realize undiscounted cash flows in excess of the carrying amounts of such assets are affected by factors such as the ongoing maintenance and improvements of the assets, changes in economic conditions, and changes in operating performance. As the ongoing expected cash flows and carrying amounts of long-lived assets are assessed, these factors could cause the Company to realize a material impairment charge. In 2002, the Company recognized a $495,000 charge for the writedown of one LongHorn Steakhouse restaurant and in 2001 recognized a $2,802,000 charge for the writedown of five LongHorn Steakhouse restaurants based on an evaluation of expected cash flows.

Self-Insurance Reserves:
The Company self-insures for a significant portion of expected losses under its workers' compensation, employee medical and general liability programs. Accrued liabilities have been recorded based on estimates of the ultimate costs to settle incurred and incurred but not reported claims.

The accounting policies regarding self-insurance programs include certain management judgments and assumptions regarding the frequency or severity of claims and claim development patterns, and claim reserve, management, and settlement practices. Unanticipated changes in these factors may produce materially different amounts of expense that would be reported under these programs.

Income Taxes:
Income taxes are accounted for by the Company in accordance with Statement of Financial Accounting Standards 109, "Accounting for Income Taxes" ("SFAS 109") which requires that deferred tax assets and liabilities be recognized for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The Company reviews and assesses the recoverability of any deferred tax assets recorded on the balance sheet and provides any necessary allowances as required. An adjustment to the deferred tax asset would be charged to income in the period such determination was made.

INTEREST RATE RISK

The Company may be exposed to market risk from changes in interest rates on debt.

As of December 29, 2002, the Company had no borrowings outstanding under its $100.0 million revolving credit facility. Amounts outstanding under such credit facility bear interest at LIBOR plus a margin of 1.25% to 1.75% (the "applicable margin" depending on the Company's leverage ratio), or the administrative agent's prime rate of interest at the Company's option. Accordingly, the Company is exposed to the impact of interest rate movements. To achieve the Company's objective of managing its exposure to interest rate changes, the Company may from time to time use interest rate swaps.

INVESTMENT PORTFOLIO

The Company invests portions of its excess cash, if any, in highly liquid investments. At December 29, 2002, the Company had $9.8 million in high-grade overnight repurchase agreements, and $17.7 million in short-term investments in the form of federal, state, and municipal bonds. As of December 29, 2002, the Company has classified all short-term investments as trading securities. The market risk on such investments is minimal due to their short-term nature.

CONSOLIDATED BALANCE SHEETS

DECEMBER 29, 2002 AND DECEMBER 30, 2001

	2002	2001
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 13,732**	$ 25,979
Short-term investments	**17,735**	–
Accounts receivable	**6,576**	5,769
Inventories	**14,309**	13,437
Prepaid expenses	**3,477**	3,069
Refundable income taxes (note 7)	**4,124**	3,902
Deferred income taxes (note 7)	**4,484**	6,643
Total current assets	**64,437**	58,799
Property and equipment, less accumulated depreciation and amortization (notes 4 and 9)	**299,773**	269,323
Goodwill	**19,187**	19,187
Deferred income taxes (note 7)	**–**	2,276
Other	**3,510**	2,871
Total assets	**$ 386,907**	$ 352,456
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 17,727**	$ 27,189
Accrued expenses (note 5)	**44,015**	36,483
Current installments of obligations under capital leases (note 9)	**78**	58
Total current liabilities	**61,820**	63,730
Debt, net of current installments (note 6)	**–**	10,000
Deferred income taxes (note 7)	**1,138**	–
Obligations under capital leases, net of current installments (note 9)	**22,406**	20,867
Total liabilities	**85,364**	94,597
Minority interest	**1,411**	1,329
Shareholders' equity (notes 2, 6, 10, and 11):		
Preferred stock, no par value. Authorized 10,000 shares, none issued	**–**	–
Common stock, no par value. Authorized 60,000 shares; issued 22,066 shares and 21,522 shares at December 29, 2002 and December 30, 2001, respectively	**191,174**	178,787
Unearned compensation – restricted stock	**(1,124)**	(522)
Retained earnings	**112,446**	79,007
Accumulated other comprehensive loss	**–**	(583)
Treasury shares at cost; 95 shares and 10 shares at December 29, 2002 and December 30, 2001, respectively	**(2,364)**	(159)
Total shareholders' equity	**300,132**	256,530
Commitments and contingencies (notes 4, 6, 8, 9, and 12)		
Total liabilities and shareholders' equity	**$ 386,907**	$ 352,456

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 29, 2002, DECEMBER 30, 2001 AND DECEMBER 31, 2000

	2002	2001	2000
	(in thousands, except per share data)		
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	**$ 416,917**	$ 366,538	$ 320,189
The Capital Grille	**88,637**	80,131	64,362
Bugaboo Creek Steak House	**71,216**	66,141	61,421
Other restaurants	**7,389**	7,188	7,312
Total restaurant sales	**584,159**	519,998	453,284
Franchise revenues	**345**	328	380
Total revenues	**584,504**	520,326	453,664
Costs and expenses:			
Cost of restaurant sales	**211,006**	189,869	166,421
Operating expenses – restaurants	**257,252**	228,340	194,874
Provision for asset impairments, restaurant closings, and other charges (note 3)	**495**	2,802	–
Depreciation and amortization – restaurants	**23,920**	21,248	17,022
Pre-opening expense	**3,802**	3,764	3,318
General and administrative expenses	**34,933**	31,675	30,723
Total costs and expenses	**531,408**	477,698	412,358
Operating income	**53,096**	42,628	41,306
Interest expense, net	**1,718**	2,128	4,159
Early termination of interest rate swap agreement	**1,540**	1,100	–
Provision for litigation settlement (note 12)	**–**	–	1,000
Minority interest (note 2)	**448**	639	1,407
Earnings before income taxes	**49,390**	38,761	34,740
Income tax expense (note 7)	**15,951**	12,603	11,480
Net earnings	**$ 33,439**	$ 26,158	$ 23,260
Basic earnings per common share	**$ 1.54**	$ 1.25	$ 1.27
Diluted earnings per common share	**$ 1.46**	$ 1.18	$ 1.20
Weighted average common shares outstanding (basic)	**21,724**	21,002	18,271
Weighted average common shares outstanding (diluted)	**22,845**	22,144	19,416

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

YEARS ENDED DECEMBER 29, 2002, DECEMBER 30, 2001 AND DECEMBER 31, 2000

	Common Stock					Accumulated Other Comprehensive	Total
(in thousands)	Shares	Dollars	Restricted Stock	Retained Earnings	Treasury Stock	Income (Loss)	Shareholders' Equity
BALANCE, DECEMBER 26, 1999	18,576	$ 110,258	$ (376)	$ 29,589	$(1,887)	$ –	$ 137,584
Net earnings	–	–	–	23,260	–	–	23,260
Issuance of shares in connection with purchase of minority interest	356	6,827	–	–	–	–	6,827
Issuance of shares pursuant to restricted stock awards	7	127	(127)	–	–	–	–
Amortization of restricted stock	–	–	165	–	–	–	165
Purchase of common stock for treasury	–	–	–	–	(7,864)	–	(7,864)
Issuance of shares pursuant to exercise of stock options	688	6,406	–	–	–	–	6,406
Tax benefit of stock options exercised	–	879	–	–	–	–	879
BALANCE, DECEMBER 31, 2000	19,627	124,497	(338)	52,849	(9,751)	–	167,257
Comprehensive income (net of tax):							
Net earnings	–	–	–	26,158	–	–	26,158
Cumulative effect of change in accounting principle, net of taxes	–	–	–	–	–	(624)	(624)
Change in unrealized loss from interest rate swaps, net of taxes	–	–	–	–	–	41	41
Total comprehensive income							25,575
Issuance of shares pursuant to public offering	1,429	47,872	–	–	9,751	–	57,623
Purchase of common stock for treasury	–	–	–	–	(159)	–	(159)
Issuance of shares pursuant to restricted stock awards	18	414	(414)	–	–	–	–
Amortization of restricted stock	–	–	230	–	–	–	230
Issuance of shares to retirement plans	28	656	–	–	–	–	656
Issuance of shares pursuant to exercise of stock options	420	4,303	–	–	–	–	4,303
Tax benefit of stock options exercised	–	1,045	–	–	–	–	1,045
BALANCE, DECEMBER 30, 2001	21,522	178,787	(522)	79,007	(159)	(583)	256,530
Comprehensive income (net of tax):							
Net earnings	–	–	–	33,439	–	–	33,439
Other comprehensive income, change in unrealized loss from interest rate swaps	–	–	–	–	–	583	583
Total comprehensive income							34,022
Purchase of common stock for treasury	–	–	–	–	(2,205)	–	(2,205)
Issuance of shares to retirement plans	11	219	–	–	–	–	219
Issuance of shares pursuant to restricted stock awards	44	1,038	(1,038)	–	–	–	–
Amortization of restricted stock	–	–	436	–	–	–	436
Issuance of shares pursuant to exercise of stock options	489	5,262	–	–	–	–	5,262
Tax benefit of stock options exercised	–	5,868	–	–	–	–	5,868
BALANCE, DECEMBER 29, 2002	**22,066**	**$ 191,174**	**$(1,124)**	**$112,446**	**$(2,364)**	**$ –**	**$ 300,132**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 29, 2002, DECEMBER 30, 2001 AND DECEMBER 31, 2000

	2002	2001	2000
		(in thousands)	
Cash flows from operating activities:			
Net earnings	**$ 33,439**	$ 26,158	$ 23,260
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	**25,597**	24,067	19,378
Non-cash portion of provision for asset impairments, restaurant closings and other charges	**495**	2,802	–
Minority interest	**448**	639	1,407
Deferred tax expense (benefit)	**5,573**	(823)	(1,020)
Issuance of common stock to employee retirement plans	**219**	656	–
Changes in assets and liabilities:			
Purchase of short-term investments, net	**(17,735)**	–	–
Accounts receivable	**(807)**	(1,114)	(2,549)
Inventories	**(872)**	(2,284)	(966)
Prepaid expenses	**(408)**	(1,823)	(431)
Other assets	**(731)**	(796)	452
Refundable income taxes	**5,646**	1,187	(597)
Accounts payable	**(5,943)**	6,550	1,666
Accrued expenses	**8,190**	2,164	6,311
Net cash provided by operating activities	**53,111**	57,383	46,911
Cash flows from investing activities:			
Purchase of property and equipment	**(54,397)**	(55,497)	(58,430)
Purchase of joint venture and franchise interests	**–**	–	(3,220)
Net cash used in investing activities	**(54,397)**	(55,497)	(61,650)
Cash flows from financing activities:			
Proceeds from (repayments of) debt, net	**(10,000)**	(41,000)	11,000
Proceeds from issuance of common stock	**–**	57,623	–
Principal payments on capital leases	**(58)**	(44)	(40)
Proceeds from minority partner contributions	**156**	–	184
Distributions to minority partners	**(522)**	(779)	(1,907)
Increase (decrease) in bank overdraft included in accounts payable and accrued liabilities	**(3,594)**	378	1,867
Purchase of common stock for treasury	**(2,205)**	(159)	(7,864)
Proceeds from exercise of stock options	**5,262**	4,303	6,406
Net cash provided by (used in) financing activities	**(10,961)**	20,322	9,646
Net increase (decrease) in cash and cash equivalents	**(12,247)**	22,208	(5,093)
Cash and cash equivalents at beginning of year	**25,979**	3,771	8,864
Cash and cash equivalents at end of year	**$ 13,732**	$ 25,979	$ 3,771
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	**$ 6,243**	$ 11,914	$ 12,823
Cash paid for interest	**$ 2,912**	$ 3,137	$ 5,117
Supplemental disclosure of non-cash financing and investing activities:			
Assets acquired under capital lease	**$ 1,617**	$ –	$ 11,277
Issuance of common stock in purchase of minority interest	**$ –**	$ –	$ 6,827

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 29, 2002, DECEMBER 30, 2001 AND DECEMBER 31, 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

OPERATIONS

RARE Hospitality International, Inc., including its wholly owned subsidiaries (the "Company"), is a multi-concept restaurant company operating primarily in the Eastern half of the United States. At December 29, 2002, the Company operated the following restaurants:

CONCEPT	NUMBER IN OPERATION
LongHorn Steakhouse	170
Bugaboo Creek Steak House	22
The Capital Grille	15
Other specialty concepts	2

The Company is a partner in several joint ventures and limited partnerships organized for the purpose of operating LongHorn Steakhouse restaurants. As of December 29, 2002, three of the Company's restaurants operate in joint ventures managed by the Company.

BASIS OF PRESENTATION

The consolidated financial statements include the financial statements of RARE Hospitality International, Inc., its wholly owned subsidiaries, and joint ventures over which the Company exercises control. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company's fiscal year is a 52- or 53-week year ending on the last Sunday in each calendar year. Each of the four fiscal quarters is typically made up of 13 weeks; however, since fiscal 2000 was a 53-week period, the first quarter of 2000 contained 14 operating weeks.

The Company effected a three-for-two stock split in the form of a 50% stock dividend paid on September 5, 2000 to shareholders of record on August 15, 2000. All references to the number of common shares and per share amounts prior to the stock split have been restated to give retroactive effect to the stock split for all periods presented.

ACCOUNTING CHANGE

In November 2001, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") reached a consensus on EITF Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer." EITF 01-9 addresses the recognition, measurement and income statement classification for sales incentives offered to customers. Sales incentives include discounts, coupons, free products or services and generally any other offers that entitle a customer to receive a reduction in the price of a product. Under EITF 01-9, the reduction in or refund of the selling price of the product resulting from any sales incentives should be classified as a reduction of revenue. Prior to adopting the provisions of EITF 01-9, the Company recognized certain sales incentives as either general and administrative or restaurant operating expense. Although this pronouncement does not have any impact on the Company's consolidated results of operations or financial position, the presentation prescribed has the effect of reducing net sales and operating expenses. The Company adopted EITF 01-9 as of the beginning of 2002 and has reclassified prior years' sales and operating expenses to conform to the new presentation requirement. The reduction in net sales and operating expenses resulting from the adoption of EITF 01-9 amounted to $12,881,000 and $10,364,000 for 2001 and 2000, respectively.

CASH EQUIVALENTS

The Company considers all highly liquid investments which have original maturities of three months or less to be cash equivalents. Cash equivalents are comprised of overnight repurchase agreements and totaled approximately $9.8 million at December 29, 2002 and $21.0 million at December 30, 2001. There were no cash equivalents held by the Company on December 31, 2000. The carrying amount of these instruments approximates their fair market values. All overdraft balances have been reclassified as current liabilities.

SHORT TERM INVESTMENTS

Short term investments consist of federal, state and municipal bonds. The Company accounts for its investments under the provisions of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). Pursuant to the provisions of SFAS 115, the Company has classified its investment portfolio as "trading." Trading securities are bought and held principally for the purpose of selling them in the near term and are recorded at fair value. Unrealized gains and losses on trading securities are included in the determination of net earnings.

INVENTORIES

Inventories, consisting principally of food and beverages, are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Property under capital leases is stated at the present value of minimum lease payments. Leasehold improvements and property held under capital leases are amortized on the straight-line method over the shorter of the term of the lease, which may include renewals, or the estimated useful life of the assets (generally 15 years for non-ground lease sites and 25 years for ground lease sites). Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the related assets, which approximates 25 years for buildings and land improvements, seven years for restaurant equipment, and three years for computer hardware and software.

PRE-OPENING AND ORGANIZATION COSTS

The Company accounts for pre-opening and organization costs in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires entities to expense as incurred all organization and pre-opening costs.

COMPUTER SOFTWARE FOR INTERNAL USE

At the beginning of fiscal 1999, the Company adopted the AICPA SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 identifies the characteristics of internal-use software and specifies that once the preliminary project stage is complete, certain external direct costs, certain direct internal payroll and payroll-related costs and interest costs incurred during the development of computer software for internal use should be capitalized and amortized. Prior to fiscal 1999 the Company expensed all such costs as incurred. The adoption of SOP 98-1 did not have a material impact on the Company's results of operations or financial position.

UNREDEEMED GIFT CERTIFICATES

The Company records a liability for outstanding gift certificates at the time they are issued. Upon redemption, sales are recorded and the liability is reduced by the amount of certificates redeemed.

GOODWILL

The Company adopted SFAS 142, "Goodwill and Other Intangible Assets", effective as of the beginning of fiscal year 2002. SFAS 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. In the first quarter of fiscal 2002, the Company ceased amortization of goodwill and performed the required goodwill impairment testing. The fair value of each reporting unit was compared to its carrying value to determine whether there is an indication that impairment may exist. If an impairment of goodwill is determined to exist, it is measured as the excess of its carrying value over its fair value. Upon performing the initial test for impairment of the carrying value of the Company's goodwill, it was concluded that there was no current indication of impairment to goodwill. Accordingly, no impairment losses were recorded upon the initial adoption of SFAS 142.

As of the date of adoption of SFAS 142, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million and $0.9 million for fiscal years 2001 and 2000, respectively. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for fiscal 2002.

OTHER ASSETS

Other assets consist of debt issuance costs, trademarks, deposits, and purchased liquor licenses. Trademarks are amortized on a straight-line basis over five years. The Company applies the provisions of SFAS 142 to purchased liquor licenses; accordingly, in

the first quarter of fiscal 2002, the Company ceased amortizing purchased liquor licenses. Debt issuance costs are amortized on a straight-line basis over the term of the debt.

RESTAURANT CLOSING COSTS

Upon the decision to close or relocate a restaurant, estimated unrecoverable costs are charged to expense. Such costs include the write-down of buildings and/or leasehold improvements, equipment, and furniture and fixtures, to the estimated fair market value less costs of disposal, and a provision for future lease obligations, less estimated subrental income. The Company provided for the closure of one restaurant in each of fiscal year 2002 and 2001.

RECOVERABILITY OF LONG-LIVED ASSETS

The Company accounts for long-lived assets in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires the Company to review its long-lived assets related to each restaurant periodically or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Considerable management judgment is required to estimate cash flows and fair value less costs to sell. Accordingly, actual results could vary significantly from such estimates.

INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax benefits credited to equity relate to tax benefits associated with amounts that are deductible for income tax purposes but do not affect net earnings. These benefits are principally generated from employee exercises of stock options and vesting of employee restricted stock awards.

STOCK-BASED COMPENSATION

Prior to January 1, 1996, the Company accounted for its stock option plan in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. On January 1, 1996, the Company adopted Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation", which permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant.

Alternatively, SFAS 123 also allows entities to continue to apply the provisions of APB 25 and provide pro forma net earnings (loss) and pro forma earnings (loss) per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method defined in SFAS 123 had been applied. The Company has elected to continue to apply the provisions of APB 25 and provide the pro forma disclosures required by SFAS 123. The fair value of the options granted during 2002, 2001 and 2000 is estimated at approximately $4.9 million, $8.6 million, and $7.0 million, respectively, on the date of grant, using the Black-Scholes option pricing model with the following assumptions:

	2002	2001	2000
Dividend yield	**0**	0	0
Volatility	**46%**	51%	50%
Risk-free interest rate	**4%**	4%	6%
Average expected life	**5 yrs**	6 yrs	6 yrs

In accordance with the provisions of APB 25, the Company did not recognize any compensation expense from the issuance of employee stock options. The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of SFAS 123 *(in thousands except per share amounts)*:

	2002	2001	2000
Net earnings, as reported	**$ 33,439**	$ 26,158	$ 23,260
Total stock-based employee compensation expense determined under fair value methods for all awards, net of related tax effects	**3,275**	3,261	2,505
Pro forma net earnings	**$ 30,164**	$ 22,897	$ 20,755
Basic earnings per common share:			
Net earnings, as reported	**$ 1.54**	$ 1.25	$ 1.27
Net earnings, pro forma	**$ 1.39**	$ 1.09	$ 1.14
Diluted earnings per common share:			
Diluted earnings, as reported	**$ 1.46**	$ 1.18	$ 1.20
Diluted earnings, pro forma	**$ 1.32**	$ 1.03	$ 1.07

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS 148"). SFAS 148 amends the transition and disclosure provisions of SFAS 123. The Company is currently evaluating SFAS 148 to determine if it will adopt SFAS 123 to account for employee stock options using the fair value method and, if so, when to begin transition to that method. See Note 11 for further discussion of the Company's stock option plans.

ADVERTISING EXPENSES

Advertising costs are expensed in the periods in which the costs are incurred. Total advertising expense included in operating expenses - restaurants was approximately $16.8 million, $16.1 million and $12.3 million for the years ended December 29, 2002, December 30, 2001 and December 31, 2000, respectively.

SEGMENT DISCLOSURE

Due to the similar economic characteristics, as well as a single type of product, production process, distribution system and type of customer, the Company reports the operations of its different concepts on an aggregated basis and does not separately report segment information. Revenues from external customers are derived principally from food and beverage sales. The Company does not rely on any major customers as a source of revenue.

EARNINGS PER SHARE

The Company accounts for earnings per share in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"). SFAS 128 requires dual disclosure of earnings per share-basic and diluted. Basic earnings per share equals net earnings divided by the weighted average number of common shares outstanding and does not include the dilutive effects of stock options and restricted stock. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding after giving effect to dilutive stock options and restricted stock.

The following table presents a reconciliation of weighted average shares and earnings per share amounts *(amounts in thousands, except per share data)*:

	2002	2001	2000
Weighted average number of common shares used in basic calculation	**21,724**	21,002	18,271
Dilutive effect of restricted stock awards	**97**	74	61
Dilutive effect of net shares issuable pursuant to stock option plans	**1,024**	1,068	1,084
Weighted average number of common shares used in diluted calculation	**22,845**	22,144	19,416
Net earnings	**$ 33,439**	$ 26,158	$ 23,260
Basic earnings per common share	**$ 1.54**	$ 1.25	$ 1.27
Diluted earnings per common share	**$ 1.46**	$ 1.18	$ 1.20

Options to purchase 227,607 shares of common stock at December 29, 2002, were excluded from the computation of diluted earnings per common share because the related exercise prices were greater than the average market price for 2002 and would have been antidilutive.

ACCOUNTS RECEIVABLE
Accounts receivable is primarily comprised of amounts due from the Company's credit card processor.

FINANCIAL INSTRUMENTS
The carrying value of the Company's cash and cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses, debt, and obligations under capital leases approximates their fair value. The fair value of a financial instrument is the amount for which the instrument could be exchanged in a current transaction between willing parties. The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

For cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses the carrying amounts approximate fair value because of the short maturity of these financial instruments. The fair value of the Company's debt and obligations under capital leases is estimated by discounting future cash flows for these instruments at rates currently offered to the Company for similar debt or long-term leases, as appropriate.

DERIVATIVE FINANCIAL INSTRUMENTS
The Company, from time to time, has used interest rate swap agreements in the management of interest rate risk. The Company carries all derivative instruments on the balance sheet at fair value. Prior to November 2002, the Company used interest rate swap agreements to effectively fix the interest rate on a portion of the variable rate borrowings under the Company's $100.0 million revolving credit facility (see Note 6). These interest rate swap agreements were classified as a hedge of a cash flow exposure under SFAS No. 133, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" and accordingly, the effective portion of the initial fair value and subsequent changes in the fair value of those agreements are reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted cash flows affect earnings.

The Company adopted SFAS No. 133 beginning January 2001. As a result of adopting this new accounting standard, the Company recorded a net transition adjustment of $624,000 ($1,006,000 transition adjustment loss net of related tax benefit of $382,000) in accumulated other comprehensive income at January 1, 2001. Concurrent with the completion of the February 2001 common stock offering, the Company amended its interest rate swap agreements to fix the interest rate on future amounts under the Company's credit facility. The Company paid approximately $1.1 million resulting in an after-tax expense of $682,000 associated with amending the interest rate swap agreements to reduce the notional principal to amounts equal to the variable rate debt expected to be outstanding in the future under the Company's credit facility. The repayment of amounts outstanding under the credit agreement combined with the termination of the associated hedge created an ineffective hedge relationship, which is reported in earnings immediately; accordingly, the $1.1 million payment to terminate a portion of the swap agreements was reported as early termination of interest rate swap agreement in the Company's statement of operations.

Concurrent with the November 2002, amendment and extension of the Company's $100.0 million revolving credit facility, all amounts outstanding under the credit facility were repaid and the interest rate swap agreement was terminated. The Company paid $1,540,000 resulting in an after-tax expense of $961,000 associated with terminating this interest rate swap, which was reported as early termination of interest rate swap agreement in the Company's statement of operations.

At December 29, 2002 the Company had no interest rate swap agreements.

USE OF ESTIMATES
Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

COMPREHENSIVE INCOME
For 2002 and 2001, comprehensive income includes net earnings adjusted for net unrealized losses on interest rate swaps. During 2000, net earnings were the same as comprehensive income.

RECENTLY ADOPTED ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). The Company adopted SFAS 142 effective as of the beginning of fiscal year 2002. SFAS 142 requires that an intangible asset that is acquired shall be initially recognized and measured based on its fair value. This statement also provides that goodwill should not be amortized, but shall be tested for impairment annually, or more frequently if circumstances indicate potential impairment, through a comparison of fair value to its carrying amount. In the first quarter of fiscal 2002, the Company ceased amortization of goodwill and performed the required goodwill impairment testing. The impairment test required the Company to compare the fair value of each reporting unit to its carrying value to determine whether there is an indication that an impairment may exist. If an impairment of goodwill is determined to exist, it is measured as the excess of its carrying value over its fair value. Upon performing the initial test for impairment of the carrying value of the Company's goodwill, it was concluded that there was no current indication of impairment to goodwill. Accordingly, no impairment losses were recorded upon the initial adoption of SFAS 142.

As of the date of adoption, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million and $0.9 million for fiscal year 2001 and 2000, respectively. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for 2002. For the foreseeable future, management believes the only impact on the Company's consolidated financial statements from the adoption of SFAS 142 will be the elimination of goodwill amortization expense.

The pro forma effects of the adoption of SFAS 142 on net earnings and basic and diluted earnings per share is as follows *(in thousands, except per share amounts)*:

	2002	2001	2000
Net earnings, as reported	**$ 33,439**	$ 26,158	$ 23,260
Goodwill amortization, net of tax benefit	**–**	679	549
Net earnings, pro forma	**$ 33,439**	$ 26,837	$ 23,809
Basic earnings per common share:			
Net earnings, as reported	**$ 1.54**	$ 1.25	$ 1.27
Goodwill amortization, net of tax benefit	**–**	0.03	0.03
Net earnings, pro forma	**$ 1.54**	$ 1.28	$ 1.30
Diluted earnings per common share:			
Net earnings, as reported	**$ 1.46**	$ 1.18	$ 1.20
Goodwill amortization, net of tax benefit	**–**	0.03	0.03
Net earnings, pro forma	**$ 1.46**	$ 1.21	$ 1.23

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", and the accounting and reporting provisions of APB No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions", for the disposal of a segment of a business. SFAS 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company adopted SFAS 144 effective as of the beginning of fiscal 2002. The adoption of SFAS 144 did not have a material impact on the Company's consolidated financial statements.

RECENTLY ISSUED ACCOUNTING STANDARDS

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"), SFAS Nos. 4 and 64 required gains and losses from extinguishment of debt to be classified as extraordinary items. SFAS 145 recinds this requirement and stipulates that gains or losses on extinguishment of debt would have to meet the criteria of APB Opinion No. 30 to be classified as an extraordinary item. In addition, any extraordinary gains or losses on extinguishment of debt in prior periods presented would require reclassification. SFAS 145 is effective for fiscal years beginning after May 15, 2002. The Company does not expect the initial adoption of SFAS 145 to have a material impact on the Company's consolidated results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized only when the liability is incurred and measured at fair value. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the initial adoption of this statement to have a material impact on the Company's consolidated results of operations or financial position.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34." This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on the Company's financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS 148"). SFAS 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", and provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also amends the disclosure requirements of SFAS 123 to require more prominent and frequent disclosures in financial statements about the effects of stock-based compensation. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company is currently evaluating SFAS 148 to determine if it will adopt SFAS 123 to account for employee stock options using the fair value method and, if so, when to begin transition to that method.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that the Company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective. The application of this Interpretation is not expected to have a material effect on the Company's financial statements.

RECLASSIFICATIONS
Certain reclassifications have been made to the 2001 and 2000 consolidated financial statements to conform with the 2002 presentation.

2. BUSINESS COMBINATIONS AND JOINT VENTURES

In July 2000, the Company acquired the ownership interest of its partners in two joint ventures. The first joint venture partner, located in the Tampa, Florida market, had an ownership interest of approximately 10% in five LongHorn Steakhouse restaurants. The interest was purchased for an aggregate price of approximately $1.2 million; comprised of $287,500 in cash, a $25,000 note payable, and 48,492 shares of Company common stock. The excess purchase price over the book value of the minority interest acquired in this transaction was approximately $1.1 million and was recorded as goodwill to be amortized over 20 years. The second joint venture (consisting of two partners), located in the North Carolina market, had an approximate one-third ownership interest in 14 LongHorn Steakhouse restaurants. Their interests were purchased for an aggregate price of approximately $9.0 million; comprised of $2.9 million in cash, $100,000 in notes payable and 307,035 shares of Company common stock. The excess purchase price over the book value of the minority interest acquired in this transaction was approximately $6.8 million and was recorded as goodwill to be amortized over 20 years. Both of these transactions were accounted for under the purchase method of accounting.

3. PROVISION FOR ASSET IMPAIRMENTS, RESTAURANT CLOSINGS, AND OTHER CHARGES

The provision for asset impairments, restaurant closings, and other charges of $495,000 in fiscal 2002 consisted of the write down of one LongHorn Steakhouse restaurant. The amount of the charge was determined under SFAS 144 by comparing discounted future cash flows to the carrying value of impaired assets.

The provision for asset impairments, restaurant closings, and other charges of $2.8 million in fiscal 2001 consisted primarily of the write down of five LongHorn Steakhouse restaurants. The amount of the charge was determined under SFAS 121 by comparing discounted future cash flows to the carrying value of impaired assets.

4. PROPERTY AND EQUIPMENT

Major classes of property and equipment at December 29, 2002 and December 30, 2001 are summarized as follows *(in thousands)*:

	2002	2001
Land and improvements	**$ 44,585**	$ 33,543
Buildings	**45,978**	34,657
Leasehold improvements	**182,022**	163,538
Assets under capital lease	**22,626**	21,009
Restaurant equipment	**72,970**	64,136
Furniture and fixtures	**36,366**	33,220
Construction in progress	**16,896**	19,276
	421,443	369,379
Less accumulated depreciation and amortization	**121,670**	100,056
	$ 299,773	$ 269,323

During 2002, 2001 and 2000, the Company capitalized interest during construction of approximately $978,000, $826,000, and $790,000, respectively, as a component of property and equipment.

The Company has, in the normal course of business, entered into agreements with vendors for the purchase of restaurant equipment, furniture, fixtures, buildings, and improvements for restaurants that have not yet opened. At December 29, 2002, such commitments totaled approximately $13.5 million.

5. ACCRUED EXPENSES

Accrued expenses consist of the following at December 29, 2002 and December 30, 2001 *(in thousands)*:

	2002	2001
Accrued self insurance reserves	**$ 4,200**	$ 3,240
Accrued provision for asset impairments, restaurant closings, and other charges	**536**	603
Accrued rent	**7,362**	5,983
Accrued compensation	**8,071**	7,777
Other taxes accrued	**5,777**	5,677
Accrued gift certificate liability	**15,174**	11,229
Other	**2,895**	1,974
	$ 44,015	$ 36,483

6. DEBT

The Company has a variable interest rate revolving credit facility (the “Revolving Credit Facility”), which permits the Company to borrow up to $100.0 million through the termination date in November 2007. The Revolving Credit Facility is the result of amendments to and a restatement of the Company’s previous $100.0 million credit facility. The Revolving Credit Facility bears interest at the Company's option of LIBOR plus a margin of 1.25% to 1.75% (the “applicable margin”) (depending on the Company's leverage ratio) or the administrative agent's prime rate of interest, and requires payment of a commitment fee on any unused portion at a rate of 0.3% to 0.4% per year (depending on the Company’s leverage ratio). At December 29, 2002 and

December 30, 2001, the applicable margin was 1.25%. On December 29, 2002, there were no amounts outstanding under the Company's revolving credit facility. At December 30, 2001, the interest rate on the $10.0 million outstanding obligations under the Company's revolving credit facility was 3.1875%, based on the applicable margin. The commitment fee on the unused portion of the Revolving Credit Facility on December 29, 2002, and on December 30, 2001 was 0.3% per year. Amounts available under the Company's Revolving Credit Facility totaled $100.0 million and $90.0 million at December 29, 2002 and December 30, 2001, respectively.

The Revolving Credit Facility restricts payment of dividends, without prior approval of the lender, and contains certain financial covenants, including debt to capitalization, leverage and interest coverage ratios, as well as minimum net worth and maximum capital expenditure covenants. The Revolving Credit Facility is secured by the common stock of entities that own substantially all of the Bugaboo Creek Steak House and The Capital Grille restaurants. At December 29, 2002, the Company was in compliance with the provisions of the Revolving Credit Facility.

7. INCOME TAXES

Income tax (benefit) expense consists of *(in thousands)*:

	Current	Deferred	Total
Year ended December 29, 2002:			
U.S. Federal	$ 9,314	$ 5,001	$ 14,315
State and local	1,064	572	1,636
	$ 10,378	$ 5,573	$ 15,951
Year ended December 30, 2001:			
U.S. Federal	$ 12,049	$ (739)	$ 11,310
State and local	1,377	(84)	1,293
	$ 13,426	$ (823)	$ 12,603
Year ended December 31, 2000:			
U.S. Federal	$ 10,937	$ (892)	$ 10,045
State and local	1,563	(128)	1,435
	$ 12,500	$ (1,020)	$ 11,480

The differences between the statutory Federal income tax rate and the effective income tax rate reflected in the consolidated statements of operations are as follows:

	2002	2001	2000
Federal statutory income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit	**2.6**	2.6	3.3
Meals and entertainment	**0.1**	0.1	0.1
FICA tip credit	**(4.8)**	(5.2)	(5.4)
Other	**(0.6)**	–	–
Effective tax rates	**32.3%**	32.5%	33.0%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 29, 2002 and December 30, 2001 are presented below *(in thousands)*:

	2002	2001
Deferred tax assets (liabilities):		
Provisions for restaurant closings, and other charges	**$ 2,115**	$ 2,148
Accrued rent	**2,768**	2,182
Accrued joint venture contract termination	**115**	662
Pre-opening costs	**138**	268
Accrued insurance	**403**	251
Accrued workers' compensation	**582**	707
Property and equipment	**(1,954)**	1,631
Deferred compensation plan	**911**	610
Smallwares	**(2,192)**	–
Other	**460**	460
Net deferred tax asset (liability)	**$ 3,346**	$ 8,919

In assessing the realizability of deferred tax assets, the Company's management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company's management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections of future taxable income over the periods in which the temporary differences are deductible, the Company's management believes it is more likely than not the Company will realize the benefits of these deductible differences.

8. EMPLOYEE BENEFIT PLANS

The Company provides employees who meet minimum service requirements with retirement benefits under a 401(k) plan (the "RARE Plan"). Under the RARE Plan, eligible employees may make contributions of between 1% and 20% of their annual compensation. Effective for 2000, contributions to the RARE Plan by officers and highly compensated employees were limited to 2% of their annual compensation and effective for 2001, officers and highly compensated employees do not participate in this plan. The Company makes quarterly matching contributions in an amount equal to 50% of the first 5% of employee compensation contributed, resulting in a maximum Company contribution of 2.5% of employee compensation. The Company's expense under the RARE Plan was $627,000, $574,000 and $641,000, for 2002, 2001 and 2000, respectively.

Effective January 1, 2000, the Company implemented the Supplemental Deferred Compensation Plan (the "Supplemental Plan"), a nonqualified plan which allows officers and highly compensated employees to defer receipt of a portion of their compensation and contribute such amounts to one or more investment funds. The maximum aggregate amount deferred under the Supplemental Plan and the RARE Plan could not exceed the lesser of 20% of annual compensation or $20,000 in 2002 and 2001 or $10,500 in 2000. The Company makes quarterly matching contributions in an amount equal to 50% of employee contributions, not to exceed the lesser of 2.5% of the employee's total annual compensation or $5,000. The Company's expense under the Supplemental Plan was $324,000, $302,000 and $104,000 for 2002, 2001 and 2000, respectively.

Company contributions to both the RARE Plan and the Supplemental Plan vest at the rate of 20% each year beginning after the employee's first year of service and were made in the form of Company common stock in the first half of 2002 and all of 2001 and cash in the second half of 2002 and all of 2000.

9. LEASES AND RELATED COMMITMENTS

The Company is obligated under various capital leases for certain restaurant facilities that expire at various dates during the next 30 years. The Company also has noncancelable operating leases for certain restaurant facilities. Rental payments include minimum rentals, plus contingent rentals based on restaurant sales at the individual stores. These leases generally contain renewal options for periods ranging from three to 15 years and require the Company to pay all executory costs such as insurance and maintenance. Under the provisions of certain 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 anticipated life of the leases.

Future minimum lease payments under capital lease obligations and noncancelable operating leases at December 29, 2002 are as follows *(in thousands)*:

Years ending at or about December 31:	Capital	Operating
2003	$ 2,096	$ 15,679
2004	2,190	15,554
2005	2,203	14,378
2006	2,275	12,629
2007	2,301	11,412
Thereafter	40,203	43,356
Total minimum lease payments	51,268	$ 113,008
Less imputed interest (at 9%)	28,784	
Present value of minimum lease payments	22,484	
Less current maturities	78	
Obligations under capital leases, excluding current maturities	$ 22,406	

Rental expense consisted of the following amounts *(in thousands)*:

	2002	2001	2000
Minimum lease payments	**$ 15,961**	$ 14,686	$ 12,571
Contingent rentals	**1,721**	1,651	1,713
Total rental expense	**$ 17,682**	$ 16,337	$ 14,284

10. SHAREHOLDERS' EQUITY

In September 2001, the Company's Board of Directors authorized the Company to use up to $15.0 million to purchase shares of its common stock through open market transactions, block purchases or in privately negotiated transactions through September 2002. In July 2002, the Company's Board of Directors extended this share repurchase program through April 2003. During the third quarter of 2001, the Company purchased 10,000 shares of its common stock for a total purchase price of approximately $159,000 (average price of $15.90 per share). During the fourth quarter of 2002, the Company purchased 85,000 shares of its common stock for a total purchase price of approximately $2,205,000 (average price of $25.94 per share).

In February 2000, the Company's Board of Directors authorized the Company to purchase up to $10.0 million of its common stock through February 2001, subject to market conditions. In April 2000, the Company's Board of Directors increased the dollar amount of the Company's common stock authorized to be repurchased from $10.0 million to $25.0 million. During 2000, the Company purchased 654,000 shares of its common stock under this program at an aggregate cost of approximately $7.9 million (average price of $12.02 per share). In February 2001, the Company completed a public offering for 2.3 million shares of its common stock. Net proceeds to the Company from this offering were approximately $57.6 million.

The Company's Articles of Incorporation authorize 10,000,000 shares of preferred stock, no par value. The Board of Directors of the Company may determine the preferences, limitations, and relative rights of any class of shares of preferred stock prior to the issuance of such class of shares. In November 1997, in connection with the adoption of a Shareholders Rights Plan, the Board of Directors designated 500,000 shares of Series A Junior Participating Preferred Stock (the "Series A Stock") and filed such designation as an amendment to the Company's Articles of Incorporation. Holders of shares of Series A Stock are entitled to receive, when, as and if declared by the Board of Directors, (i) on each date that dividends or other distributions (other than dividends or distributions payable in common stock) are payable on the common stock comprising part of the Reference Package (as defined in the Articles of Incorporation), an amount per whole share of Series A Stock equal to the aggregate amount of dividends or other distributions that would be payable on such date to a holder of the Reference Package and (ii) on the last day of March, June, September and December in each year, an amount per whole share of Series A Stock equal to the excess of $1.00 over the aggregate dividends paid per whole share of Series A Stock during the three-month period ending on such last day. If any shares of Series A Stock are issued, no dividends (other than dividends payable in common stock) may be declared or paid unless the full cumulative dividends on all outstanding shares of Series A Stock have been or are contemporaneously paid. Upon the liquidation, dissolution or winding up of the affairs of the Company and before any distribution or payment to the holders of common stock, holders of shares of the Series A Stock are entitled to be paid in full an amount per whole share of Series A Stock equal to the greater of (i) $1.00 or (ii) the aggregate amount distributed or to be distributed prior to the date of such liquidation, dissolution or winding up to a holder of the Reference Package. After payment in full to each holder of shares of Series A Stock, the Series A Stock shall have no right or claim to any of the remaining assets of the Company. Each outstanding share of Series A Stock votes on all matters as a class with any other capital stock comprising part of the Reference Package and shall have the number of votes that a holder of the Reference Package would have.

As of December 29, 2002, there were no shares of Series A Stock issued and outstanding and all of such shares are issuable in accordance with the Company's Shareholders Rights Plan.

11. STOCK OPTIONS

The Company's 2002 Stock Option Plan (the "2002 Stock Option Plan"), provides for the granting of incentive stock options and nonqualified stock options to employees, officers, directors, consultants, and advisors. All stock options issued under the 2002 Stock Option Plan were granted at prices which equate to or were higher than current market value on the date of the grant, are generally exercisable after three to five years, and must be exercised within ten years from the date of grant. The 2002 Stock Option Plan authorized the granting of options to purchase 900,000 shares of common stock.

The Company's 1997 Long-Term Incentive Plan, as amended (the "1997 Stock Option Plan"), provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, performance units, restricted stock, dividend equivalents and other stock based awards to employees, officers, directors, consultants, and advisors. All stock options issued under the 1997 Stock Option Plan were granted at prices which equate to or were higher than current market value on the date of the grant, are generally exercisable after three to five years, and must be exercised within ten years from the date of grant. The 1997 Stock Option Plan authorized the granting of options to purchase 1,987,500 shares of common stock.

The Company's Amended and Restated 1996 Stock Plan for Outside Directors (the "1996 Stock Option Plan") provides for the automatic granting of non qualified stock options to outside directors. The 1996 Stock Option Plan authorizes the granting of options to purchase up to an aggregate of 150,000 shares of common stock. All stock options issued under the 1996 Stock Option Plan are granted at prices which are equal to the current market value on the date of the grant, become exercisable six months and one day after the date of grant, and must be exercised within ten years from the date of grant.

As of December 29, 2002 and December 30, 2001, options to purchase 1,495,134 and 1,512,470 shares of common stock, respectively, were exercisable at weighted average exercise prices of $11.83 and $10.00 per share, respectively. Option activity under the Company's stock option plans is as follows:

	Shares	Weighted Average Price
Outstanding at December 26, 1999	2,544,783	$ 9.52
Granted in 2000	954,629	13.24
Exercised in 2000	(680,332)	9.40
Canceled in 2000	(251,979)	11.76
Outstanding at December 31, 2000	2,567,101	10.68
Granted in 2001	742,250	21.97
Exercised in 2001	(423,781)	10.40
Canceled in 2001	(148,309)	16.03
Outstanding at December 30, 2001	2,737,261	13.52
Granted in 2002	434,428	24.81
Exercised in 2002	(496,363)	10.55
Canceled in 2002	(49,208)	18.16
Outstanding at December 29, 2002	2,626,118	15.85

The following table summarizes information concerning options outstanding and exercisable as of December 29, 2002:

	Options Outstanding			Options Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$5.83 to $10.00	692,269	4.4	$ 8.23	690,769	$ 8.24
$10.01 to $15.00	818,230	6.0	12.66	597,730	12.67
$15.01 to $20.00	133,984	8.2	18.60	54,683	18.27
$20.01 to $25.00	754,028	8.4	22.67	146,218	22.41
$25.01 or greater	227,607	9.4	26.31	5,734	27.53

12. COMMITMENTS AND CONTINGENCIES

LITIGATION SETTLEMENT

In March 2000, an ongoing legal dispute with a former joint venture partner was resolved by an arbitrator, resulting in a judgement against the Company in the amount of $2 million. The Company's consolidated statement of earnings for 2000 reflects a nonrecurring charge of $1 million ($670,000 net of income taxes) for amounts not previously reserved for this dispute.

PURCHASE COMMITMENTS

The Company has entered into purchasing agreements with certain meat suppliers requiring the Company to purchase contracted quantities of meat at established prices through their expiration on varying dates in 2003 and 2004. The quantities contracted for are based on usage projections management believes to be conservative estimates of actual requirements during the contract terms. The Company does not anticipate any material adverse effect on its financial condition or results of operations from these contracts.

OTHER

Under the Company's insurance programs, coverage is obtained for significant exposures as well as those risks required to be insured by law or contract. It is the Company's preference to self-insure a significant portion of certain expected losses related primarily to workers' compensation, employee medical and general liability costs. Provisions for losses expected under these programs are recorded based upon the Company's estimates of the aggregate liability for claims incurred.

The Company has deposits totaling $3.5 million at December 29, 2002 that are being maintained as security under the Company's workers' compensation policies.

The Company is involved in various legal actions incidental to the normal conduct of its business. Management does not believe that the ultimate resolution of these incidental actions will have a material adverse effect on the Company's financial condition or results of operations.

13. QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations for the years ended December 29, 2002 and December 30, 2001 (in thousands, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2002:					
Revenues	**$ 145,298**	**$ 145,386**	**$ 139,942**	**$ 153,878**	**$ 584,504**
Operating income	**15,159**	**13,977**	**10,121**	**13,839**	**53,096**
Earnings before income taxes	**14,530**	**13,436**	**9,506**	**11,918**	**49,390**
Net earnings	**9,735**	**9,141**	**6,416**	**8,147**	**33,439**
Net earnings per share:					
Basic	**0.45**	**0.42**	**0.29**	**0.37**	**1.54**
Diluted	**0.43**	**0.40**	**0.28**	**0.35**	**1.46**
2001:					
Revenues	$ 131,960	$ 128,161	$ 125,443	$ 134,762	$ 520,326
Operating income	14,704	11,542	7,607	8,775	42,628
Earnings before income taxes	12,686	11,004	6,985	8,086	38,761
Net earnings	8,551	7,372	4,681	5,554	26,158
Net earnings per share:					
Basic	0.43	0.35	0.22	0.26	1.25
Diluted	0.40	0.33	0.21	0.25	1.18

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
RARE Hospitality International, Inc.

We have audited the accompanying consolidated balance sheets of RARE Hospitality International, Inc. and subsidiaries (the "Company") as of December 29, 2002 and December 30, 2001, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 29, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RARE Hospitality International, Inc. and subsidiaries as of December 29, 2002 and December 30, 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 29, 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets in 2002 and its method of accounting for derivative instruments and hedging activities in 2001.

KPMG LLP

Atlanta, Georgia
February 7, 2003

DIRECTORS AND EXECUTIVE OFFICERS

Philip J. Hickey, Jr.
Chairman, Chief Executive Officer and Director

Eugene I. Lee, Jr.
President, Chief Operating Officer and Director

W. Douglas Benn
Executive Vice President, Finance, Chief Financial Officer

Thomas W. Gathers
Executive Vice President, Human Resources

Joia M. Johnson
Executive Vice President, General Counsel and Secretary

Dennis D. Pedra
President, Bugaboo Creek Steak House

George W. McKerrow, Sr.
Director

Ronald W. San Martin
Director
Chief Financial Officer and Secretary, We're Cookin' Inc. (restaurants)

Don L. Chapman
Director
Chairman and Chief Executive Officer, Tug Investment Corporation (investment company)

Lewis H. Jordan
Director
Founder and Principal Officer, Wingspread Enterprises LLC (investments and consulting)

Carolyn H. Byrd
Director
Chairman and Chief Executive Officer, GlobalTech Financial, LLC (financial services)

Dick R. Holbrook
Director
President and Chief Operating Officer, AFC Enterprises, Inc. (restaurants)

CORPORATE INFORMATION

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Registrar and Transfer Agent
SunTrust Bank, Atlanta
Stock Transfer Department
58 Edgewood Avenue, Room 225 Annex
Atlanta, Georgia 30303
(404) 588-7817

Form 10-K/Investor Contact
A copy of the RARE Hospitality International, Inc. Annual Report on Form 10-K for 2002 as filed with the Securities and Exchange Commission is available on the Company's web site, www.rarehospitality.com. It is also available at no charge from the Company. These requests and other investor contacts should be directed to W. Douglas Benn, Executive Vice President, Finance and Chief Financial Officer, at the Company's corporate office.

Annual Meeting
The annual meeting of shareholders will be held on Monday, May 12, 2003, at 2:00 p.m. at The Capital Grille of Atlanta, 255 East Paces Road, Atlanta, Georgia.

Common Stock and Dividend Information
The common stock of RARE Hospitality International, Inc. is traded on the Nasdaq Stock Market (National Market) under the symbol RARE. At March 18, 2003, there were approximately 6,850 holders of the common stock of the Company, including approximately 479 shareholders of record. The market value of the Company's common stock on March 18, 2003, was $28.49 per share. Since the Company's initial public offering in 1992, the Company has not declared or paid any cash dividends. The Company does not intend to pay any cash dividends on its Common Stock in the foreseeable future, as the current policy of the Company's Board of Directors is to retain all earnings to support operations and finance expansion. The Company's existing revolving line of credit restricts the payment of cash dividends without prior lender approval. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources." Future declaration and payment of dividends, if any, will be determined in light of then current conditions, including the Company's earnings, operations, capital requirements, financial condition, restrictions in financing agreements and other factors deemed relevant by the Board of Directors.

As of December 29, 2002, there were 22,066,000 shares of common stock outstanding. The following table shows, for the periods indicated, the high and low sales prices per share for the common stock as reported by Nasdaq.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2002				
High	**$27.54**	**$29.75**	**$28.01**	**$28.70**
Low	**$21.20**	**$23.44**	**$20.75**	**$21.90**
2001				
High	$32.00	$28.43	$23.63	$23.60
Low	$20.06	$19.70	$14.84	$14.15

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