



Great Teams
CREATING
Great Dining
Experiences

RARE Concepts

At March 1, 2002



ALABAMA

Birmingham - 1
Dothan - 1
Huntsville - 1
Mobile - 1
Montgomery - 2

FLORIDA

Daytona Beach - 1
Destin - 1
Ft. Myers - 2
Jacksonville - 5
Miami/Ft. Lauderdale - 6
Ocala - 1
Orlando - 8
St. Augustine - 1
Tallahassee - 1
Tampa/St. Petersburg - 8
West Palm Beach - 2

GEORGIA

Albany - 1
Athens - 1
Atlanta - 28
Augusta - 1
Cartersville - 1
Columbus - 1
Dalton - 1
Macon - 1
Rome - 1
Savannah - 1
Statesboro - 1
Valdosta - 1
Warner Robbins - 1

ILLINOIS

Fairview Heights - 1

INDIANA

Indianapolis - 3

KANSAS

Leawood - 1

KENTUCKY

Bowling Green - 1
Florence - 1

MASSACHUSETTS

Boston - 5

MISSOURI

Kansas City - 3
St. Louis - 5

NEW HAMPSHIRE

Concord - 2

NEW JERSEY

Rochelle Park - 1

NORTH CAROLINA

Burlington - 1
Charlotte - 7
Greensboro/
High Point/
Winston-Salem - 4

OHIO

Cincinnati - 4
Cleveland - 10
Columbus - 6
Toledo - 1

PENNSYLVANIA

Erie - 1
Philadelphia - 1

RHODE ISLAND

Warwick - 1

SOUTH CAROLINA

Columbia - 3
Greenville/Spartanburg - 2
Hilton Head - 1
Mt. Pleasant - 1
Rock Hill - 1

TENNESSEE

Chattanooga - 1
Nashville - 6

VIRGINIA

McLean - 1

WEST VIRGINIA

Charleston - 1

Total Existing
Company-Owned/Joint
Venture Restaurants - 158

EXISTING FRANCHISEE-OWNED RESTAURANTS

PUERTO RICO

Bayamon - 1
Carolina - 1
San Patricio - 1

Total Existing
Franchisee-Owned
Restaurants - 3

TOTAL LONGHORN STEAKHOUSE RESTAURANTS - 161

SPECIALTY RESTAURANTS

MASSACHUSETTS

Seekonk - 1
The Old Grist Mill Tavern

RHODE ISLAND

Providence - 1
Hemenway's Seafood Grille
& Oyster Bar,

CONNECTICUT

Manchester - 1

DELAWARE

Newark - 1

GEORGIA

Atlanta - 1

MAINE

Bangor - 1
Portland - 1

MARYLAND

Gaithersburg - 1

MASSACHUSETTS

Boston - 6
Seekonk - 1

NEW HAMPSHIRE

Newington - 1

NEW YORK

Albany - 1
Poughkeepsie - 1
Rochester - 1

PENNSYLVANIA

Philadelphia - 1

RHODE ISLAND

Warwick - 1

TOTAL
BUGABOO CREEK
STEAK HOUSE
RESTAURANTS - 19

DISTRICT OF COLUMBIA

Washington - 1

FLORIDA

Miami - 1

GEORGIA

Atlanta - 1

ILLINOIS

Chicago - 1

MASSACHUSETTS

Boston - 2

MICHIGAN

Troy - 1

MINNESOTA

Minneapolis - 1

MISSOURI

Kansas City - 1

NORTH CAROLINA

Charlotte - 1

PENNSYLVANIA

Philadelphia - 1

RHODE ISLAND

Providence - 1

TEXAS

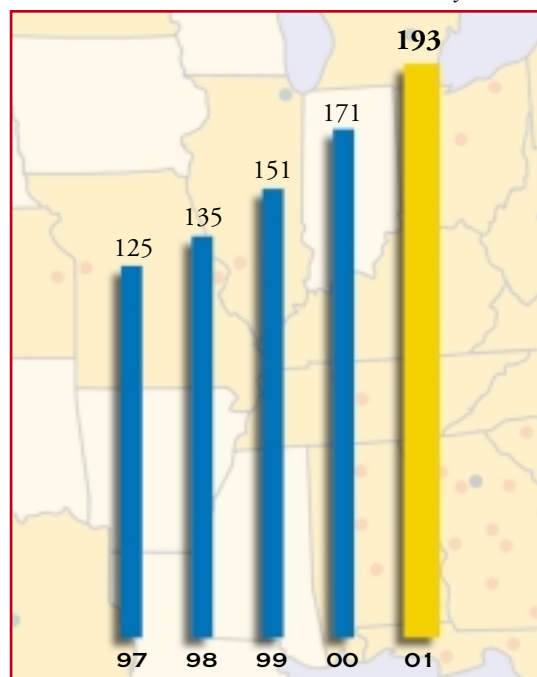
Dallas - 1
Houston - 1

VIRGINIA

McLean - 1

TOTAL
THE CAPITAL GRILLE
RESTAURANTS - 15

RESTAURANTS IN OPERATION (at year end)



ABOUT THE *Company*

RARE Hospitality International, Inc. owns, operates and franchises 197 restaurants, including 161 LongHorn Steakhouse restaurants located primarily in the southeastern and midwestern United States, 19 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.

ABOUT THE *Cover*

With nearly 200 restaurants in operation and more than 11,000 team members, our efforts to shape an organization that recognizes the power of the individual to make a difference – be it in our guest's enjoyment of their dining experience at RARE or in the greater world around us – are more important than ever. The cover of this annual report and the letter to shareholders focus on four of our team members and celebrates their willingness to make a difference. At RARE, we are committed to building the best team in the restaurant business. Thousands of team members making a difference, like the four pictured on the cover, are the clearest measure of our success.

FINANCIAL *Highlights*

(in thousands, except per share data)

For the Fiscal Year	2001	2000
Revenues	\$ 533,207	\$ 464,028
Operating income, before nonrecurring items ⁽¹⁾	\$ 45,430	\$ 41,306
Net earnings, before nonrecurring items ^{(1) (2)}	\$ 28,577	\$ 23,930
Diluted earnings per share, before nonrecurring items ^{(1) (2)}	\$ 1.29	\$ 1.23
Weighted average common shares outstanding (diluted)	22,144	19,416

⁽¹⁾ Excludes nonrecurring expenses for fiscal 2001, of \$2,802 (\$1,737, or \$0.08 per diluted share after tax).

⁽²⁾ Excludes nonrecurring expenses for fiscal 2001, of \$1,100 (\$682, or \$0.03 per diluted share, after tax) and for fiscal 2000 of \$1,000 (\$670, or \$0.03 per diluted share, after tax).

At Year End

Working capital (deficit)	\$ (4,931)	\$ (23,114)
Total assets	353,397	295,381
Debt, net of current installments	10,000	51,000
Obligations under capital leases, net of current installments	20,867	20,925
Minority interest	1,329	1,469
Total shareholders' equity	256,530	167,257

FELLOW *Shareholders*

We are pleased to report that despite a difficult operating environment, RARE Hospitality again produced record revenues, earnings and earnings per share, before nonrecurring items, for 2001. RARE's growth for 2001 fell short of our initial targets, primarily because of the impact of the softening economy and the tragic events of September 11th. While frankly, we are not satisfied with our financial results for 2001, we are proud of the Company's many achievements under unusually trying circumstances.

Some key achievements for 2001 include growth in total Company sales to more than one-half billion dollars, positive same-store sales growth for each of our three concepts, improvement in already favorable management retention rates, completion of a \$57.6 million stock offering that substantially strengthened the Company's balance sheet and positioned us for future expansion, and growth of our stock price for the fourth consecutive year. We were also honored to be included in the annual listing by Forbes as one of the 200 Best Small Companies in America.

Perhaps most encouraging, the response from the people of RARE (some of whom are pictured on these pages) to the challenges of 2001 validated our strategic decision to build RARE into one of the top employers of choice in the restaurant industry. The spirit and dedication of these people, exemplified in thousands of selfless actions every day, confirm our confidence in the power of people to drive the continuing success of our Company.

Our Company persevered in 2001 through the most challenging economic operating environment in more than a decade. When current management came to RARE four years ago, we established a five-year target of 20% for compounded annual growth in operating earnings per share. Thus far, from 1998 through 2001, we have exceeded this target with a compounded annual growth rate of 31.0% for earnings per diluted share, before non-recurring items. We believe this performance springs from the consistent delivery of the RARE value proposition – high quality food and outstanding service delivered in a warm, friendly environment. Complementing the dedication of the great teams that deliver this value proposition in each of our restaurants, we remain confident that we have the concepts, the management experience and the financial resources to expand our record of profitable growth in the years ahead.

DINING EXPERIENCES • GREAT TEAMS CREATING GREAT DINING EXPERIENCES •



T H E CAPITAL® G · R · I · L · L · E

OUR TEAM MEMBERS AT RARE ARE PEOPLE FOR WHOM GOING THE EXTRA MILE IS STANDARD BEHAVIOR. PEOPLE LIKE KIRA DIXON, A HOSTESS WHOSE BRIGHT DISPOSITION HAS BROUGHT SMILES TO EVEN OUR MOST EXACTING GUESTS. LEARNING THAT A FREQUENT GUEST WAS GOING INTO THE HOSPITAL, KIRA TOOK IT UPON HERSELF TO ARRANGE FOR THE GUEST'S FAVORITE MEAL TO BE PREPARED AND DELIVERED, TOPPED OFF WITH A GET WELL CARD SIGNED BY THE RESTAURANT STAFF. THROUGH THIS COMPASSIONATE ACT, KIRA ILLUSTRATES THE TYPE OF DEDICATION THAT ENGENDERS STRONG GUEST LOYALTY AT THE CAPITAL GRILLE. EXCEEDING GUEST EXPECTATIONS IS THE FOUNDATION OF CONSISTENTLY SUPERIOR PERFORMANCE.

KIRA *Dixon*

HOSTESS,
THE CAPITAL GRILLE



EVERY SUCCESSFUL RESTAURANT DEPENDS ON REPEAT BUSINESS FROM SATISFIED GUESTS, AND SERVICE IS USUALLY THE DIFFERENTIATING FACTOR IN A GUEST'S DECISION TO RETURN. THAT'S WHY WE TAKE NOTICE WHEN PEOPLE KEEP WRITING TO LET US KNOW HOW IMPRESSED THEY ARE WITH DAGO MELENDEZ. ACCORDING TO THESE LETTERS, DAGO IS A VISIBLE, HANDS-ON MANAGER WHO IS GENUINELY INTERESTED IN PEOPLE; THE TYPE OF PERSON WHO, ACCORDING TO ONE GUEST, "KNOWS EVERY PERSON IN OUR GROUP OF ABOUT 10 BY NAME." ANOTHER GUEST IN PRAISING THE PRIDE DAGO TAKES IN HIS JOB, SAID "LONGHORN'S REAL AMBASSADORS ARE EMPLOYEES LIKE MR. MELENDEZ." WE COULDN'T HAVE SAID IT BETTER OURSELVES.

DAGO *Melendez*
GENERAL MANAGER,
LONGHORN STEAKHOUSE

GREAT TEAMS CREATING GREAT DINING EXPERIENCES • GREAT TEAMS CREATING

2001 IN REVIEW

RARE produced record revenues of \$533,207,000 for 2001, which was a 52-week year, rising above the one-half billion dollar milestone for the first time in the Company's history. The Company's revenues increased 14.9% over revenues of \$464,028,000 for 2000, which was a 53-week year. Net earnings, before nonrecurring items, increased 19.4% for 2001 to \$28,577,000, from \$23,930,000 for 2000, and increased 4.9% to \$1.29 per diluted share from \$1.23 per diluted share. Diluted weighted average common shares outstanding expanded 14.1% for 2001 from 2000, primarily because of shares issued in the Company's stock offering in February 2001. RARE estimates that the extra week for 2000 provided a benefit of approximately \$0.03 per diluted share and, in addition, results for 2001 included a contribution of \$315,000, or approximately \$0.01 per diluted share to the "Dine for America" program, in which contributions were made to the American Red Cross Disaster Relief Fund to aid victims of the September 11th attack.

The Company's nonrecurring items for 2001 included an expense of \$2,802,000 (\$1,737,000, or \$0.08 per diluted share, after tax) resulting from a review of the carrying amounts of long-lived assets as required by FAS 121 and an expense of \$1,100,000 (\$682,000, or \$0.03 per diluted share, after tax) for the early termination of an interest rate swap agreement. For 2000, the nonrecurring item was related to the settlement of a legal dispute. Actual net earnings, which include these nonrecurring items, were \$26,158,000, or \$1.18 per diluted share for 2001 and \$23,260,000, or \$1.20 per diluted share, for 2000.

We attribute RARE's revenue growth for 2001 primarily to both increased same-store sales for the year and to the expansion in the Company's base of restaurants in operation. The increase in same-store sales for each of our concepts reflected the net impact of increases in average check, offsetting small declines in guest counts. LongHorn Steakhouse achieved its eighth consecutive year of increased same-store sales with 1.8% growth for 2001. The Capital Grille produced its sixth consecutive annual increase, also with 1.8% growth in same-store sales, while same-store sales rose 2.9% for Bugaboo Creek Steak House, its third consecutive annual increase.

We opened 22 new restaurants during 2001, increasing the number of restaurants in operation by 12.9% to 193 at year end, from 171 at the end of 2001. LongHorn Steakhouse added 19 restaurants during 2001, all three of The Capital Grille's scheduled openings occurred in the first half of the year, and we pushed the planned late-year opening of one Bugaboo Creek Steak House into the current year.

RARE's financial results for 2001 and its stock offering in February 2001 substantially strengthened the Company's financial position. We completed 2001 with cash and cash equivalents of \$25,979,000, up from \$3,771,000 at the end of 2000. In addition, long-term debt of \$10,000,000 and shareholders' equity of \$256,530,000 at the end of 2001, compared with \$51,000,000 and \$167,257,000, respectively, at the end of 2000, lowering the Company's ratio of funded debt to total capitalization to 3.8% at year end from 23.4% at the end of 2000.

OUTLOOK FOR 2002: PROCEEDING WITH SENSIBILITY

We believe that the best way to drive long-term growth in shareholder value is to provide consistent, significant profitable growth. To achieve this goal, we have developed and are consistently implementing strategies that deliver controlled growth through superior execution of the day-to-day fundamentals of the restaurant business. In spite of the more difficult environment of the last several quarters, we believe our business model remains capable of producing long-term compounded annual growth in earnings per diluted share, before nonrecurring items, of 20%.

For 2002, we are targeting growth in earnings per diluted share below this level because of uncertainty about the current strength of same-store sales, which we believe is the primary indicator of the vitality of our business. With same-store sales growth for 2001 below that of 2000 for each of our concepts, our highest priority for 2002 is to focus on the performance of our existing restaurant base. We currently assume that same-store sales for 2002 will increase in a range of 1% to 2% for both LongHorn Steakhouse and Bugaboo Creek Steak House, and be in a range of between negative 2% to flat for The Capital Grille. While we are confident that each of our concepts has the potential to produce stronger same-store results, we will proceed pragmatically in our expansion efforts until we see sustained improvement in the same-store sales performance of our restaurants.

As a result, the current new restaurant development schedule assumes the opening of 20 to 24 restaurants during 2002, comprised of 17 to 20 LongHorn Steakhouse restaurants, two to three Bugaboo Creek Steak House restaurants and one The Capital Grille restaurant.

DINING EXPERIENCES • GREAT TEAMS CREATING GREAT DINING EXPERIENCES •



WE OFTEN SAY THAT THOSE COMPANIES WITH THE BEST PEOPLE WIN, AND JASON WOODLAND PERSONIFIES THE TYPE OF PERSON WE HAVE IN MIND. JASON WAS RECENTLY CONTACTED BY A FAMILY WITH AN ILL SIX-YEAR OLD DAUGHTER WITH EXTREME DIETARY RESTRICTIONS. HE NOT ONLY TOLD THEM HE WOULD PREPARE A SPECIAL MEAL FOR HER, BUT WHEN THE FAMILY ARRIVED AT HIS RESTAURANT, HE ALSO INTRODUCED HIMSELF, DESCRIBED EXACTLY HOW HE WOULD PREPARE THE MEAL, AND THEN SERVED IT TO THE LITTLE GIRL HIMSELF. HER PARENTS WROTE US TO LET US KNOW HOW WONDERFUL JASON'S KIND ATTENTION HAD MADE THEIR DAUGHTER FEEL, AND HOW IMPRESSED THEY WERE WITH JASON'S "OUTSTANDING COMMITMENT TO SERVING THE CUSTOMER."

JASON *Woodland*

CHEF,
BUGABOO CREEK STEAK HOUSE



JUNE *Preston*

MANAGER OF CORPORATE ACCOUNTING,
RARE SUPPORT CENTER

WHEN JUNE PRESTON JOINED THE COMPANY 17 YEARS AGO, WE OPERATED SIX LONGHORN STEAKHOUSE RESTAURANTS. AS WE HAVE GROWN TO ALMOST 200 RESTAURANTS, SHE HAS COME TO DEFINE FOR RARE THE POSITIVE ATTITUDE EMBODIED BY THE COMMENT, "IF YOU'RE NOT SERVING OUR GUESTS, YOU SHOULD BE SUPPORTING SOMEONE WHO IS!" JUNE HAS WORKED WITH HUNDREDS OF RESTAURANT MANAGERS AND SUPPORT STAFF, DEVELOPING A REPUTATION THROUGHOUT RARE FOR GOING ABOVE AND BEYOND WITH A SMILE. HAVE A QUESTION? JUNE CAN USUALLY PROVIDE AN ANSWER. SEEKING ADVICE? JUNE CAN AND DOES HELP. SHE EXEMPLIFIES ON A DAILY BASIS THE INITIATIVE AND COMMITMENT THAT ARE HELPING RARE BUILD THE BEST TEAM IN THE RESTAURANT INDUSTRY.

GREAT TEAMS CREATING GREAT DINING EXPERIENCES • GREAT TEAMS CREATING

SUMMARY

Despite all that has changed since we concluded this letter last year, the key determinants of the success of this Company remain constant. We are focused on providing a superior dining experience to each guest in our restaurants through our value-added service and the high quality of our food. Recognizing the absolute consistency of execution required to achieve this goal, we also continue our emphasis on acquiring the most promising human talent and honing this talent through extensive, ongoing training. We are committed to this philosophy because experience has demonstrated that its successful application creates the solid foundation from which additional long-term growth can be pursued. Our near-term goal is to return to a stronger trend of consistent profitable growth; for the longer-term, our goal is to become the premier restaurant company of our size in the United States.

To help us achieve these goals, we have continued to refine our management team. Since we last wrote to you, Dave George has been promoted to Senior Vice President of Operations for the LongHorn Steakhouse concept, having previously been Vice President of Operations for both LongHorn Steakhouse and The Capital Grille. In addition, John Martin, a 14-year veteran with RARE, was promoted to Vice President of Operations for The Capital Grille, and Harry Day was brought on board as Vice President of Marketing for RARE.

The statement on the cover of this report, "Great Teams Creating Great Dining Experiences", is an appropriate summation of RARE's core operating focus for 2002 and beyond. We thank everyone throughout the RARE organization – now more than 11,000 strong - who bring this mantra to life every day. The strength of our commitment to excellence is reflected by the high quality of these people. We also thank you for your investment in RARE and the past and future support it provides. As your fellow shareholders, we are fully dedicated to the long-term growth in the value of your investment.

Sincerely,

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

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

SELECTED *Financial Data*

Fiscal Years Ended	December 30, 2001	December 31, 2000	December 26, 1999	December 27, 1998	December 28, 1997
	<i>(in thousands, except per share data)</i>				
STATEMENT OF OPERATIONS DATA:					
Revenues:					
Restaurant sales	\$ 532,879	\$ 463,648	\$ 382,275	\$ 319,084	\$ 264,727
Franchise revenues	328	380	195	–	27
Total revenues	533,207	464,028	382,470	319,084	264,754
Costs and expenses:					
Cost of restaurant sales	189,869	166,421	137,416	116,602	97,568
Operating expenses– restaurants	240,510	204,652	171,943	142,730	119,480
Provision for asset impairments, restaurant closings, and other charges	2,802	–	1,800	2,500	23,666
Depreciation and amortization–restaurants	21,248	17,022	15,249	17,636	15,218
Pre-opening expense	3,764	3,318	3,051	–	–
General and administrative expenses	32,386	31,309	26,052	22,470	23,590
Total costs and expenses	490,579	422,722	355,511	301,938	279,522
Operating income (loss)	42,628	41,306	26,959	17,146	(14,768)
Interest expense, net	2,128	4,159	3,866	2,939	1,245
Early termination of interest rate swap agreement	1,100	–	–	–	–
Provision for litigation settlement	–	1,000	–	–	–
Minority interest	639	1,407	1,609	1,334	1,219
Earnings (loss) before income taxes and cumulative effect of change in accounting principle	38,761	34,740	21,484	12,873	(17,232)
Income tax expense (benefit)	12,603	11,480	7,060	4,120	(5,000)
Earnings (loss) before cumulative effect of change in accounting principle	26,158	23,260	14,424	8,753	(12,232)
Cumulative effect of change in accounting principle (net of tax benefit of \$760)	–	–	1,587	–	–
Net earnings (loss)	\$ 26,158	\$ 23,260	\$ 12,837	\$ 8,753	\$ (12,232)
Basic earnings (loss) per common share before cumulative effect of change in accounting principle	\$ 1.25	\$ 1.27	\$ 0.80	\$ 0.49	\$ (0.69)
Cumulative effect per common share of change in accounting principle	–	–	0.09	–	–
Basic earnings (loss) per common share	\$ 1.25	\$ 1.27	\$ 0.71	\$ 0.49	\$ (0.69)
Diluted earnings (loss) per common share before cumulative effect of change in accounting principle	\$ 1.18	\$ 1.20	\$ 0.76	\$ 0.48	\$ (0.69)
Cumulative effect per common share of change in accounting principle	–	–	0.08	–	–
Diluted earnings (loss) per common share	\$ 1.18	\$ 1.20	\$ 0.68	\$ 0.48	\$ (0.69)
Weighted average common shares outstanding (basic)	21,002	18,271	18,048	18,006	17,627
Weighted average common shares outstanding (diluted)	22,144	19,416	18,819	18,149	17,627
BALANCE SHEET DATA:					
Working capital (deficit)	\$ (4,931)	\$ (23,114)	\$ (11,031)	\$ 1,136	\$ 1,359
Total assets	353,397	295,381	237,118	218,862	195,486
Debt, net of current installments	10,000	51,000	40,000	48,000	43,000
Obligations under capital leases, net of current installments	20,867	20,925	9,732	9,732	5,051
Minority interest	1,329	1,469	3,982	2,610	4,890
Total shareholders' equity	256,530	167,257	137,584	120,618	111,980

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, and for fiscal years prior to 1999, amortization associated with pre-opening 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. 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 30, 2001	December 31, 2000	December 26, 1999
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	70.5%	70.6%	68.1%
The Capital Grille	15.3	14.1	15.1
Bugaboo Creek Steak House	12.7	13.6	14.9
Other restaurants	1.4	1.6	1.8
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⁾	35.6	35.9	35.9
Operating expenses – restaurants ⁽¹⁾	45.1	44.1	45.0
Provision for asset impairments, restaurant closings, and other charges	0.5	–	0.5
Depreciation and amortization – restaurants ⁽¹⁾	4.0	3.7	4.0
Pre-opening expense – restaurants ⁽¹⁾	0.7	0.7	0.8
General and administrative expenses	6.1	6.7	6.8
Total costs and expenses	92.0	91.1	93.0
Operating income	8.0	8.9	7.0
Interest expense, net	0.4	0.9	1.0
Early termination of interest rate swap agreement	0.2	–	–
Provision for litigation settlement	–	0.2	–
Minority interest	0.1	0.3	0.4
Earnings before income taxes and cumulative effect of change in accounting principle	7.3	7.5	5.6
Income tax expense	2.4	2.5	1.8
Earnings before cumulative effect of change in accounting principle	4.9	5.0	3.8
Cumulative effect of change in accounting principle (net of tax benefit)	–	–	0.4
Net earnings	4.9%	5.0%	3.4%

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

REVENUES

Total revenues increased 14.9% to \$533.2 million for 2001, compared to \$464.0 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 14.6% to \$375.7 million for 2001, compared to \$327.8 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 weeks for 2001 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 \$49,037, a 1.3% 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 25.1% to \$81.8 million for 2001, compared to \$65.4 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 weeks for 2001 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 \$110,394, a 0.6% 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 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 7.9% to \$68.0 million for 2001, compared to \$63.0 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 weeks for 2001 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 \$68,850, a 4.6% 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 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 35.6% in 2001 from 35.9% 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 45.1%, from 44.1% 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 \$32.4 million in 2001, from \$31.3 million in 2000, but decreased as a percent of total revenues to 6.1% from 6.7% 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 created an ineffective hedge relationship, which 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.

RESULTS OF OPERATIONS

Year Ended December 31, 2000 Compared to Year Ended December 26, 1999

REVENUES

Total revenues increased 21.3% to \$464.0 million for 2000 compared to \$382.5 million for 1999. 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. This additional week had a favorable effect on the Company's revenue comparisons and operating results for 2000.

LongHorn Steakhouse:

Sales in the LongHorn Steakhouse restaurants increased 25.8% to \$327.8 million for 2000, compared to \$260.5 million for 1999. The increase reflects a 17.2% increase in restaurant operating weeks in 2000 as compared to 1999, resulting from an increase in the restaurant base from 118 Company-owned and joint venture LongHorn Steakhouse restaurants at the end of 1999 to 135 restaurants at the end of 2000. Total operating weeks for 2000 were positively affected by the additional week in the 2000 53-week operating period as compared to 52 weeks in 1999. Average weekly sales for all Company-owned and joint venture LongHorn Steakhouse restaurants in 2000 were \$48,408, a 7.4% increase over 1999. Sales for the comparable LongHorn Steakhouse restaurants increased 5.6% in 2000 as compared to 1999. The increase in comparable restaurant sales for 2000 at LongHorn Steakhouse was attributable primarily to an increase in guest counts.

The Capital Grille:

Sales in The Capital Grille restaurants increased 13.0% to \$65.4 million for 2000, compared to \$57.9 million for 1999. The increase reflects a 3.0% increase in restaurant operating weeks in 2000 as compared to 1999, resulting from an increase in the restaurant base from 11 The Capital Grille restaurants at the end of 1999 to 12 restaurants at the end of 2000. Total operating weeks for 2000 were positively affected by the additional week in the 2000 53-week operating period as compared to 52 weeks in 1999. Average weekly sales for all The Capital Grille restaurants in 2000 were \$111,025, a 9.7% increase from 1999. Sales for the comparable The Capital Grille restaurants increased 10.3% in 2000, as compared to 1999. 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 10.6% to \$63.0 million for 2000, compared to \$56.9 million for 1999. The increase reflects a 6.1% increase in restaurant weeks in 2000 as compared to 1999, resulting from an increase in the restaurant base from 18 Bugaboo Creek Steak House restaurants at the end of 1999 to 19 restaurants at the end of 2000. Total operating weeks for 2000 were positively affected by the additional week in the 2000 53-week operating period as compared to 52 weeks in 1999. Average weekly sales for all Bugaboo Creek Steak House restaurants in 2000 were \$65,793, a 4.3% increase from 1999. Sales for the comparable Bugaboo Creek Steak House restaurants increased 4.5% in 2000, as compared to 1999. The increase in comparable restaurant sales at Bugaboo Creek Steak House restaurants is attributable primarily to an increase in guest counts.

Franchise Revenue:

During 1997, the Company acquired all of the LongHorn Steakhouse restaurants that were then paying franchise revenues. In September 1998, a franchise LongHorn Steakhouse restaurant opened in Puerto Rico. The franchisee began paying royalties in January 1999. No franchise revenues were earned during 1998. The Company's franchisee opened one franchise LongHorn Steakhouse in Puerto Rico in each of 2000 and 1999. The Company earned \$380,000 and \$195,000 in franchise revenue in 2000 and 1999, respectively.

COSTS AND EXPENSES

Cost of restaurant sales, as a percentage of restaurant sales, remained constant at 35.9% in 2000 as compared to 1999.

Restaurant operating expenses decreased as a percentage of restaurant sales in 2000 to 44.1% from 45.0% in 1999. This was due to greater sales leverage of fixed and semi-fixed expenses (principally management labor and rent), partially offset by an increase in management incentives and advertising expense.

Depreciation and amortization – restaurants increased to \$17.0 million in 2000 from \$15.2 million in 1999 due to the Company's new restaurant construction and remodeling programs, but decreased as a percent of total restaurant sales due to the effect of higher average weekly sales leveraging this relatively fixed expense item.

Pre-opening expense increased to \$3.3 million in 2000 from \$3.1 million in 1999, principally due to the opening of 19 Company-owned restaurants in 2000 compared to the opening of 16 Company-owned restaurants in 1999.

General and administrative expenses increased to \$31.3 million in 2000 from \$26.1 million in 1999, but decreased as a percent of total revenues to 6.7% from 6.8% in 1999. The increased costs in 2000 were primarily payroll related, associated with building the

infrastructure necessary to support the Company's growth and increased goodwill amortization associated with the acquisition of the joint venture partners' ownership interest in 19 LongHorn Steakhouse restaurants in July 2000. General and administrative expenses, as a percent of total revenues, decreased slightly principally due to greater leverage of fixed and semi-fixed expenses.

Interest expense increased to \$4.2 million in 2000, from \$3.9 million in 1999. The increase in interest expense is due to higher average balances outstanding under the Company's obligations under capital leases as well as additional expenses associated with amending the Company's \$100.0 million 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 2000, compared to 8.7% in 1999.

In March 2000, an ongoing legal dispute with a former joint venture partner was resolved by an arbitrator, resulting in a judgment against the Company in the amount of \$2.0 million. The Company's consolidated statement of earnings for 2000 reflects a nonrecurring charge of \$1.0 million (\$670,000 net of income taxes) for amounts not previously reserved for this dispute.

Minority interest decreased to \$1.4 million in 2000 from \$1.6 million in 1999. This reflects a decrease in the number of joint venture restaurants for most of 2000 compared to 1999 due to the purchase of joint venture partners' partnership interests in 19 joint venture restaurants during 2000 and 14 joint venture restaurants during 1999, partially offset by the overall improved performance of the joint ventures prior to their sale in 2000 and improved performance at the remaining eight joint venture restaurants.

Income tax expense in 2000 was 33.0% 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 \$23.3 million in 2000, as compared to net income of \$12.8 million in 1999, 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 2001 were proceeds from the issuance of 2.3 million shares of common stock in a registered public offering (\$57.6 million), cash flow from operations (\$57.4 million), and proceeds from the exercise of employee stock options (\$4.3 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 (\$55.5 million) and the repayment of amounts outstanding under the Company's revolving credit facility (\$41.0 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 significant increase in cash and cash equivalents at December 30, 2001, as compared to the end of the prior year, is due to i) \$10.0 million in borrowings that the Company maintains to support an interest rate swap agreement, and ii) proceeds from the Company's holiday gift certificate sales program. The increases in accounts receivable, inventory, prepaid expenses, accounts payable, and accrued expenses are principally due to the new restaurants which were opened during 2001 and the result of generally higher average unit volumes experienced during 2001. Further increases in current asset and liability accounts are expected as the Company continues its restaurant development program.

Under the Company's amended and restated \$100.0 million revolving credit facility, beginning with the last day of the quarter ending September 2004, the amount available under the revolving credit facility will be reduced each quarter by \$10.0 million, reducing the commitment to \$50.0 million as of the termination date in September 2005. 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 2.0% (depending on the Company's leverage ratio) or the administrative agent's prime rate of interest plus a margin of 0% to 0.75% (depending on the Company's leverage ratio), at the Company's option, and pay a commitment fee of 0.3% to 0.5% per year on any unused portion of the facility. As of December 30, 2001, interest on the revolving credit facility accrued at LIBOR plus 1.25% or the prime rate. As of December 30, 2001, 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 mainte-

nance 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.

In February 2001, the Company completed an offering of 2,300,000 shares of its no par value common stock at \$26 per share. Total net proceeds to the Company were approximately \$57.6 million. The Company used approximately \$56.5 million of those proceeds to repay amounts outstanding under its \$100.0 million revolving line of credit, and approximately \$1.1 million to pay a non recurring pre-tax expense associated with amending its interest rate swap agreements to fix the interest rate on amounts expected to be outstanding under the Company's credit facility following its application of these proceeds. The \$1.1 million (\$682,000 after-tax) non-recurring, separately stated expense associated with amending the interest rate swap agreements resulted in a decrease of approximately \$0.03 in diluted earnings per share for the first quarter of 2001. After amending the interest rate swap agreements, the Company had effectively fixed the interest rate at 6.52%, plus the applicable margin on \$10.0 million from July 2001 through June 2002; \$15.0 million from July 2002 through March 2003; and \$17.5 million from April 2003 through August 2004. At December 30, 2001, \$10.0 million was outstanding and \$90.0 million was available under the Company's \$100.0 million revolving credit agreement at a weighted average interest rate of 7.77% after considering the effect of the interest rate swap agreement.

The Company currently plans to open 17 to 20 Company-owned LongHorn Steakhouse restaurants, two or three Bugaboo Creek Steak House restaurants and one The Capital Grille restaurant in 2002. The Company estimates that its capital expenditures will be approximately \$65.0 to \$70.0 million in 2002. The capital expenditure estimate for 2002 includes the estimated cost of developing 20 to 24 new restaurants, ongoing refurbishment in existing restaurants, costs associated with obtaining real estate for year 2003 planned openings, 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 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).

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 2004.

The preceding discussion of liquidity and capital resources contains certain forward-looking statements. Forward-looking statements involve a number of risks and uncertainties, and among the other factors that could cause actual results to differ materially are the following: failure of facts to conform to necessary management estimates and assumptions; the Company's ability to identify and secure suitable restaurant locations on acceptable terms, open new restaurants in a timely manner, 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 of cost of sales 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; changes in customer dining patterns; competitive pressures from other national and regional restaurant chains; business conditions, such as inflation or a recession, 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 other risks identified from time to time in the Company's SEC reports, including the Company's Annual Report on Form 10-K for 2001, registration statements and public announcements.

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

The table below summarizes our significant contractual obligations other than hedging contracts, by maturity, as of December 30, 2001 (in thousands):

	Total	Less Than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
Bank revolving credit facility	\$ 10,000	\$ –	\$ –	\$ 10,000	\$ –
Capital lease obligations	49,594	1,951	4,019	4,152	39,472
Operating leases	93,660	13,856	25,279	10,633	33,892
Other purchase obligations	13,002	13,002	–	–	–
Total contractual cash obligations	\$ 166,256	\$ 28,809	\$ 29,298	\$ 24,785	\$ 73,364

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 July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Under SFAS 142, beginning fiscal year 2002, the Company will no longer amortize goodwill and intangible assets with indefinite lives, but instead will test those assets for impairment at least annually. The Company is required to adopt SFAS 142 at the beginning of fiscal 2002 and assess in accordance with the provisions of the Statement whether there is an indication that any goodwill or other intangible assets with indefinite lives are impaired as of that date.

As soon as possible after a determination that any goodwill or other intangible assets may be impaired, but not later than December 29, 2002, the Company must determine the fair value of such goodwill or other intangible asset with an indefinite life in accordance with the provisions of the Statement. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle.

As of the date of adoption, the Company had unamortized goodwill in the amount of \$19.2 million, which will be subject to the transition provisions of SFAS 142. Amortization expense related to goodwill was approximately \$1.1 million for fiscal year 2001. 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 approximately \$1.1 million of annual amortization.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets", 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 No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company will adopt SFAS No. 144 beginning in fiscal 2002. Management does not believe that the adoption of SFAS No. 144 will have a material impact on the Company's consolidated financial statements.

In November 2001, the Emerging Issues Task Force ("EITF") of the 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 by submitting a claim for a refund or rebate. 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. Currently, the Company recognizes certain sales incentives as restaurant operating expense. Although this pronouncement will not have any impact on the Company's consolidated results of operations or financial position, the presentation prescribed will have an effect of reducing net sales and restaurant operating expense. Upon adoption of EITF 01-9, prior years' sales and restaurant operating expenses will be restated to conform to the new presentation requirement. The Company will adopt EITF 01-9 for fiscal 2002. Sales incentives included in restaurant operating expense for 2001 and 2000 amounted to \$8,228,000 and \$6,420,000, respectively.

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 judgements 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, plant 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, plant 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.

Long-lived assets, including 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. 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 (excluding interest) is less than the carrying value, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

Income taxes are accounted for by the Company in accordance with Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting for Income Taxes", 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 No. 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 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

As of December 30, 2001, \$10.0 million was outstanding under the Company's \$100.0 million revolving credit facility. Amounts outstanding under such credit facility bear interest at LIBOR plus a margin of 1.25% to 2.0% (the "applicable margin" depending on the Company's leverage ratio), or the administrative agent's prime rate of interest plus a margin of 0% to 0.75% (depending on the Company's leverage ratio) 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 from time to time uses interest rate swaps.

As of December 30, 2001, the Company had interest rate swap agreements with a commercial bank, which effectively fixed the interest rate at 6.52%, plus the applicable margin on \$10.0 million through June 2002; \$15.0 million from July 2002 through March 2003; and \$17.5 million from April 2003 through August 2004. The applicable margin on December 30, 2001 was 1.25%. The Company is exposed to credit losses on this interest rate swap in the event of counterparty non-performance, but does not anticipate any such losses.

While changes in LIBOR and the administrative agent's prime rate of interest could affect the cost of borrowings under the credit facility in excess of amounts covered by the interest rate swap agreement in the future, the Company does not consider its current exposure to changes in such rates to be material, and the Company believes that the effect, if any, of reasonably possible near-term changes in interest rates on the Company's financial condition, results of operations or cash flows would not be material.

INVESTMENT PORTFOLIO

The Company invests portions of its excess cash, if any, in highly liquid investments. At December 30, 2001, the Company had \$21.0 million in overnight repurchase agreements. The market risk on such investment is minimal.

CONSOLIDATED *Balance Sheets*

	December 30, 2001	December 31, 2000
<i>(in thousands)</i>		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 25,979	\$ 3,771
Accounts receivable	6,710	5,596
Inventories	13,437	11,179
Prepaid expenses	3,069	1,246
Refundable income taxes	3,902	4,044
Deferred income taxes (note 7)	6,643	5,780
Total current assets	<u>59,740</u>	<u>31,616</u>
Property and equipment, less accumulated depreciation and amortization (notes 4 and 9)	269,323	238,850
Goodwill, less accumulated amortization	19,187	20,272
Deferred income taxes (note 7)	2,276	2,316
Other	2,871	2,327
Total assets	<u>\$ 353,397</u>	<u>\$ 295,381</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 27,189	\$ 19,738
Accrued expenses (note 5)	37,424	34,948
Current installments of obligations under capital leases (note 9)	58	44
Total current liabilities	<u>64,671</u>	<u>54,730</u>
Debt, net of current installments (note 6)	10,000	51,000
Obligations under capital leases, net of current installments (note 9)	20,867	20,925
Total liabilities	<u>95,538</u>	<u>126,655</u>
Minority interest	1,329	1,469
Shareholders' equity (notes 2, 6, 11, and 12):		
Preferred stock, no par value. Authorized 10,000 shares, none issued	-	-
Common stock, no par value. Authorized 60,000 shares; issued 21,522 shares and 19,627 shares at December 30, 2001 and December 31, 2000, respectively	178,787	124,497
Unearned compensation – restricted stock	(522)	(338)
Retained earnings	79,007	52,849
Accumulated other comprehensive loss	(583)	-
Treasury shares at cost; 10 shares and 871 shares at December 30, 2001 and December 31, 2000, respectively	(159)	(9,751)
Total shareholders' equity	<u>256,530</u>	<u>167,257</u>
Commitments and contingencies (notes 4, 6, 8, 9, and 13)		
Total liabilities and shareholders' equity	<u>\$ 353,397</u>	<u>\$ 295,381</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED *Statements of Operations*

Years Ended	December 30, 2001	December 31, 2000	December 26, 1999
	<i>(in thousands, except per share data)</i>		
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	\$ 375,700	\$ 327,820	\$ 260,507
The Capital Grille	81,802	65,394	57,890
Bugaboo Creek Steak House	68,024	62,964	56,925
Other restaurants	7,353	7,470	6,953
Total restaurant sales	532,879	463,648	382,275
Franchise revenues	328	380	195
Total revenues	533,207	464,028	382,470
Costs and expenses:			
Cost of restaurant sales	189,869	166,421	137,416
Operating expenses – restaurants	240,510	204,652	171,943
Provision for asset impairments, restaurant closings, and other charges (note 3)	2,802	–	1,800
Depreciation and amortization – restaurants	21,248	17,022	15,249
Pre-opening expense	3,764	3,318	3,051
General and administrative expenses	32,386	31,309	26,052
Total costs and expenses	490,579	422,722	355,511
Operating income	42,628	41,306	26,959
Interest expense, net	2,128	4,159	3,866
Early termination of interest rate swap agreement	1,100	–	–
Provision for litigation settlement (note 13)	–	1,000	–
Minority interest (note 2)	639	1,407	1,609
Earnings before income taxes and cumulative effect of change in accounting principle	38,761	34,740	21,484
Income tax expense (note 7)	12,603	11,480	7,060
Earnings before cumulative effect of change in accounting principle	26,158	23,260	14,424
Cumulative effect of change in accounting principle (net of tax benefit of \$760) (note 1)	–	–	1,587
Net earnings	\$ 26,158	\$ 23,260	\$ 12,837
Basic earnings per common share before cumulative effect of change in accounting principle	\$ 1.25	\$ 1.27	\$ 0.80
Cumulative effect per common share of change in accounting principle	–	–	0.09
Basic earnings per common share	\$ 1.25	\$ 1.27	\$ 0.71
Diluted earnings per common share before cumulative effect of change in accounting principle	\$ 1.18	\$ 1.20	\$ 0.76
Cumulative effect per common share of change in accounting principle	–	–	0.08
Diluted earnings per common share	\$ 1.18	\$ 1.20	\$ 0.68
Weighted average common shares outstanding (basic)	21,002	18,271	18,048
Weighted average common shares outstanding (diluted)	22,144	19,416	18,819

See accompanying notes to consolidated financial statements.

CONSOLIDATED *Statements of Shareholders' Equity*

YEARS ENDED DECEMBER 30, 2001, DECEMBER 31, 2000, AND DECEMBER 26, 1999

(in thousands)

	Common Stock		Restricted Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Dollars					
BALANCE, DECEMBER 27, 1998	18,116	\$ 105,092	\$ (478)	\$ 16,752	\$ (748)	\$ —	\$ 120,618
Net earnings	—	—	—	12,837	—	—	12,837
Exercise of stock options	264	2,100	—	—	—	—	2,100
Tax benefit of non-qualified stock options exercised	—	195	—	—	—	—	195
Issuance of shares in connection with purchase of minority interest	193	2,827	—	—	—	—	2,827
Issuance of shares pursuant to restricted stock awards	3	44	(44)	—	—	—	—
Amortization of restricted stock	—	—	146	—	—	—	146
Purchase of common stock for treasury	—	—	—	—	(1,139)	—	(1,139)
BALANCE, DECEMBER 26, 1999	18,576	110,258	(376)	29,589	(1,887)	—	137,584
Net earnings	—	—	—	23,260	—	—	23,260
Exercise of stock options	688	6,406	—	—	—	—	6,406
Tax benefit of non-qualified stock options exercised	—	879	—	—	—	—	879
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)
BALANCE, DECEMBER 31, 2000	19,627	124,497	(338)	52,849	(9,751)	—	167,257
Comprehensive income (loss):							
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)
Amortization of restricted stock	—	—	230	—	—	—	230
Issuance of shares pursuant to restricted stock awards	18	414	(414)	—	—	—	—
Issuance of shares to retirement plans	28	656	—	—	—	—	656
Exercise of stock options	420	4,303	—	—	—	—	4,303
Tax benefit of non-qualified stock options exercised	—	1,045	—	—	—	—	1,045
BALANCE, DECEMBER 30, 2001	21,522	\$ 178,787	\$ (522)	\$ 79,007	\$ (159)	\$ (583)	\$ 256,530

See accompanying notes to consolidated financial statements.

CONSOLIDATED *Statements of Cash Flows*

Years Ended	December 30, 2001	December 31, 2000	December 26, 1999
		<i>(in thousands)</i>	
Cash flows from operating activities:			
Net earnings	\$ 26,158	\$ 23,260	\$ 12,837
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	24,067	19,378	16,758
Non-cash portion of provision for asset impairments, restaurant closings and other charges	2,802	–	1,800
Cumulative effect of accounting change	–	–	1,587
Minority interest	639	1,407	1,609
Deferred tax benefit	(823)	(1,020)	(2,307)
Issuance of common stock to employee retirement plans	656	–	–
Changes in assets and liabilities:			
Accounts receivable	(1,114)	(2,549)	396
Inventories	(2,284)	(966)	(604)
Prepaid expenses	(1,823)	(431)	(26)
Other assets	(796)	452	64
Refundable income taxes	1,187	(597)	1,847
Accounts payable	6,550	1,666	3,366
Accrued expenses	2,164	6,311	(672)
Net cash provided by operating activities	<u>57,383</u>	<u>46,911</u>	<u>36,655</u>
Cash flows from investing activities:			
Purchase of property and equipment	(55,497)	(58,430)	(36,822)
Purchase of joint venture and franchise interests	–	(3,220)	(206)
Net cash used in investing activities	<u>(55,497)</u>	<u>(61,650)</u>	<u>(37,028)</u>
Cash flows from financing activities:			
Proceeds from (repayments of) debt, net	(41,000)	11,000	(8,000)
Proceeds from issuance of common stock	57,623	–	–
Principal payments on capital leases	(44)	(40)	–
Proceeds from minority partner contributions	–	184	2,180
Distributions to minority partners	(779)	(1,907)	(2,417)
Increase in bank overdraft included in accounts payable and accrued liabilities	378	1,867	4,453
Purchase of common stock for treasury	(159)	(7,864)	(1,139)
Proceeds from exercise of stock options	4,303	6,406	2,100
Net cash provided by (used in) financing activities	<u>20,322</u>	<u>9,646</u>	<u>(2,823)</u>
Net increase (decrease) in cash and cash equivalents	<u>22,208</u>	<u>(5,093)</u>	<u>(3,196)</u>
Cash and cash equivalents at beginning of year	<u>3,771</u>	<u>8,864</u>	<u>12,060</u>
Cash and cash equivalents at end of year	<u>\$ 25,979</u>	<u>\$ 3,771</u>	<u>\$ 8,864</u>
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	<u>\$ 11,914</u>	<u>\$ 12,823</u>	<u>\$ 7,508</u>
Cash paid for interest, net of interest capitalized	<u>\$ 1,552</u>	<u>\$ 4,191</u>	<u>\$ 3,510</u>
Supplemental disclosure of non-cash financing and investing activities:			
Assets acquired under capital lease	<u>\$ –</u>	<u>\$ 11,277</u>	<u>\$ –</u>
Issuance of common stock in purchase of minority interest	<u>\$ –</u>	<u>\$ 6,827</u>	<u>\$ 2,827</u>

See accompanying notes to consolidated financial statements.

NOTES *to Consolidated Financial Statements*

DECEMBER 30, 2001, DECEMBER 31, 2000 AND DECEMBER 26, 1999

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 30, 2001, the Company operated the following restaurants:

<u>CONCEPT</u>	<u>NUMBER IN OPERATION</u>
LongHorn Steakhouse	154
Bugaboo Creek Steak House	19
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 30, 2001, 10 of the Company's restaurants operate in joint ventures and limited partnerships.

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.

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 \$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.

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, and seven years for equipment.

PRE-OPENING AND ORGANIZATION COSTS

At the beginning of fiscal 1999, the Company adopted the American Institute of Certified Public Accountants (“AICPA”) Statement of Position (SOP) 98-5, “Reporting on the Costs of Start-Up Activities”. SOP 98-5 requires most entities to expense as incurred all organization and pre-opening costs that are not otherwise capitalizable as long-lived assets. The Company previously deferred such costs and amortized them over a twelve-month period following the opening of each restaurant, as was the practice in the restaurant industry. As a result of the adoption of this change in accounting policy, the Company recorded a cumulative effect charge of \$2.3 million (approximately \$1.6 million net of tax benefit, or \$0.08 per diluted share). Prior to fiscal 1999, amortization of deferred pre-opening costs was included with depreciation and amortization expense on the consolidated statements of operations. Effective with fiscal 1999, pre-opening costs are included as a separate item on the consolidated statements of operations.

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

Goodwill, net of accumulated amortization of approximately \$3.2 million and \$2.1 million at December 30, 2001 and December 31, 2000, respectively, represents the excess of purchase price over fair value of net assets acquired. Goodwill is amortized using the straight-line method over the expected period to be benefited (from 13 to 25 years). The Company assesses the recoverability of goodwill by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting the Company’s average cost of funds. The assessment of the recoverability of goodwill will be impacted if estimated future operating cash flows are not achieved.

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. Purchased liquor licenses are amortized over 20 to 40 years. Debt issuance costs are amortized on a straight-line basis over the term of the debt. The first quarter 1999 adoption of the change in accounting method prescribed by SOP 98-5 resulted in a one time charge of approximately \$200,000, less applicable income taxes, related to the write-off of organization costs.

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 2001.

RECOVERABILITY OF LONG-LIVED ASSETS

The Company accounts for long-lived assets in accordance with Statement of Financial Accounting Standards No. 121 (“SFAS No. 121”), “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of,” 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 discounted 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 carryforwards. 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.

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 ("APB 25"), "Accounting for Stock Issued to Employees", 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 No. 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 No. 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 No. 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 No. 123.

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 \$16.1 million, \$12.3 million, and \$10.8 million for the years ended December 30, 2001, December 31, 2000, and December 26, 1999, 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 ("SFAS No. 128"), "Earnings Per Share". SFAS No. 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):

	2001	2000	1999
Weighted average number of common shares used in basic calculation	21,002	18,271	18,048
Dilutive effect of restricted stock award	74	61	42
Dilutive effect of net shares issuable pursuant to stock option plans	1,068	1,084	729
Weighted average number of common shares used in diluted calculation	22,144	19,416	18,819
Earnings before cumulative effect of change in accounting principle	\$ 26,158	\$ 23,260	\$ 14,424
Cumulative effect of change in accounting principle (net of tax benefit)	-	-	1,587
Net earnings	\$ 26,158	\$ 23,260	\$ 12,837
Basic earnings per common share before cumulative effect of change in accounting principle	\$ 1.25	\$ 1.27	\$ 0.80
Cumulative effect per common share of change in accounting principle	-	-	0.09
Basic earnings per common share	\$ 1.25	\$ 1.27	\$ 0.71
Diluted earnings per common share before cumulative effect of change in accounting principle	\$ 1.18	\$ 1.20	\$ 0.76
Cumulative effect per common share of change in accounting principle	-	-	0.08
Diluted earnings per common share	\$ 1.18	\$ 1.20	\$ 0.68

Options to purchase 44,250 shares of common stock at December 30, 2001, were excluded from the computation of diluted earnings per share because the related exercise prices were greater than the average market price for 2001 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, 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, 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, uses interest rate swap agreements in the management of interest rate risk. The Company carries all derivative instruments on the balance sheet at fair value. The Company uses 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 are classified as a hedge of a cash flow exposure under SFAS No. 133 and No. 138, "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 and SFAS No. 138 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 is reported as a non-recurring expense. At December 30, 2001, the fair market value of the Company's interest rate swap was a net payable of approximately \$940,000 of which approximately \$456,000 is classified as current.

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 2001, comprehensive income includes net earnings adjusted for net unrealized losses on interest rate swaps. During 2000 and 1999, net earnings were the same as comprehensive income.

FUTURE APPLICATION OF ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). Under SFAS No. 142, beginning fiscal year 2002, the Company will no longer amortize goodwill and intangible assets with indefinite lives, but instead will test those assets for impairment at least annually. The Company is required to adopt SFAS No. 142 at the beginning of fiscal 2002 and assess in accordance with the provisions of the statement whether there is an indication that any goodwill or other intangible assets with indefinite lives are impaired as of that date.

As soon as possible after a determination that any goodwill or other intangible assets may be impaired, but not later than December 29, 2002, the Company must determine the fair value of such goodwill or other intangible asset with an indefinite life in accordance with the provisions of the statement. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle.

As of the date of adoption, the Company had unamortized goodwill in the amount of \$19.2 million, which will be subject to the transition provisions of SFAS No. 142. Amortization expense related to goodwill was approximately \$1.1 million for fiscal year 2001. For the foreseeable future, management believes the only impact on the Company's consolidated financial statements from the adoption of SFAS No. 142 will be the elimination of approximately \$1.1 million of annual amortization.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets", which supercedes SFAS 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 No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company will adopt SFAS No. 144 beginning in fiscal 2002. Management does not believe that the adoption of SFAS No. 144 will have a material impact on the Company's consolidated financial statements.

In November 2001, the Emerging Issues Task Force ("EITF") of the 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 by submitting a claim for a refund or rebate. 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. Currently, the Company recognizes certain sales incentives as restaurant operating expense. Although this pronouncement will not have any impact on the Company's consolidated results of operations

or financial position, the presentation prescribed will have an effect of reducing net sales and restaurant operating expense. The Company will adopt EITF 01-9 for fiscal 2002. Sales incentives included in restaurant operating expense for 2001 and 2000 amounted to \$8,228,000 and \$6,420,000, respectively.

RECLASSIFICATIONS

Certain reclassifications have been made to the 2000 and 1999 consolidated financial statements to conform with the 2001 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.

In September 1999, the Company acquired the ownership interest of its joint venture partner in ten LongHorn Steakhouse restaurants located in south Florida markets for an aggregate purchase price of approximately \$2.9 million; comprised of 156,000 shares of Company common stock and approximately \$600,000 in notes payable in a transaction accounted for under the purchase method. The excess purchase price over the book value of the minority interest acquired was approximately \$2.9 million and was recorded as goodwill to be amortized over 20 years.

In May 1999, the Company acquired the ownership interest of its joint venture partner in four LongHorn Steakhouse restaurants located in the Columbus, Ohio market for an aggregate purchase price of \$750,000; comprised of 37,500 shares of Company common stock, \$150,000 in cash and a \$30,000 note, in a transaction accounted for under the purchase method. The excess of purchase price over the book value of the minority interest acquired was approximately \$750,000 and was recorded as goodwill to be amortized over 20 years.

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

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.

The provision for asset impairments, restaurant closings, and other charges of \$1.8 million in fiscal 1999 consisted primarily of the write down of two Bugaboo Creek Steak House 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.

4. PROPERTY AND EQUIPMENT

Major classes of property and equipment at December 30, 2001 and December 31, 2000 are summarized as follows (in thousands):

	2001	2000
Land and improvements	\$ 33,543	\$ 27,806
Buildings	34,657	29,322
Leasehold improvements	163,538	135,959
Assets under capital lease	21,009	21,009
Restaurant equipment	64,136	55,170
Furniture and fixtures	33,220	27,536
Construction in progress	19,276	21,874
	369,379	318,676
Less accumulated depreciation and amortization	100,056	79,826
	\$ 269,323	\$ 238,850

During 2001, 2000, and 1999, the Company capitalized interest during construction of approximately \$826,000, \$790,000, and \$457,000, 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 30, 2001, such commitments totaled approximately \$13.0 million.

5. ACCRUED EXPENSES

Accrued expenses consist of the following at December 30, 2001 and December 31, 2000 (in thousands):

	2001	2000
Accrued self insurance reserves	\$ 3,240	\$ 2,863
Accrued provision for asset impairments, restaurant closings, and other charges	603	354
Accrued rent	5,983	4,393
Accrued compensation	7,777	10,542
Other taxes accrued	5,677	4,305
Accrued Gift certificate liability	11,229	8,561
Other	2,915	3,930
	\$ 37,424	\$ 34,948

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. Beginning with the last day of the quarter ending September 2004 the amount available under the revolving credit facility would be reduced each quarter by \$10.0 million, reducing the commitment to \$50.0 million as of the termination date in September 2005. 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 2.0% (the "applicable margin" depending on the Company's leverage ratio) or the administrative agent's prime rate of interest, plus a margin of 0% to 0.75% (depending on the Company's leverage ratio) and requires payment of a commitment fee on any unused portion at a rate of 0.3% to 0.5% per year (depending on the Company's leverage ratio). At December 30, 2001 and December 31, 2000, the applicable margin was 1.25% and 1.5%, respectively. At December 30, 2001 and December 31, 2000, the interest rate on outstanding obligations under the Company's revolving credit facilities was 3.1875% and 8.202%, respectively, based on the applicable margin. The commitment fee on the unused portion of the Revolving Credit Facility on December 30, 2001, was 0.30% per year. At December 30, 2001 and December 31, 2000, debt outstanding under the revolving credit facilities totaled \$10.0 million and \$51.0 million, respectively. Amounts available under the Company's revolving credit facilities totaled \$90.0 million and \$49.0 million at December 30, 2001 and December 30, 2000, 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, which own substantially all of the Bugaboo Creek Steak House and The Capital Grille restaurants. At December 30, 2001, the Company was in compliance with the provisions of the Revolving Credit Facility.

The Company has an interest rate swap agreement with a commercial bank, which effectively fixes the interest rate at 6.52%, plus the applicable margin on \$10.0 million of the Company's borrowings through June 2002; \$15.0 million through March 2003; and \$17.5 million through August 2004. The applicable margin was 1.25% on December 30, 2001, and is expected to be 1.25% during the first quarter of 2002. Under the interest rate swap agreement, the Company pays a fixed rate of 6.52% and receives an amount based on the 30 day LIBOR. This interest rate swap agreement is accounted for as a cash flow hedge of the interest rate risk on the Company's revolving credit facility. The Company is exposed to credit losses on this interest rate swap in the event of counterparty non-performance, but does not anticipate any such losses.

7. INCOME TAXES

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

	Current	Deferred	Total
Year ended December 30, 2001:			
U.S. Federal	\$ 12,049	\$ (739)	\$ 11,310
State and local	1,377	(84)	1,293
	<u>\$ 13,426</u>	<u>\$ (823)</u>	<u>\$ 12,603</u>
Year ended December 31, 2000:			
U.S. Federal	\$ 10,937	\$ (892)	\$ 10,045
State and local	1,563	(128)	1,435
	<u>\$ 12,500</u>	<u>\$ (1,020)</u>	<u>\$ 11,480</u>
Year ended December 26, 1999:			
U.S. Federal	\$ 7,483	\$ (1,354)	\$ 6,129
State and local	1,124	(193)	931
	<u>\$ 8,607</u>	<u>\$ (1,547)</u>	<u>\$ 7,060</u>

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:

	2001	2000	1999
Federal statutory income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.6	3.3	3.3
Meals and entertainment	0.1	0.1	0.8
FICA tip credit	(5.2)	(5.4)	(6.7)
Other	—	—	0.5
Effective tax rates	<u>32.5%</u>	<u>33.0%</u>	<u>32.9 %</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 30, 2001 and December 31, 2000 are presented below (in thousands):

	2001	2000
Deferred tax assets (liabilities):		
Provisions for restaurant closings, and other charges	\$ 2,148	\$ 1,665
Accrued rent	2,182	1,104
Accrued joint venture contract termination	662	553
Pre-opening costs	268	571
Accrued insurance	251	415
Accrued workers' compensation	707	730
Property and equipment	1,631	2,068
Deferred Compensation Plan	610	159
Other	460	831
Net deferred tax assets	<u>\$ 8,919</u>	<u>\$ 8,096</u>

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 did 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. For 2000 and 1999, the matching contributions were made in cash. The Company's expense under the RARE Plan was \$574,000, \$641,000, and \$396,000, for 2001, 2000, and 1999, 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 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 \$4,250. For 2000, the matching contributions were made in cash. The Company's expense under the Supplemental Plan was \$302,000 and \$104,000 for 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 2001 and cash in 2000 and 1999.

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 25 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 certain 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 life of the anticipated lease terms.

Future minimum lease payments under capital lease obligations and noncancelable operating leases at December 30, 2001 are as follows (in thousands):

Years ending at or about December 31:	Capital	Operating
2002	\$ 1,951	\$ 13,856
2003	1,991	13,011
2004	2,028	12,268
2005	2,037	11,043
2006	2,115	9,590
Thereafter	39,472	33,892
Total minimum lease payments	49,594	\$ 93,660
Less imputed interest (at 9%)	28,669	
Present value of minimum lease payments	20,925	
Less current maturities	58	
Obligations under capital leases, excluding current maturities	\$ 20,867	

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

	2001	2000	1999
Minimum lease payments	\$ 14,686	\$ 12,571	\$ 10,942
Contingent rentals	1,831	1,713	1,228
Total rental expense	\$ 16,517	\$ 14,284	\$ 12,170

A standby letter of credit in the amount of \$750,000 has been issued to secure the Company's obligations under a lease of real estate. Drafts may be presented against this letter of credit in the event that the Company is in default of the terms of the lease, all applicable grace periods have expired and the Company has failed to cure all such defaults. The amount of such drafts may be for the amount presently due and owing by the Company to the landlord or the full amount of the letter of credit if the landlord has notified tenant that it has terminated the lease or has exercised its right to repossess the leased premises.

10. RELATED PARTY TRANSACTIONS

During 2000 and 1999, RDM Design, a company owned by a relative of two Company directors, provided architectural design services to the Company. Fees paid for these services (including payments for subcontracted engineering services) amounted to approximately \$1,000, and \$106,000, for the years 2000 and 1999, respectively.

Through August 1999, the Company leased, from entities in which certain of the Company's directors had a financial interest, the land and building in which it operates one LongHorn Steakhouse restaurant. Rental expense included approximately \$71,800 in 1999, for rents paid related to this restaurant site. In August 1999, the Company acquired this land and building for a purchase price of \$911,000.

11. SHAREHOLDERS' EQUITY

During 1998, the Company's Board of Directors authorized the Company to purchase up to \$5.0 million of its common stock through October 1999. During 1999 and 1998, the Company purchased 127,500 and 89,250 shares, respectively, of its common stock under this program at an aggregate cost of approximately \$1.9 million (average price of \$8.71 per share). In February 2000, the Company's Board of Directors authorized the Company to purchase up to an additional \$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 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 29, 2002. 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).

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 30, 2001, 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.

12. STOCK OPTIONS

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. The Company's Amended and Restated 1992 Incentive Plan (the "1992 Stock Option Plan") provides for the granting of incentive stock options, nonqualified stock options, and stock appreciation rights to key employees and directors, based upon selection by the Compensation Committee. All stock options issued under the 1997 Stock Option Plan and the 1992 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 and the 1992 Stock Option Plan authorized the granting of options to purchase 1,987,500 shares of common stock and 2,250,000 shares of common stock, respectively.

The 1994 Bugaboo Creek Stock Option Plan (the "1994 Stock Option Plan") provides for the granting of options to acquire 459,825 shares of the Company's common stock to directors, officers, and key employees of Bugaboo Creek Steak House, Inc. Through December 27, 1998, the Company had granted options to purchase approximately 214,050 shares of common stock pursuant to the terms of the 1994 Stock Option Plan. Options awarded under the 1994 Stock Option Plan prior to the merger were adjusted based on the exchange ratio of 1.78 shares of common stock of Bugaboo Creek Steak House, Inc. for each share of the Company's common stock. Options awarded under the 1994 Stock Option Plan were generally granted at prices which equate to current market value on the date of the grant, are generally exercisable after two to three years, and expire ten years subsequent to award. The 1994 Stock Option Plan was cancelled by the Company in 1999; accordingly, no additional shares are available to be issued.

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.

The Company applies APB 25 in accounting for its stock option plans. Accordingly, no compensation expense has been recognized for the Company's stock-based compensation plans. Had compensation cost for the Company's stock option plans been

determined based upon the fair value methodology prescribed under SFAS No. 123, the Company's 2001, 2000, and 1999 net earnings and net earnings per share would have been reduced by approximately \$2.9 million, \$1.0 million, and \$1.7 million, or approximately \$0.13, \$0.06, and \$0.09 per share, respectively. The effects of disclosing compensation cost under SFAS No. 123 may not be representative of the effects on reported earnings for future years. The fair value of the options granted during 2001, 2000, and 1999 is estimated at approximately \$8.6 million, \$7.0 million, and \$1.4 million, respectively, on the date of grant, using the Black-Scholes option-pricing model with the following assumptions:

	2001	2000	1999
Dividend yield	0	0	0
Volatility	51%	50%	20%
Risk-free interest rate	4%	6%	6%
Average expected life	6 yrs	6 yrs	8 yrs

As of December 30, 2001 and December 31, 2000, options to purchase 1,512,470 and 1,489,945 shares of common stock, respectively, were exercisable at weighted average exercise prices of \$10.00 and \$9.35 per share, respectively. Option activity under the Company's stock option plans is as follows:

	Shares	Weighted Average Price
Outstanding at December 27, 1998	2,702,772	\$ 9.05
Granted in 1999	308,269	12.43
Exercised in 1999	(262,944)	7.97
Canceled in 1999	(203,314)	9.37
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

The following table summarizes information concerning options outstanding and exercisable as of December 30, 2001:

Range of exercise prices	Options Outstanding		Options Exercisable	
	Number outstanding	Weighted average remaining life	Number exercisable	Weighted average exercise price
\$5.83 to \$10.00	1,028,861	6.0	974,990	\$ 8.10
\$10.01 to \$15.00	904,941	7.6	464,204	12.69
\$15.01 to \$20.00	190,208	8.7	45,524	16.40
\$20.01 to \$25.00	597,251	8.9	27,052	22.79
\$25.01 or greater	16,000	9.3	700	27.00

13. 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 judgment 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.

JOINT VENTURES

Several of the Company's limited partnership agreements and employment agreements with limited partners, who are restaurant managers, require or provide the Company with the option to purchase the managers' interests upon termination of the joint venture. The purchase prices are based upon certain multiples of the relevant restaurant's cash flow or profits.

PURCHASE COMMITMENTS

The Company has entered into certain 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 2002 and 2003. 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 a surety bond totaling \$1.5 million at December 30, 2001 that is 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.

14. QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations for the years ended December 30, 2001 and December 31, 2000 (in thousands, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2001:					
Revenues	\$ 135,043	\$ 131,160	\$ 128,734	\$ 138,270	\$ 533,207
Operating income	14,704	11,542	7,608	8,774	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
2000:					
Revenues	\$ 120,612	\$ 110,419	\$ 112,536	\$ 120,461	\$ 464,028
Operating income	11,971	9,874	8,446	11,015	41,306
Earnings before income taxes	9,297	8,364	7,308	9,771	34,740
Net earnings	6,227	5,584	4,903	6,546	23,260
Net earnings per share:					
Basic	0.35	0.31	0.26	0.35	1.27
Diluted	0.33	0.29	0.25	0.33	1.20

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 30, 2001 and December 31, 2000, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2001. 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 30, 2001 and December 31, 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 30, 2001 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 derivative instruments and hedging activities in 2001.

KPMG LLP

Atlanta, Georgia
February 8, 2002

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

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*

Corporate Office

RARE Hospitality International, Inc.
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(770) 399-9595

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 2001 as filed with the Securities and Exchange Commission is available from the Company at no charge. 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 13, 2002, at 2:00 p.m. at The Capital Grille of Atlanta, 255 East Paces Ferry 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 19, 2002, there were approximately 3,800 holders of the common stock of the Company, including approximately 441 shareholders of

record. The market value of the Company's common stock on March 19, 2002, was \$26.24 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 30, 2001, there were 21,522,000 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, adjusted to give retroactive effect to the Company's 50% stock dividend paid on September 5, 2000.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2001				
High	\$ 32.00	\$ 28.43	\$ 23.63	\$ 23.60
Low	\$ 20.06	\$ 19.70	\$ 14.84	\$ 14.15
2000				
High	\$ 14.88	\$ 23.83	\$ 21.33	\$ 29.00
Low	\$ 9.83	\$ 12.75	\$ 16.42	\$ 19.13



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