

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

This discussion and analysis below for Darden Restaurants, Inc. (Darden, the Company, we, us or our) should be read in conjunction with our consolidated financial statements and related financial statement notes found elsewhere in this report.

We operate on a 52/53 week fiscal year, which ends on the last Sunday in May. Fiscal 2008, 2007 and 2006 each consisted of 52 weeks of operation.

OVERVIEW OF OPERATIONS

Our business operates in the full-service dining segment of the restaurant industry, primarily in the United States. At May 25, 2008, we operated 1,702 Red Lobster[®], Olive Garden[®], LongHorn Steakhouse[®], The Capital Grille[®], Bahama Breeze[®], Seasons 52[®], Hemenway's Seafood Grille & Oyster Bar[®] and The Old Grist Mill Tavern[®] restaurants in the United States and Canada. Through subsidiaries, we own and operate all of our restaurants in the United States and Canada, except three. Those three restaurants are located in Central Florida and are owned by joint ventures managed by us. The joint ventures pay management fees to us, and we control the joint ventures' use of our service marks. None of our restaurants in the United States or Canada are franchised. As of May 25, 2008, we franchised five LongHorn Steakhouse restaurants in Puerto Rico to an unaffiliated franchisee, and 27 Red Lobster restaurants in Japan to an unaffiliated Japanese corporation, under area development and franchise agreements.

On August 16, 2007, we announced that we had entered into an agreement to purchase the common stock of RARE Hospitality International, Inc. (RARE) through a tender offer for \$38.15 per share in cash, to be followed by a merger in which the remaining RARE shareholders would each receive \$38.15 per share in cash, or \$1.27 billion in total purchase price. Additionally, as a result of the acquisition, we repaid RARE's 2.5 percent convertible notes for approximately \$134.8 million, including \$9.8 million related to a conversion premium. RARE owned two principal restaurant concepts, LongHorn Steakhouse and The Capital Grille, of which 288 and 29 locations, respectively, were in operation as of the date of acquisition. The acquisition was completed on October 1, 2007 and the acquired operations are included in our consolidated financial statements since the date of acquisition.

On May 5, 2007, we announced the closure of 54 Smokey Bones and two Rocky River Grillhouse restaurants as well as our intention to offer for sale the remaining 73 operating Smokey Bones restaurants. Sales declines at Smokey Bones led us to reevaluate our new restaurant opening strategy and test a new direction for the business. In fiscal 2007, we opened a new repositioned Smokey Bones restaurant named Rocky River Grillhouse, and a second Rocky River Grillhouse from a converted Smokey Bones. However, the Smokey Bones concept business model was designed to be a nationally advertised

brand, and since it was not on a path to achieving that vision, we concluded it was not a meaningful growth vehicle for the Company. As a result of these actions, we recognized \$229.5 million and \$13.7 million of long-lived asset impairment charges and closing costs, respectively, during the fourth quarter of fiscal 2007. On November 30, 2007, we entered into a definitive agreement to sell the 73 operating Smokey Bones restaurants to Barbeque Integrated, Inc. (BII), an affiliate of Sun Capital Partners, Inc., a worldwide private investment firm, for \$82.0 million, net of selling costs of approximately \$1.8 million. On December 31, 2007, we closed with BII on the sale of 62 of the restaurants, and as of February 24, 2008, we had closed on the sale of an additional ten restaurants for a total of 72 restaurants. The sale of the remaining restaurant closed on June 13, 2008. As of May 25, 2008, we had received \$81.5 million in net cash proceeds related to the sale and have recognized a gain on the sale of \$18.0 million, which is included in earnings from discontinued operations for fiscal 2008. Additionally, on April 28, 2007, we closed nine under-performing Bahama Breeze restaurants. We have classified the results of operations, gains and losses on disposition, impairment charges and closing costs of these Smokey Bones and Rocky River Grillhouse restaurants and the nine closed Bahama Breeze restaurants as discontinued operations in our consolidated statements of earnings and cash flows for all periods presented.

Our sales from continuing operations were \$6.63 billion in fiscal 2008 compared to \$5.57 billion in fiscal 2007. The 19.0 percent increase was primarily driven by the acquisition of RARE, the addition of 39 net new Olive Gardens in fiscal 2008 and a same-restaurant sales increase at Olive Garden. Olive Garden had same-restaurant sales increases in each fiscal quarter, bringing its string of consecutive quarters with same-restaurant sales growth to 55. Net earnings from continuing operations for fiscal 2008 were \$369.5 million (\$2.55 per diluted share) compared with net earnings from continuing operations for fiscal 2007 of \$377.1 million (\$2.53 per diluted share). Net earnings from continuing operations for fiscal 2008 decreased 2.0 percent and diluted net earnings per share from continuing operations increased 0.8 percent compared with fiscal 2007. The decrease in net earnings from continuing operations was primarily due to integration costs and purchase accounting adjustments related to the RARE acquisition of approximately \$44.8 million, on a pre-tax basis, in addition to increased food and beverage costs, wage rates and interest costs, which were only partially offset by the operating profit contribution of LongHorn Steakhouse and The Capital Grille, same-restaurant sales increases at Olive Garden as well as the operating profit contribution of 39 net new Olive Gardens. While net earnings from continuing operations declined versus prior year, diluted earnings per share increased slightly primarily due to a reduction in diluted weighted average shares outstanding.

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Our net earnings (losses) from discontinued operations were \$7.7 million and (\$175.7) million for fiscal 2008 and 2007, respectively. Our diluted net earnings (losses) per share from discontinued operations were \$0.05 and (\$1.18) for fiscal 2008 and 2007, respectively. The gain on the sale of Smokey Bones contributed approximately \$0.08 to diluted net earnings per share from discontinued operations in fiscal 2008. When combined with results from continuing operations, our diluted net earnings per share were \$2.60 and \$1.35 for fiscal 2008 and 2007, respectively.

In fiscal 2009, we expect a net increase of approximately 75 to 80 restaurants. We expect combined U.S. same-restaurant sales growth in fiscal 2009 of approximately 2 percent for Red Lobster, Olive Garden and LongHorn Steakhouse. We expect total sales growth of between 14 percent and 15 percent compared to sales from continuing operations of \$6.63 billion in fiscal 2008. This sales growth includes the impact of a 53rd week in fiscal 2009, which we estimate will be 2 percentage points. Diluted net earnings per share growth from continuing operations is expected to be between 14 percent and 15 percent including the impact of the 53rd week of approximately two percentage points. Transaction and integration-related costs and purchase accounting adjustments are expected to favorably impact diluted net earnings per share growth from fiscal 2008 to fiscal 2009 by approximately 5 percentage points.

In June 2008, we announced that we would pay a quarterly dividend of 20 cents per share on August 1, 2008. Previously, we had paid a quarterly dividend of 18 cents per share or 72 cents per share on an annual basis. Based on the 20 cent quarterly dividend declaration, our indicated annual dividend is 80 cents per share, an 11 percent increase.

Our mission is to be the best in full-service dining, now and for generations. We believe we can achieve this goal by continuing to build on our strategy to be a multi-brand restaurant growth company, which is grounded in:

- Competitively superior leadership;
- Strong brand building that reflects brand management and restaurant operating excellence; and
- Brand support excellence.

We seek to increase profits by leveraging our fixed and semi-fixed costs with sales from new restaurants and increased guest traffic and sales at existing restaurants. To evaluate our operations and assess our financial performance, we monitor a number of operating measures, with a special focus on two key factors:

- Same-restaurant sales – which is a year-over-year comparison of each period's sales volumes for restaurants open at least 16 months, including recently acquired restaurants, absent consideration of when the restaurants were acquired; and

- Restaurant earnings – which is restaurant-level profitability (restaurant sales, less restaurant-level cost of sales, marketing and depreciation).

Increasing same-restaurant sales can improve restaurant earnings because these incremental sales provide better leverage of our fixed and semi-fixed restaurant-level costs. A restaurant concept can generate same-restaurant sales increases through increases in guest traffic, increases in the average guest check, or a combination of the two. The average guest check can be impacted by menu price changes and by the mix of menu items sold. For each restaurant concept, we gather daily sales data and regularly analyze the guest traffic counts and the mix of menu items sold to aid in developing menu pricing, product offerings and promotional strategies. We view same-restaurant guest counts as a measure of the long-term health of a restaurant concept, while increases in average check and menu mix may contribute more significantly to near-term profitability. We focus on balancing our pricing and product offerings with other initiatives to produce sustainable same-restaurant sales growth.

We compute same-restaurant sales using restaurants open at least 16 months because new restaurants experience a period of time before sales levels normalize. Sales at newly opened restaurants generally do not make a significant contribution to profitability in their initial months of operation due to operating inefficiencies. Our sales and expenses can be impacted significantly by the number and timing of the opening of new restaurants and the closing, relocation and remodeling of existing restaurants. Pre-opening expenses each period reflect the costs associated with opening new restaurants in current and future periods.

There are significant risks and challenges that could impact our operations and ability to increase sales and earnings. The full-service dining restaurant industry is intensely competitive and sensitive to economic cycles and other business factors, including changes in consumer tastes and dietary habits. Other risks and uncertainties are discussed in Forward-Looking Statements found elsewhere in this report.

RESULTS OF OPERATIONS FOR FISCAL 2008, 2007 AND 2006

The following table sets forth selected operating data as a percentage of sales from continuing operations for the 52-week periods ended May 25, 2008, May 27, 2007 and May 28, 2006. This information is derived from the consolidated statements of earnings, found elsewhere in this report. Additionally, this information and the following analysis have been presented with the results of operations, gains and losses on disposition, impairment charges and closing costs for the Smokey Bones and Rocky River Grillhouse restaurants and the nine closed Bahama Breeze restaurants classified as discontinued operations for all

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periods presented. The results of operations of the LongHorn Steakhouse, The Capital Grille, Hemenway's Seafood Grille & Oyster Bar and The Old Grist Mill Tavern restaurants have been included for the period subsequent to the date of acquisition.

	Fiscal Years		
	2008	2007	2006
Sales	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of sales:			
Food and beverage	30.1	29.0	29.3
Restaurant labor	32.1	32.5	32.2
Restaurant expenses	15.3	15.0	15.1
Total cost of sales, excluding restaurant depreciation and amortization of 3.5%, 3.3% and 3.4%, respectively	77.5%	76.5%	76.6%
Selling, general and administrative	9.7	9.7	9.4
Depreciation and amortization	3.7	3.6	3.7
Interest, net	1.3	0.7	0.8
Total costs and expenses	92.2%	90.5%	90.5%
Earnings before income taxes	7.8	9.5	9.5
Income taxes	(2.2)	(2.7)	(2.9)
Earnings from continuing operations	5.6	6.8	6.6
Earnings (losses) from discontinued operations, net of taxes	0.1	(3.2)	(0.3)
Net earnings	5.7%	3.6%	6.3%

SALES

Sales from continuing operations were \$6.63 billion in fiscal 2008, \$5.57 billion in fiscal 2007 and \$5.35 billion in fiscal 2006. The 19.0 percent increase in sales from continuing operations for fiscal 2008 was primarily due to the acquisition of RARE, a net increase of 39 Olive Garden restaurants, and U.S. same-restaurant sales increases at Olive Garden.

Olive Garden sales of \$3.07 billion in fiscal 2008 were 10.0 percent above last year. Olive Garden opened 39 net new restaurants during fiscal 2008. Annual U.S. same-restaurant sales for Olive Garden increased 4.9 percent due to a 3.0 percent increase in average guest check and a 1.9 percent increase in same-restaurant guest counts. Average annual sales per restaurant for Olive Garden were \$4.9 million in fiscal 2008 compared to \$4.7 million in fiscal 2007. Olive Garden reported its 55th consecutive quarter of U.S. same-restaurant sales growth at the end of fiscal 2008.

Red Lobster sales of \$2.63 billion in fiscal 2008 were 1.0 percent above last year. Annual U.S. same-restaurant sales for Red Lobster increased 1.1 percent due to a 2.4 percent increase in average guest check, partially offset by a 1.3 percent decrease in guest counts. Average annual sales per restaurant for Red Lobster were \$3.9 million in fiscal 2008 compared to \$3.8 million in fiscal 2007.

LongHorn Steakhouse sales of \$574.9 million in fiscal 2008 (for the period October 1, 2007 through May 25, 2008) were 6.9 percent above the comparable prior year period (which were included in RARE's separately reported results of operations), driven by revenue from 24 net new restaurants, partially offset by a same-restaurant sales decrease. Annual same-restaurant sales for LongHorn Steakhouse decreased 1.9 percent due to a 4.2 percent decrease in same-restaurant guest counts, partially offset by a 2.3 percent increase in average guest check. Average annual sales per restaurant for LongHorn Steakhouse were \$2.9 million in fiscal 2008.

The Capital Grille sales of \$169.8 million in fiscal 2008 (for the period October 1, 2007 through May 25, 2008) were 11.6 percent above the comparable prior year period (which were included in RARE's separately reported results of operations), driven by revenue from four net new restaurants, partially offset by a same-restaurant sales decrease. Annual same-restaurant sales for The Capital Grille decreased 1.1 percent due to a 4.4 percent decrease in same-restaurant guest counts, partially offset by a 3.3 percent increase in average guest check. Average annual sales per restaurant for The Capital Grille were \$8.1 million in fiscal 2008.

Bahama Breeze sales from continuing operations of \$135.2 million in fiscal 2008 were 1.9 percent below last year. Same-restaurant sales for Bahama Breeze decreased 1.8 percent for fiscal 2008. Average annual sales per restaurant for Bahama Breeze were \$5.9 million in fiscal 2008.

The 4.0 percent increase in Company-wide sales for fiscal 2007 versus fiscal 2006 was primarily due to a net increase of 32 Company-owned restaurants, on a continuing operations basis, compared with fiscal 2006 and U.S. same-restaurant sales increases at Olive Garden, Red Lobster and Bahama Breeze. Olive Garden's fiscal 2007 sales of \$2.79 billion were 6.6 percent above fiscal 2006. U.S. same-restaurant sales for Olive Garden increased 2.7 percent in fiscal 2007 due to a 2.0 percent increase in average guest check and a 0.7 percent increase in same-restaurant guest counts. Average annual sales per restaurant for Olive Garden were \$4.7 million in fiscal 2007 compared to \$4.6 million in fiscal 2006. Red Lobster's sales of \$2.60 billion in fiscal 2007 were 0.9 percent above fiscal 2006 sales. In fiscal 2007, its U.S. same-restaurant sales increased 0.2 percent due to a 2.7 percent increase in average check and a 2.5 percent decrease in same-restaurant guest counts. Average annual sales per restaurant for Red Lobster were \$3.8 million in fiscal 2007 and 2006. Bahama Breeze fiscal 2007 sales from continuing operations of \$137.9 million increased 0.9 percent from fiscal 2006. On a continuing operations basis, Bahama Breeze same-restaurant sales increased 0.9 percent in fiscal 2007 and average annual sales per restaurant for Bahama Breeze in fiscal 2007 were \$6.0 million compared to \$5.9 million in fiscal 2006.

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COSTS AND EXPENSES

Total costs and expenses from continuing operations were \$6.11 billion in fiscal 2008, \$5.04 billion in fiscal 2007 and \$4.85 billion in fiscal 2006. As a percent of sales, total costs and expenses from continuing operations in fiscal 2008 were 92.2 percent, an increase from 90.5 percent in both fiscal 2007 and fiscal 2006.

Food and beverage costs increased \$380.1 million, or 23.5 percent, from \$1.62 billion in fiscal 2007 to \$2.00 billion in fiscal 2008. Food and beverage costs increased \$46.1 million, or 2.9 percent, from \$1.57 billion in fiscal 2006 to \$1.62 billion in fiscal 2007. As a percent of sales, food and beverage costs increased from fiscal 2007 to fiscal 2008 primarily as a result of the acquisition of RARE, whose concepts have historically had higher food and beverage costs, as a percent of sales, compared to our consolidated average prior to the acquisition. As a percent of sales, food and beverage costs also increased as a result of an increase in food costs, such as dairy, wheat, non-perishables and seafood, partially offset by pricing increases. As a percent of sales, food and beverage costs decreased from fiscal 2006 to fiscal 2007 primarily as a result of favorable pricing partially offset by menu mix changes. During fiscal 2007 food and beverage costs, as a percent of sales, also decreased from fiscal 2006 as a result of the larger contribution from Olive Garden, which has historically had lower food and beverage costs, to our overall sales and operating results.

Restaurant labor costs increased \$316.5 million, or 17.5 percent, from \$1.81 billion in fiscal 2007 to \$2.12 billion in fiscal 2008. Restaurant labor costs increased \$86.1 million, or 5.0 percent, from \$1.72 billion in fiscal 2006 to \$1.81 billion in fiscal 2007. As a percent of sales, restaurant labor costs decreased in fiscal 2008 primarily as a result of the acquisition of RARE, whose concepts have historically had lower restaurant labor costs, as a percent of sales, compared to our consolidated average prior to the acquisition, as well as sales growth leveraging. As a percent of sales, this decrease in restaurant labor costs was partially offset by an increase in wage rates, benefit costs and manager compensation. As a percent of sales, restaurant labor costs increased in fiscal 2007 from fiscal 2006 primarily as a result of an increase in wage rates and an increase in FICA taxes on higher reported tips, which was partially offset by the favorable impact of higher sales volumes. The increase in FICA tax expense on higher reported tips is fully offset at the consolidated net earnings from continuing operations level by a corresponding income tax credit, which reduces income tax expense.

Restaurant expenses (which include lease, property tax, credit card, utility, workers' compensation, insurance, new restaurant pre-opening and other restaurant-level operating expenses) increased \$183.3 million, or 22.0 percent, from \$834.5 million in fiscal 2007 to \$1.02 billion in fiscal 2008.

Restaurant expenses increased \$28.1 million, or 3.5 percent, from \$806.4 million in fiscal 2006 to \$834.5 million in fiscal 2007. As a percent of sales, restaurant expenses increased in fiscal 2008 as compared to fiscal 2007 primarily as a result of RARE's higher restaurant expenses as a percentage of sales compared to our consolidated average prior to the acquisition and integration costs and purchase accounting adjustments related to the RARE acquisition, partially offset by increased sales growth leveraging. As a percent of sales, restaurant expenses decreased in fiscal 2007 as compared with fiscal 2006 as a result of the favorable impact of higher sales volumes and decreases in our insurance and workers' compensation expenses.

Selling, general and administrative expenses increased \$104.7 million, or 19.5 percent, from \$537.0 million in fiscal 2007 to \$641.7 million in fiscal 2008. Selling, general and administrative expenses increased \$30.9 million, or 6.1 percent, from \$506.1 million in fiscal 2006 to \$537.0 million in fiscal 2007. As a percent of sales, selling, general and administrative expenses were consistent from fiscal 2007 to fiscal 2008 primarily as a result of transaction and integration-related costs and purchase accounting adjustments related to the RARE acquisition and increased legal costs, which were offset by increased sales growth leveraging. As a percent of sales, selling, general and administrative expenses increased in fiscal 2007 as compared with fiscal 2006 primarily as a result of the recognition of stock-based compensation expense due to the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payment," in fiscal 2007 and increased marketing expenses, partially offset by the favorable impact of higher sales volumes and a decrease in litigation related costs.

Depreciation and amortization expense increased \$45.3 million, or 22.6 percent, from \$200.4 million in fiscal 2007 to \$245.7 million in fiscal 2008. Depreciation and amortization expense increased \$3.4 million, or 1.7 percent, from \$197.0 million in fiscal 2006 to \$200.4 million in fiscal 2007. As a percent of sales, depreciation and amortization expense increased in fiscal 2008 as a result of new restaurant activity, including the acquisition of RARE, which was partially offset by increased sales growth leveraging. As a percent of sales, depreciation and amortization declined from fiscal 2006 to fiscal 2007 primarily as a result of the continued use of fully depreciated, well-maintained equipment and the favorable impact of higher sales volumes, which were only partially offset by new restaurant and remodel activities.

Net interest expense increased \$45.6 million or 113.7 percent from \$40.1 million in fiscal 2007 to \$85.7 million in fiscal 2008. Net interest expense decreased \$3.8 million, or 8.7 percent, from \$43.9 million in fiscal 2006 to \$40.1 million in fiscal 2007. As a percent of sales, net interest expense increased in fiscal 2008 compared to fiscal 2007 due mainly to an increase in

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average long-term debt balances, primarily as a result of the RARE acquisition. As a percent of sales, net interest expense decreased in fiscal 2007 compared with fiscal 2006, as a result of the favorable impact of higher sales volumes and lower average long-term debt balances in fiscal 2007.

INCOME TAXES

The effective income tax rates for fiscal 2008, 2007 and 2006 continuing operations were 28.2 percent, 29.0 percent and 30.8 percent, respectively. The decrease in our effective rate for fiscal 2008 is due primarily to a decrease in our effective state income tax rate due to the favorable resolution of prior year tax matters expensed in prior years, in addition to a decrease in our federal effective rate, related to an increase in FICA tax credits for employee reported tips. The rate decrease in fiscal 2007 was primarily due to an increase in FICA tax credits for employee-reported tips and a decrease in our federal effective income tax rate resulting from the favorable resolution of prior year tax matters expensed in prior years.

NET EARNINGS AND NET EARNINGS PER SHARE FROM CONTINUING OPERATIONS

Net earnings from continuing operations for fiscal 2008 were \$369.5 million (\$2.55 per diluted share) compared with net earnings from continuing operations for fiscal 2007 of \$377.1 million (\$2.53 per diluted share) and net earnings from continuing operations for fiscal 2006 of \$351.8 million (\$2.24 per diluted share).

Net earnings from continuing operations for fiscal 2008 decreased 2.0 percent and diluted net earnings per share from continuing operations increased 0.8 percent compared with fiscal 2007. The decrease in net earnings from continuing operations was primarily due to transaction and integration-related costs and purchase accounting adjustments related to the RARE acquisition of approximately \$44.8 million, on a pre-tax basis, in addition to increased food and beverage costs and interest costs, which were only partially offset by the operating profit contributions of LongHorn Steakhouse and The Capital Grille. While net earnings from continuing operations declined slightly, diluted net earnings per share from continuing operations increased slightly due to a reduction in the average diluted shares outstanding from fiscal 2007 to fiscal 2008, primarily as a result of the cumulative impact of our continuing repurchase of our common stock.

Fiscal 2007 net earnings from continuing operations increased 7.2 percent and diluted net earnings per share increased 13.0 percent compared with fiscal 2006. The increases in net earnings and diluted net earnings per share from continuing operations were primarily due to decreases in food

and beverage costs, restaurant expenses, depreciation and amortization expenses and interest expenses as a percent of sales, which were only partially offset by increases in restaurant labor and selling, general and administrative expenses as a percent of sales. The increase in diluted net earnings per share from continuing operations was also due to a reduction in the average diluted shares outstanding from fiscal 2006 to fiscal 2007, primarily as a result of the cumulative impact of our continuing repurchase of our common stock.

EARNINGS (LOSSES) FROM DISCONTINUED OPERATIONS

On an after-tax basis, earnings from discontinued operations for fiscal 2008 were \$7.7 million (\$0.05 per diluted share) compared with losses from discontinued operations for fiscal 2007 of \$175.7 million (\$1.18 per diluted share) and losses from discontinued operations for fiscal 2006 of \$13.6 million (\$0.08 per diluted share). During fiscal 2008, we recorded an \$18.0 million gain on disposal related to the sale of 72 operating Smokey Bones restaurants, as described in the Overview of Operations section. Losses from discontinued operations for fiscal 2007 increased \$162.1 million compared to fiscal 2006, primarily due to asset impairment charges and closing costs of \$236.4 million (\$146.0 million after tax) and \$13.7 million (\$8.5 million after tax), respectively, primarily related to the decision to close or hold for sale all Smokey Bones and Rocky River Grillhouse restaurants and \$12.7 million (\$7.8 million after tax) and \$2.7 million (\$1.7 million, net of tax) of asset impairment charges and closing costs, respectively, related to the closure of nine Bahama Breeze restaurants in fiscal 2007.

SEASONALITY

Our sales volumes fluctuate seasonally. During fiscal 2008, 2007 and 2006 our average sales per restaurant were highest in the spring and winter, followed by the summer, and lowest in the fall. Holidays, severe weather and similar conditions may impact sales volumes seasonally in some operating regions. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

IMPACT OF INFLATION

We attempt to minimize the annual effects of inflation through appropriate planning, operating practices and menu price increases. We do not believe inflation had a significant overall effect on our annual results of operations during fiscal 2007 and 2006. However, we experienced higher than normal inflationary costs in fiscal 2008 and were able to reduce the annual impact utilizing these strategies.

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CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates.

Critical accounting policies are those we believe are both most important to the portrayal of our financial condition and operating results and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Judgments and uncertainties affecting the application of those policies may result in materially different amounts being reported under different conditions or using different assumptions. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at cost less accumulated depreciation. Building components are depreciated over estimated useful lives ranging from seven to 40 years using the straight-line method. Leasehold improvements, which are reflected on our consolidated balance sheets as a component of buildings, are amortized over the lesser of the expected lease term, including cancelable option periods, or the estimated useful lives of the related assets using the straight-line method. Equipment is depreciated over estimated useful lives ranging from two to 20 years, also using the straight-line method.

Our accounting policies regarding land, buildings and equipment, including leasehold improvements, include our judgments regarding the estimated useful lives of these assets, the residual values to which the assets are depreciated or amortized, the determination of what constitutes expected lease term 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 reported depreciation and amortization expense if different assumptions were used. As discussed further below, these judgments may also impact our need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized. As discussed further below, these judgments may also impact our need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized, or as our expectations of estimated future cash flows change.

Leases

We are obligated under various lease agreements for certain restaurants. For operating leases, we recognize rent expense on a straight-line basis over the expected lease term, including option periods as described below. Capital leases are recorded as an asset and an obligation at an amount equal to the present value of the minimum lease payments during the lease term.

Within the provisions of certain of our 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 expected lease term, which includes option periods we are reasonably assured to exercise because failure to exercise such options would result in an economic penalty to the Company. The lease term commences on the date when we have the right to control the use of the leased property, which is typically before rent payments are due under the terms of the lease. The leasehold improvements and property held under capital leases for each restaurant facility are amortized on the straight-line method over the shorter of the estimated life of the asset or the same expected lease term used for lease accounting purposes. Many of our leases have renewal periods totaling five to 20 years, exercisable at our option, and require payment of property taxes, insurance and maintenance costs in addition to the rent payments. The consolidated financial statements reflect the same lease term for amortizing leasehold improvements as we use to determine capital versus operating lease classifications and in calculating straight-line rent expense for each restaurant. Percentage rent expense is generally based upon sales levels and is accrued at the point in time we determine that it is probable that such sales levels will be achieved.

Our judgments related to the probable term for each restaurant affect the classification and accounting for leases as capital versus operating, the rent holidays and escalation in payments that are included in the calculation of straight-line rent and the term over which leasehold improvements for each restaurant facility are amortized. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

Impairment of Long-Lived Assets

Land, buildings and equipment and certain other assets, including capitalized software costs and liquor licenses, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted net cash flows expected to

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be generated by the assets. Identifiable cash flows are measured at the lowest level for which they are largely independent of the cash flows of other groups of assets and liabilities, generally at the restaurant level. If these assets are determined to be impaired, the amount of impairment recognized is the amount by which the carrying amount of the assets exceeds their fair value. Fair value is generally determined by appraisals or sales prices of comparable assets. Restaurant sites and certain other assets to be disposed of are reported at the lower of their carrying amount or fair value, less estimated costs to sell. Restaurant sites and certain other assets to be disposed of are included in assets held for sale when certain criteria are met. These criteria include the requirement that the likelihood of disposing of these assets within one year is probable. For assets that meet the held for sale criteria, we separately evaluate whether those assets also meet the requirements to be reported as discontinued operations. Principally, if we discontinue cash flows and no longer have any significant continuing involvement with respect to the operations of the assets, we classify the assets and related results of operations as discontinued. We consider guest transfer (an increase in guests at another location as a result of the closure of a location) as continuing cash flows and evaluate the significance of expected guest transfer when evaluating a restaurant for discontinued operations reporting. To the extent we dispose of enough assets where classification between continuing operations and discontinued operations would be material to our consolidated financial statements, we utilize the reporting provisions for discontinued operations. Assets whose disposal is not probable within one year remain in land, buildings and equipment until their disposal is probable within one year.

The judgments we make related to the expected useful lives of long-lived assets and our ability to realize undiscounted cash flows in excess of the carrying amounts of these assets are affected by factors such as the ongoing maintenance and improvements of the assets, changes in economic conditions, changes in usage or operating performance, desirability of the restaurant sites and other factors, such as our ability to sell our assets held for sale. As we assess the ongoing expected cash flows and carrying amounts of our long-lived assets, significant adverse changes in these factors could cause us to realize a material impairment charge. During fiscal 2008, we recognized impairment charges of \$0.1 million (\$0.1 million after tax), which is included in selling, general and administrative expenses on our consolidated statements of earnings. During fiscal 2007, we recognized impairment charges of \$236.4 million (\$146.0 million after tax), primarily related to the decision to close or hold for sale all Smokey Bones and Rocky River Grillhouse restaurants, and we recognized impairment charges of \$12.7 million (\$7.8 million after tax) related to the decision to permanently close nine Bahama Breeze restaurants. The impairment charges were based on a comparison of the net book

value and the estimated fair value of the restaurants. These charges are included in losses from discontinued operations, net of tax on our consolidated statements of earnings. In fiscal 2007, we also recognized \$2.4 million (\$1.5 million after tax) of impairment charges, included in selling, general and administrative expenses on our consolidated statements of earnings, primarily related to the permanent closing of one Red Lobster and one Olive Garden. During fiscal 2006, we recognized impairment charges of \$8.4 million (\$5.2 million after tax), related to the closing of three Smokey Bones restaurants and the impairment of two other Smokey Bones restaurants based on an evaluation of expected cash flows. These charges are included in losses from discontinued operations, net of tax, on our consolidated statements of earnings. During fiscal 2006, we also recorded charges of \$1.3 million (\$0.8 million after tax), included in selling, general and administrative expenses in our consolidated statements of earnings, primarily related to the closing of three Red Lobster and two Olive Garden restaurants.

Valuation and Recoverability of Goodwill and Indefinite Lived Intangible Assets

Intangible assets with indefinite useful lives represented \$974.9 million of our \$4.73 billion in total assets as of May 25, 2008, comprised of \$519.9 million and \$455.0 million of goodwill and trademarks, respectively. We have identified LongHorn Steakhouse® and The Capital Grille® trademarks as indefinite lived intangible assets, in addition to our goodwill, after considering the expected use of the assets and the regulatory and economic environment within which they are being used. We review our goodwill and trademarks, which relate to the LongHorn Steakhouse and The Capital Grille restaurant concepts, annually, on the first day of our fourth fiscal quarter, for impairment, or more frequently if indicators of impairment exist. We continually assess whether any indicators of impairment exist. A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include: a significant decline in our expected future cash flows; a sustained, significant decline in our stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; the testing for recoverability of a significant asset group within a reporting unit; and/or slower growth rates, among others. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on our consolidated financial statements.

When required, we first test goodwill for impairment by comparing the fair value of the LongHorn Steakhouse and The Capital Grille concepts with their carrying amounts. If the fair value of the concepts exceeds the carrying amount of the concepts, goodwill is not deemed to be impaired, and no further testing would be necessary. If the carrying amount of these

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concepts were to exceed their fair value, we would perform a second test to measure the amount of impairment loss, if any. To measure the amount of any impairment loss, we would determine the implied fair value of goodwill in the same manner as if these concepts were being acquired in a business combination. Specifically, we would allocate the fair value of each of these concepts to all of the assets and liabilities of each concept, including any unrecognized intangible assets, in a hypothetical calculation that would yield the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we would record an impairment charge for the difference.

When required, we test trademarks for impairment by comparing the trademarks' respective carrying values to estimates of fair value, determined based on an income valuation model using the relief from royalty method, which requires assumptions related to projected revenues from our annual long-range plan; assumed royalty rates that could be payable if we did not own the trademarks; and a discount rate. Our trademarks are tested separately as a single unit of accounting as prescribed by Emerging Issues Task Force (EITF) Issue No. 02-7, Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets.

The accounting estimates related to our goodwill and other indefinite lived intangible assets require us to make significant assumptions about fair values. Our assumptions regarding fair values require significant judgment about economic factors, industry factors and technology considerations, as well as our views regarding the prospects of our concepts. Changes in these judgments may have a significant effect on the estimated fair values.

Insurance Accruals

Through the use of insurance program deductibles and self-insurance, we retain a significant portion of expected losses under our workers' compensation, employee medical and general liability programs. However, we carry insurance for individual workers' compensation and general liability claims that generally exceed \$0.25 million. Accrued liabilities have been recorded based on our estimates of the anticipated ultimate costs to settle all claims, both reported and not yet reported.

Our accounting policies regarding these insurance programs include our judgments and independent actuarial assumptions about economic conditions, 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 reported expense under these programs.

Stock-Based Compensation

Beginning in fiscal 2007, we account for stock-based compensation in accordance with the fair value recognition provisions

of SFAS No. 123R. We use the Black-Scholes option pricing model, which requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (expected term), the volatility of our common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements (forfeitures). From year to year, our determination of these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and, consequently, the related amount recognized in our consolidated statements of earnings during each period.

Income Taxes

We estimate certain components of our provision for income taxes. These estimates include, among other items, depreciation and amortization expense allowable for tax purposes, allowable tax credits for items such as taxes paid on reported employee tip income, effective rates for state and local income taxes and the tax deductibility of certain other items. We adjust our annual effective income tax rate as additional information on outcomes or events becomes available.

Effective May 28, 2007 we adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." FIN 48 requires that a position taken or expected to be taken in a tax return be recognized (or derecognized) in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

We base our estimates on the best available information at the time that we prepare the provision. We generally file our annual income tax returns several months after our fiscal year-end. Income tax returns are subject to audit by federal, state and local governments, generally years after the returns are filed. These returns could be subject to material adjustments or differing interpretations of the tax laws.

The major jurisdictions in which the Company files income tax returns include the U.S. federal jurisdiction, Canada, and most states in the U.S. that have an income tax. With a few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001.

Included in the balance of unrecognized tax benefits at May 25, 2008 is \$24.5 million related to tax positions for which it is reasonably possible that the total amounts could materially change during the next twelve months based on the outcome of examinations or as a result of the expiration

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of the statute of limitations for specific jurisdictions. Of this amount, approximately \$19.8 million relates to items temporary in nature which will have no impact on our effective income tax rate.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows generated from operating activities provide us with a significant source of liquidity, which we use to finance the purchases of land, buildings and equipment and to repurchase shares of our common stock. Since substantially all of our sales are for cash and cash equivalents and accounts payable are generally due in five to 30 days, we are able to carry current liabilities in excess of current assets. In addition to cash flows from operations, we use a combination of long-term and short-term borrowings to fund our capital needs.

We currently manage our business and our financial ratios to maintain an investment grade bond rating, which allows flexible access to financing at reasonable costs. Currently, our publicly issued long-term debt carries "Baa3" (Moody's Investors Service), "BBB" (Standard & Poor's) and "BBB" (Fitch) ratings. Our commercial paper has ratings of "P-3" (Moody's Investors Service), "A-2" (Standard & Poor's) and "F-2" (Fitch). These ratings are as of the date of this annual report and have been obtained with the understanding that Moody's Investors Service, Standard & Poor's and Fitch will continue to monitor our credit and make future adjustments to these ratings to the extent warranted. The ratings are not a recommendation to buy, sell or hold our securities, may be changed, superseded or withdrawn at any time and should be evaluated independently of any other rating.

Our commercial paper program serves as our primary source of short-term financing. To support our commercial paper program, until September 20, 2007, we maintained a credit facility under a Credit Agreement dated August 16, 2005 (Prior Credit Agreement) with a consortium of banks under which we could borrow up to \$500.0 million. As part of the Prior Credit Agreement, we could request issuance of up to \$100.0 million in letters of credit, the outstanding amount of which reduced the net borrowing capacity under the Prior Credit Agreement. The Prior Credit Agreement allowed us to borrow at interest rates that varied based on a spread over (i) LIBOR or (ii) a base rate that was the higher of the prime rate or one-half of one percent above the federal funds rate, at our option. The interest rate spread over LIBOR was determined by our debt rating. We could also request that loans be made at interest rates offered by one or more of the banks, which may have varied from the LIBOR or base rate. The Prior Credit Agreement supported our commercial paper borrowing program and would have expired on August 15, 2010, but was terminated on September 20, 2007 in connection with the new credit arrangements described below. We were required to pay a facility fee of 10 basis points per annum on the average daily

amount of loan commitments by the consortium. The amount of interest and annual facility fee were subject to change based on our maintenance of certain debt ratings and financial ratios, such as maximum debt to capital ratios. Advances under the Prior Credit Agreement were unsecured. At May 27, 2007, no borrowings under the Prior Credit Agreement were outstanding. However, as of May 27, 2007, there were \$211.4 million of commercial paper and no letters of credit outstanding, which were backed by this facility.

On September 20, 2007, to fund the RARE acquisition, we entered into (i) a \$750.0 million revolving Credit Agreement dated as of September 20, 2007 (New Revolving Credit Agreement) with Bank of America, N.A. (BOA), as administrative agent, and the lenders (Revolving Credit Lenders) and other agents party thereto, and (ii) a \$1.15 billion 364-Day Credit Agreement dated as of September 20, 2007 (Interim Credit Agreement) with BOA, as administrative agent, and the lenders thereto. The Interim Credit Agreement became available to us upon the consummation of the RARE acquisition. The Interim Credit Agreement and the New Revolving Credit Agreement were used to fund the RARE acquisition. On October 11, 2007, we completed the issuance of \$1.15 billion aggregate principal amount of long-term senior notes described below, the proceeds of which were used to fully repay the Interim Credit Agreement.

The New Revolving Credit Agreement is a senior unsecured debt obligation of the Company and contains customary representations, affirmative and negative covenants (including limitations on liens and subsidiary debt, and a maximum consolidated lease adjusted total debt to total capitalization ratio of 0.75 to 1.00) and events of default usual for credit facilities of this type. As of May 25, 2008, we were in compliance with all covenants under the New Revolving Credit Agreement.

The New Revolving Credit Agreement expires on September 20, 2012, and the proceeds may be used for commercial paper back-up, working capital and capital expenditures, the refinancing of certain indebtedness, the partial financing of the RARE acquisition as well as general corporate purposes. The New Revolving Credit Agreement also contains a sub-limit of \$150.0 million for the issuance of letters of credit. The borrowings and letters of credit obtained under the New Revolving Credit Agreement may be denominated in U.S. Dollars, Euro, Sterling, Yen, Canadian Dollars and each other currency approved by the Revolving Credit Lenders. The Company may elect to increase the commitments under the New Revolving Credit Agreement by up to \$250.0 million (to an aggregate amount of up to \$1.00 billion), subject to the Company obtaining commitments from new and existing lenders for the additional amounts.

Loans under the New Revolving Credit Agreement bear interest at a rate of LIBOR plus a margin determined by reference to a ratings-based pricing grid, or the base rate (which is defined as the higher of the BOA prime rate and the federal

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funds rate plus 0.500 percent). Assuming a "BBB" equivalent credit rating level, the applicable margin under the New Revolving Credit Agreement will be 0.350 percent. We may also request that loans under the New Revolving Credit Agreement be made at interest rates offered by one or more of the Revolving Credit Lenders, which may vary from the LIBOR or base rate, for up to \$100.0 million of borrowings. The New Revolving Credit Agreement requires that we pay a facility fee on the total amount of such facility (ranging from 0.070 percent to 0.175 percent, based on our credit ratings) and, in the event that the outstanding amounts under the applicable New Revolving Credit Agreement exceeds 50 percent of such New Revolving Credit Agreement, a utilization fee on the total amount outstanding under such facility (ranging from 0.050 percent to 0.150 percent, based on our credit ratings). As of May 25, 2008, \$130.0 million was outstanding under the New Revolving Credit Agreement. In addition, \$48.4 million of commercial paper was outstanding as of May 25, 2008, which is backed by this facility.

On October 11, 2007, we issued \$350.0 million of unsecured 5.625 percent senior notes due October 2012, \$500.0 million of unsecured 6.200 percent senior notes due October 2017 and \$300.0 million of unsecured 6.800 percent senior notes due October 2037 (collectively, the New Senior Notes) under a registration statement filed with the Securities and Exchange Commission (SEC) on October 9, 2007. Discount and issuance costs, which were \$4.3 million and \$11.7 million, respectively, are being amortized over the terms of the New Senior Notes using the straight-line method, the results of which approximate the effective interest method. The interest rate payable on each series of the New Senior Notes will be subject to adjustment from time to time if the debt rating assigned to such series of the New Senior Notes is downgraded below a certain rating level (or subsequently upgraded). The maximum adjustment is 2.000 percent above the initial interest rate and the interest rate cannot be reduced below the initial interest rate. As of May 25, 2008, no such adjustments to the interest rates had been made. We may redeem any series of the New Senior Notes at any time in whole or from time to time in part, at the principal amount plus a make-whole premium. If we experience a change of control triggering event, we may be required to purchase the New Senior Notes from the holders.

During the second quarter of fiscal 2008, we entered into treasury-lock derivative instruments with \$550.0 million of notional value to hedge a portion of the risk of changes in the benchmark interest rate prior to the issuance of the New Senior Notes, as changes in the benchmark interest rate would cause variability in our forecasted interest payments. These instruments were all settled at the issuance of the New Senior Notes for a cumulative gain of \$6.2 million. This amount was recorded in accumulated other comprehensive income (loss) and will be reclassified into earnings as an adjustment to

interest expense as interest on the New Senior Notes or similar debt is incurred. A gain of \$0.5 million was recognized in earnings during fiscal 2008 as an adjustment to interest expense.

During the fourth quarter of fiscal 2008, we also entered into treasury-lock derivative instruments with \$100.0 million of notional value to hedge a portion of the risk of changes in the benchmark interest rate associated with the expected issuance of the long-term debt to refinance our existing long-term debt due to mature in fiscal 2011, as changes in the benchmark interest rate will cause variability in our forecasted interest payments. The fair value of these outstanding treasury-lock derivative instruments was a net gain of \$2.3 million at May 25, 2008 and is included, net of tax of \$0.9 million, in accumulated other comprehensive income (loss).

On August 12, 2005, we issued \$150.0 million of unsecured 4.875 percent senior notes due in August 2010 and \$150.0 million of unsecured 6.000 percent senior notes due in August 2035 under our prior shelf registration statement on file with the SEC. The net proceeds of \$295.4 million from the issuance of these senior notes were used to repay at maturity our \$150.0 million of 8.375 percent senior notes on September 15, 2005 and our \$150.0 million of 6.375 percent notes on February 1, 2006. In March 2007, we repaid, at maturity our \$150.0 million unsecured 5.750 percent medium-term notes with cash from operations and short-term borrowings.

At May 25, 2008, our long-term debt consisted principally of:

- \$150.0 million of unsecured 4.875 percent senior notes due in August 2010;
- \$75.0 million of unsecured 7.450 percent medium-term notes due in April 2011;
- \$350.0 million of unsecured 5.625 percent senior notes due in October 2012;
- \$100.0 million of unsecured 7.125 percent debentures due in February 2016;
- \$500.0 million of unsecured 6.200 percent senior notes due in October 2017;
- \$150.0 million of unsecured 6.000 percent senior notes due in August 2035;
- \$300.0 million of unsecured 6.800 percent senior notes due in October 2037; and
- An unsecured, variable rate \$15.5 million commercial bank loan due in December 2018 that is used to support two loans from us to the Employee Stock Ownership Plan portion of the Darden Savings Plan.

Through our shelf registration statement on file with the SEC, we may issue an indeterminate amount of unsecured debt securities from time to time in one or more series, which may consist of notes, debentures or other evidences of indebtedness in one or more offerings.

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A summary of our contractual obligations and commercial commitments at May 25, 2008, is as follows (in millions):

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Short-term debt	\$ 178.4	\$ 178.4	\$ -	\$ -	\$ -
Long-term debt ⁽¹⁾	2,966.3	106.5	431.8	518.4	1,909.6
Operating leases	697.8	115.3	198.0	146.0	238.5
Purchase obligations ⁽²⁾	604.7	590.7	7.0	7.0	-
Capital lease obligations ⁽³⁾	114.7	4.9	10.0	10.4	89.4
Benefit obligations ⁽⁴⁾	281.1	24.5	41.2	49.0	166.4
Unrecognized income tax benefits ⁽⁵⁾	88.5	28.0	55.5	5.0	-
Total contractual obligations	\$ 4,931.5	\$ 1,048.3	\$ 743.5	\$ 735.8	\$ 2,403.9

Other Commercial Commitments	Amount of Commitment Expiration per Period				
	Total Committed	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Standby letters of credit ⁽⁶⁾	\$ 74.4	\$ 74.4	\$ -	\$ -	\$ -
Guarantees ⁽⁷⁾	5.8	1.3	1.9	0.9	1.7
Total commercial commitments	\$ 80.2	\$ 75.7	\$ 1.9	\$ 0.9	\$ 1.7

- 1) Includes interest payments associated with existing long-term debt, including the current portion. Variable-rate interest payments associated with the ESOP loan were estimated based on an average interest rate of 6 percent. Excludes issuance discount of \$6.2 million.
- 2) Includes commitments for food and beverage items and supplies, capital projects and other miscellaneous commitments.
- 3) Includes total imputed interest of \$53.9 million over the life of the capital lease obligations.
- 4) Includes expected payments associated with our defined benefit plans, postretirement benefit plan and our non-qualified deferred compensation plan through fiscal 2018.
- 5) Includes interest on unrecognized income tax benefits of \$11.0 million.
- 6) Includes letters of credit for \$64.4 million of workers' compensation and general liabilities accrued in our consolidated financial statements, letters of credit for \$3.2 million of lease payments included in the contractual operating lease obligation payments noted above and other letters of credit totaling \$6.8 million.
- 7) Consists solely of guarantees associated with leased properties that have been assigned to third parties. We are not aware of any non-performance under these arrangements that would result in us having to perform in accordance with the terms of the guarantees.

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Our fixed-charge coverage ratio, which measures the number of times each year that we earn enough to cover our fixed charges, amounted to 5.1 times and 8.6 times, on a continuing operations basis, for the fiscal years ended May 25, 2008 and May 27, 2007, respectively. Our adjusted debt to adjusted total capital ratio (which includes 6.25 times the total annual minimum rent of \$102.0 million and \$64.3 million for the fiscal years ended May 25, 2008 and May 27, 2007, respectively, as components of adjusted debt and adjusted total capital) was 64 percent and 50 percent at May 25, 2008 and May 27, 2007, respectively. We use the lease-debt equivalent in our adjusted debt to adjusted total capital ratio reported to shareholders, as we believe its inclusion better represents the optimal capital structure that we target from period to period.

Based on these ratios, we believe our financial condition is strong. The composition of our capital structure is shown in the following table.

<i>(In millions, except ratios)</i>	May 25, 2008	May 27, 2007
Capital Structure		
Short-term debt	\$ 178.4	\$ 211.4
Long-term debt	1,640.5	494.1
Capital lease obligations	60.8	–
Stockholders' equity	1,409.1	1,094.5
Total capital	\$3,288.8	\$ 1,800.0
Adjustments to Capital		
Short-term debt	\$ 178.4	\$ 211.4
Long-term debt	1,640.5	494.1
Capital lease obligations	60.8	–
Lease-debt equivalent	637.5	397.0
Adjusted debt	\$2,517.2	\$ 1,102.5
Stockholders' equity	1,409.1	1,094.5
Adjusted total capital	\$3,926.3	\$ 2,197.0
Capital Structure Ratios		
Debt to total capital ratio	57%	39%
Adjusted debt to adjusted total capital ratio	64%	50%

Net cash flows provided by operating activities from continuing operations were \$766.8 million, \$569.8 million and \$699.1 million in fiscal 2008, 2007 and 2006, respectively. Net cash flows provided by operating activities include net earnings from continuing operations of \$369.5 million, \$377.1 million and \$351.8 million in fiscal 2008, 2007 and 2006, respectively. Net cash flows provided by operating activities from continuing operations increased in fiscal 2008 primarily as a result of the timing of purchases of inventories and restaurant level services. Net cash flows provided by operating activities also reflect income tax payments of \$119.7 million, \$75.9 million

and \$126.3 million in fiscal 2008, 2007 and 2006, respectively. The lower tax payments in fiscal 2007, as compared with tax payments in fiscal 2008 and fiscal 2006, primarily relate to lower taxable income in fiscal 2007 caused by the closing of the 54 Smokey Bones, two Rocky River Grillhouse and nine Bahama Breeze restaurants.

Net cash flows used in investing activities from continuing operations were \$1.62 billion, \$289.5 million and \$258.3 million in fiscal 2008, 2007 and 2006, respectively. Net cash flows used in investing activities included capital expenditures incurred principally to acquire RARE, build new restaurants, replace equipment and remodel existing restaurants. Capital expenditures related to continuing operations were \$429.2 million in fiscal 2008, compared to \$345.2 million in fiscal 2007 and \$273.5 million in fiscal 2006. In addition to the acquisition of RARE, the increased expenditures in fiscal 2008 and 2007 resulted primarily from increased spending associated with building more new restaurants and replacement of restaurant equipment. During fiscal 2007, we also received \$45.2 million in cash from the sale and leaseback of our current restaurant support center. We estimate that our fiscal 2009 capital expenditures will approximate \$600 million, including approximately \$85 million on our new restaurant support center. The overall cost of our new restaurant support center will be largely offset by various state and local tax credits and incentives and cash proceeds received from the sale of our current restaurant support center.

Net cash flows provided by (used in) financing activities from continuing operations were \$805.5 million, (\$322.9) million and (\$392.9) million in fiscal 2008, 2007 and 2006, respectively. During fiscal 2008 we completed the offering of \$1.15 billion of New Senior Notes, resulting in net proceeds of \$1.13 billion, which were used to repay borrowings under the Interim Credit Agreement, which funded the acquisition of RARE. Proceeds received from the New Revolving Credit Agreement were used to partially fund the acquisition of RARE and to repay the \$125.0 million 2.5 percent convertible notes assumed from RARE. Net cash flows used in financing activities also included our repurchase of 5.0 million shares of our common stock for \$159.4 million in fiscal 2008 compared with 9.4 million shares of our common stock for \$371.2 million in fiscal 2007 and 11.9 million shares for \$434.2 million in fiscal 2006. As of May 25, 2008, our Board of Directors had authorized us to repurchase up to 162.4 million shares of our common stock and a total of 147.0 million shares had been repurchased under the authorization. The repurchased common stock is reflected as a reduction of stockholders' equity. As of May 25, 2008, our unused authorization was 15.4 million shares. During fiscal 2006 we completed the offering of \$300.0 million in senior

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notes, resulting in net proceeds of \$294.7 million, which were used to repay, at maturity, \$300.0 million in notes outstanding. We received proceeds primarily from the issuance of common stock upon the exercise of stock options of \$66.8 million, \$56.6 million and \$61.8 million in fiscal 2008, 2007 and 2006, respectively. Net cash flows used in financing activities also included dividends paid to stockholders of \$100.9 million, \$65.7 million and \$59.2 million in fiscal 2008, 2007 and 2006, respectively. The increase in dividend payments reflects the increase in our annual dividend rate from \$0.40 per share in fiscal 2006, to \$0.46 per share in fiscal 2007 and to \$0.72 per share in fiscal 2008. In June 2008, the Board of Directors approved an increase in the quarterly dividend to \$0.20 per share, which indicates an annual dividend of \$0.80 per share in fiscal 2009.

Our defined benefit and other postretirement benefit costs and liabilities are determined using various actuarial assumptions and methodologies prescribed under the SFAS No. 87, "Employers' Accounting for Pensions" and No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." We use certain assumptions including, but not limited to, the selection of a discount rate, expected long-term rate of return on plan assets and expected health care cost trend rates. We set the discount rate assumption annually for each plan at its valuation date to reflect the yield of high quality fixed-income debt instruments, with lives that approximate the maturity of the plan benefits. At May 25, 2008, our discount rate was 6.50 percent. The expected long-term rate of return on plan assets and health care cost trend rates are based upon several factors, including our historical assumptions compared with actual results, an analysis of current market conditions, asset allocations and the views of leading financial advisers and economists. Our assumed expected long-term rate of return on plan assets was 9.0 percent for each of the fiscal years reported. At May 25, 2008, the expected health care cost trend rates assumed for fiscal 2009 ranged from 8.0 percent to 9.0 percent, depending on the medical service category. The rates gradually decrease to 5.0 percent through fiscal 2013 and remain at that level thereafter. We made contributions of approximately \$0.5 million, \$0.5 million and \$0.3 million in fiscal years 2008, 2007 and 2006, respectively, to our defined benefit pension plan to maintain its fully funded status as of each annual valuation date (the most recent of which was February 29, 2008).

The expected long-term rate of return on plan assets component of our net periodic benefit cost is calculated based on the market-related value of plan assets. Our target asset fund allocation is 35 percent U.S. equities, 30 percent high-quality, long-duration fixed-income securities, 15 percent

international equities, 10 percent private equities and 10 percent real assets. We monitor our actual asset fund allocation to ensure that it approximates our target allocation and believe that our long-term asset fund allocation will continue to approximate our target allocation. Our historical ten-year rate of return on plan assets, calculated using the geometric method average of returns, is approximately 9.4 percent as of May 25, 2008.

We have recognized net actuarial losses, net of tax, as a component of accumulated other comprehensive income (loss) for the defined benefit plans and postretirement benefit plan as of May 25, 2008 of \$12.3 million and \$6.3 million, respectively. These net actuarial losses represent changes in the amount of the projected benefit obligation and plan assets resulting from differences in the assumptions used and actual experience. The amortization of the net actuarial loss component of our fiscal 2009 net periodic benefit cost for the defined benefit plans and postretirement benefit plan is expected to be approximately \$0.4 million and \$0.6 million, respectively.

We believe our defined benefit and postretirement benefit plan assumptions are appropriate based upon the factors discussed above. However, other assumptions could also be reasonably applied that could differ from the assumptions used. A quarter-percentage point change in the defined benefit plans' discount rate and the expected long-term rate of return on plan assets would increase or decrease earnings before income taxes by \$0.9 million and \$0.4 million, respectively. A quarter-percentage point change in our postretirement benefit plan discount rate would increase or decrease earnings before income taxes by \$0.1 million. A one-percentage point increase in the health care cost trend rates would increase the accumulated postretirement benefit obligation (APBO) by \$4.4 million at May 25, 2008 and the aggregate of the service cost and interest cost components of net periodic postretirement benefit cost by \$0.5 million for fiscal 2008. A one-percentage point decrease in the health care cost trend rates would decrease the APBO by \$3.9 million at May 25, 2008 and the aggregate of the service cost and interest cost components of net periodic postretirement benefit cost by \$0.3 million for fiscal 2008. These changes in assumptions would not significantly impact our funding requirements.

We are not aware of any trends or events that would materially affect our capital requirements or liquidity. We believe that our internal cash-generating capabilities, borrowings available under our shelf registration for unsecured debt securities and short-term commercial paper program should be sufficient to finance our capital expenditures, debt maturities, stock repurchase program and other operating activities through fiscal 2009.

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OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, sales or expenses, results of operations, liquidity, capital expenditures or capital resources.

FINANCIAL CONDITION

Our total current assets were \$467.9 million at May 25, 2008, compared with \$545.4 million at May 27, 2007. The decrease resulted primarily from a decrease in assets held for sale related primarily to the sale of Smokey Bones to BII, partially offset by increases in current liabilities related to the addition of RARE.

Our total current liabilities were \$1.14 billion at May 25, 2008, compared with \$1.07 billion at May 27, 2007. The increase in current liabilities resulted primarily from an increase in our level of operations due to the acquisition of RARE, partially offset by the effects of the adoption of FIN 48 and the related reclassification of reserves for uncertain tax positions to non-current liabilities, and a reduction in liabilities associated with assets held for sale related to the sale of Smokey Bones to BII.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to a variety of market risks, including fluctuations in interest rates, foreign currency exchange rates, compensation and commodity prices. To manage this exposure, we periodically enter into interest rate, foreign currency exchange, equity forwards and commodity instruments for other than trading purposes (see Notes 1 and 11 of the Notes to Consolidated Financial Statements, included elsewhere in this report).

We use the variance/covariance method to measure value at risk, over time horizons ranging from one week to one year, at the 95 percent confidence level. At May 25, 2008, our potential losses in future net earnings resulting from changes in foreign currency exchange rate instruments, commodity instruments, equity forwards and floating rate debt interest rate exposures were approximately \$12.5 million over a period of one year (including the impact of the interest rate swap agreements discussed in Note 11 of the Notes to Consolidated Financial Statements, included elsewhere in this report). The value at risk from an increase in the fair value of all of our long-term fixed rate debt, over a period of one year, was approximately \$159.4 million. The fair value of our long-term fixed rate debt during fiscal 2008 averaged \$1.22 billion, with a high of \$1.69 billion and a low of \$468.4 million. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows by targeting an appropriate mix of variable and fixed rate debt.

APPLICATION OF NEW ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measures." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. For financial assets and liabilities, SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, which will require us to adopt these provisions in fiscal 2009. For nonfinancial assets and liabilities, SFAS No. 157 is effective for fiscal years beginning after November 15, 2008, which will require us to adopt these provisions in fiscal 2010. We do not believe the adoption of SFAS No. 157 will have a significant impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, which will require us to adopt these provisions in fiscal 2009. We do not believe the adoption of SFAS No. 159 will have a significant impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R provides companies with principles and requirements on how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree as well as the recognition and measurement of goodwill acquired in a business combination. SFAS No. 141R also requires certain disclosures to enable users of the financial statements to evaluate the nature and financial effects of the business combination. Acquisition costs associated with the business combination will generally be expensed as incurred. SFAS No. 141R is effective for business combinations occurring in fiscal years beginning after December 15, 2008, which will require us to adopt these provisions for business combinations occurring in fiscal 2010 and thereafter. Early adoption of SFAS No. 141R is not permitted. We do not believe the adoption of SFAS No. 141R will have a significant impact on our consolidated financial statements; however, the application of this standard will significantly change how we account for future business combinations.

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In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." SFAS No. 161 provides companies with requirements for enhanced disclosures about derivative instruments and hedging activities to enable investors to better understand their effects on a company's financial position, financial performance and cash flows. These requirements include the disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008, which will require us to adopt these provisions in fiscal 2009. Early adoption of SFAS No. 161 is permitted. We are currently evaluating the impact SFAS No. 161 will have on our consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation method for computing earnings per share when an entity's capital structure includes either two or more classes of common stock or common stock and participating securities. It determines earnings per share based on dividends declared on common stock and participating securities (i.e., distributed earnings) and participation rights of participating securities in any undistributed earnings. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008, which will require us to adopt these provisions in fiscal 2010 and will require the recast of all previously reported earnings per share data. We are currently evaluating the impact FSP EITF 03-6-1 will have on our consolidated financial statements.

FORWARD-LOOKING STATEMENTS

Certain statements included in this report and other materials filed or to be filed by us with the SEC (as well as information included in oral or written statements made or to be made by us) may contain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995, as codified in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Words or phrases such as "believe," "plan," "will," "expect," "intend," "estimate," and "project" and similar expressions are intended to identify forward-looking statements. All of these statements, and any other statements in this report that are not historical facts, are forward-looking. These forward-looking statements are based on assumptions concerning important factors, risks and uncertainties that could significantly affect anticipated results in the future and, accordingly, could cause the actual results to differ materially from those expressed in the forward-looking statements. These factors, risks and uncertainties include, but are not limited to those discussed below and in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended May 25, 2008:

- The intensely competitive nature of the restaurant industry, especially pricing, service, location, personnel and type and quality of food;
- Economic and business factors, both specific to the restaurant industry and generally, that are largely out of our control, including changes in consumer preferences, demographic trends, severe weather conditions including hurricanes, a protracted economic slowdown or worsening economy, energy prices, interest rates, industry-wide cost pressures and public safety conditions, including actual or threatened armed conflicts or terrorist attacks;
- The price and availability of food, ingredients and utilities, including the general risk of inflation;
- The impact of shortages or interruptions in the delivery of food and other supplies;

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- Labor and insurance costs, including increased labor costs as a result of federal and state-mandated increases in minimum wage rates and increased insurance costs as a result of increases in our current insurance premiums;
- The loss of key personnel or difficulties recruiting and retaining qualified personnel;
- A material information technology interruption or security failure;
- Increased advertising and marketing costs;
- Higher-than-anticipated costs to open, close, relocate or remodel restaurants;
- Litigation by employees, consumers, suppliers, shareholders or others, regardless of whether the allegations made against us are valid or we are ultimately found liable;
- Unfavorable publicity relating to food safety or other concerns;
- A lack of suitable new restaurant locations or a decline in the quality of the locations of our current restaurants;
- Federal, state and local regulation of our business, including laws and regulations relating to our relationships with our employees, zoning, land use, environmental matters and liquor licenses;
- Growth objectives, including lower-than-expected sales and profitability of newly-opened restaurants, our expansion of newer concepts that have not yet proven their long-term viability, our ability to develop new concepts, risks associated with growth through acquisitions, and our ability to manage risks relating to the opening of new restaurants, including real estate development and construction activities, union activities, the issuance and renewal of licenses and permits, the availability and cost of funds to finance growth and our ability to hire and train qualified personnel;
- Our plans to expand newer concepts like Bahama Breeze and Seasons 52 that have not yet proven their long-term viability;
- Our ability to combine and integrate the business of RARE into our operations in a successful and timely manner and to achieve synergies following the completion of the acquisition, including the ultimate realization of goodwill;
- The impact of the substantial indebtedness we incurred in connection with the acquisition of RARE; and
- A failure of our internal controls over financial reporting.

Since it is not possible to foresee all such factors, risks and uncertainties, investors should not consider these factors to be a complete list of all risks or uncertainties.