RARE People ◆ RARE Quality ◆ RARE Experiences

RARE *Hospitality*

2003 Annual Report

Longhorn Steakhouse restaurants, which are located primarily in the Eastern half of the United States, are full-service, casual dining restaurants serving both lunch and dinner in a comfortable western-style atmosphere. LongHorn Steakhouse restaurants offer a variety of top-quality menu items, including their specialty, seasoned steaks grilled to perfection. In addition to a variety of steaks, the full menu includes signature items such as the LongHorn Salmon, slow roasted prime rib, baby back ribs, chicken and entrée salads. Designed with an inviting décor reminiscent of a classic western American steakhouse, LongHorn appeals to all ages with its distinctive combination of attentive service, flavorful entrees and inviting comfortable atmosphere.

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

Bugaboo Creek Steak House restaurants, primarily located in states along the East coast, are attractive, family-friendly restaurants featuring moderately priced, flavorful menu items. Bugaboo Creek Steak House restaurants attract guests of all ages with a rustic décor reminiscent of a Canadian Rocky Mountain lodge. Stressing a friendly and attentive service style, Bugaboo Creek Steak House restaurants offer a variety of menu items including steaks, prime rib, spit roasted chicken, smoked baby-back ribs, grilled salmon and flavorful pasta entrees.

About the Company

RARE Hospitality International, Inc. owns, operates and franchises 234 restaurants as of the end of 2003, including 190 LongHorn Steakhouse restaurants located primarily in the Eastern half of the United States, 25 Bugaboo Creek Steak House restaurants located primarily in states along the East coast, and 17 The Capital Grille restaurants located in major metropolitan areas across the country.

Financial Highlights

(In thousands, except per share data)

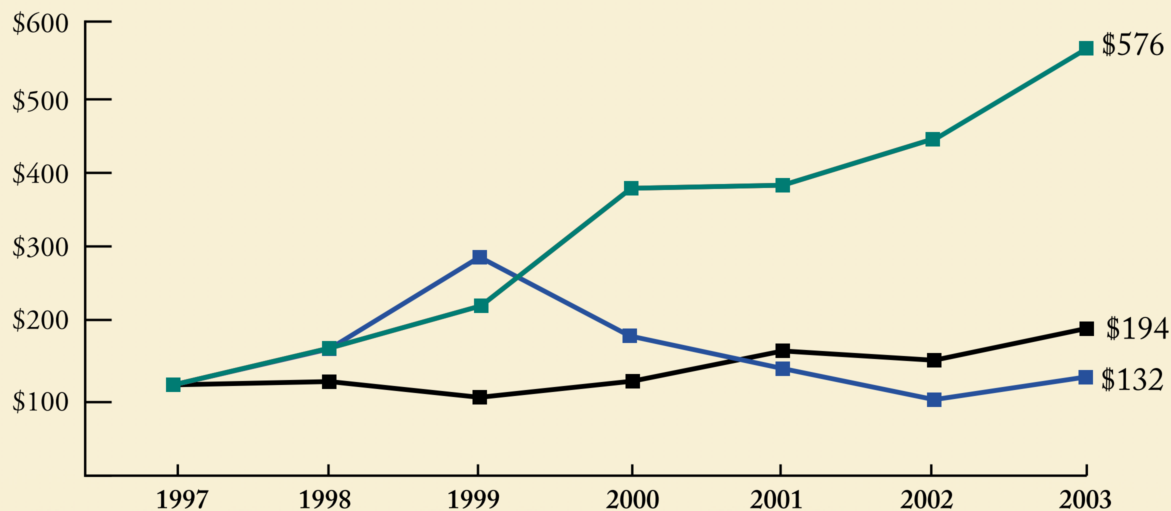
For the Fiscal Year	**2003**	2002
Revenues	**$ 680,832**	$ 584,504
Net earnings	**$ 42,277**	$ 33,439
Diluted earnings per share [1]	**$ 1.21**	$ 0.98
Adjusted diluted earnings per share [1] [2]	**$ 1.21**	$ 1.01
Weighted average common shares outstanding (diluted) [1]	**34,843**	34,268

(1) Adjusted to reflect a 3-for-2 stock split effective September 2003.

(2) See page 10 for a reconciliation of adjusted diluted earnings per share to diluted earnings per share.

At Year End		
Cash and short-term investments	**$ 44,544**	$ 31,467
Total assets	**464,542**	389,309
Long-term debt	**–**	–
Obligations under capital leases, net of current portion	**27,462**	22,406
Minority interest	**1,371**	1,411
Total shareholders' equity	**352,055**	300,132

RARE Stock Performance



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

RARE Hospitality International, Inc. 2003 Annual Report

Letter to Shareholders

RARE *Performance*

Fellow Shareholders:

RARE Hospitality produced another year of outstanding operating performance and strong, profitable growth for 2003. The fact that our earnings per share growth for 2003 met our long-term target is reason enough to celebrate. But when you consider the consistent record of profitable growth your Company has produced since the current management team arrived at RARE in late 1997 – and the shareholder value that growth has created – then you'll understand why we are so proud of our team and grateful for their hard work and perseverance.

Since your Company's success is absolutely dependent on extraordinary performance by its people, our guiding principle from the beginning has been to build the best restaurant team in the casual dining industry. While we can never afford to rest on our laurels with such a mission, this letter does offer us an opportunity to reflect not only on the performance this team produced in the past year, but also on the longer-term record we've achieved since 1997. Let's begin by reviewing some key performance metrics.

- Total revenues for 2003 grew 16.5% to $680.8 million, from $584.5 million for 2002. Over the last six years, RARE has produced an annual compounded growth rate in revenues of 17.5%.

- Both our short-term and long-term revenue growth reflect the consistent record of positive same-store sales that each of our concepts has achieved. Same-store sales growth is one of the three key elements driving our strategy for achieving long-term growth in annual earnings per diluted share of 20%. LongHorn Steakhouse produced a 4.6% increase, its tenth consecutive year of positive same-store sales growth. Bugaboo Creek generated its fifth consecutive year of same-store sales growth, with an increase of 2.6% for 2003. The Capital Grille achieved extraordinary results for 2003, with same-store sales growth of 10.9%, its eighth consecutive year of same-store sales improvement.

- RARE's revenue growth is also attributable to the consistent, controlled expansion of the Company's base of restaurants in operation, the second key element of our long-term growth strategy. For 2003, this base increased by 10.4% to 234 at year-end from 212 at the end of 2002. We've grown by more than 100 restaurants in the past six years, from a total of 125 at the end of 1997. This achievement has only been possible through the increasing expertise of our real estate and construction team, which has steadily expanded their capabilities in tempo with the Company's growth.

- Profit margin growth through increased leveraging of our fixed operating costs and corporate overhead is the third key element of our long-term growth strategy. Our adjusted net earnings as a percentage of total revenues increased for the sixth consecutive year, to 6.2% from 5.9% for 2002, having doubled from 3.1% for 1997. (See page 10 – Selected Financial Data – for a reconciliation of adjusted net earnings to net earnings.)

- Because of our strong top-line performance and increased operating leverage, earnings per diluted share for 2003 grew 23.5% to $1.21 from $0.98 for 2002. Adjusted earnings per diluted share increased 19.8% to $1.21 for 2003 from $1.01 for 2002. Adjusted earnings per diluted share have nearly quadrupled from $0.31 for 1997, increasing at a six-year compounded annual growth rate of 25.5%.

- The consistency of our financial performance over the past six years has resulted in an extremely favorable financial position. At the end of 2003, we had cash and cash equivalents of $44.5 million, no balance outstanding on our $100 million credit facility, and total shareholders' equity of $352.1 million. In contrast, at the end of 1997, RARE had cash and cash equivalents of $1.8 million, long-term bank debt of $43.0 million and total shareholders' equity of $112.0 million. Because of our financial position at the end of 2003, we are well positioned to finance our expansion plans in 2004 and beyond. We're also continuing to generate substantial cash flow from operations, which was over $80 million for 2003, enabling us to finance 100% of our 2003 capital expenditures internally.

- Our financial performance has also created exceptional growth in shareholder value. The market price of a share of our common stock at year-end has now risen for six consecutive years, producing a compounded annual growth rate of 35.2%. RARE's market capitalization increased to $823 million at the end of 2003 from $610 million at the end of 2002, while growing almost eight-fold from $108 million at the end of 1997. In recognition of the Company's performance and based on the Company's continuing prospects, the Board of Directors declared a three-for-two stock split in 2003, complementing the three-for-two stock split in 2000.

Our earnings guidance for 2004 reflects planned restaurant openings in 2004, including 23 to 24 LongHorns, three to four Bugaboo Creeks and two to three Capital Grilles. Our guidance also assumes same-store sales growth for 2004 in a range of 3% to 4% for each concept. With the substantial rise in beef costs, which we expect will have a net earnings impact of $0.08 to $0.09 per share on our results for 2004, our earnings guidance for the year is in a range of $1.36 to $1.38 per diluted share. While the impact of increased beef costs is material to our anticipated 2004 results, we are confident of producing our seventh consecutive year of profitable growth in 2004.

Our confidence in meeting our goals is squarely based on the imbedded culture of this Company. We are uncompromising in our attention to quality and relentless in our pursuit of superior execution. We obsess over building guest loyalty. We are passionate in our quest to enhance the guest value proposition by delivering delicious food and outstanding service exceeding guest expectations one meal at a time.

This "we" extends throughout RARE and reflects this Company's total dedication to training and support of the people who demonstrate this culture every day. We thank all our team members and recognize their RARE performance, because if we know one thing about the restaurant business, it's that success begins with talented, dedicated people. We also applaud the strong ongoing support provided by our Board of Directors and thank them for the integrity and responsibility with which they perform their duties. By striving to build the best team of people in the industry, we are all acting decisively on our bedrock commitments to create guest loyalty through superior execution, to give back to the communities in which we operate, and to maximize long-term shareholder value.

Sincerely,

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

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

RARE *People*

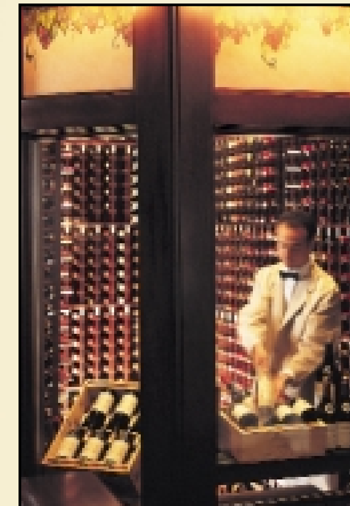
RARE wants to bring quality individuals into the fold and groom them for future opportunities and enrichment. Our goal as a company is to become the "Employer of Choice" in the restaurant industry and that can't be achieved unless we're willing to invest in our team members' future. Consequently, hourly-team members receive continuous training on-site through RARE's Certified Training Program. New managers are enrolled in a comprehensive training program, which includes a rigorous four-day experience at RARE University in Atlanta, Georgia.

The opportunity for growth doesn't end there. Managers also have access to a variety of Leadership Day Camps, Emerging Leaders seminars and Learning Series programs designed to further their development and career. In fact, last year alone, over 400 new managers were hired and trained. But the inherent value of our system is validated by the impressive number of executives and managers who took advantage of these programs and subsequently, worked their way up from hourly positions.

Arguably, our biggest drawing card for management prospects is our Managing Partner Program. Simply stated, Managing Partners share in the growth and profits of their restaurants. These Managing Partners are incentivized with a 5-year contract which promotes a long term partnership and sense of ownership at the restaurant level. Our low turnover rate, from the management level and throughout the team, is directly attributable to this Managing Partner program.

Despite our vigorous work ethic and our impressive sales figures, we still find time at RARE to celebrate our successes. For example, this past year our hourly team members were rewarded for their performance with much deserved trips, TVs, DVD players and other exciting prizes during each quarterly promotion. LongHorn managers earn five-day cruises to the Caribbean; chefs at The Capital Grille study in Napa Valley; and Bugaboo Creek managers escape to a mountain resort appropriately nestled near the majestic Bugaboo Mountains of British Columbia.

Given our track record for mentoring new hires and promoting from within, it should come as no surprise that RARE promotes diversity. We recognize and embrace individual differences among guests, team members, and business partners within the various communities in which we operate. This commitment



to diversity enlarges our pool of potential team members, broadens our guest base and contributes to increased profitability. Diversity is an enriching part of life and we draw strength from the energy that comes from people of different backgrounds working together towards a common goal—great food and great service that make every guest a loyal guest.

RARE also has a long and distinguished history of "giving back" to our surrounding communities. Some of our more notable beneficiaries include Children's Healthcare of Atlanta (over $1.3 million in donations), Habitat for Humanity and The March of Dimes. Our restaurants also vigorously support teachers and schools within our communities. Our team members frequently contribute to these and other local causes with their own time, money and talents.

Successful restaurants aren't only built with glass, steel or mortar. No, the real foundation of any successful restaurant is "the people." People who instinctively know what every guest desires. People who are charmingly attentive without calling attention to themselves. People who refuse to compromise the highest culinary standards. And by all means, people who exhibit a burning ambition to learn more, do more and ultimately, achieve more for the greater good of themselves, our guests, and the Company. Interestingly enough, they're the people you inevitably find greeting you at the door, taking your order, preparing your meal and actively managing our LongHorn, Bugaboo Creek and Capital Grille restaurants.

RARE *Quality*

RARE quality means more than simply offering the freshest ingredients, the finest cuts of meat, and attention to detail in a warm, engaging atmosphere. It means recalling a name versus recognizing a face. Anticipating a desire instead of merely granting a request. And flying salmon in fresh as opposed to retrieving it from a crowded freezer. More importantly, though, RARE quality means sustaining that elusive level of excellence whether it's a party of one, a bustling weekend evening or a gathering of friends for a special occasion. Elusive as that goal may be, that's precisely the kind of team we aspire to assemble at each of our restaurants.

In the restaurant business, it takes years of dedication to earn a loyal following and only a few momentary lapses to lose it. With literally thousands of establishments out there vying for your patronage, meeting today's accepted standards isn't enough. To sustain a loyal following, we must continually exceed our guest's rising level of expectations.

Of course, you can't gain any real feedback on a restaurant's overall performance by simply consulting the "suggestion box" or reading a review by the local food critic. That's why at RARE, we use a legion of veteran "mystery shoppers" to monitor the level of quality across the board. These "independent undercover agents" frequent each location, evaluate the quality of the food and service and then file a detailed report. After reviewing over 12,000 reports in our database, we're pleased to report that each of our concepts—LongHorn Steakhouse, Bugaboo Creek Steak House and The Capital Grille—achieved record-breaking guest satisfaction scores during the 2003 fiscal year.

There's tangible evidence that great strides have been made to carve out a more distinctive dining experience for the LongHorn Steakhouse concept. The July 2003 issue of Consumer Reports magazine honored LongHorn Steakhouse as the top rated casual dining steakhouse in America. From the moment you cross the threshold, you're met with an inviting smile, a comfortable table and experience an overwhelming desire to enjoy a Bacon Wrapped Filet chargrilled over an open flame. This year, guests were also greeted by a stampede of tantalizing new menu items like our Firecracker Chicken Wraps and our Caramel Apple Goldrush.

At Bugaboo Creek Steak House, we expanded our menu beyond our signature, hearty fare to include more adventurous dishes like the mouth-watering Crab-Topped Filet, the Asian Salmon Salad and the decidedly decadent Bananas Mountain Foster. And that's just a tasty sampling of the popular new items drawing prospectors to this Canadian Rockies mountain lodge. In 2003, Consumer Reports Magazine ranked Bugaboo Creek as the number-two casual dining steak house in the nation.

The Capital Grille continues to secure its preeminent position among fine dining establishments by adopting an uncompromising pursuit of quality. Each member of this distinguished team is responsible for seeing to it that every taste of food, every sip of wine and every verbal exchange between our team and guest exceeds our guest's expectations. If any member of the team overhears anything to the contrary, they are not only empowered, but obligated to rectify the situation by any means possible. Nothing less than complete satisfaction is acceptable if The Capital Grille hopes to maintain its competitive edge. This might explain why two of our restaurants received the 2003 Award of Excellence From DiRoNA (Distinguished Restaurants of North America), we have received consistently high Zagat survey ratings, and every location open prior to 2003 was the recipient of Wine Spectator's Award of Excellence.

RARE *Experiences*

Back in November, my son, Justin flew home from serving in Iraq. And wouldn't you know it, the first place he wanted to stop on the way back from the airport was the LongHorn Steakhouse in McDonough. He ordered a big steak and had his first cold beer in over eight months. The manager and Wendy, our server, were great. The staff sang him a belated Happy Birthday. Even the customers got into the act by personally thanking him for protecting our freedom. We really appreciate everything they did to welcome him back and make him feel at home.

Tom — Dublin, Georgia

My family recently visited your Bugaboo Creek in Bangor. We were there to celebrate my youngest son's birthday. I can't say enough about how Mark, the manager, went far beyond what was expected or even necessary. You see, my son suffers from severe food allergies. Nonetheless, he was really looking forward to eating dessert while the crew sang Happy Birthday. Early on, we explained our quandary to Mark and asked for a recommendation. He said, "Don't worry, I'll take care of it." And sure enough he did. In fact, he drove clear across town to a special bakery and bought our son his own special cake. THANK YOU VERY MUCH!!

Michael — Bangor, Maine

My dad is getting on in years and lives in a nursing home in Newark, Delaware, so he doesn't get out very much. We wanted to surprise him with a special treat, and he had always loved your famous ribs. So my sister-in-law called ahead to make sure you could accommodate Dad's wheel chair and if at all possible, find a way to seat us near the fireplace since Dad chills so easily. We spent the better part of two hours huddled around a cozy fire sharing stories while Celine, our server, doted on us like royalty. And as if that weren't enough, Bugaboo picked up the check. I only wish there was a Bugaboo Creek in my hometown.

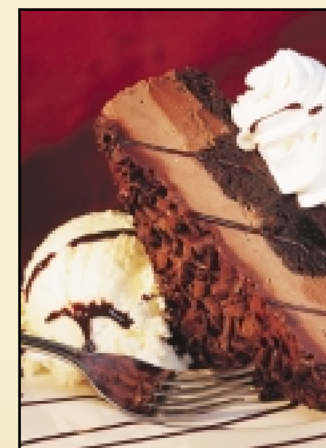
Pam — Chicago, Illinois

We had a couple with three small children come in for dinner one Saturday evening. One of the children—the birthday boy—was hearing impaired and their server, Cathy, overheard the mother telling the father that the boy's hearing aid wasn't working. Apparently, the batteries were dead. So Cathy found an opportune time to sneak out to her car and take the batteries out of her portable CD player so the little boy could hear his birthday song! As they were leaving, the father pulled me aside and said we'd won them over for life.

Ron, Manager — Chesterfield, Missouri

Last Thursday, a couple had made a reservation to celebrate their anniversary at The Capital Grille in downtown Charlotte, a good 90 minutes away from their home. As the night passed, there was no word from them. The kitchen closed and the team was preparing to depart. Ray, our manager, called everyone together and informed them that the anniversary couple had finally arrived—victims of unexpected car trouble. Ray gave the team the option of leaving or taking care of their beleaguered guests. The vote was unanimous to "make them happy." As they left, the couple's parting words were, "All the trouble we've had tonight was erased and well worth it given your food, service and generosity toward us."

Steve, Regional Director — Charlotte, North Carolina



At RARE, the focus of our entire organization is to drive guest loyalty by surpassing their expectations. An inviting atmosphere and good food are expected standards in the restaurant industry. Engendering passionate guest loyalty requires more. It's the small things; it's attention to detail, from picking the right ingredients to building personal relationships. This is a skill we seem to have a knack for. But don't take our word for it. Here are just a few of the many notes we receive every year reminding us that personalized attention seldom goes unnoticed.

Selected Financial Data

Fiscal years ended	**December 28, 2003**	December 29, 2002	December 30, 2001	December 31, 2000	December 26, 1999	December 27, 1998	December 28, 1997
			(in thousands, except per share data)				
Statement of Operations Data:							
Total revenues	**$ 680,832**	$ 584,504	$ 520,326	$ 453,664	$ 371,946	$ 311,938	$ 258,824
Total operating costs and expenses	**616,877**	531,408	477,698	412,358	344,987	294,792	273,592
Operating income	**63,955**	53,096	42,628	41,306	26,959	17,146	(14,768)
Interest expense, net	**1,015**	1,718	2,128	4,159	3,866	2,939	1,245
Early termination of interest rate swap agreement	–	1,540	1,100	–	–	–	–
Provision for litigation settlement	–	–	–	1,000	–	–	–
Minority interest	**300**	448	639	1,407	1,609	1,334	1,219
Earnings (loss) before income taxes and cumulative effect of a change in accounting principle	**62,640**	49,390	38,761	34,740	21,484	12,873	(17,232)
Income tax expense (benefit)	**20,363**	15,951	12,603	11,480	7,060	4,120	(5,000)
Cumulative effect of change in accounting principle (net of tax benefit)	–	–	–	–	1,587	–	–
Net earnings (loss)	**$ 42,277**	$ 33,439	$ 26,158	$ 23,260	$ 12,837	$ 8,753	$ (12,232)
Weighted average common shares outstanding							
Basic	**33,162**	32,586	31,503	27,407	27,072	27,009	26,441
Diluted	**34,843**	34,268	33,216	29,124	28,229	27,224	26,441
Earnings (loss) per common share							
Basic	**$ 1.27**	$ 1.03	$ 0.83	$ 0.85	$ 0.47	$ 0.32	$ (0.46)
Diluted	**$ 1.21**	$ 0.98	$ 0.79	$ 0.80	$ 0.45	$ 0.32	$ (0.46)
Adjusted Net Earnings Reconciliation:							
Net earnings (loss)	**$ 42,277**	$ 33,439	$ 26,158	$ 23,260	$ 12,837	$ 8,753	$ (12,232)
Plus reconciling items (after tax):							
Provision for asset impairment	–	309	1,737	–	1,116	1,700	20,359
Early termination of interest rate swap agreement	–	961	682	–	–	–	–
Provision for litigation settlement	–	–	–	675	–	–	–
Cumulative effect of change in accounting principle	–	–	–	–	1,587	–	–
Adjusted net earnings [1]	**$ 42,277**	$ 34,709	$ 28,577	$ 23,935	$ 15,540	$ 10,453	$ 8,127
Adjusted earnings per diluted share [1]	**$ 1.21**	$ 1.01	$ 0.86	$ 0.82	$ 0.55	$ 0.38	$ 0.31
Balance Sheet Data:							
Cash, cash equivalents, and short-term investments	**$ 44,544**	$ 31,467	$ 25,979	$ 3,771	$ 8,864	$ 12,060	$ 2,361
Total assets	**464,542**	389,309	352,456	295,381	237,118	218,862	195,486
Long-term debt	–	–	10,000	51,000	40,000	48,000	43,000
Obligations under capital leases, net of current installments	**27,462**	22,406	20,867	20,925	9,732	9,732	5,051
Minority interest	**1,371**	1,411	1,329	1,469	3,982	2,610	4,890
Total shareholders' equity	**352,055**	300,132	256,530	167,257	137,584	120,618	111,980

[1] *Adjusted net earnings and adjusted net earnings per diluted share ("the adjusted items") are non-GAAP financial measures. The Company excludes the identified reconciling items because both management and industry analysts rely on the adjusted items as a primary measure to review and assess the ongoing operating performance of the Company. The Company believes it is useful to investors to provide disclosures of its operating results on the same basis as that used by management and industry analysts. You should not consider the adjusted items in isolation or as a substitute for net earnings or earnings per basic and diluted share determined in accordance with accounting principles generally accepted in the United States.*

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

OVERVIEW

The Company's revenues are derived primarily from restaurant sales from Company-owned LongHorn Steakhouse, The Capital Grille, and Bugaboo Creek Steak House restaurants. The Company also derives a small percentage of its total revenue from two Company-owned specialty restaurants and franchise revenues from three franchised LongHorn Steakhouse restaurants. Cost of restaurant sales consists of food and beverage costs for all restaurants other than the three franchised LongHorn Steakhouse restaurants. Operating expenses – restaurants consist of other costs incurred by the Company to operate its restaurants, including the cost of labor, advertising, operating supplies, rent, and utilities. Depreciation and amortization - restaurants includes the depreciation attributable to restaurant-level capital expenditures. The depreciation and amortization relating to non-restaurant level capital expenditures is included in general and administrative expenses.

Preopening costs include direct and incremental costs such as payroll; food and beverage costs; and trainer payroll and travel expenses incurred prior to opening of new restaurants. General and administrative expenses include restaurant supervision expenses, accounting, finance, management information systems and other administrative overhead related to support functions for Company-owned, joint venture, and franchise restaurant operations. Interest expense, net includes interest on capital lease obligations and amortization of loan issue costs partially offset by capitalized construction period interest and interest income. Minority interest consists of the partner's 50% share of earnings in the three LongHorn Steakhouse restaurants that are operated as joint venture restaurants.

The Company's management believes in the importance of building incremental top line sales at each restaurant to support the longer-term profitability of the Company. The change in year-over-year sales for the comparable restaurant base is referred to as "same store sales." 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. Same store sales increases can be generated by an increase in guest traffic counts ("guest counts") or by increases in guest average check amount ("average check"). The average check can be affected by menu price changes and the mix of menu items sold ("menu mix"). The Company gathers sales data daily and regularly analyzes the guest counts and menu mix for each concept to assist in developing menu pricing, product offering and promotion strategies. Management believes that increases in guest counts are an indication of the long-term health of a concept, while increases in average check and menu mix contribute more significantly to current period profitability. The Company works to balance the pricing and product offerings with other initiatives to achieve the long-term goal of sustainable increases in same store sales.

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. Growth in average weekly sales includes the effect of newer restaurants that are not yet included in the same store sales base. Growth in average weekly sales in excess of growth in same store sales is generally an indication that newer restaurants are operating with sales levels in excess of the system average. Conversely, growth in average weekly sales less than growth in same store sales is generally an indication that newer restaurants are operating with sales levels lower than the system average. It is not uncommon in the casual dining industry for new restaurant locations to open with an initial honeymoon period of higher than normalized sales volumes and then to experience a drop off in sales after initial customer trials.

The incremental sales generated as a result of increases in same store sales make a significant contribution to the Company's profitability. Many restaurant level expenses are relatively fixed in nature and do not increase at the same rate as same store sales increases. With sales increasing and certain restaurant-level expenses staying fixed or semi-variable (rising more slowly than incremental sales), the incremental sales measured by these same store sales increases should be the Company's most profitable. When new restaurants are opened, there are preopening costs and certain relatively fixed costs, including expense items such as management labor, rent and depreciation that must be absorbed. Additionally, it generally takes some period of time after opening before restaurant margins normalize. Accordingly, the sales at newly opened restaurants do not make a significant contribution to profitability in their initial months of operation.

The Company's revenues and expenses can be affected significantly by the number and timing of the opening of additional restaurants. For instance, preopening expenses for any particular period may reflect expenses associated with restaurants to be opened in future periods, in addition to those restaurants opened during the current period. The timing of restaurant openings also can affect the average weekly 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 28, 2003	December 29, 2002	December 30, 2001
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	**71.6%**	71.3%	70.5%
The Capital Grille	**15.0**	15.2	15.3
Bugaboo Creek Steak House	**12.2**	12.2	12.8
Other restaurants	**1.1**	1.2	1.4
Total restaurant sales	**99.9**	99.9	99.9
Franchise revenues	**0.1**	0.1	0.1
Total revenues	**100.0**	100.0	100.0
Costs and expenses:			
Cost of restaurant sales (1)	**36.0**	36.1	36.5
Operating expenses--restaurants (1)	**43.9**	44.0	43.9
Provision for asset impairments, restaurant closings, and other charges	**–**	0.1	0.5
Depreciation and amortization--restaurants (1)	**3.9**	4.1	4.1
Pre-opening expense – restaurants (1)	**0.8**	0.7	0.7
General and administrative expenses	**6.0**	6.0	6.1
Total costs and expenses	**90.6**	90.9	91.8
Operating income	**9.4**	9.1	8.2
Interest expense, net	**0.1**	0.3	0.4
Early termination of interest rate swap agreement	**–**	0.3	0.2
Minority interest	**–**	0.1	0.1
Earnings before income taxes	**9.2**	8.5	7.4
Income tax expense	**3.0**	2.7	2.4
Net earnings	**6.2%**	5.7%	5.0%

(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 28, 2003 Compared to Year Ended December 29, 2002

REVENUES

Total revenues increased 16.5% to $680.8 million for 2003, compared to $584.5 million for 2002.

LongHorn Steakhouse:
Sales in the LongHorn Steakhouse restaurants increased 16.9% to $487.2 million for 2003, compared to $416.9 million for 2002. The increase reflects a 9.8% increase in restaurant operating weeks in 2003 as compared to 2002, resulting from an increase in the restaurant base from 170 Company-owned and joint venture LongHorn Steakhouse restaurants at the end of 2002 to 187 restaurants at the end of 2003. Average weekly sales for Company-owned and joint venture LongHorn Steakhouse restaurants in 2003 were $52,570, a 6.4% increase over 2002. Same store sales for LongHorn Steakhouse restaurants increased 4.6% in 2003 as compared to 2002. The increase in same store sales for 2003 at LongHorn Steakhouse was attributable to an increase in guest counts of approximately 2.5% and the remainder was due to an increase in average check. Management believes a number of factors have contributed to the increased guest counts including a more effective use of media advertising resulting from the concentration of restaurants; menu evolution with more appealing menu offerings; and improved restaurant-level execution; all of which work together to provide a better overall customer experience.

The Capital Grille:
Sales in The Capital Grille restaurants increased 15.5% to $102.4 million for 2003, compared to $88.6 million for 2002. The increase reflects a 5.3 % increase in restaurant operating weeks in 2003 as compared to 2002, resulting from the two new The Capital Grille restaurants opened during 2003, bringing the total The Capital Grille restaurants in operation to 17. Average weekly sales for The

Capital Grille restaurants in 2003 were $124,743, a 9.8 % increase from 2002. Same store sales for The Capital Grille restaurants increased 10.9% in 2003, as compared to 2002. The increase in comparable restaurant sales at The Capital Grille restaurants is primarily attributable to an increase in guest counts, which management believes was driven principally by better execution at the restaurant level.

During 2003, average weekly sales increased at a rate slightly less than the increase in same store sales. 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 casual dining restaurant concepts. Accordingly, sales volumes at the Company's two new The Capital Grille restaurants opened during 2003 had the impact of reducing average weekly sales for the overall concept.

Bugaboo Creek Steak House:
Sales in the Bugaboo Creek Steak House restaurants increased 17.0% to $83.3 million for 2003, compared to $71.2 million for 2002. The increase reflects a 15.4% increase in restaurant weeks in 2003 as compared to 2002, resulting from an increase in the restaurant base from 22 Bugaboo Creek Steak House restaurants at the end of 2002 to 25 restaurants at the end of 2003. Average weekly sales for the Bugaboo Creek Steak House restaurants in 2003 were $69,553, a 1.4% increase from 2002. Same store sales for the Bugaboo Creek Steak House restaurants increased 2.6% in 2003, as compared to 2002. The increase in same store sales at Bugaboo Creek Steak House restaurants is attributable to an increase in average check offset by a slight decrease in guest counts. During 2003, average weekly sales increased at a rate slightly less than the increase in same store sales due to lower average weekly sales at restaurants opened in new competitive markets.

Franchise Revenue:
The Company has a franchisee that operates three LongHorn Steakhouse restaurants in Puerto Rico. The Company earned $374,000 and $345,000 in franchise revenue in 2003 and 2002, respectively. Franchise revenue is computed based on a fixed percentage of the franchisee's sales; therefore, the increase in 2003 franchise revenue over the prior year was due to the 8.7% increase in same store sales for the Company's franchised restaurants.

COSTS AND EXPENSES

Cost of restaurant sales, as a percentage of total restaurant sales, decreased to 36.0 % in 2003 from 36.1% in 2002. Contract pricing on certain protein and other products during 2003 was favorable as compared to the prior year. However, cost of sales increased in the second half of 2003 as compared to the prior year due to i) increases in the beef costs for certain contracts as they were renewed and ii) higher prices on beef purchases made when sales growth exceeded contracted quantities.

Restaurant operating expenses decreased as a percentage of total restaurant sales in 2003 to 43.9%, from 44.0% in 2002. The increased average weekly sales rate in 2003 leveraged fixed and semi-variable expenses (principally management labor and rent) as a percentage of total restaurant sales. The leveraging of these fixed expenses was partially offset by an increase in advertising spending, credit card fees and utility costs as a percentage of total restaurant sales. Advertising increased by approximately 0.3% of total restaurant sales but was within the Company's historical targeted spending range of 2.8% to 3.2% of total restaurant sales. Increased credit card usage by customers caused credit card processing fees to increase by 0.1% as a percentage of total restaurant sales. Additionally, utilities expenses increased by approximately 9.5% per operating week in 2003 as compared to 2002 principally due to rate increases, resulting in a 0.1% increase as a percentage of total restaurant sales.

Depreciation and amortization – restaurants increased to $26.5 million in 2003, from $23.9 million in 2002, due to the Company's new restaurant construction and depreciation of capital expenditures associated with the Company's remodeling of older restaurants. The amount of depreciation expense per operating week was approximately the same in 2003 as it was in 2002.

Pre-opening expense increased to $5.8 million or 0.8% of total restaurant sales in 2003 from $3.8 million or 0.7% of total restaurant sales in 2002. This increase was the result of the Company opening a total of 26 new restaurants in 2003 as compared to opening 20 restaurants in 2002. The amount of pre-opening expense per new restaurant in 2003 was approximately equal to preopening expense per new restaurant in 2002.

General and administrative expenses increased to $40.5 million in 2003, from $34.9 million in 2002, but remained flat at 6.0% as a percent of total revenue in 2003 and 2002. The increased amounts expensed in 2003 were primarily compensation related, associated with increased bonuses, payroll and other costs of building the infrastructure necessary to support the Company's growth.

Interest expense, net decreased to $1.0 million in 2003, from $1.7 million in 2002. The decrease in interest expense, net was due to lower average borrowings under the Company's revolving credit facility and increased interest income earned as the balances of cash and short-term investments increased in 2003 as compared to 2002.

Minority interest decreased to $300,000 in 2003, from $448,000 in 2002. This reflects a decrease in the average number of joint venture restaurants in 2003 compared to 2002 resulting primarily from the purchase of the joint venture partner's interest in two restaurants during 2003 and seven joint venture restaurants during 2002. The Company currently has three joint venture LongHorn Steakhouse restaurants remaining.

Income tax expense in 2003 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 $42.3 million in 2003, as compared to net income of $33.4 million in 2002, reflects the net effect of the items discussed above.

RESULTS OF OPERATIONS

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

REVENUES

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

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

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

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

Franchise Revenue:
The Company's franchise revenue increased to $345,000 in 2002 from $328,000 in 2001 due to a 5.2% increase in same store sales for the Company's three franchised LongHorn Steakhouse restaurants.

COSTS AND EXPENSES

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

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

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

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

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

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

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

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

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

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

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

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 2003 were cash flow from operations ($84.7 million), and proceeds from the exercise of employee stock options ($7.1 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 ($76.9 million) and the purchase of short-term investments ($6.3 million).

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

The increases in accounts receivable, inventory, prepaid expenses, accounts payable and accrued expenses are principally due to the new restaurants which were opened during 2003 and the result of generally higher average unit volumes experienced during 2003. Further increases in current asset and liability accounts are expected as the Company continues its restaurant development program.

Due to the relatively short time period (less than 30 days) between the ordering of inventories, preparation for sale, collection of payment and subsequent payment for inventories, there are no material changes in the underlying drivers of cash flows that are not clearly identifiable in the Company's consolidated statement of cash flows.

The Company has a revolving credit facility, which allows the Company to borrow up to $100.0 million through its maturity in November 2007. The terms of the revolving credit facility, as amended, require the Company to pay interest on outstanding borrowings at LIBOR plus a margin of 1.25% to 1.75% (depending on the Company's leverage ratio) or the administrative agent's prime rate of interest, at the Company's option, and pay a commitment fee of 0.3% to 0.4% (depending on the Company's leverage-ratio) per year on any unused portion of the facility. No amounts were outstanding, and $100.0 million was available, under the Company's revolving credit agreement on December 28, 2003. As of December 28, 2003, terms of the revolving credit facility provide for interest to be accrued at LIBOR plus 1.25% or the prime rate and payment of the commitment fee at a rate of 0.30% per year on any unused portion of the facility.

The revolving credit facility contains various covenants and restrictions which, among other things, require the maintenance of stipulated leverage and fixed charge coverage ratios and minimum consolidated net worth, as defined, and also limit additional indebtedness in excess of specified amounts. The Company is currently in compliance with such covenants.

The Company currently plans to open 23 or 24 LongHorn Steakhouse restaurants, three or four Bugaboo Creek Steak House restaurants and two or three The Capital Grille restaurants in 2004. The Company estimates that its capital expenditures will be approximately $83 to $88 million in 2004. The capital expenditure estimate for 2004 includes the estimated cost of developing 28 to 31 new restaurants, ongoing refurbishment in existing restaurants, costs associated with obtaining real estate for year 2005 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. In July 2002, the Board of Directors extended this program through April 2003. During the first quarter of 2003, the Company purchased 150,000 shares of its common stock under this program for a total purchase price of $2.625 million (average price of $17.50 per share). In July 2003, the Company's Board of Directors authorized the Company to use up to $25.0 million to purchase shares of its common stock from time to time through May 2005. No purchases have been made under this program.

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 2006.

OUTLOOK FOR FUTURE OPERATING RESULTS

Revenues. The Company plans to grow revenues by opening additional restaurants and by increasing average unit volumes at both existing and new restaurants. The Company's new restaurant development plans for 2004 are summarized in the section entitled "LIQUIDITY AND CAPITAL RESOURCES". Based upon current economic conditions and the Company's business trends, the Company is targeting same store sales growth in 2004 of 3% to 4% for all three concepts, compared with 2003. The Company anticipates that this same store sales increase will be comprised of an approximate 2% to 3% increase in average check and 1% to 2% increase in guest counts. New restaurant development and the targeted same store sales growth are expected to result in an increase in total revenue of approximately 17% to 18%.

Cost of restaurant sales. The Company is anticipating increased commodity prices in 2004 based primarily on higher protein pricing particularly with respect to beef. The Company is under fixed price contracts with its primary suppliers for the majority of its anticipated usage of protein products in 2004; however, the Company pays market prices for other products such as produce and fresh seafood and for any protein purchases in excess of contracted amounts. Based on the fixed prices negotiated for its protein products partially offset by current and anticipated menu price increases, the Company expects its costs of goods sold as a percentage of total restaurant sales to increase by 0.6% to 0.7% in 2004 as compared with 2003.

Operating expenses – restaurants. For the last several years, the Company has experienced wage rate pressure for both restaurant management and hourly positions, resulting from a tight labor market for skilled positions in the restaurant industry. Based upon labor market conditions that exist today, the Company expects this trend to continue in 2004. In addition, the Company expects that both (i) an increase in the cost of employee health insurance coverage and (ii) an increase in unemployment insurance expense will contribute to upward pressure on overall labor costs as a percentage of total restaurant sales. The Company's targeted growth in same store sales of 3% to 4%, if achieved, will greatly mitigate these cost pressures resulting in a slight amount of leveraging of operating expenses as a percentage of total restaurant sales.

Pre-opening expense. Pre-opening costs are expensed as incurred and are expected to approximate $190,000 for each LongHorn Steakhouse restaurant, $200,000 for each Bugaboo Creek Steak House restaurant, and $375,000 for each The Capital Grille restaurant.

Restaurant pre-opening expenses may vary materially from period to period depending on when restaurants open. As a result of the planned opening of more new restaurants in 2004, as compared to 2003, the Company anticipates that pre-opening expenses will be higher in 2004 by approximately $800,000 to $1,100,000.

Depreciation and amortization – restaurants. The Company expects depreciation to increase as it invests in the development of new restaurants, the ongoing refurbishment in existing restaurants, and due to the full-year effect of the installation of a new point of sale system in all existing restaurants during 2003. Due to greater leverage of this fixed expense resulting from expected average weekly sales increases in 2004, the Company expects depreciation and amortization to decrease slightly as a percentage of restaurant sales.

General and administrative expenses. To support the Company's expected increase in the number of new restaurants in 2004, the Company plans to increase total general and administrative expenses by approximately 16% to 17%, compared with 2003. This percentage growth in general and administrative expense is expected to be slightly less than the percentage growth in revenue causing this expense category to decrease slightly as a percentage of total revenue in 2004 as compared to 2003.

Interest expense, net. The Company does not plan to have any amounts outstanding under its revolving credit facility during 2004. However, due to the addition of capital leases during 2003 and 2004 the Company expects net interest expense to increase in 2004 compared with 2003 by approximately $200,000 to $300,000.

Income tax expense. The Company expects its effective income tax rate for 2004 to be approximately 33.25% of earnings before income taxes. In years subsequent to 2004, the company expects its effective income tax rate to increase slightly each year.

Earnings per share. Based upon the net effect of the items discussed above, the Company expects 2004 diluted earnings per common share in a range of $1.36 to $1.38.

The preceding discussion of liquidity and capital resources and outlook for future operating results contain certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements regarding the intent, belief or current expectations of the Company and members of its management team, as well as assumptions on which such statements are based. All forward-looking statements in this annual report are based upon information available to the Company on the date of this report. Forward-looking statements involve a number of risks and uncertainties, and in addition to the factors discussed elsewhere in this annual report, other factors that could cause actual results, performance or developments to differ materially from those expressed or implied by those forward-looking statements include the following: failure of facts to conform to necessary management estimates and assumptions regarding financial and operating matters; the Company's ability to identify and secure suitable locations for new restaurants on acceptable terms, open the anticipated number of new restaurants on time and within budget, achieve anticipated rates of same store sales, hire and train additional restaurant personnel and integrate new restaurants into its operations; the continued implementation of the Company's business discipline over a large restaurant base; unexpected increases in cost of sales or employee, pre-opening or other expenses; the economic conditions in the new markets into which the Company expands and possible uncertainties in the customer base in these areas; fluctuations in quarterly operating results; seasonality; unusual weather patterns or events; changes in customer dining patterns; the impact of any negative publicity or public attitudes related to the consumption of beef; disruption of established sources of product supply or distribution; competitive pressures from other national and regional restaurant chains; legislation affecting the restaurant industry; business conditions, such as inflation or a recession, or other negative effect on dining patterns, or some other negative effect on the economy, in general, including (without limitation) war, insurrection and/or terrorist attacks on United States soil; growth in the restaurant industry and the general economy; changes in monetary and fiscal policies, laws and regulations; and the risks identified from time to time in the Company's SEC reports, including the Company's Annual Report on Form 10-K for 2003, registration statements and public announcements. The Company undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any transactions with unconsolidated entities, that are financial guarantees, retained or contingent interests in transferred assets, derivative instruments, or obligations arising out of a variable interest entity that provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with the Company and that have a material current effect, or that are reasonably likely to have a material future effect, on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

The table below summarizes the Company's significant contractual obligations, by maturity, as of December 28, 2003 *(in thousands)*:

	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Bank revolving credit facility	$ –	$ –	$ –	$ –	$ –
Capital lease obligations	63,203	2,593	5,403	5,632	49,575
Operating leases	118,963	17,228	30,776	23,858	47,101
Purchase obligations	21,544	21,544	–	–	–
Total contractual cash obligations	$ 203,710	$ 41,365	$ 36,179	$ 29,490	$ 96,676

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, at least to some degree, customer spending at its restaurants.

RECENT ACCOUNTING PRONOUNCEMENTS

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

As of the date of adoption, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million for fiscal year 2001. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for 2003 or 2002. For the foreseeable future, management believes the only impact on the Company's consolidated financial statements from the adoption of SFAS 142 will be the elimination of goodwill amortization expense.

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

	Year Ended		
	2003	2002	2001
Net earnings, as reported	**$ 42,277**	$ 33,439	$ 26,158
Goodwill amortization, net of tax benefit	**–**	–	$ 679
Net earnings, pro forma	**$ 42,277**	$ 33,439	$ 26,837
Basic earnings per common share:			
Net earnings, as reported	**$ 1.27**	$ 1.03	$ 0.83
Goodwill amortization, net of tax benefit	**–**	–	0.02
Net earnings, pro forma	**$ 1.27**	$ 1.03	$ 0.85
Diluted earnings per common share:			
Net earnings, as reported	**$ 1.21**	$ 0.98	$ 0.79
Goodwill amortization, net of tax benefit	**–**	–	0.02
Net earnings, pro forma	**$ 1.21**	$ 0.98	$ 0.81

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which addresses consolidation by business enterprises of variable interest entities ("VIEs") either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB issued modifications to FIN 46 ("Revised Interpretations") resulting in multiple effective dates based on the nature as well as the creation date of the VIE. VIEs created after January 31, 2003, but prior to January 1, 2004, may be accounted for either based on the original interpretation or the Revised Interpretations. However, the Revised Interpretations must be applied no later than the first quarter of 2004. VIEs created after January 1, 2004 must be accounted for under the Revised Interpretations. Non-Special Purpose Entities created prior to February 1, 2003, should be accounted for under the revised interpretation's provisions no later than the first quarter of fiscal 2004. The Company has adopted FIN 46, which did not have, and the Company does not expect the Revised Interpretations to have an impact on the Company's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment to Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies the financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement is effective for hedging relationships designated and contracts entered into or modified after June 30, 2003, except for the provisions that relate to SFAS No. 133 implementation issues, which will continue to be applied in accordance with their respective dates. The adoption of SFAS No. 149 in the third quarter of 2003 did not impact the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity, and imposes certain additional disclosure requirements. The provisions of SFAS No. 150 are generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted SFAS No. 150 and it did not have a material impact on the Company's consolidated financial statements.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

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

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

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

Impairment of long-lived assets
Long-lived assets, including restaurant sites, fixed assets, intangibles and goodwill are reviewed by the Company for impairment whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. Expected cash flows associated with an asset is a key factor in determining the recoverability of the asset. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance. The Company's estimates of undis-

counted cash flow may differ from actual cash flow due to, among other things, technological changes, economic conditions, changes to its business model or changes in its operating performance. If the sum of the undiscounted cash flows is less than the carrying value of the asset, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

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

Self-insurance reserves

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

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

Income taxes

Income taxes are accounted for by the Company in accordance with Statement of Financial Accounting Standards No. 109 ("SFAS 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 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

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

INTEREST RATE RISK

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

As of December 28, 2003, the Company had no borrowings outstanding under its $100.0 million revolving credit facility. Amounts outstanding under such credit facility bear interest at LIBOR plus a margin of 1.25% to 1.75% (the "applicable margin" depending on the Company's leverage ratio), or the administrative agent's prime rate of interest at the Company's option. Accordingly, the Company is exposed to the impact of interest rate movements. To achieve the Company's objective of managing its exposure to interest rate changes, the Company may from time to time use interest rate swaps.

INVESTMENT PORTFOLIO

The Company invests portions of its excess cash, if any, in highly liquid investments. At December 28, 2003, the Company had $16.0 million in high-grade overnight repurchase agreements, and $24.0 million in short-term investments in the form of federal, state, and municipal bonds. As of December 28, 2003, the Company has classified all short-term investments as trading securities. The market risk on such investments is minimal due to their short-term nature.

Consolidated Balance Sheets

DECEMBER 28, 2003 AND DECEMBER 29, 2002

	2003	2002
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 20,508**	$ 13,732
Short-term investments	**24,036**	17,735
Accounts receivable	**8,730**	6,576
Inventories	**16,558**	14,309
Prepaid expenses	**5,039**	3,477
Refundable income taxes (note 6)	**2,162**	4,124
Deferred income taxes (note 6)	**4,887**	4,484
Total current assets	**81,920**	64,437
Property and equipment, less accumulated depreciation and amortization (notes 3 and 8)	**354,448**	299,773
Goodwill	**19,187**	19,187
Other	**8,987**	5,912
Total assets	**$ 464,542**	$ 389,309
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 18,729**	$ 17,727
Accrued expenses (note 4)	**55,218**	44,015
Current installments of obligations under capital leases (note 8)	**124**	78
Total current liabilities	**74,071**	61,820
Deferred income taxes (note 6)	**5,452**	1,138
Obligations under capital leases, net of current installments (note 8)	**27,462**	22,406
Other	**4,131**	2,402
Total liabilities	**111,116**	87,766
Minority interest	**1,371**	1,411
Shareholders' equity (notes 5, 9, and 10):		
Preferred stock, no par value. Authorized 10,000 shares, none issued	**–**	–
Common stock, no par value. Authorized 60,000 shares; issued 34,042 shares and 33,099 shares at December 28, 2003 and December 29, 2002, respectively	**203,624**	191,174
Unearned compensation – restricted stock	**(1,303)**	(1,124)
Retained earnings	**154,723**	112,446
Treasury shares at cost; 293 shares and 143 shares at December 28, 2003 and December 29, 2002, respectively	**(4,989)**	(2,364)
Total shareholders' equity	**352,055**	300,132
Commitments and contingencies (notes 3, 5, 7, 8 and 11)		
Total liabilities and shareholders' equity	**$ 464,542**	$ 389,309

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

YEARS ENDED DECEMBER 28, 2003, DECEMBER 29, 2002, AND DECEMBER 30, 2001

	2003	2002	2001
	(in thousands, except per share data)		
Revenues:			
Restaurant sales:			
LongHorn Steakhouse	**$ 487,221**	$ 416,917	$ 366,538
The Capital Grille	**102,414**	88,637	80,131
Bugaboo Creek Steak House	**83,325**	71,216	66,141
Other restaurants	**7,498**	7,389	7,188
Total restaurant sales	**680,458**	584,159	519,998
Franchise revenues	**374**	345	328
Total revenues	**680,832**	584,504	520,326
Costs and expenses:			
Cost of restaurant sales	**245,094**	211,006	189,869
Operating expenses-- restaurants	**298,978**	257,252	228,340
Provision for asset impairments, restaurant closings, and other charges (note 2)	**–**	495	2,802
Depreciation and amortization-- restaurants	**26,508**	23,920	21,248
Pre-opening expense	**5,782**	3,802	3,764
General and administrative expenses	**40,515**	34,933	31,675
Total costs and expenses	**616,877**	531,408	477,698
Operating income	**63,955**	53,096	42,628
Interest expense, net	**1,015**	1,718	2,128
Early termination of interest rate swap agreement	**–**	1,540	1,100
Minority interest	**300**	448	639
Earnings before income taxes	**62,640**	49,390	38,761
Income tax expense (note 6)	**20,363**	15,951	12,603
Net earnings	**$ 42,277**	$ 33,439	$ 26,158
Basic earnings per common share	**$ 1.27**	$ 1.03	$ 0.83
Diluted earnings per common share	**$ 1.21**	$ 0.98	$ 0.79
Weighted average common shares outstanding (basic)	**33,162**	32,586	31,503
Weighted average common shares outstanding (diluted)	**34,843**	34,268	33,216

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity and Comprehensive Income

YEARS ENDED DECEMBER 28, 2003, DECEMBER 29, 2002 AND DECEMBER 30, 2001

(in thousands)	Common Stock Shares	Common Stock Dollars	Restricted Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
BALANCE, DECEMBER 31, 2000	29,441	$ 124,497	$ (338)	$ 52,849	$ (9,751)	$ –	$ 167,257
Comprehensive income (net of tax):							
Net earnings	–	–	–	26,158	–	–	26,158
Cumulative effect of change in accounting principle, net of taxes	–	–	–	–	–	(624)	(624)
Change in unrealized loss from interest rate swaps, net of taxes	–	–	–	–	–	41	41
Total comprehensive income							25,575
Issuance of shares pursuant to public offering	2,144	47,872	–	–	9,751	–	57,623
Purchase of common stock for treasury	–	–	–	–	(159)	–	(159)
Issuance of shares pursuant to restricted stock awards	26	414	(414)	–	–	–	–
Amortization of restricted stock	–	–	230	–	–	–	230
Issuance of shares to retirement plans	42	656	–	–	–	–	656
Issuance of shares pursuant to exercise of stock options	630	4,303	–	–	–	–	4,303
Tax benefit of stock options exercised	–	1,045	–	–	–	–	1,045
BALANCE, DECEMBER 30, 2001	32,283	178,787	(522)	79,007	(159)	(583)	256,530
Comprehensive income (net of tax):							
Net earnings	–	–	–	33,439	–	–	33,439
Other comprehensive income, change in unrealized loss from interest rate swaps	–	–	–	–	–	583	583
Total comprehensive income							34,022
Purchase of common stock for treasury	–	–	–	–	(2,205)	–	(2,205)
Issuance of shares to retirement plans	16	219	–	–	–	–	219
Issuance of shares pursuant to restricted stock awards	66	1,038	(1,038)	–	–	–	–
Amortization of restricted stock	–	–	436	–	–	–	436
Issuance of shares pursuant to exercise of stock options	734	5,262	–	–	–	–	5,262
Tax benefit of stock options exercised	–	5,868	–	–	–	–	5,868
BALANCE, DECEMBER 29, 2002	33,099	191,174	(1,124)	112,446	(2,364)	–	300,132
Net earnings and other comprehensive income	–	–	–	42,277	–	–	42,277
Purchase of common stock for treasury	–	–	–	–	(2,625)	–	(2,625)
Issuance of shares pursuant to restricted stock award	47	969	(969)	–	–	–	–
Amortization of restricted stock	–	–	790	–	–	–	790
Forfeiture of restricted stock	(11)	(263)	–	–	–	–	(263)
Issuance of shares pursuant to exercise of stock options	907	7,120	–	–	–	–	7,120
Tax benefit of stock options exercised	–	4,624	–	–	–	–	4,624
BALANCE, DECEMBER 28, 2003	**34,042**	**$ 203,624**	**$ (1,303)**	**$ 154,723**	**$ (4,989)**	**$ –**	**$ 352,055**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

YEARS ENDED DECEMBER 28, 2003, DECEMBER 29, 2002 AND DECEMBER 30, 2001

	2003	2002	2001
	(in thousands, except per share data)		
Cash flows from operating activities:			
Net earnings	**$ 42,277**	$ 33,439	$ 26,158
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	**27,992**	25,597	24,067
Non-cash portion of provision for asset impairments, restaurant closings and other charges	**–**	495	2,802
Minority interest	**300**	448	639
Deferred tax expense (benefit)	**3,911**	5,573	(823)
Issuance of common stock to employee retirement plans	**–**	219	656
Changes in assets and liabilities:			
Accounts receivable	**(2,154)**	(807)	(1,114)
Inventories	**(2,249)**	(872)	(2,284)
Prepaid expenses	**(1,562)**	(408)	(1,823)
Other assets	**(1,390)**	(731)	(796)
Refundable income taxes	**6,586**	5,646	1,187
Accounts payable	**229**	(5,943)	6,550
Accrued expenses	**10,782**	8,190	2,164
Net cash provided by operating activities	**84,722**	70,846	57,383
Cash flows from investing activities:			
Purchase of property and equipment	**(76,915)**	(54,397)	(55,497)
Purchase of short-term investments, net	**(6,301)**	(17,735)	–
Net cash used in investing activities	**(83,216)**	(72,132)	(55,497)
Cash flows from financing activities:			
Repayments of debt, net	**–**	(10,000)	(41,000)
Proceeds from issuance of common stock	**–**	-	57,623
Principal payments on capital leases	**(79)**	(58)	(44)
Proceeds from minority partner contributions	**–**	156	–
Distributions to minority partners	**(340)**	(522)	(779)
Increase (decrease) in bank overdraft included in accounts payable and accrued expenses	**1,194**	(3,594)	378
Purchase of common stock for treasury	**(2,625)**	(2,205)	(159)
Proceeds from exercise of stock options	**7,120**	5,262	4,303
Net cash provided by (used in) financing activities	**5,270**	(10,961)	20,322
Net increase (decrease) in cash and cash equivalents	**6,776**	(12,247)	22,208
Cash and cash equivalents at beginning of year	**13,732**	25,979	3,771
Cash and cash equivalents at end of year	**$ 20,508**	$ 13,732	$ 25,979
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	**$ 9,737**	$ 6,243	$ 11,914
Cash paid for interest net of amounts capitalized	**$ 1,078**	$ 1,934	$ 2,311
Supplemental disclosure of non-cash financing and investing activities:			
Assets acquired under capital lease	**$ 5,181**	$ 1,617	$ –

See accompanying notes to consolidated financial statements.

Note to Consolidated Financial Statements

DECEMBER 28, 2003, DECEMBER 29, 2002 AND DECEMBER 30, 2001

(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 in 28 states and the District of Columbia, which are located primarily in the Eastern half of the United States. At December 28, 2003, the Company operated the following restaurants:

CONCEPT	NUMBER IN OPERATION
LongHorn Steakhouse	187
Bugaboo Creek Steak House	25
The Capital Grille	17
Other specialty concepts	2

The Company is a partner in joint ventures that, in the aggregate, operate three LongHorn Steakhouse restaurants, which are managed by the Company.

BASIS OF PRESENTATION

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

The Company's fiscal year is a 52- or 53-week year ending on the last Sunday in each calendar year. Each of the four fiscal quarters is typically made up of 13 weeks.

The Company effected a three-for-two stock split in the form of a 50% stock dividend paid on September 2, 2003 to shareholders of record on August 12, 2003. All references to the number of common shares and per share amounts prior to the stock split have been restated to give retroactive effect to the stock split for all periods presented.

ACCOUNTING CHANGE

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

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 $16.0 million at December 28, 2003 and $9.8 million at December 29, 2002. The carrying amount of these instruments approximates their fair market values. All overdraft balances have been reclassified as current liabilities.

SHORT TERM INVESTMENTS

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

INVENTORIES

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

PROPERTY AND EQUIPMENT

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

PRE-OPENING AND ORGANIZATION COSTS

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

COMPUTER SOFTWARE FOR INTERNAL USE

The Company accounts for the costs of developing or acquiring computer software in accordance with the American Institute of Certified Public Accountants 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.

UNREDEEMED GIFT CERTIFICATES

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

GOODWILL

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

As of the date of adoption of SFAS 142, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million for fiscal years 2001. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for fiscal 2003 or 2002.

OTHER ASSETS

Other assets consist of debt issuance costs, trademarks, deposits, and purchased liquor licenses. Trademarks are amortized on a straight-line basis over five years. The Company applies the provisions of SFAS 142 to purchased liquor licenses; accordingly, in the first quarter of fiscal 2002, the Company ceased amortizing purchased liquor licenses and began testing the liquor licenses for impairment annually. There was no impairment in 2003 or 2002. Debt issuance costs are amortized on a straight-line basis over the term of the debt.

RESTAURANT CLOSING COSTS

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

RECOVERABILITY OF LONG-LIVED ASSETS

The Company accounts for long-lived assets in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires the Company to review its long-lived assets relat-

ed to each restaurant periodically or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Considerable management judgment is required to estimate cash flows and fair value less costs to sell. Accordingly, actual results could vary significantly from such estimates.

INCOME TAXES

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

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

STOCK-BASED COMPENSATION

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

Alternatively, SFAS 123 also allows entities to continue to apply the provisions of APB 25 and provide pro forma net earnings (loss) and pro forma earnings (loss) per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method defined in SFAS 123 had been applied. The Company has elected to continue to apply the provisions of APB 25 and provide the pro forma disclosures required by SFAS 123. The fair value of the options granted during 2003, 2002 and 2001 is estimated at approximately $5.8 million, $4.9 million and $8.6 million, respectively, on the date of grant, using the Black-Scholes option pricing model with the following assumptions:

	2003	2002	2001
Dividend yield	**0**	0	0
Volatility	**44%**	46%	51%
Risk-free interest rate	**3.25%**	4%	4%
Average expected life	**5 yrs**	5 yrs	6 yrs

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

	2003	2002	2001
Net earnings, as reported	**$ 42,277**	$ 33,439	$ 26,158
Total stock-based employee compensation expense determined under fair value methods for all awards, net of related tax effects	**3,853**	3,275	3,261
Pro forma net earnings	**$ 38,424**	$ 30,164	$ 22,897
Basic earnings per common share:			
Net earnings, as reported	**$ 1.27**	$ 1.03	$ 0.83
Net earnings, pro forma	**$ 1.16**	$ 0.93	$ 0.73
Diluted earnings per common share:			
Diluted earnings, as reported	**$ 1.21**	$ 0.98	$ 0.79
Diluted earnings, pro forma	**$ 1.12**	$ 0.89	$ 0.70

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS 148"). SFAS 148 amends the transition and disclosure provisions of SFAS 123. The Company has not elected to use the fair value method of accounting for stock-based employee compensation. See Note 10 for further discussion of the Company's stock option plans.

ADVERTISING EXPENSES

Advertising costs are expensed in the periods in which the costs are incurred. Total advertising expense included in operating expenses - restaurants was approximately $21.2 million, $16.8 million and $16.1 million for the years ended December 28, 2003, December 29, 2002 and December 30, 2001, respectively.

SEGMENT DISCLOSURE

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

EARNINGS PER SHARE

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

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

	2003	2002	2001
Weighted average number of common shares used in basic calculation	**33,162**	32,586	31,503
Dilutive effect of restricted stock awards	**179**	146	111
Dilutive effect of net shares issuable pursuant to stock option plans	**1,502**	1,536	1,602
Weighted average number of common shares used in diluted calculation	**34,843**	34,268	33,216
Net earnings	**$ 42,277**	$ 33,439	$ 26,158
Basic earnings per common share	**$ 1.27**	$ 1.03	$ 0.83
Diluted earnings per common share	**$ 1.21**	$ 0.98	$ 0.79

Options to purchase 82,402 shares of common stock at December 28, 2003, were excluded from the computation of diluted earnings per common share because the related exercise prices were greater than the average market price for 2003 and would have been antidilutive.

ACCOUNTS RECEIVABLE

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

FINANCIAL INSTRUMENTS

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

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

DERIVATIVE FINANCIAL INSTRUMENTS

The Company, from time to time, has used interest rate swap agreements in the management of interest rate risk. The Company carries all derivative instruments on the balance sheet at fair value. Prior to November 2002, the Company used interest rate swap agreements to effectively fix the interest rate on a portion of the variable rate borrowings under the Company's $100.0 million revolving credit facility (see Note 5). These interest rate swap agreements were classified as a hedge of a cash flow exposure under

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and accordingly, the effective portion of the initial fair value and subsequent changes in the fair value of those agreements are reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted cash flows affect earnings.

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

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

At December 28, 2003 the Company had no interest rate swap agreements.

USE OF ESTIMATES

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

COMPREHENSIVE INCOME

During 2003, net earnings were the same as comprehensive income. For 2002 and 2001, comprehensive income includes net earnings adjusted for net unrealized losses on interest rate swaps.

RECENTLY ADOPTED ACCOUNTING STANDARDS

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

As of the date of adoption, the Company had unamortized goodwill in the amount of approximately $19.2 million. Amortization expense related to goodwill was approximately $1.1 million for fiscal year 2001. In accordance with SFAS 142, no goodwill amortization expense was recorded in the Company's financial statements for 2003 or 2002. For the foreseeable future, management believes the only impact on the Company's consolidated financial statements from the adoption of SFAS 142 will be the elimination of goodwill amortization expense.

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

	2003	2002	2001
Net earnings, as reported	**$ 42,277**	$ 33,439	$ 26,158
Goodwill amortization, net of tax benefit	–	–	679
Net earnings, pro forma	**$ 42,277**	$ 33,439	$ 26,837
Basic earnings per common share:			
Net earnings, as reported	**$ 1.27**	$ 1.03	$ 0.83
Goodwill amortization, net of tax benefit	**–**	–	0.02
Net earnings, pro forma	**$ 1.27**	$ 1.03	$ 0.85
Diluted earnings per common share:			
Net earnings, as reported	**$ 1.21**	$ 0.98	$ 0.79
Goodwill amortization, net of tax benefit	**–**	–	0.02
Net earnings, pro forma	**$ 1.21**	$ 0.98	$ 0.81

RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which addresses consolidation by business enterprises of variable interest entities ("VIEs") either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB issued modifications to FIN 46 ("Revised Interpretations") resulting in multiple effective dates based on the nature as well as the creation date of the VIE. VIEs created after January 31, 2003, but prior to January 1, 2004, may be accounted for either based on the original interpretation or the Revised Interpretations. However, the Revised Interpretations must be applied no later than the first quarter of 2004. VIEs created after January 1, 2004 must be accounted for under the Revised Interpretations. Non-Special Purpose Entities created prior to February 1, 2003, should be accounted for under the revised interpretation's provisions no later than the first quarter of fiscal 2004. The Company has adopted FIN 46, which did not have, and the Company does not expect the Revised Interpretations to have an impact on the Company's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment to Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies the financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement is effective for hedging relationships designated and contracts entered into or modified after June 30, 2003, except for the provisions that relate to SFAS No. 133 implementation issues, which will continue to be applied in accordance with their respective dates. The adoption of SFAS No. 149 in the third quarter of 2003 did not impact the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity, and imposes certain additional disclosure requirements. The provisions of SFAS No. 150 are generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted SFAS No. 150 and it did not have a material impact on the Company's consolidated financial statements.

RECLASSIFICATIONS

Certain reclassifications have been made to the 2002 and 2001 consolidated financial statements to conform with the 2003 presentation. Assets under the Company's Supplemental Deferred Compensation Plan equate to the liabilities under the plan (see Note 7 for further discussion of the Company's Supplemental Deferred Compensation Plan). The asset and corresponding liability account balances at December 29, 2003 and December 28, 2002, were approximately $4.1 million and $2.4 million, respectively. The asset and liability accounts were netted for balance sheet presentation prior to 2003. For 2003 presentation, these amounts have been shown as separate non-current assets and liabilities. The respective asset and liability amounts have been reclassified in the 2002 consolidated balance sheet to conform with the 2003 presentation.

(2) PROVISION FOR ASSET IMPAIRMENTS, RESTAURANT CLOSINGS, AND OTHER CHARGES

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

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

(3) PROPERTY AND EQUIPMENT

Major classes of property and equipment at December 28, 2003 and December 29, 2002 are summarized as follows *(in thousands)*:

	2003	2002
Land and improvements	**$ 53,083**	$ 44,585
Buildings	**55,874**	45,978
Leasehold improvements	**209,934**	182,022
Assets under capital lease	**27,807**	22,626
Restaurant equipment	**87,232**	72,970
Furniture and fixtures	**40,443**	36,366
Construction in progress	**26,084**	16,896
	500,457	421,443
Less accumulated depreciation and amortization	**146,009**	121,670
	$ 354,448	$299,773

During 2003, 2002 and 2001, the Company capitalized interest during construction of approximately $1,067,000, $978,000 and $826,000, 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 28, 2003, such commitments totaled approximately $21.5 million.

(4) ACCRUED EXPENSES

Accrued expenses consist of the following at December 28, 2003 and December 29, 2002 *(in thousands)*:

	2003	2002
Accrued self insurance reserves	**$ 5,300**	$ 4,200
Accrued provision for asset impairments, restaurant closings, and other charges	**454**	536
Accrued rent	**9,076**	7,362
Accrued compensation	**10,529**	8,071
Other taxes accrued	**5,909**	5,777
Accrued gift certificate liability	**19,402**	15,174
Other	**4,548**	2,895
	$ 55,218	$ 44,015

(5) DEBT

The Company has a variable interest rate revolving credit facility (the "Revolving Credit Facility"), which permits the Company to borrow up to $100.0 million through the termination date in November 2007. The Revolving Credit Facility is the result of amendments to and a restatement of the Company's previous $100.0 million credit facility. The Revolving Credit Facility bears interest at the Company's option of LIBOR plus a margin of 1.25% to 1.75% (the "applicable margin") depending on the Company's leverage ratio or the administrative agent's prime rate of interest, and requires payment of a commitment fee on any unused portion at a rate of 0.3% to 0.4% per year (depending on the Company's leverage ratio). At December 28, 2003 and December 29, 2002, the applicable margin was 1.25%. On December 28, 2003 and December 27, 2002, there were no amounts outstanding under the Company's revolving credit facility. The commitment fee on the unused portion of the Revolving Credit Facility on December 28, 2003, and on December 29, 2002 was 0.3% per year. Amounts available under the Company's revolving credit facility totaled $100.0 million on both December 28, 2003 and December 29, 2002, respectively.

The Revolving Credit Facility restricts payment of dividends, without prior approval of the lender, and contains certain financial covenants, including debt to capitalization, leverage and interest coverage ratios, as well as minimum net worth and maximum capital expenditure covenants. The Revolving Credit Facility is secured by the common stock of entities that own substantially all of the Bugaboo Creek Steak House and The Capital Grille restaurants. At December 28, 2003, the Company was in compliance with the provisions of the Revolving Credit Facility.

(6) INCOME TAXES

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

	Current	Deferred	Total
Year ended December 28, 2003:			
U.S. Federal	**$ 14,764**	**$ 3,510**	**$ 18,274**
State and local	**1,688**	**401**	**2,089**
	$ 16,452	**$ 3,911**	**$ 20,363**
Year ended December 29, 2002:			
U.S. Federal	$ 9,314	$ 5,001	$ 14,315
State and local	1,064	572	1,636
	$ 10,378	$ 5,573	$ 15,951
Year ended December 30, 2001:			
U.S. Federal	$ 12,049	$ (739)	$ 11,310
State and local	1,377	(84)	1,293
	$ 13,426	$ (823)	$ 12,603

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:

	2003	2002	2001
Federal statutory income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefit	**2.6**	2.6	2.6
Meals and entertainment	**0.1**	0.1	0.1
FICA tip credit	**(4.7)**	(4.8)	(5.2)
Other	**(0.5)**	(0.6)	–
Effective tax rates	**32.5%**	32.3%	32.5%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 28, 2003 and December 29, 2002 are presented below *(in thousands)*:

	2003	2002
Deferred tax assets (liabilities):		
Provisions for restaurant closings, and other charges	**$ 1,667**	$ 2,115
Accrued rent	**3,413**	2,768
Accrued joint venture contract termination	**–**	115
Pre-opening costs	**57**	138
Accrued insurance	**362**	403
Accrued workers' compensation	**860**	582
Property and equipment	**(6,628)**	(1,954)
Deferred Compensation Plan	**1,689**	911
Restricted stock	**1,148**	759
Smallwares	**(2,495)**	(2,192)
Other	**(638)**	(299)
Net deferred tax asset (liability)	**$ (565)**	$ 3,346

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.

(7) EMPLOYEE BENEFIT PLANS

The Company provides employees who meet minimum service requirements with retirement benefits under a 401(k) plan (the "RARE Plan"). Under the RARE Plan, eligible employees may make contributions of between 1% and 20% of their annual compensation. Effective for 2000, contributions to the RARE Plan by officers and highly compensated employees were limited to 2% of their annual compensation and effective for 2001, officers and highly compensated employees do not participate in this plan. The

Company makes quarterly matching contributions in an amount equal to 50% of the first 5% of employee compensation contributed, resulting in a maximum Company contribution of 2.5% of employee compensation. The Company's expense under the RARE Plan was $592,000, $627,000 and $574,000 for 2003, 2002 and 2001, 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. The Company makes quarterly matching contributions in an amount equal to 50% of employee contributions, not to exceed the lesser of 2.5% of the employee's total annual compensation or $5,000. The Company's expense under the Supplemental Plan was $414,000, $324,000 and $302,000 for 2003, 2002 and 2001, 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.

The Company entered into a rabbi trust agreement to protect the assets of the Supplemental Plan. Each participant's account is comprised of their contribution, the Company's matching contribution and each participant's share of earnings or losses in the plan. In accordance with EITF No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Are Held in a Rabbi Trust and Invested," the accounts of the rabbi trust are reported in the Company's consolidated financial statements. The Company's consolidated balance sheet includes the investments in other non-current assets and the offsetting obligation is included in other non-current liabilities. The deferred compensation plan investments are considered trading securities and are reported at fair value with the realized and unrealized holding gains and losses related to these investments, as well as the offsetting compensation expense, are recorded in operating income.

(8) LEASES AND RELATED COMMITMENTS

The Company is obligated under various capital leases for certain restaurant facilities that expire at various dates during the next 30 years. The Company also has noncancelable operating leases for certain restaurant facilities. Rental payments include minimum rentals, plus contingent rentals based on restaurant sales at the individual stores. These leases generally contain renewal options for periods ranging from three to 15 years and require the Company to pay all executory costs such as insurance and maintenance. Under the provisions of certain leases, there are rent holidays and/or escalations in payments over the base lease term, as well as renewal periods. The effects of the holidays and escalations have been reflected in rent expense on a straight-line basis over the anticipated life of the leases.

Future minimum lease payments under capital lease obligations and noncancelable operating leases at December 28, 2003 are as follows *(in thousands)*:

Years ending at or about December 31:	Capital	Operating
2004	$ 2,593	$ 17,228
2005	2,665	16,259
2006	2,738	14,517
2007	2,763	13,318
2008	2,869	10,540
Thereafter	49,575	47,101
Total minimum lease payments	63,203	$118,963
Less imputed interest (at 9%)	35,617	
Present value of minimum lease payments	27,586	
Less current maturities	124	
Obligations under capital leases, excluding current maturities	$ 27,462	

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

	2003	2002	2001
Minimum lease payments	**$ 17,746**	$ 15,961	$ 14,686
Contingent rentals	**2,219**	1,721	1,651
Total rental expense	**$ 19,965**	$ 17,682	$ 16,337

(9) SHAREHOLDERS' EQUITY

In September 2001, the Company's Board of Directors authorized the Company to use up to $15.0 million to purchase shares of its common stock through open market transactions, block purchases or in privately negotiated transactions through September 2002. In July 2002, the Company's Board of Directors extended this share repurchase program through April 2003. During the third

quarter of 2001, the Company purchased 15,000 shares of its common stock for a total purchase price of approximately $159,000 (average price of $10.60 per share). During the fourth quarter of 2002, the Company purchased 127,500 shares of its common stock for a total purchase price of approximately $2,205,000 (average price of $17.29 per share). During the first quarter of 2003, the Company purchased 150,000 shares of its common stock for a total purchase price of approximately $2,625,000 (average price of $17.50 per share). On July 23, 2003, the Company's Board of Directors authorized the Company to purchase up to an additional $25.0 million of its common stock from time-to-time through May 2005.

In February 2001, the Company completed a public offering for 3.45 million shares of its common stock. Net proceeds to the Company from this offering were approximately $57.6 million.

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

As of December 28, 2003, 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.

(10) STOCK OPTIONS

The Company's Amended and Restated 2002 Long-Term Incentive Plan (the "2002 Plan"), provides for the granting of incentive stock options, nonqualified stock options, and restricted stock to employees, officers, directors, consultants, and advisors. All stock options issued under the 2002 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 aggregate number of shares authorized to be awarded under the 2002 Plan is 2,250,000. Not more than 300,000 of such aggregate number of shares may be granted as awards of restricted stock.

The Company's 1997 Long-Term Incentive Plan, as amended (the "1997 Plan"), provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, performance units, restricted stock, dividend equivalents and other stock based awards to employees, officers, directors, consultants, and advisors. All stock options issued under the 1997 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 Plan authorized the granting of options to purchase 2,981,250 shares of common stock.

The Company's Amended and Restated 1996 Stock Plan for Outside Directors (the "1996 Stock Option Plan") provides for the automatic granting of non-qualified stock options to outside directors. The 1996 Stock Option Plan authorizes the granting of options to purchase up to an aggregate of 225,000 shares of common stock. All stock options issued under the 1996 Stock Option Plan are granted at prices which are equal to the current market value on the date of the grant, become exercisable six months and one day after the date of grant, and must be exercised within ten years from the date of grant.

As of December 28, 2003 and December 29, 2002, options to purchase 2,019,575 and 2,242,701 shares of common stock, respectively, were exercisable at weighted average exercise prices of $10.04 and $7.89 per share, respectively. Option activity under the Company's stock option plans is as follows:

	Shares	Weighted Average Price
Outstanding at December 31, 2000	3,850,652	$ 7.12
Granted in 2001	1,113,375	14.65
Exercised in 2001	(635,672)	6.93
Canceled in 2001	(222,463)	10.69
Outstanding at December 30, 2001	4,105,892	9.01
Granted in 2002	651,642	16.54
Exercised in 2002	(744,545)	7.17
Canceled in 2002	(73,812)	12.11
Outstanding at December 29, 2002	3,939,177	10.57
Granted in 2003	732,003	20.01
Exercised in 2003	(907,252)	7.85
Canceled in 2003	(31,753)	16.17
Outstanding at December 28, 2003	3,732,175	12.99

The following table summarizes information concerning options outstanding and exercisable as of December 28, 2003:

	Options Outstanding			Options Exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining life	Weighted average exercise price	Number exercisable	Weighted average exercise price
$0.01 to $5.00	59,475	3.7	$ 4.34	59,475	$ 4.34
$5.01 to $10.00	1,477,907	5.1	7.62	1,282,157	7.50
$10.01 to $15.00	798,878	7.0	14.41	389,636	14.26
$15.01 to $20.00	1,136,728	8.6	17.33	288,307	16.80
$20.01 to $25.00	250,187	9.6	22.04	–	–
$25.01 or greater	9,000	9.8	25.60	–	–

(11) COMMITMENTS AND CONTINGENCIES

PURCHASE COMMITMENTS

The Company has entered into purchasing agreements with certain meat suppliers requiring the Company to purchase contracted quantities of meat at established prices through their expiration on varying dates in 2004 and 2005. 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, employment practices and general liability costs. Provisions for losses expected under these programs are recorded based upon the Company's estimates of the aggregate liability for claims incurred.

The Company has deposits totaling $4.6 million at December 28, 2003 that are being maintained as security under the Company's workers' compensation policies.

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

(12) QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations for the years ended December 28, 2003 and December 29, 2002 *(in thousands, except per share data)*:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2003:					
Revenues	**$ 164,149**	**$ 168,620**	**$ 166,247**	**$ 181,816**	**$ 680,832**
Operating income	**17,698**	**16,359**	**11,862**	**18,036**	**63,955**
Earnings before income taxes	**17,334**	**16,064**	**11,525**	**17,717**	**62,640**
Net earnings	**11,701**	**10,840**	**7,779**	**11,957**	**42,277**
Net earnings per share*:					
Basic	**0.36**	**0.33**	**0.23**	**0.36**	**1.27**
Diluted	**0.34**	**0.31**	**0.22**	**0.34**	**1.21**
2002:					
Revenues	$ 145,298	$ 145,386	$ 139,942	$ 153,878	$ 584,504
Operating income	15,159	13,977	10,121	13,839	53,096
Earnings before income taxes	14,530	13,436	9,506	11,918	49,390
Net earnings	9,735	9,141	6,416	8,147	33,439
Net earnings per share*:					
Basic	0.30	0.28	0.20	0.25	1.03
Diluted	0.29	0.26	0.19	0.24	0.98

* *Per share amounts do not necessarily sum to the total year amounts due to changes in shares outstanding and rounding.*

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 28, 2003 and December 29, 2002, and the related consolidated statements of operations, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 28, 2003. 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 28, 2003 and December 29, 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 28, 2003 in conformity with accounting principles generally accepted in the United States of America.

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

KPMG LLP

Atlanta, Georgia
February 6, 2004

Directors and Executive Officers

Roger L. Boeve
Former Executive Vice President and
Chief Financial Officer
Performance Food Group Company

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

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

James D. Dixon
Former Executive Director,
BankofAmerica.com

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

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

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

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

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

George W. McKerrow, Sr.
Director

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

Thomas W. Gathers
Executive Vice President,
Human Resources

David C. George
President,
LongHorn Steakhouse

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

Dennis D. Pedra
President,
Bugaboo Creek Steak House

Corporate Information

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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
(800) 568-3476

Form 10-K/Investor Contact
A copy of the RARE Hospitality International, Inc. Annual Report on Form 10-K for 2003 as filed with the Securities and Exchange Commission is available on the Company's web site, www.rarehospitality.com. It is also available at no charge from the Company. These requests and other investor contacts should be directed to W. Douglas Benn, Executive Vice President, Finance and Chief Financial Officer, at the Company's corporate office.

Annual Meeting
The annual meeting of shareholders will be held on Monday, May 10, 2004, 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 16, 2004, there were approximately 9,700 holders of the common stock of the Company, including approximately 474 shareholders of record. The market value of the Company's common stock on March 16, 2004, was $27.57 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 28, 2003, there were 34,042,000 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 as adjusted for the three-for-two stock split paid in the form of 50% stock dividend on September 2, 2003.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2003				
High	**$ 20.61**	**$21.86**	**$ 27.24**	**$ 27.95**
Low	**$ 16.89**	**$17.81**	**$ 21.49**	**$ 21.68**
2002				
High	$ 18.36	$19.83	$ 18.67	$ 19.13
Low	$ 14.13	$15.63	$ 13.83	$ 14.60

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