

CHEESECAKE FACTORY INCORPORATED  
Form 10-Q  
December 08, 2006

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

**x**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended October 3, 2006**

**or**

**£**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number 0-20574**

**THE CHEESECAKE FACTORY INCORPORATED**  
**(Exact name of registrant as specified in its charter)**

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**51-0340466**

(I.R.S. Employer  
Identification No.)

**26901 Malibu Hills Road**

**Calabasas Hills, California**

(Address of principal executive offices)

**91301**

(Zip Code)

Registrant's telephone number, including area code: **(818) 871-3000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **x** No **o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer **x**

Accelerated filer **o**

Non-accelerated filer **o**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes **o** No **x**

As of December 1, 2006, 77,817,118 shares of the registrant's Common Stock, \$.01 par value, were outstanding.

Commission File Number 0-20574



**THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

(Unaudited)

	October 3, 2006	January 3, 2006 (restated)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 19,571	\$ 31,052
Investments and marketable securities	66,388	63,222
Accounts receivable	6,250	8,108
Other receivables	33,195	26,390
Inventories	26,312	19,119
Prepaid expenses	15,317	14,583
Deferred income taxes	10,083	10,339
Total current assets	177,116	172,813
Property and equipment, net	698,598	609,918
Other assets:		
Marketable securities	39,903	83,700
Trademarks	3,061	2,730
Prepaid rent	42,575	38,673
Other	23,417	18,416
Total other assets	108,956	143,519
Total assets	\$ 984,670	\$ 926,250
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 40,998	\$ 32,150
Income taxes payable	11,147	6,015
Other accrued expenses	84,299	94,937
Total current liabilities	136,444	133,102
Deferred income taxes	68,318	73,375
Deferred rent	40,121	35,977
Deemed landlord financing liability	43,382	26,273
Other noncurrent liabilities	13,483	10,824
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized; none issued	—	—
Junior participating cumulative preferred stock, \$.01 par value, 150,000 shares authorized; none issued	—	—
Common stock, \$.01 par value, 150,000,000 shares authorized; 81,396,250 and 80,910,422 issued at October 3, 2006 and January 3, 2006, respectively	814	809
Additional paid-in capital	311,964	287,080
Retained earnings	451,362	390,516
Accumulated other comprehensive loss	(753 )	(1,235 )
Treasury stock, 3,627,217 and 2,078,617 shares at cost at October 3, 2006 and January 3, 2006, respectively	(80,465 )	(30,471 )
Total stockholders' equity	682,922	646,699
Total liabilities and stockholders' equity	\$ 984,670	\$ 926,250

See the accompanying notes to the consolidated financial statements.



**THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

	<b>Thirteen Weeks Ended October 3, 2006</b>	<b>Thirteen Weeks Ended September 27, 2005 (restated)</b>	<b>Thirty-Nine Weeks Ended October 3, 2006</b>	<b>Thirty-Nine Weeks Ended September 27, 2005 (restated)</b>
<b>Revenues</b>	\$ 325,337	\$ 296,873	\$ 954,629	\$ 853,433
Costs and expenses:				
Cost of sales	81,420	74,660	238,742	217,935
Labor expenses	104,931	90,986	306,594	263,941
Other operating costs and expenses	77,072	67,102	223,411	193,503
General and administrative expenses	18,418	14,050	50,924	38,549
Depreciation and amortization expenses	13,465	11,386	38,859	32,243
Preopening costs	5,369	3,760	12,916	10,280
Total costs and expenses	300,675	261,944	871,446	756,451
Income from operations	24,662	34,929	83,183	96,982
Interest income, net	1,044	1,133	3,545	2,857
Other income, net	168	114	1,969	400
Income before income taxes	25,874	36,176	88,697	100,239
Income tax provision	7,747	12,572	27,851	34,849
Net income	\$ 18,127	\$ 23,604	\$ 60,846	\$ 65,390
Net income per share:				
Basic	\$ 0.23	\$ 0.30	\$ 0.78	\$ 0.84
Diluted	\$ 0.23	\$ 0.29	\$ 0.76	\$ 0.82
Weighted average shares outstanding:				
Basic	77,757	78,511	78,299	78,228
Diluted	78,695	80,235	79,576	80,063

See the accompanying notes to the consolidated financial statements.

**THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

(In thousands)

(Unaudited)

	<b>Shares of Common Stock</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income/(Loss)</b>	<b>Treasury Stock</b>	<b>Total</b>
Balance, January 3, 2006, as restated	80,910	\$ 809	\$ 287,080	\$ 390,516	\$ (1,235 )	\$ (30,471 )	\$ 646,699
<b>Comprehensive income:</b>							
Net income				60,846			
Unrealized gain on available-for-sale securities					482		
Total comprehensive income							61,328
Issuance of common stock from stock option exercises	486	5	7,636				7,641
Tax benefit related to stock options exercised			3,165				3,165
Stock-based compensation			14,083				14,083
Purchase of treasury stock					(49,994 )	(49,994 )	
Balance, October 3, 2006	81,396	\$ 814	\$ 311,964	\$ 451,362	\$ (753 )	\$ (80,465 )	\$ 682,922

See the accompanying notes to the consolidated financial statements.

**THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	Thirty-Nine Weeks Ended October 3, 2006	Thirty-Nine Weeks Ended September 27, 2005 (restated)
<b>Cash flows from operating activities:</b>		
Net income	\$ 60,846	\$ 65,390
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	38,859	32,243
Loss on sale of available-for-sale securities	11	15
Loss (gain) on asset sale	54	(8 )
Deferred income taxes	(5,070 )	17,370
Stock-based compensation	14,083	639
Tax benefit related to stock options exercised	3,165	5,930
Excess tax benefit related to stock options exercised	(1,744 )	—
Changes in assets and liabilities:		
Accounts receivable	1,858	1,689
Other receivables	(6,805 )	2,282
Inventories	(7,193 )	(9,958 )
Prepaid expenses	(734 )	390
Other	(9,417 )	(8,635 )
Accounts payable	8,848	(6,770 )
Income taxes payable	5,132	1,088
Other accrued expenses	(4,032 )	7,884
Cash provided by operating activities	97,861	109,549
<b>Cash flows from investing activities:</b>		
Additions to property and equipment	(128,436 )	(111,770 )
Investments in available-for-sale securities	(50,336 )	(64,772 )
Sales of available-for-sale securities	91,708	55,027
Cash used in investing activities	(87,064 )	(121,515 )
<b>Cash flows from financing activities:</b>		
Deemed landlord financing proceeds	18,847	14,290
Deemed landlord financing payments	(516 )	(227 )
Proceeds from exercise of employee stock options	7,641	8,975
Purchase of treasury stock	(49,994 )	(3,986 )
Excess tax benefit related to stock options exercised	1,744	—
Cash provided by (used in) financing activities	(22,278 )	19,052
Net change in cash and cash equivalents	(11,481 )	7,086
Cash and cash equivalents at beginning of period	31,052	14,041
Cash and cash equivalents at end of period	\$ 19,571	\$ 21,127
<b>Supplemental disclosures:</b>		
Interest paid	\$ 1,333	\$ 588
Income taxes paid	\$ 24,596	\$ 10,372

See the accompanying notes to the consolidated financial statements.



**THE CHEESECAKE FACTORY INCORPORATED AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Basis of Presentation and Significant Accounting Policies**

The accompanying consolidated financial statements include the accounts of The Cheesecake Factory Incorporated (referred to herein as the Company or in the first person notations we, us and our) and its wholly owned subsidiaries prepared in accordance with generally accepted accounting principles and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The financial statements presented herein have not been audited by an independent registered public accounting firm, but include all material adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair statement of the financial condition, results of operations and cash flows for the period. However, these results are not necessarily indicative of results for any other interim period or for the full fiscal year. The consolidated balance sheet data presented herein for January 3, 2006 was derived from our audited consolidated financial statements for the fiscal year then ended, but does not include all disclosures required by generally accepted accounting principles. The preparation of financial statements in accordance with generally accepted accounting principles requires us to make certain estimates and assumptions for the reporting periods covered by the financial statements. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses. Actual amounts could differ from these estimates.

Certain information and footnote disclosures normally included in financial statements in accordance with generally accepted accounting principles have been omitted pursuant to the rules of the Securities and Exchange Commission. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Form 10-K/A for the fiscal year ended January 3, 2006.

*Reclassification*

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. On the Consolidated Balance Sheets, our restaurant smallware balance, previously included in inventories, was moved to property and equipment.

*Restatement of Financial Statements due to Review of Stock Option Grants and Procedures*

On July 18, 2006, we announced that the Audit Committee of our Board of Directors, which is comprised solely of independent directors, was reviewing the Company's practices relating to its stock option grants with the assistance of special outside legal counsel from the law firm of Cooley Godward Kronish LLP. This voluntary review was initiated in response to media and Wall Street reports regarding the option granting practices at numerous publicly traded companies.

On November 20, 2006, we announced the conclusion of the Audit Committee's review, which covered the period beginning with the Company's initial public offering registration in 1992 to the present. The Audit Committee reported that its special counsel received full cooperation from Company management, was given complete access to all necessary and relevant electronic and other documents, and interviewed all persons involved in the stock option granting process at the Company, as well as the Company's advisors.

Based upon the Audit Committee's findings, we concluded that we selected the grant date of options based upon the lowest price, generally within a 30-day window because we incorrectly believed that the applicable accounting guidance allowed us to establish the grant date within a certain window from authorization. As a result, we incorrectly applied the measurement date, as defined in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," with respect to certain option grants made to executive officers in fiscal years 1997 through 2001, to non-executive officers and other employees in fiscal years 1997 through 2004, and to outside directors in fiscal years 2000 and 2001. Because we incorrectly selected grant dates which resulted in a cumulative adjustment of \$5.4 million expense on an after-tax basis through fiscal 2005, we amended our Annual Report on Form 10-K for the fiscal year ended January 3, 2006 to restate the Consolidated Balance Sheets at January 3, 2006 and December 28, 2004 and the Consolidated Statements of Operations, Stockholders' Equity and Cash Flows for the years ended January 3, 2006, December 28, 2004 and December 30, 2003. We also restated the Consolidated Balance Sheet at April 4, 2006 and the Consolidated Statements of Operations, Stockholders' Equity and Cash Flows for the quarterly periods ended April 4, 2006 and March 29, 2005.



These restated financial statements are included in the Quarterly Report on Form 10-Q/A for the quarter ended April 4, 2006. Throughout this Form 10-Q, all referenced amounts for prior periods and prior period comparisons reflect the balances and amounts on a restated basis.

*Correction of Other Matters*

As part of the restatement process resulting from the review of our stock option granting practices, we assessed generally whether there were other matters, which should be corrected in our previously issued financial statements. We concluded that three additional errors should be corrected.

- We recognize a liability upon the sale of a gift card and recognize revenue when the gift card is redeemed in our restaurants or on our website. Beginning in 2001, we adjusted the gift card liability upon the sale of a gift card for the estimated portion of the gift card value that would not be redeemed ( breakage ). We have now determined that the appropriate accounting is to record breakage ratably over the estimated time period that our gift cards are generally redeemed and that no breakage should be recognized until there is sufficient history to establish the estimated redemption period. As a result, we are restating the periods 2001 through the second quarter of 2005 to reverse breakage that was previously recognized since we did not have sufficient data to estimate the redemption periods. For the third and fourth quarters of 2005, we are restating to recognize breakage both cumulatively and prospectively over a thirty-six month period based on an ability to estimate breakage due to a full cycle of redemptions being tracked since 2002. As part of this restatement, we are also correcting our classification of breakage income. The adjustment to the gift card liability account for breakage was previously classified as a reduction of general and administrative expenses in our consolidated statements of operations. As part of this restatement, we are reclassifying gift card breakage to revenue. The impact of these breakage related adjustments was an understatement of net income by \$1.1 million in fiscal 2005 and an overstatement of net income by \$0.4 million and \$0.7 million in fiscal 2004 and 2003, respectively, and an understatement of other accrued expenses of \$1.7 million and \$3.4 million at January 3, 2006 and December 28, 2004, respectively. Net income for the first quarter of fiscal 2006 was understated by \$0.1 million.
- We previously recorded expense for our operations bonuses on a one-quarter lag. While our Consolidated Statements of Operations reflected four quarters of bonus-related expense, our Consolidated Balance Sheet did not reflect the accrued bonus liability for the most recent quarter. The impact of this error was an overstatement of net income by \$0.2 million, \$0.1 million and \$0.2 million in fiscal 2005, 2004 and 2003, respectively, and an understatement of other accrued expenses of \$1.6 million and \$1.3 million at January 3, 2006 and December 28, 2004, respectively. Net income for the first quarter of fiscal 2006 was understated by \$0.1 million.
- Historically, we did not amortize the cost of liquor licenses as we had considered them indefinite-lived assets. We have now concluded that certain liquor licenses are not transferable and therefore have finite lives corresponding with the terms of the related operating lease. These non-transferable liquor licenses are now amortized over the primary lease terms of the respective leases plus any exercised extensions of those lease terms. The impact of this error was an overstatement of net income by \$27,000, \$25,000 and \$22,000 in fiscal 2005, 2004 and 2003, respectively, and an overstatement of other assets of \$0.2 million at both January 3, 2006 and December 28, 2004. Net income for the first quarter of fiscal 2006 was overstated by \$8,000.

The aggregate adjustments increased net income by \$0.4 million in fiscal year 2005 and reduced net income by \$1.2 million and \$1.6 million in fiscal years 2004 and 2003, respectively. Net income for the first quarter of fiscal 2006 increased by \$6,000. Diluted net income per share increased by \$0.01 for the year ended January 3, 2006 and decreased by \$0.02 and \$0.03 for the years ended December 28, 2004 and December 30, 2003, respectively, and was unchanged for the first quarter of fiscal 2006. The restatement also resulted in a \$5.2 million, or 2.8%, reduction in retained earnings as of December 31, 2002. The restatement adjustments were non-cash and had no impact on net cash flow.

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The following table reflects the impact of the restatement on the Consolidated Statements of Operations (in thousands, except per share data):

	<b>Thirteen Weeks Ended September 27, 2005 (as previously reported)</b>	<b>Thirteen Weeks Ended September 27, 2005 (restated)</b>	<b>Thirty-Nine Weeks Ended September 27, 2005 (as previously reported)</b>	<b>Thirty-Nine Weeks Ended September 27, 2005 (restated)</b>
<b>Selected Statement of Operations Data:</b>				
Revenues	\$ 292,807	\$ 296,873	\$ 849,367	\$ 853,433
Labor expenses	90,910	90,986	263,704	263,941
Other operating costs and expenses	67,080	67,102	193,486	193,503
General and administrative expenses	12,653	14,050	36,612	38,549
Depreciation and amortization expenses	11,375	11,386	32,211	32,243
Total costs and expenses	260,438	261,944	754,228	756,451
Income from operations	32,369	34,929	95,139	96,982
Income before income taxes	33,616	36,176	98,396	100,239
Income tax provision	11,698	12,572	34,241	34,849
Net income	21,918	23,604	64,155	65,390
<b>Net income per share:</b>				
Basic	\$ 0.28	\$ 0.30	\$ 0.82	\$ 0.84
Diluted	\$ 0.27	\$ 0.29	\$ 0.80	\$ 0.82

The following table reflects the impact of the restatement on the Consolidated Statements of Cash Flows (in thousands):

	<b>Thirty-Nine Weeks Ended September 27, 2005 (as previously reported)</b>	<b>Thirty-Nine Weeks Ended September 27, 2005 (restated)</b>
<b>Selected Cash Flow Data:</b>		
Net income	\$ 64,155	\$ 65,390
Depreciation and amortization	32,211	32,243
Deferred income tax	16,631	17,370
Stock-based compensation		639
Tax benefit related to stock options exercised	6,050	5,930
Income taxes payable	1,099	1,088
Other accrued expenses	10,398	7,884

There was no impact to the subtotals for the operating, investing or financing sections of the consolidated statements of cash flows, because all adjustments occurred within the operating activities component.

### *Stock-Based Compensation*

Prior to the January 4, 2006 adoption of Financial Accounting Standards Board ( FASB ) Statement No. 123(R), Share-Based Payment ( SFAS 123R ), we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Historically, no compensation expense was recognized for Company-issued stock options. As permitted by SFAS 123, Accounting for Stock-Based Compensation ( SFAS 123 ), stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements.

However, as further discussed above, the Audit Committee of our Board of Directors initiated earlier this year a voluntary review of our stock option granting practices from 1992 to the present. The review encompassed all grants made under our various stock option plans in effect during this period. Based on the results of this review, we restated our historical accounting to correct the application of the measurement date, as defined in APB Opinion No. 25, for certain grants of stock options to directors, officers and employees, resulting from administrative

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oversight and the date selection methods used by the Company. The restatement adjustments were non-cash and had no impact on net cash flow.

Effective January 4, 2006, we adopted SFAS 123R using the modified prospective transition method and, as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 4, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 4, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees, which is then amortized on a straight-line basis over the requisite service period. See Note 4 of the Notes to Consolidated Financial Statements in this Form 10-Q for further discussion of stock-based compensation.

*Recent Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The Statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact this Statement will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. This Statement requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other postretirement benefit plans. The Statement requires prospective application, and the recognition and disclosure requirements are effective for companies with fiscal years ending after December 15, 2006. Additionally, SFAS No. 158 requires companies to measure plan assets and obligations at their year-end balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. We are currently evaluating the impact this Statement will have on our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin ( SAB ) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which provides interpretive guidance regarding the consideration given to prior year misstatements when determining materiality in current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We do not expect SAB No. 108 to have any impact on our consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, on a tax return. This Interpretation also provides guidance on derecognition, classification, interest, penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this Interpretation will be a two-step process. The first step will determine if it is more likely than not that a tax position will be sustained upon examination and should therefore be recognized. The second step will measure a tax position that meets the more likely than not recognition threshold to determine the amount of benefit to recognize in the financial statements. This Interpretation is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact this Interpretation will have on our consolidated financial statements.

In March 2006, the Emerging Issues Task Force ( EITF ) issued EITF Issue 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for presenting these sales taxes in our consolidated financial statements.

In November 2005, the FASB issued Staff Position FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, ( FSP 115-1 ) which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is required to be applied to reporting periods beginning after December 15, 2005. We adopted FSP 115-1 on January 4, 2006 and included the required disclosures in Note 2 of Notes to the Consolidated Financial Statements in this Form 10-Q. There was no impact to our consolidated financial statements as the result of our adoption of FSP 115-1.

In October 2005, the FASB issued Staff Position FAS 13-1, Accounting for Rental Costs Incurred during a Construction Period, which requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense. This Staff Position is effective for reporting periods beginning after December 15, 2005, and retrospective application is permitted but not required. We adopted FAS 13-1 on January 4, 2006 on a prospective basis. Prior to adoption, we capitalized rent incurred during the tenant improvement construction phase, which averaged approximately \$45,000 per new restaurant opened during fiscal 2005.

## **2. Investments and Marketable Securities**

Investments and marketable securities, consisted of the following in thousands:

Classification	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Maturity
<b>At October 3, 2006:</b>					
Current assets:					
Available-for-sale securities:					
Corporate debt securities	\$ 18,303	\$ —	\$ (75 )	\$ 18,228	October 2006 to September 2007
U.S. government agency obligations	48,602	—	(442 )	48,160	October 2006 to August 2007
Total	\$ 66,905	\$ —	\$ (517 )	\$ 66,388	
Other assets:					
Available-for-sale securities:					
Corporate debt securities	\$ 14,792	\$ —	\$ (185 )	\$ 14,607	October 2007 to January 2011
U.S. government agency obligations	25,727	—	(431 )	25,296	November 2007 to September 2010
Total	\$ 40,519	\$ —	\$ (616 )	\$ 39,903	
<b>At January 3, 2006:</b>					
Current assets:					
Available-for-sale securities:					
Corporate debt securities	\$ 29,922	\$ 2	\$ (222 )	\$ 29,702	January 2006 to December 2006
U.S. government agency obligations	33,738	1	(219 )	33,520	February 2006 to November 2006
Total	\$ 63,660	\$ 3	\$ (441 )	\$ 63,222	
Other assets:					
Available-for-sale securities:					
Corporate debt securities	\$ 27,861	\$ 11	\$ (291 )	\$ 27,581	January 2007 to May 2010
U.S. government agency obligations	57,286	17	(1,184 )	56,119	January 2007 to September 2010

(In thousands, except share data)

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Total	\$ 85,147	\$ 28	\$ (1,475 )	\$ 83,700
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The following tables present the length of time available-for-sale securities were in continuous unrealized loss positions, but were not deemed to be other-than-temporarily impaired (in thousands):

	Less Than 12 Months		Greater Than or Equal to 12 Months	
	Gross Losses	Fair Value	Gross Losses	Fair Value
<b>At October 3, 2006:</b>				
Corporate debt securities	\$ (24 )	\$ 14,492	\$ (236 )	\$ 17,842
U.S. government agency obligations	(103 )	15,117	(770 )	58,339
Total	\$ (127 )	\$ 29,609	\$ (1,006 )	\$ 76,181
<b>At January 3, 2006:</b>				
Corporate debt securities	\$ (131 )	\$ 13,582	\$ (382 )	\$ 29,019
U.S. government agency obligations	(120 )	25,007	(1,283 )	56,229
Total	\$ (251 )	\$ 38,589	\$ (1,665 )	\$ 85,248

Gross unrealized holding losses of \$0.1 million for less than twelve months and \$1.0 million for greater than or equal to twelve months as of October 3, 2006, pertain to 27 and 45 fixed income securities, respectively, and were primarily caused by interest rate increases. Since we have the ability and intent to hold these securities until a recovery of fair value, which may be at maturity, and because the unrealized losses were primarily due to higher interest rates, we do not consider these securities to be other-than-temporarily impaired. In addition, the U.S. government agency obligations are rated AAA, and the contractual terms of these securities do not permit the issuer to settle at a price less than the par value of the investment, which is the equivalent of the amount due at maturity.

There were no realized losses recorded for other than temporary impairments during fiscal 2005, nor the first three quarters of fiscal 2006.

### 3. Inventories

Inventories consisted of (in thousands):

	October 3, 2006	January 3, 2006
Restaurant food and supplies	\$ 9,890	\$ 9,026
Bakery finished goods	12,630	7,836
Bakery raw materials	3,792	2,257
Total	\$ 26,312	\$ 19,119

### 4. Stock-Based Compensation

We maintain performance incentive plans under which incentive stock options, non-qualified stock options, stock appreciation rights, restricted shares, deferred shares, performance shares and performance units may be granted to employees, consultants and non-employee directors. To date, we have only granted non-qualified stock options under these plans. Stock options generally vest at 20% per year, expire ten years from the date of grant, and become exercisable provided that we meet or exceed certain performance criteria approved by our Board of Directors.

Historically, no compensation expense was recognized for Company-issued stock options. As permitted by SFAS 123, Accounting for Stock-Based Compensation (SFAS 123), stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements.

However, as further discussed in Note 1, earlier this year the Audit Committee of our Board of Directors initiated a voluntary review of our stock option granting practices from 1992 to the present. The review encompassed all grants made under our various stock option plans in effect during this period. Based on the results of this review, we restated our historical accounting to correct the application of the measurement date, as defined in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, for certain grants of stock options to directors, officers and employees, resulting from administrative oversights and the date selection methods used by the Company. The restatement

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adjustments were non-cash and had no impact on net cash flow.

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Effective January 4, 2006, we adopted Financial Accounting Standards Board ( FASB ) Statement No. 123(R), Share-Based Payment ( SFAS 123R ), using the modified prospective transition method, and as a result, did not retroactively adjust results from prior periods. Under this transition method, stock-based compensation was recognized for: 1) expense related to the remaining unvested portion of all stock option awards granted prior to January 4, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) expense related to all stock option awards granted on or subsequent to January 4, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. We apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees. The resulting compensation expense is recognized over the requisite service period, which is generally the option vesting term of five years. Prior to fiscal 2006, stock-based compensation was included as a pro forma disclosure in the Notes to the Consolidated Financial Statements as permitted by SFAS 123.

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

As a result of adopting SFAS 123R, the impact to the Consolidated Statement of Operations for the thirteen weeks ended October 3, 2006 on income before income taxes and net income was \$4.3 million and \$3.0 million, respectively, and \$0.04 on both basic and diluted earnings per share. For the thirty-nine weeks ended October 3, 2006, the impact of stock-based compensation expense on income before income taxes and net income was \$13.1 million and \$9.0 million, respectively, and \$0.11 and \$0.12 on basic and diluted earnings per share, respectively. Capitalized stock-based compensation for the thirteen and thirty-nine weeks ended October 3, 2006 was \$0.3 million and \$1.0 million, respectively, and was included in property and equipment, net and other assets on the Consolidated Balance Sheet. In addition, prior to the adoption of SFAS 123R, we presented the tax benefit resulting from the exercise of stock options as operating cash inflows in the Consolidated Statements of Cash Flows. Upon the adoption of SFAS 123R, the excess tax benefits for those options are classified as financing cash inflows.

The pro forma table below reflects net income and basic and diluted net income per share for the third quarter of fiscal 2005, had we applied the fair value recognition provisions of SFAS 123 (in thousands, except per share data):

	<b>Thirteen Weeks Ended September 27, 2005 (restated)</b>	<b>Thirty-Nine Weeks Ended September 27, 2005 (restated)</b>
Net income, as reported	\$ 23,604	\$ 65,390
Total stock-based compensation included in net income, as reported	125	390
Total stock-based compensation expense, net of taxes, under the fair value method	(2,888)	) (8,493)
Net income, pro forma	\$ 20,841	\$ 57,287
Basic net income per share, as reported	\$ 0.30	\$ 0.84
Basic net income per share, pro forma	\$ 0.27	\$ 0.73
Diluted net income per share, as reported	\$ 0.29	\$ 0.82
Diluted net income per share, pro forma	\$ 0.26	\$ 0.72

Pro forma disclosure for fiscal 2006 is not presented because the amounts are recognized in the consolidated financial statements.

The weighted average fair value at the grant date for options issued during the third quarter of fiscal 2006 and 2005 was \$8.75 and \$13.73 per option, respectively. For the first three quarters of fiscal 2005, we employed the binomial lattice option valuation model.

Upon further review of the various valuation techniques and the relevance of our historical exercise patterns, we believe the Black-Scholes option pricing model is currently a better tool for estimating our stock-based compensation cost. We utilized the Black-Scholes model beginning with the fourth quarter of fiscal 2005 and will employ it on a go-forward basis. The fair value of options at date of grant was estimated using the following weighted average assumptions for the third quarter of fiscal 2006 and 2005, respectively: (a) no dividend yield on our stock, (b) expected stock price volatility of 32.2% and 33.1%, (c) a risk-free interest rate of 4.9% and a range of 4.2% to 4.6%, and (d) an expected option term of 4.75 years under the Black-Scholes model for the third quarter of 2006. Under the binomial lattice model for the third quarter of fiscal 2005, we used a termination rate of 0.6% and an exercise multiple of 1.35.

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar options, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on a combination of the historical volatility of our stock and the implied volatility of actively traded options on our common stock. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. We have not paid dividends in the past and do not currently plan to pay dividends in the near future.

Stock option activity during the thirty-nine weeks ended October 3, 2006 was as follows:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 3, 2006	7,564	\$ 22.96		
Granted	1,429	\$ 33.21		
Exercised	(486 )	\$ 15.73		
Cancelled	(286 )	\$ 28.75		
Outstanding at October 3, 2006	8,221	\$ 24.93	6.9	\$ 34,979
Vested and expected to vest at October 3, 2006	7,929	\$ 24.76	6.8	\$ 34,656
Exercisable at October 3, 2006	2,624	\$ 18.25	5.0	\$ 24,286

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between our closing stock price on October 3, 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders, had all option holders exercised their options on October 3, 2006. This amount changes based on the fair market value of our stock. Total intrinsic value of options exercised for the thirteen and thirty-nine weeks ended October 3, 2006 was \$0.3 million and \$8.5 million, respectively. As of October 3, 2006, total unrecognized stock-based compensation expense related to nonvested stock options was \$41 million, which is expected to be recognized over a weighted average period of approximately 2.7 years. As of October 3, 2006 there were 8.7 million shares of common stock available for issuance pursuant to future stock option grants.

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Additional information regarding options outstanding as of October 3, 2006 is as follows:

Range of Exercise Prices	Shares (in thousands)	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Shares (in thousands)	Weighted Average Exercise Price
\$ 3.58 - \$18.61	1,419	3.6	\$ 11.50	1,294	\$ 10.89
\$ 18.75 - \$21.81	1,380	6.2	\$ 20.28	424	\$ 20.24
\$ 21.82 - \$26.37	1,497	6.8	\$ 23.37	305	\$ 22.48
\$ 26.53 - \$29.36	1,376	7.5	\$ 28.69	368	\$ 29.30
\$ 29.37 - \$34.00	1,370	8.4	\$ 31.86	198	\$ 31.82
\$ 34.02 - \$38.24	1,179	9.2	\$ 36.07	35	\$ 36.63
\$ 3.58 - \$38.24	8,221	6.9	\$ 24.93	2,624	\$ 18.25

## 5. Net Income Per Share

In accordance with the provisions of SFAS No. 128, Earnings Per Share, basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share includes the dilutive effect of potential stock option exercises, calculated using the treasury stock method. Outstanding stock options issued by us represent the only dilutive effect reflected in diluted weighted average shares outstanding.

(In thousands, except per share data)	Thirteen Weeks Ended October 3, 2006	Thirteen Weeks Ended September 27, 2005 (restated)	Thirty-Nine Weeks Ended October 3, 2006	Thirty-Nine Weeks Ended September 27, 2005 (restated)
<b>Net Income per Common Share Basic:</b>				
Weighted average shares outstanding	77,757	78,511	78,299	78,228
Net income	\$ 18,127	\$ 23,604	\$ 60,846	\$ 65,390
Net income per share basic	\$ 0.23	\$ 0.30	\$ 0.78	\$ 0.84
<b>Net Income per Common Share Diluted:</b>				
Weighted average shares outstanding	77,757	78,511	78,299	78,228
Effect of dilutive stock options	938	1,724	1,277	1,835
Weighted average shares outstanding diluted	78,695	80,235	79,576	80,063
Net income	\$ 18,127	\$ 23,604	\$ 60,846	\$ 65,390
Net income per share diluted	\$ 0.23	\$ 0.29	\$ 0.76	\$ 0.82

Shares of common stock equivalents of approximately 4.6 million and 4.1 million for the thirteen and thirty-nine weeks ended October 3, 2006, respectively, were not included in the diluted calculation because they were anti-dilutive.

## 6. Comprehensive Income

Comprehensive income consisted of (in thousands):

	Thirteen Weeks Ended October 3, 2006	Thirteen Weeks Ended September 27, 2005 (restated)	Thirty-Nine Weeks Ended October 3, 2006	Thirty-Nine Weeks Ended September 27, 2005 (restated)
Net income	\$ 18,127	\$ 23,604	\$ 60,846	\$ 65,390
Net unrealized gain (loss) on available-for-sale securities	684	(257 )	482	(335 )
Total	\$ 18,811	\$ 23,347	\$ 61,328	\$ 65,055

(In thousands, except share data)



## 7. Commitments and Contingencies

On August 1, 2006, we received final approval by the Superior Court of the State of California of a negotiated settlement of consolidated class action wage and hour lawsuits originally filed in December 2002 by two former hourly restaurant employees in California alleging violations of California labor laws with respect to providing meal and rest breaks. Notices of the settlement were sent to all class members, the claims period has expired, and the administration of claims has been completed. A number of former and current employees also filed individual wage and hour claims, based upon alleged similar violations, directly with various offices of the California Division of Labor Standards Enforcement ( DLSE ). The DLSE claims filed by employees who joined the approved settlement also will be resolved by such settlement.

On February 22, 2006, a current employee filed a claim in the General Court of Justice - Superior Court Division, Durham County, North Carolina (Chandler v. The Cheesecake Factory Restaurants, Inc. et al.; Case No. 6CVS00724), alleging that the Company unlawfully failed to pay the named plaintiff and similarly situated tipped employees certain wages and tips in violation of the tip pooling provisions of the North Carolina wage and hour laws. The Plaintiff seeks class certification and recovery of back wages and liquidated damages under the North Carolina Wage and Hour Act. It is the Company's position that the Plaintiff and any other purported class members have been paid all wages and tips owed, the Company does not have any tip pooling arrangement, and the Company's suggested tip-out guidelines, which are voluntary, comply with all federal, state and local laws. The Company intends to vigorously defend this action.

On June 23, 2006, three current restaurant management employees in Ohio filed a charge of discrimination with the U.S. Equal Employment Opportunity Commission (EEOC) against The Cheesecake Factory Restaurants, Inc. alleging violations of Title VII of the Civil Rights Act resulting from alleged sex discrimination in the Company's promotion process. The claimants seek unspecified amounts of penalties and other monetary payments. The Company is cooperating with the EEOC's investigation of this matter. The Company intends to vigorously defend against this matter.

On August 29, 2006, five present and former hourly restaurant employees in the States of Tennessee, Texas and Arizona filed a lawsuit in the U.S. District Court for the Middle District of Tennessee against the Company alleging violations of the Fair Labor Standards Act with respect to alleged minimum wage violations, improper payroll deductions, and requiring work off the clock, among others claims (Smith v. The Cheesecake Factory Restaurants, Inc. et al; Case No. 3 06 0829). The lawsuit seeks unspecified amounts of penalties and other monetary payments on behalf of the plaintiffs and other purported class members. The plaintiffs also seek attorneys' fees for themselves. Discovery is currently continuing in this matter. The Company intends to vigorously defend its position.

Following our announcement on July 18, 2006 of the Audit Committee of our Board of Directors' review of our historical stock option granting practices, a number of purported Company shareholders brought eight separate putative shareholder derivative actions (the Options Derivative Actions) against the Company, our entire Board of Directors, and certain of our current and former officers alleging that the defendants improperly dated certain historical stock option grants. The plaintiffs in these cases, filed in Los Angeles County Superior Court and styled as Siebles v. Deitchle et. al. (Case No. BC355872) (subsequently re-filed in federal court), McGee v. Overton et al. (Case No. BC355953); Rigotti v. Overton, et al. (Case No. BC356850), Cullen v. Overton, et al. (Case No. BC356851), Sachs v. Overton et al. (Case No. BC357065), and filed in United States District Court for the Central District and styled as Siebles v. Deitchle et.al. (Case No. CV06 6234), Kuhns v. Deitchle et al. (Case No. SACV06917) and Freed v. Overton et al. (Case No. CV 06 06486) contend, among other things, that the defendants conduct violated the California and/or federal securities laws, breached defendants' fiduciary duties, wasted corporate assets, unjustly enriched the defendants, and caused errors in the Company's financial statements. The plaintiffs seek, among other things, unspecified damages and disgorgement of profits from the alleged conduct to be paid to the Company. The plaintiffs also seek attorneys' fees for themselves. The Options Derivative Actions are in the preliminary stages of litigation. We intend to vigorously defend these actions.

We are subject to various legal proceedings that are discussed in our Annual Report on Form 10-K/A for the fiscal year ended January 3, 2006.

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## 8. Segment Information

We operate in two business segments – restaurants and bakery. Restaurants include both The Cheesecake Factory and Grand Lux Cafe, which have similar investment criteria and economic and operating characteristics. The bakery segment produces baked desserts and other products for our restaurants and for other foodservice operators, retailers and distributors. Bakery sales to the restaurants are recorded at prices similar to third-party national accounts. Unallocated corporate expenses, which include all stock-based compensation, are presented below as reconciling items to the amounts presented in the consolidated financial statements.

Segment information is presented below (in thousands):

	<b>Thirteen Weeks Ended October 3, 2006</b>	<b>Thirteen Weeks Ended September 27, 2005</b>	<b>Thirty-Nine Weeks Ended October 3, 2006</b>	<b>Thirty-Nine Weeks Ended September 27, 2005</b>
	(restated)	(restated)	(restated)	(restated)
<b>Revenue:</b>				
Restaurants	\$ 311,627	\$ 282,537	\$ 913,633	\$ 813,344
Bakery	24,495	23,368	71,198	66,957
Intercompany bakery sales	(10,785 )	(9,032 )	(30,202 )	(26,868 )
Total	\$ 325,337	\$ 296,873	\$ 954,629	\$ 853,433
<b>Income from operations:</b>				
Restaurants	\$ 40,731	\$ 44,534	\$ 127,796	\$ 124,251
Bakery	3,936	4,517	10,779	11,182
Corporate	(20,005 )	(14,122 )	(55,392 )	(38,451 )
Total	\$ 24,662	\$ 34,929	\$ 83,183	\$ 96,982
<b>Depreciation and amortization:</b>				
Restaurants	\$ 11,922	\$ 10,130	\$ 34,681	\$ 28,599
Bakery	686	466	1,658	1,353
Corporate	857	790	2,520	2,291
Total	\$ 13,465	\$ 11,386	\$ 38,859	\$ 32,243
<b>Capital expenditures:</b>				
Restaurants	\$ 65,064	\$ 50,335	\$ 118,169	\$ 100,765
Bakery	607	170	7,215	3,294
Corporate	886	2,147	3,052	7,711
Total	\$ 66,557	\$ 52,652	\$ 128,436	\$ 111,770
	<b>October 3, 2006</b>	<b>January 3, 2006 (restated)</b>		
<b>Total assets:</b>				
Restaurants	\$ 708,583	\$ 619,814		
Bakery	55,835	44,305		
Corporate	220,252	262,131		
Total	\$ 984,670	\$ 926,250		

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

Certain information included in this Form 10-Q and other materials filed or to be filed by us with the Securities and Exchange Commission, in press releases and other written communications and in oral or written statements made by or with the approval of one of our authorized officers, may contain forward-looking statements about our current and expected performance trends, growth plans, business goals and other matters. Words or phrases such as believe, plan, will likely result, expect, intend, will continue, is anticipated, estimate, project, should, and similar expressions are intended to identify forward-looking statements. These statements, and any other statements that are not historical facts, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as codified in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended from time to time (the "Act").

In connection with the safe harbor provisions of the Act, we have identified and filed important factors, risks and uncertainties that could cause our actual results to differ materially from those projected in forward-looking statements made by us, or on our behalf (see Part I, Item 1A, Risk Factors included in our Form 10-K/A for the fiscal year ended January 3, 2006 and Part II, Item 1A of this Form 10-Q). These cautionary statements are to be used as a reference in connection with any forward-looking statements. The factors, risks and uncertainties identified in these cautionary statements are in addition to those contained in any other cautionary statements, written or oral, which may be made or otherwise addressed in connection with a forward-looking statement or contained in any of our subsequent filings with the Securities and Exchange Commission. Because of these factors, risks and uncertainties, we caution against placing undue reliance on forward-looking statements. Although we believe that the assumptions underlying forward-looking statements are reasonable, any of the assumptions could be incorrect, and there can be no assurance that forward-looking statements will prove to be accurate. Forward-looking statements speak only as of the date on which they are made. We do not undertake any obligation to modify or revise any forward-looking statement to take into account or otherwise reflect subsequent events or circumstances arising after the date that the forward-looking statement was made.

**Restatement of Financial Statement due to Review of Stock Option Grants and Procedures**

On July 18, 2006, we announced that the Audit Committee of our Board of Directors, which is comprised solely of independent directors, was reviewing the Company's practices relating to its stock option grants with the assistance of special outside legal counsel from the law firm of Cooley Godward Kronish LLP. This voluntary review was initiated in response to media and Wall Street reports regarding the option granting practices at numerous publicly traded companies.

**On November 20, 2006, we announced the conclusion of the Audit Committee's review, which covered the period beginning with the Company's initial public offering registration in 1992 to the present. The Audit Committee reported that its special counsel received full cooperation from Company management, was given complete access to all necessary and relevant electronic and other documents, and interviewed all persons involved in the stock option granting process at the Company, as well as the Company's advisors.**

While the review resulted in a conclusion that until 2002, and in some cases after, we incorrectly followed date selection methodologies that were generally limited to 30-day time windows, the Audit Committee found no evidence that any person acted with an intent to deceive or mislead, and did not recommend termination of any current Company management or the resignation of any member of our Board of Directors. However, the Audit Committee did recommend, among other matters, that we obtain reimbursement from the Company's Chief Executive Officer and former Chief Financial Officer, who had oversight responsibility for the stock option granting process, as well as from those members of the Compensation Committee of our Board of Directors who received misdated options, in an amount equal to the difference between the stock option proceeds received and the proceeds that would have been received had the proper measurement dates been used, and that any unexercised stock option grants be treated in the same manner. We will seek reimbursement totaling approximately \$1 million from these individuals. All of the affected individuals have indicated that they intend to comply with the Audit Committee's recommendation.

**In addition, the Audit Committee recommended that we implement the following Corporate Governance enhancements, all of which we are adopting:**

- Increase the size of the Board of Directors by at least one additional member (preferably two additional members);
- Create a position of Chief Compliance Officer;
- Implement more robust stock option granting practices, including approval of all equity-related compensation by the Compensation Committee of the Board of Directors only on regularly scheduled review dates;
- Implement tighter controls over the use of unanimous written consents;
- Revise the Board of Directors' compensation arrangements to provide competitive compensation with less emphasis on equity compensation and an automatic mechanism for stock option grants; and
- Evaluate the legal department's resources.

Based upon the Audit Committee's findings, we concluded that we selected the grant date of options based upon the lowest price, generally within a 30-day window because we incorrectly believed that the applicable accounting guidance allowed us to establish the grant date within a certain window from authorization. As a result, we incorrectly applied the measurement date, as defined in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," with respect to certain option grants made to executive officers in fiscal years 1997 through 2001, to non-executive officers and other employees in fiscal years 1997 through 2004, and to outside directors in fiscal years 2000 and 2001. Because we incorrectly selected grant dates which resulted in a cumulative adjustment of \$5.4 million expense on an after-tax basis through fiscal 2005, we amended our Annual Report on Form 10-K for the fiscal year ended January 3, 2006 to restate the Consolidated Balance Sheets at January 3, 2006 and December 28, 2004 and the Consolidated Statements of Operations, Stockholders' Equity and Cash Flows for the years ended January 3, 2006, December 28, 2004 and December 30, 2003. We also restated the Consolidated Balance Sheet at April 4, 2006 and the Consolidated Statements of Operations, Stockholders' Equity and Cash Flows for the quarterly periods ended April 4, 2006 and March 29, 2005. These restated financial statements are included in the Quarterly Report on Form 10-Q/A for the quarter ended April 4, 2006. Throughout this Form 10-Q, all referenced amounts for prior periods and prior period comparisons reflect the balances and amounts on a restated basis. We did not amend and do not intend to amend any other previously filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods prior to January 1, 2003.

We are considering the application of Section 409A of the Internal Revenue Code to those options for which we incorrectly applied the measurement date as defined in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." It is possible that these options will not be treated as having been granted at fair market value for federal income tax purposes and thus subject to Section 409A. Accordingly, we may adopt remedial measures to address the application of Section 409A. We do not currently know what impact of any remedial measures, if adopted, would have on our results of operations, financial position or cash flows.

#### **Administrative Proceedings and Pending Litigation Related to Options Misdating**

Following our announcement of the Audit Committee's review of our historical stock option granting practices, we received an informal request for information from the staff of the Los Angeles regional office of the Securities and Exchange Commission (SEC) regarding our stock option granting practices. We are cooperating fully with the SEC in connection with its informal inquiry. We do not know when this inquiry will be resolved or what, if any, actions the SEC may take as a result of this inquiry. Response to this inquiry could require expenditure of significant financial resources and an unfavorable outcome could require us to pay damages or penalties, or result in other remedies imposed upon us, any of which could have a material adverse affect our business, results of operations, financial position and cash flows.

In addition, we and certain of our directors and current and former officers are defendants in eight shareholder derivative actions relating to our stock option granting practices.

These actions are in preliminary stages and we cannot provide assurance that their ultimate outcome will not have a material adverse effect on our business, financial condition, results of operations or cash flows.

On August 17, 2006, we received an initial Staff Determination letter from The Nasdaq Stock Market indicating that we are not in compliance with the filing requirements for continued listing under Marketplace Rule 4310(c)(14) due to the delayed filing of our Quarterly Report on Form 10-Q for the quarter ended April 4, 2006. We filed a notice of appeal of the staff determination and a hearing was held on September 27, 2006. No decision has been rendered to date. On November 15, 2006, we received an additional staff determination letter stating that our failure to file our Quarterly Report on Form 10-Q for the quarter ended October 3, 2006 is an additional basis for delisting. Until a decision is made by the Nasdaq Listing Qualifications Panel, the Company's common stock will remain listed on The Nasdaq Global Select Market. There can be no assurance that the Panel will grant the Company's request for continued listing.

#### **Correction of Other Matters**

As part of the restatement process resulting from the review of our stock option granting practices, we assessed generally whether there were other matters, which should be corrected in our previously issued financial statements. We concluded that three additional errors should be corrected.

- We recognize a liability upon the sale of a gift card and recognize revenue when the gift card is redeemed in our restaurants or on our website. Beginning in 2001, we adjusted the gift card liability upon the sale of a gift card for the estimated portion of the gift card value that would not be redeemed (breakage). We have now determined that the appropriate accounting is to record breakage ratably over the estimated time period that our gift cards are generally redeemed and that no breakage should be recognized until there is sufficient history to establish the estimated redemption period. As a result, we are restating the periods 2001 through the second quarter of 2005 to reverse breakage that was previously recognized since we did not have sufficient data to estimate the redemption periods. For the third and fourth quarters of 2005, we are restating to recognize breakage both cumulatively and prospectively over a thirty-six month period based on an ability to estimate breakage due to a full cycle of redemptions being tracked since 2002. As part of this restatement, we are also correcting our classification of breakage income. The adjustment to the gift card liability account for breakage was previously classified as a reduction of general and administrative expenses in our consolidated statements of operations. As part of this restatement, we are reclassifying gift card breakage to revenue. The impact of these breakage related adjustments was an understatement of net income by \$1.1 million in fiscal 2005 and an overstatement of net income by \$0.4 million and \$0.7 million in fiscal 2004 and 2003, respectively, and an understatement of other accrued expenses of \$1.7 million and \$3.4 million at January 3, 2006 and December 28, 2004, respectively. Net income for the first quarter of fiscal 2006 was understated by \$0.1 million.
- We previously recorded expense for our operations bonuses on a one-quarter lag. While our Consolidated Statements of Operations reflected four quarters of bonus-related expense, our Consolidated Balance Sheet did not reflect the accrued bonus liability for the most recent quarter. The impact of this error was an overstatement of net income by \$0.2 million, \$0.1 million and \$0.2 million in fiscal 2005, 2004 and 2003, respectively, and an understatement of other accrued expenses of \$1.6 million and \$1.3 million at January 3, 2006 and December 28, 2004, respectively. Net income for the first quarter of fiscal 2006 was understated by \$0.1 million.
- Historically, we did not amortize the cost of liquor licenses as we had considered them indefinite-lived assets. We have now concluded that certain liquor licenses are not transferable and therefore have finite lives corresponding with the terms of the related operating lease. These non-transferable liquor licenses are now amortized over the primary lease terms of the respective leases plus any exercised extensions of those lease terms. The impact of this error was an overstatement of net income by \$27,000, \$25,000 and \$22,000 in fiscal 2005, 2004 and 2003, respectively, and an overstatement of other assets of \$0.2 million at both January 3, 2006 and December 28, 2004. Net income for the first quarter of fiscal 2006 was overstated by \$8,000.

The aggregate adjustments increased net income by \$0.4 million in fiscal year 2005 and reduced net income by \$1.2 million and \$1.6 million in fiscal years 2004 and 2003, respectively. Net income for the first quarter of fiscal 2006 increased by \$6,000. Diluted net income per share increased by \$0.01 for the year ended January 3, 2006 and decreased by \$0.02 and \$0.03 for the years ended December 28, 2004 and December 30, 2003, respectively, and was unchanged for the first quarter of fiscal 2006.

The restatement also resulted in a \$5.2 million, or 2.8%, reduction in retained earnings as of December 31, 2002. The restatement adjustments were non-cash and had no impact on net cash flow.

### **General**

This discussion and analysis should be read in conjunction with our interim unaudited consolidated financial statements and related notes included in this Form 10-Q and the audited consolidated financial statements and related notes thereto included in our Form 10-K/A for the fiscal year ended January 3, 2006. The inclusion of supplementary analytical and related information herein may require us to make appropriate estimates and assumptions to enable us to fairly present, in all material respects, our analysis of trends and expectations with respect to our results of operations and financial position taken as a whole.

Refer to Part II, Item 1A, Risk Factors of this report and Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K/A for the fiscal year ended January 3, 2006 filed with the Securities and Exchange Commission for a description of risk factors that could materially affect our business, financial condition or future results.

As of December 1, 2006, we operated 118 upscale, high-volume, casual dining restaurants under The Cheesecake Factory® mark. We also operated eight upscale, casual dining restaurants under the Grand Lux Cafe® mark; one self-service, limited menu express foodservice operation under The Cheesecake Factory Express® mark inside the DisneyQuest® family entertainment center in Orlando, Florida; and two bakery production facilities. We also licensed two limited menu bakery cafes under The Cheesecake Factory Bakery Cafe® mark to another foodservice operator.

Our revenues consist of sales from our restaurant operations and sales from our bakery operations to other foodservice operators, retailers and distributors ( bakery sales ). Revenues from restaurant sales are recognized when payment is tendered at the point of sale. Revenues from bakery sales to other foodservice operators, retailers and distributors are recognized upon transfer of title to customers. We recognize a liability upon the sale of our gift cards and recognize revenue when these gift cards are redeemed in our restaurants or on our website. We adjust our gift card liability based on historical and expected non-redemption trends. These adjustments are classified as revenues in our consolidated statement of operations.

New restaurants become eligible to enter our comparable sales calculations in their 19th month of operation. We utilize a 52/53-week fiscal year ending on the Tuesday closest to December 31st for financial reporting purposes. Fiscal 2006 will consist of 52 weeks and will end on January 2, 2007. Fiscal 2005 consisted of 53 weeks and ended on January 3, 2006.

The Cheesecake Factory is an upscale, casual dining concept that offers approximately 200 menu items including appetizers, pizza, seafood, steaks, chicken, burgers, pasta, specialty items, salads, sandwiches, omelets and desserts, including approximately 40 varieties of cheesecake and other baked desserts. Grand Lux Cafe is also an upscale, casual dining concept offering approximately 150 menu items. In contrast to many chain restaurant operations, substantially all of our menu items (except desserts manufactured at our bakery production facility) are prepared on the restaurant premises using high quality, fresh ingredients based on innovative and proprietary recipes. We believe our restaurants are recognized by consumers for offering exceptional value with generous food portions at moderate prices. Our restaurants distinctive, contemporary design and decor create a high-energy ambiance in a casual setting. Our restaurants currently range in size from 5,400 to 21,000 interior square feet, provide full liquor service and are generally open seven days a week for lunch and dinner, as well as Sunday brunch.

### **Overview**

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In addition to being highly competitive, the restaurant industry is often affected by changes in consumer tastes and discretionary spending patterns; changes in general economic conditions; public safety conditions; demographic trends; weather conditions; the cost and availability of raw materials, labor and energy; purchasing power; and governmental regulations.

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Accordingly, as part of our strategy we must constantly evolve and refine the critical elements of our restaurant concepts to protect their longer-term competitiveness and to maintain and enhance the strength of our brand. Our strategy is to continue to provide guests with exceptional value through a broad menu of freshly prepared, high quality and large portion appetizers, entrees and desserts at moderate prices in an upscale, casual setting. Operationally, we strive to improve productivity and efficiency through the use of technology and a commitment to selecting, training and retaining high quality employees.

In evaluating and assessing the performance of our business, we believe the following are key performance indicators that should be taken into consideration:

- *New Restaurant Openings.* We intend to continue developing The Cheesecake Factory and Grand Lux Cafe restaurants in high profile locations within densely populated areas in both existing and new markets. Since most of our established restaurants currently operate close to full capacity during the peak demand periods of lunch and dinner, and given our relatively high average sales per productive square foot, we generally do not expect to achieve increases in comparable sales other than our effective menu price increases. Therefore, we expect that the majority of our year-over-year revenue growth will come from new restaurant openings. We have opened new restaurants at a compounded annual growth rate of approximately 26% in the 13 years that we have been a public company. Based on our review of demographic market data in the U.S. today, we estimate that there is an opportunity to open as many as 200 Cheesecake Factory restaurants and as many as 150 Grand Lux Cafes in the U.S. In fiscal 2005, we opened 18 new restaurants, including two Grand Lux Cafes. In fiscal 2006, we expect to open as many as 21 new restaurants, including one Grand Lux Cafe.
- *General and Administrative Expenses Expressed as a Percentage of Revenues.* Leveraging our restaurant and bakery support infrastructure will allow us to grow general and administrative expenses at a slightly slower rate than revenue growth over the longer-term. During fiscal 2006, we plan to continue to add resources to the corporate support, training and field supervision activities of our business, in conjunction with the planned openings of as many as 21 new restaurants during the year.
- *Income from Operations Expressed as a Percentage of Revenues ( Operating Margins ).* Operating margins are subject to fluctuations in commodity costs, labor, other operating costs, such as restaurant-level occupancy expenses, and preopening expenses. Our objective is to gradually increase our operating margin to 12% on a sustained basis, before the impact of stock option expensing, by continuing our focus on superior guest service and by capturing economies of scale and fixed cost leverage, as well as maximizing our purchasing power as we continue to grow our business

## Results of Operations

The following table sets forth, for the periods indicated, our Consolidated Statements of Operations expressed as percentages of revenues. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full fiscal year. The thirteen and thirty-nine weeks ended October 3, 2006 included \$4.3 million, or 1.3% of revenues, and \$13.1 million, or 1.4% of revenues, respectively, of stock-based compensation expense related to our fiscal 2006 adoption of SFAS 123R. This amount impacted labor expenses and general and administrative expenses by 0.5% and 0.8%, respectively, for both the thirteen and thirty-nine weeks ended October 3, 2006. Other operating costs and expenses and preopening costs were impacted by less than 0.1% and 0.1% on a combined basis for the thirteen and thirty-nine weeks ended October 3, 2006, respectively.

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	Thirteen Weeks Ended October 3, 2006	Thirteen Weeks Ended September 27, 2005 (restated)	Thirty-Nine Weeks Ended October 3, 2006	Thirty-Nine Weeks Ended September 27, 2005 (restated)	
	100.0	% 100.0	% 100.0	% 100.0	%
<b>Revenues</b>					
Costs and expenses:					
Cost of sales	25.0	25.2	25.0	25.5	
Labor expenses	32.3	30.6	32.1	30.9	
Other operating costs and expenses	23.7	22.6	23.4	22.7	
General and administrative expenses	5.7	4.7	5.3	4.5	
Depreciation and amortization expenses	4.1	3.8	4.1	3.8	
Preopening costs	1.6	1.3	1.4	1.2	
Total costs and expenses	92.4	88.2	91.3	88.6	
Income from operations	7.6	11.8	8.7	11.4	
Interest income, net	0.3	0.4	0.4	0.3	
Other income, net	0.1	0.0	0.2	0.0	
Income before income taxes	8.0	12.2	9.3	11.7	
Income tax provision	2.4	4.2	2.9	4.0	
Net income	5.6	% 8.0	% 6.4	% 7.7	%

**Thirteen Weeks Ended October 3, 2006 Compared to Thirteen Weeks Ended September 27, 2005**

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### *Revenues*

Revenues increased 10% to \$325.3 million for the thirteen weeks ended October 3, 2006 compared to \$296.9 million for the thirteen weeks ended September 27, 2005.

Restaurant sales increased 10% to \$311.6 million compared to \$282.5 million for the same period of the prior year. The resulting sales increase of \$29.1 million consisted of a \$4.0 million, or a 1.6%, decrease in comparable restaurant sales and \$33.1 million increase from restaurants not in the comparable sales base. The decrease in comparable restaurant sales was driven primarily by a reduction in guest traffic at The Cheesecake Factory restaurants.

Comparable sales at The Cheesecake Factory restaurants decreased approximately 2.1%. We implemented an approximate 1% effective menu price increase during January and February 2006. Since most of our established restaurants usually operate close to full capacity during the peak demand periods of lunch and dinner, we generally expect to achieve increases in comparable restaurant sales over the long-term in the range of our effective menu price increases.

Comparable sales at the Grand Lux Cafes increased approximately 6.7% and benefited in part from an approximate 2% effective menu price increase implemented in October 2005. Since Grand Lux Cafe is a relatively newer concept and still building its customer base, we expect comparable sales growth to outpace menu price increases for the foreseeable future.

As a result of the openings of new restaurants during the past twelve months, total restaurant operating weeks increased 15% to 1,509 for the thirteen weeks ended October 3, 2006. Average sales per restaurant operating week decreased 3% to \$206,000 compared to \$212,700 for the same period last year. This decrease in average weekly sales is due principally to two factors. First, as reflected in our comparable sales results, we have experienced a decrease in traffic at our restaurants. Second, the majority of our new restaurants over the past 12 months have opened in markets where we already have a presence. In these instances, we do not expect to achieve significant grand opening or "honeymoon" sales levels.

During 2006, our goal is to open as many as 21 restaurants, including one Grand Lux Cafe. Seven new Cheesecake Factory restaurants and one new Grand Lux Cafe opened through the third quarter of fiscal 2006, including two during the first quarter, two in the second quarter and four in the third quarter. Although it is difficult for us to predict the timing of our new restaurant openings by quarter, due to the nature of our leased restaurant locations and our highly customized layouts, our current plans call for as many as 13 new restaurant openings in the fourth quarter. Based on this opening schedule, we plan to achieve approximately 18% square footage growth in fiscal 2006. However, since many of these openings are late in the year, we will not realize their full benefit until fiscal 2007. We currently project our operating week growth in fiscal 2006 compared to fiscal 2005 on a 52-week basis to be approximately 14%.

We presently update and reprint the menus in our restaurants twice a year. For Cheesecake Factory restaurants, these updates generally occur during January and February (the winter menu change) and during July and August (the summer menu change). For our 2006 winter menu change, we implemented an approximate 1% effective menu price increase for the purpose of offsetting those operating cost and expense increases that were known or expected as of January 2006. Our 2006 summer menu change was completed by mid-August, but does not include any price increase. All potential menu price increases must be carefully considered in light of their ultimate acceptability by our restaurant guests. Additionally, other factors outside of our control, such as inclement weather, holidays, general economic and competitive conditions and other factors referenced in the Annual Report on Form 10-K/A for the year ended January 3, 2006 can impact comparable sales comparisons. Accordingly, there can be no assurance that increases in comparable sales will be achieved.

Bakery sales to other foodservice operators, retailers and distributors (bakery sales) decreased 4% to \$13.7 million for the thirteen weeks ended October 3, 2006 compared to \$14.3 million for the comparable period of the prior year. This decrease was primarily due to the timing of sales to our warehouse club customers, which accounted for approximately 71% of total bakery sales in both the current period and the comparable period of the prior year.

We strive to develop and maintain long-term, growing relationships with our bakery customers, based largely on our 33-year reputation for producing high quality, creative baked desserts. However, bakery sales volumes will always be less predictable than our restaurant sales. It is difficult to predict the timing of bakery product shipments and contribution margins on a quarterly basis. Additionally, the purchasing plans of our large-account customers may fluctuate from quarter to quarter. Due to the highly competitive nature of the bakery business, we are unable to enter into long-term contracts with our large-account bakery customers, who may discontinue purchasing our products without advance notice at any time for any reason. Our objective for 2006 is to grow bakery sales in the range of 7% to 8% for the year.

#### *Cost of Sales*

Cost of sales increased 9% to \$81.4 million for the thirteen weeks ended October 3, 2006, compared to \$74.7 million for the comparable period last year. The related increase of \$6.7 million was primarily attributable to the 10% increase in revenues. As a percentage of revenues, these costs decreased to 25.0% compared to 25.2% for the same period of the prior year.

The menu at our restaurants is one of the most diversified in the foodservice industry and, accordingly, is not overly dependent on a single commodity. Changes in costs for one commodity are often, but not always, counterbalanced by cost changes in other commodity categories. The principal commodity categories for our restaurants include fresh produce, poultry, meat, fish and seafood, cheese, other fresh dairy products, bread and general grocery items. We experienced considerable improvement in poultry commodities compared to the third quarter of the prior year.

We are currently able to contract for the majority of the food commodities used in our operations for periods up to one year. With the exception of cream cheese used in our bakery operations, many of the fresh commodities, such as fish, dairy, and certain produce and poultry products are not currently contractible for periods longer than 30 days in most cases. As a result, these fresh commodities can be subject to unforeseen supply and cost fluctuations due principally to weather and other general agricultural conditions. We have entered into agreements with suppliers for those expected commodity requirements for fiscal 2006 that can be contracted. Cream cheese is the most significant commodity used in our bakery products, with an expected requirement of as much as 13 million to 14 million pounds during fiscal 2006. We have contracted for the majority of our cream cheese requirements for fiscal 2006 at a fixed cost per pound that is slightly lower than the actual cost per pound in fiscal 2005. We will also purchase cream cheese on the spot market as necessary to supplement our agreements.

As has been our past practice, we will carefully consider opportunities to introduce new menu items and implement selected menu price increases to help offset expected cost increases for key commodities and other goods and services utilized by our operations. While we have been successful in the past in reacting to inflation and other changes in the costs of key operating resources by gradually increasing prices for our menu items, coupled with more efficient purchasing practices, productivity improvements and greater economies of scale, there can be no assurance that we will be able to continue to do so in the future.

While we have taken steps to qualify multiple suppliers and enter into agreements for some of the key commodities used in our operations, there can be no assurance that future supplies and costs for commodities used in our operations will not fluctuate due to weather and other market conditions outside of our control. For new restaurants, cost of sales will typically be higher than normal during the first 90 to 120 days of operations until our management team at each new restaurant becomes more accustomed to optimally predicting, managing and servicing the high sales volumes typically experienced by our restaurants. We plan to open as many as 13 new restaurants in the fourth quarter of fiscal 2006.

#### *Labor Expenses*

Labor expenses, which include restaurant-level labor costs and bakery direct production labor, including associated fringe benefits, increased 15% to \$104.9 million for the thirteen weeks ended October 3, 2006 compared to \$91.0 million for the same period of the prior year. This increase was principally due to the impact of new restaurant openings. As a percentage of revenues, labor expenses increased to 32.3% versus 30.6% for the comparable period last year. The thirteen weeks ended October 3, 2006 included \$1.7 million, or 0.5% of revenues, of stock-based compensation expense related to our fiscal 2006 adoption of SFAS 123R. While we manage our labor judiciously to adapt to revenue fluctuations, we expect to experience some de-leveraging of labor costs at lower sales levels as we are committed to delivering the level of service our guests expect while still achieving reasonable labor costs. For new restaurants, labor expenses will typically be higher than normal during the first 90 to 120 days of operations until our management team at each new restaurant becomes more accustomed to optimally predicting, managing and servicing the high sales volumes typically experienced by our restaurants. We plan to open as many as 13 new restaurants in the fourth quarter of fiscal 2006.

#### *Other Operating Costs and Expenses*

Other operating costs and expenses consist of restaurant-level occupancy expenses (rent, insurance, licenses, taxes and utilities), other operating expenses (excluding food costs and labor expenses reported separately) and bakery production overhead, selling and distribution expenses. Other operating costs and expenses increased 15% to \$77.1 million for the thirteen weeks ended October 3, 2006 compared to \$67.1 million for the same period of the prior year. This increase was principally attributable to the 10% increase in revenues. As a percentage of revenues, other operating costs and expenses increased to 23.7% for the thirteen weeks ended October 3, 2006 versus 22.6% for the same period of fiscal 2005. Increased utility costs and the de-leveraging of fixed cost maintenance contracts due to lower sales at our restaurants accounted for the majority of this increase. We currently expect the increased level of utility costs to continue throughout fiscal 2006. The third quarter of 2006 also included \$0.1 million of stock-based compensation expense.

#### *General and Administrative Expenses*

General and administrative ( G&A ) expenses increased 30% to \$18.4 million for the thirteen weeks ended October 3, 2006 compared to \$14.1 million for the same period of fiscal 2005. As a percentage of total revenues, G&A expenses increased to 5.7% for the thirteen weeks ended October 3, 2006 versus 4.7% for the same period of fiscal 2005. This percentage increase was principally due to the addition of \$2.5 million, or 0.8% of revenues, in stock-based compensation expense related to our fiscal 2006 adoption of SFAS 123R and approximately \$1.0 million, or 0.3% of revenues, of professional fees associated with the review of stock option grants discussed in Part I, Item I, Note 1 of Notes to Consolidated Financial Statements.

G&A expenses consist of the restaurant management recruiting and training program, the restaurant field supervision organization, the bakery administrative organization and the corporate support organization. During the remainder of fiscal 2006, we plan to continue to add resources to the corporate support, training and field supervision activities of our operations, commensurate with the planned openings of as many as 21 new restaurants during fiscal 2006.

*Depreciation and Amortization Expenses*

Depreciation and amortization expenses increased 18% to \$13.5 million for the thirteen weeks ended October 3, 2006 compared to \$11.4 million for the thirteen weeks ended September 27, 2005. This increase was principally due to property and equipment additions associated with new restaurant openings. As a percentage of revenues, depreciation and amortization increased to 4.1% for the thirteen weeks ended October 3, 2006 compared to 3.8% for the same period of fiscal 2005.

*Preopening Costs*

Preopening costs increased to \$5.4 million for the thirteen weeks ended October 3, 2006 compared to \$3.8 million for the same period of the prior year. We opened three Cheesecake Factory restaurants and one Grand Lux Cafe during the thirteen weeks ended October 3, 2006 compared to three Cheesecake Factory restaurants openings for the same quarter last year. In addition, preopening costs were incurred in both periods for restaurant openings in progress. The third quarter of 2006 included less than \$0.1 million of stock-based compensation expense.

As a result of the highly customized and operationally complex nature of our upscale, high-volume concepts, the restaurant preopening process for our new restaurants is more extensive, time consuming and costly relative to that of most chain restaurant operations. The preopening costs for one of our restaurants usually includes costs to relocate and compensate an average of 12 to 13 restaurant management employees prior to opening; costs to recruit and train an average of 250 to 300 hourly restaurant employees; wages, travel and lodging costs for our opening training team and other support employees; costs for practice services activities, and straight-line base rent during the in-restaurant training period. Preopening costs will vary from location to location depending on a number of factors, including the proximity of our existing restaurants; the size and physical layout of each location; the number of management and hourly employees required to open each restaurant; the relative difficulty of the restaurant staffing process; the cost of travel to and lodging for different metropolitan areas; and the extent of unexpected delay, if any, in construction and/or obtaining final licenses and permits to open the restaurant, which may also be caused by landlord delays.

Our direct preopening costs for a typical single-story Cheesecake Factory restaurant in one of our established markets averages approximately \$785,000. There will also be other preopening costs associated with each restaurant opening, including costs for corporate travel and support activities. Preopening costs will usually be higher for larger restaurants, our initial entry into new markets and for new concepts such as Grand Lux Cafe, for which we currently expect preopening costs to run 10% to 15% higher than for The Cheesecake Factory restaurants. We usually incur the most significant portion of preopening costs for a typical restaurant opening within the two-month period immediately preceding and the month of the restaurant's opening. Preopening costs are expensed as incurred and fluctuate from period to period, based on the number and timing of restaurant openings and the specific preopening costs incurred for each restaurant, and the fluctuations could be significant.

Based on our planned openings of as many as 13 additional new restaurants during the fourth quarter of the year preopening costs will be higher during the remainder of fiscal 2006 compared to the prior year.

*Interest Income, Net, Other Income and Income Tax Provision*

Interest income, net, decreased to \$1.0 million for the thirteen weeks ended October 3, 2006 compared to \$1.1 million for the comparable prior year period due to lower investment balances stemming primarily from stock repurchases during the second quarter of fiscal 2006. We generally invest our excess cash balances in U.S Treasury and government agency securities, investment grade corporate debt securities rated "A" or better and money market mutual funds. In addition, we recorded interest expense of approximately \$0.5 million and \$0.2 million for the thirteen weeks ended October 3, 2006 and September 27, 2005, respectively, associated with landlord construction allowances deemed to be financing in accordance with EITF 97-10, "The Effect of Lessee Involvement in Asset Construction" (See Notes to Consolidated Financial Statements included in our Form 10-K/A for the fiscal year ended January 3, 2006).

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Other income was \$0.2 million and \$0.1 million for the thirteen weeks ended October 3, 2006 and September 27, 2005, respectively.

Our effective income tax rate was 29.9% for the thirteen weeks ended October 3, 2006 compared with 34.8% for the comparable prior year period. We currently estimate our effective tax rate to be approximately 31% for the full year. However, the actual effective tax rate may be different than our current estimate due to actual revenues, pretax income and tax credits achieved during the year.

**Thirty-Nine Weeks Ended October 3, 2006 Compared to Thirty-Nine Weeks Ended September 27, 2005**

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### *Revenues*

Revenues increased 12% to \$954.6 million for the thirty-nine weeks ended October 3, 2006 compared to \$853.4 million for the thirty-nine weeks ended September 27, 2005.

Restaurant sales increased 12% to \$913.6 million compared to \$813.3 million for the same period of the prior year. The resulting sales increase of \$100.3 million consisted of an \$8.3 million, or a 1.2%, decrease in comparable restaurant sales and \$108.6 million increase from restaurants not in the comparable sales base. The decrease in comparable restaurant sales was driven primarily by a reduction in guest traffic at The Cheesecake Factory restaurants.

Comparable sales at The Cheesecake Factory restaurants decreased approximately 1.6%. We implemented an approximate 1% effective menu price increase during January and February 2006 and no effective menu price increase during July and August 2006. Comparable sales at the Grand Lux Cafes increased approximately 5.4% and benefited in part from an approximate 2% effective menu price increase implemented in October 2005.

Bakery sales to other foodservice operators, retailers and distributors ( bakery sales ) increased 2% to \$41.0 million for the thirty-nine weeks ended October 3, 2006 compared to \$40.1 million for the comparable period of the prior year. This increase was primarily due to higher sales to our warehouse club customers, which accounted for approximately 72% of total bakery sales in the current period compared to approximately 68% for the same period of the prior year.

### *Cost of Sales*

During the thirty-nine weeks ended October 3, 2006, cost of sales increased 10% to \$238.7 million compared to \$217.9 million for the comparable period last year. This related increase of \$20.8 million was primarily attributable to the increase in revenues. As a percentage of revenues, these costs decreased to 25.0% compared to 25.5% for the same period of the prior year. This decrease was primarily attributable to reduced costs compared to the prior year for a variety of commodities used in our restaurants, particularly poultry.

### *Labor Expenses*

Labor expenses increased 16% to \$306.6 million for the thirty-nine weeks ended October 3, 2006 compared to \$263.9 million for the same period of the prior year. The related increase of \$42.7 million was principally related to the increase in revenues. As a percentage of revenues, labor expenses for the thirty-nine weeks ended October 3, 2006 increased to 32.1% compared to 30.9% for the comparable period last year. While we manage our labor judiciously to adapt to revenue fluctuations, we expect to experience some de-leveraging of labor costs at lower sales levels as we are committed to delivering the level of service our guests expect while still achieving reasonable labor costs.

The thirty-nine weeks ended October 3, 2006 also included \$4.8 million, or 0.5% of revenues, of stock-based compensation expense related to our fiscal 2006 adoption of SFAS 123R.

*Other Operating Costs and Expenses*

Other operating costs and expenses increased 15% to \$223.4 million for the thirty-nine weeks ended October 3, 2006 compared to \$193.5 million for the same period of the prior year. The related increase was principally attributable to the increase in revenues. As a percentage of revenues, other operating costs and expenses increased to 23.4% for the thirty-nine weeks ended October 3, 2006 versus 22.7% for the same period of fiscal 2005. Increased utility costs and the de-leveraging of fixed cost maintenance contracts due to lower sales at our restaurants accounted for the majority of this increase. We currently expect the increased level of utility costs to continue throughout fiscal 2006. The thirty-nine weeks ended October 3, 2006 also included \$0.3 million of stock-based compensation expense.

*General and Administrative Expenses*

General and administrative ( G&A ) expenses increased 32% to \$50.9 million for the thirty-nine weeks ended October 3, 2006 compared to \$38.5 million for the same period of fiscal 2005. As a percentage of total revenues, G&A expenses increased to 5.3% for the thirty-nine weeks ended October 3, 2006 versus 4.5% for the same period of fiscal 2005. This percentage increase was principally due to the addition of \$7.8 million, or 0.8% of revenues, in stock-based compensation expense related to our fiscal 2006 adoption of SFAS 123R and approximately \$1.0 million, or 0.1% of revenues, of professional fees associated with the review of stock option grants discussed in Part I, Item I, Note 1 of Notes to Consolidated Financial Statements.

*Depreciation and Amortization Expenses*

Depreciation and amortization expenses increased 21% to \$38.9 million for the thirty-nine weeks ended October 3, 2006 compared to \$32.2 million for the thirty-nine weeks ended September 27, 2005. The related increase was principally due to property and equipment additions associated with new restaurant openings. As a percentage of total revenues, depreciation and amortization increased to 4.1% for the thirty-nine weeks ended October 3, 2006 compared to 3.8% for the same period of fiscal 2005.

*Preopening Costs*

Preopening costs increased to \$12.9 million for the thirty-nine weeks ended October 3, 2006 compared to \$10.3 million for the same period of the prior year. We incurred preopening costs to open seven Cheesecake Factory restaurants, one Grand Lux Cafe and a new bakery production facility during the thirty-nine weeks ended October 3, 2006 compared to nine Cheesecake Factory restaurant openings for the same quarter last year. In addition, preopening costs were incurred in both periods for restaurant openings in progress. The thirty-nine weeks ended October 3, 2006 included \$0.2 million of stock-based compensation expense.

*Interest Income, Net, Other Income and Income Tax Provision*

Interest income, net, increased to \$3.5 million for the thirty-nine weeks ended October 3, 2006 compared to \$2.9 million for the comparable prior year period due to an increase in the general level of interest rates, partially offset by lower investment balances due to treasury stock purchases during the second quarter of fiscal 2006. In addition, we recorded interest expense of approximately \$1.3 million for the thirty-nine weeks ended October 3, 2006 versus \$0.6 million for the comparable prior year period associated with landlord construction allowances deemed to be financing in accordance with EITF 97-10, The Effect of Lessee Involvement in Asset Construction.

Other income for the thirty-nine weeks ended October 3, 2006 was \$2.0 million compared to \$0.4 million for the comparable prior year period. This increase was principally due to the contribution of land and a building for our Rocky Mount, North Carolina bakery production facility by the local government, in exchange for commitments from us to create jobs and operate a manufacturing plant in the community.

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Our effective income tax rate was 31.4% for the thirty-nine weeks ended October 3, 2006 compared with 34.8% for the comparable prior year period. We recognized a \$0.5 million benefit in the income tax provision during the thirty-nine weeks ended October 3, 2006 related to the resolution of certain income tax liabilities. We currently estimate our effective tax rate to be approximately 31% for the full year. However, the actual effective tax rate for fiscal 2006 may be different than our current estimate due to actual revenues, pretax income and tax credits achieved during the year.

## **Liquidity and Capital Resources**

The following tables set forth, for the periods indicated, a summary of our key liquidity measurements (dollar amounts in millions):

	<b>October 3, 2006</b>	<b>January 3, 2006 (restated)</b>
Cash and marketable securities on hand	\$ 125.9	\$ 178.0
Net working capital	\$ 40.7	\$ 39.7
Adjusted net working capital (1)	\$ 80.6	\$ 123.4
Current ratio	1.3:1	1.3:1
Adjusted current ratio (1)	1.6:1	1.9:1
Long-term debt, including current portion (2)	\$ 44.2	\$ 26.9

- (1) Includes all marketable securities classified as either current assets (\$66.4 million and \$63.2 million at October 3, 2006 and January 3, 2006, respectively) or noncurrent assets (\$39.9 million and \$83.7 million at October 3, 2006 and January 3, 2006, respectively).  
(2) Represents deemed landlord financing liability.

	<b>Thirty-Nine Weeks Ended October 3, 2006</b>	<b>Thirty-Nine Weeks Ended September 27, 2005</b>
Cash provided by operating activities	\$ 97.9	\$ 109.5
Capital expenditures	\$ 128.4	\$ 111.8

During the thirty-nine weeks ended October 3, 2006, our cash and marketable securities on hand decreased by \$52.1 million to \$125.9 million from the January 3, 2006 balance. This decrease was primarily attributable to purchases of treasury stock and property and equipment, partially offset by cash provided by operating activities, landlord construction contributions and proceeds from the exercise of employee stock options. In the table above, we also present adjusted net working capital and current ratio calculations that include all marketable securities classified as either current or noncurrent assets. We believe these adjusted calculations provide investors with useful information regarding our overall liquidity position because all marketable securities are readily available to meet our liquidity requirements. We continue to target a weighted average maturity for our marketable securities investment portfolio between one and two years. Accordingly, a substantial portion of our investments is classified as noncurrent assets, but remains available for our liquidity requirements.

We have no funded debt in our capital structure. However, landlord construction allowances related to restaurant locations for which we are deemed, for accounting purposes only, to have an ownership interest are reflected in our balance sheets as deemed landlord financing. This liability is amortized over the lease term based on the rent payments designated in the lease agreement.

We maintain a \$35 million revolving credit and term loan facility (the "Credit Facility"), which expires on December 31, 2008. As of December 1, 2006, there were no borrowings outstanding under the Credit Facility. A portion of the Credit Facility, \$15.2 million, has been reserved to support standby letters of credit for our self-insurance programs. Borrowings under the Credit Facility will bear interest at variable rates based, at our option, on either the prime rate of interest, the lending institution's cost of funds plus 0.75%, or the applicable LIBOR rate plus 0.75%. Upon expiration of the Credit Facility, a maximum of \$35 million of any borrowings outstanding under the Credit Facility automatically convert into a four-year term loan, payable in equal quarterly installments at interest rates of 0.5% higher than the applicable revolving credit rates. The Credit Facility is not collateralized and requires us to maintain certain financial ratios and to observe certain restrictive covenants, such as maintaining a minimum effective tangible net worth balance, with respect to the conduct of our operations, with which we are currently in compliance.



Our new restaurant development model more closely resembles that of a retail business that occupies leased space in shopping malls, office complexes, strip centers, entertainment centers and other real estate developments. We typically seek to lease our restaurant locations for primary periods of 15 years to 20 years under operating lease arrangements. Our rent structures vary from lease to lease, but generally provide for the payment of both minimum and contingent (percentage) rent based on sales, as well as other expenses related to the leases (for example our share of common area maintenance, property tax and insurance expenses). In the future, we may also develop more freestanding restaurant locations using both ground leases and built-to-suit leases, which are common arrangements used to finance freestanding locations in the restaurant industry. We disburse cash for leasehold improvements and furnishings, fixtures and equipment to build out our leased premises. We may also disburse cash for structural additions that we make to leased premises that generally are reimbursed to us by our landlords as construction contributions pursuant to agreed-upon terms in the respective leases. If obtained, landlord construction contributions usually take the form of up-front cash, full or partial credits against minimum or percentage rents otherwise payable by us, or a combination thereof. We do not have any current plans to encumber our existing leasehold interests with secured financing. We own substantially all of the equipment, furniture and trade fixtures in our restaurants and currently plan to do so in the future.

For fiscal 2006, we currently estimate our cash outlays for capital expenditures to range between \$190 million and \$195 million, net of agreed-upon, up-front cash landlord construction contributions and excluding \$23 million to \$24 million of expected noncapitalizable preopening costs for new restaurants and the new bakery facility. This amount also excludes approximately \$10 million of landlord construction contributions to be applied as reductions to minimum or percentage rent over the lease terms. The amount reflected as additions to property and equipment in the Consolidated Statements of Cash Flows may vary from this estimate based on the accounting treatment of each operating lease. This estimate contemplates a net outlay of \$163 million to \$164 million for as many as 21 new restaurants to be opened during fiscal 2006, estimated construction-in-progress disbursements for anticipated fiscal 2007 openings and estimated collections of up-front cash landlord construction contributions. Expected capital expenditures for fiscal 2006 also include approximately \$13 million to \$14 million for maintenance and capacity addition expenditures to our existing restaurants and \$9 million to \$11 million for bakery and corporate infrastructure investments. In addition, we expect to spend approximately \$5 million to \$6 million related to the completion and enhancement of our second bakery production facility in Rocky Mount, North Carolina. We commenced operations in this facility in the first quarter of 2006 and began producing cakes in the second quarter of 2006.

Based on our current expansion objectives, we believe that our cash and short-term investments on hand, combined with expected cash flow provided by operations, available borrowings under our Credit Facility and expected landlord construction contributions should be sufficient in the aggregate to finance our planned capital expenditures and other operating activities through fiscal 2006. We may seek additional funds to finance our growth in the future. However, there can be no assurance that such funds will be available when needed or be available on terms acceptable to us.

We are authorized by our Board of Directors to repurchase up to 6,000,000 shares of our common stock. The authorization does not have an expiration date. Shares may be repurchased in the open market or through privately negotiated transactions at times and prices considered appropriate by us. Under this authorization, we have repurchased a total of 3,630,967 shares for a total cost of \$80.5 million through October 3, 2006. Our share repurchase agreement does not require us to repurchase any common stock and may be discontinued at any time.

#### **Critical Accounting Policies**

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Critical accounting policies are those that management believes are both most important to the portrayal of the Company's financial conditions and results, and require management's 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.

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With the adoption of SFAS 123R at the beginning of fiscal 2006, we have modified the Stock-Based Compensation section of our critical accounting policies from the previous disclosure included in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K/A for the fiscal year ended January 3, 2006 as follows:

#### ***Stock-Based Compensation***

We account for stock-based compensation in accordance with the provisions of SFAS 123R. We use the Black-Scholes option-pricing model, which requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their stock options before exercising them (expected term), the estimated volatility of the Company's common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements (forfeitures). Changes in the subjective assumptions can materially affect the estimated fair value of stock-based compensation and consequently, the related amount recognized on the consolidated statements of operations. See Note 4 of the Notes to Consolidated Financial Statements in this Form 10-Q for further discussion of stock-based compensation.

There have been no material changes to the other critical accounting policies previously reported in our Annual Report on Form 10-K/A for the fiscal year ended January 3, 2006.

#### **Recent Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The Statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact this Statement will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. This Statement requires companies to recognize a net liability or asset and an offsetting adjustment to accumulated other comprehensive income to report the funded status of defined benefit pension and other postretirement benefit plans. The Statement requires prospective application, and the recognition and disclosure requirements are effective for companies with fiscal years ending after December 15, 2006. Additionally, SFAS No. 158 requires companies to measure plan assets and obligations at their year-end balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. We are currently evaluating the impact this Statement will have on our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which provides interpretive guidance regarding the consideration given to prior year misstatements when determining materiality in current year financial statements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We do not expect SAB No. 108 to have any impact on our consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, on a tax return. This Interpretation also provides guidance on derecognition, classification, interest, penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this Interpretation will be a two-step process. The first step will determine if it is more likely than not that a tax position will be sustained upon examination and should therefore be recognized. The second step will measure a tax position that meets the more likely than not recognition threshold to determine the amount of benefit to recognize in the financial statements. This Interpretation is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact this Interpretation will have on our consolidated financial statements.

In March 2006, the Emerging Issues Task Force ( EITF ) issued EITF Issue 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If taxes are significant, an entity should disclose its policy of presenting taxes and the amounts of taxes. The guidance is effective for periods beginning after December 15, 2006. We present company sales net of sales taxes. This issue will not impact the method for presenting these sales taxes in our consolidated financial statements.

In November 2005, the FASB issued Staff Position FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, ( FSP 115-1 ) which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is required to be applied to reporting periods beginning after December 15, 2005. We adopted FSP 115-1 on January 4, 2006 and included the required disclosures in Note 2 of Notes to the Consolidated Financial Statements in this Form 10-Q. There was no impact to our consolidated financial statements as the result of our adoption of FSP 115-1.

In October 2005, the FASB issued Staff Position FAS 13-1, Accounting for Rental Costs Incurred during a Construction Period, which requires rental costs associated with ground or building operating leases that are incurred during a construction period to be recognized as rental expense. This Staff Position is effective for reporting periods beginning after December 15, 2005, and retrospective application is permitted but not required. We adopted FAS 13-1 on January 4, 2006 on a prospective basis. Prior to adoption, we capitalized rent incurred during the tenant improvement construction phase, which averaged approximately \$45,000 per new restaurant opened during fiscal 2005.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The following discussion of market risks contains forward-looking statements. Actual results may differ materially from the following discussion based on general conditions in the financial and commodity markets.

We are exposed to market risk from changes in interest rates on funded debt. This exposure relates to our \$35 million revolving credit and term loan facility (the Credit Facility ). There were no borrowings outstanding under the Credit Facility as of December 1, 2006. Borrowings under the Credit Facility bear interest at variable rates based on either the prime rate of interest, the lending institution's cost of funds plus 0.75% or LIBOR plus 0.75%. A hypothetical 1% interest rate change would not have any current impact on our results of operations.

A change in market prices also exposes us to market risk related to our investments in marketable securities. As of October 3, 2006, we held \$106.3 million in marketable securities. A hypothetical 10% decline in the market value of those securities would result in a \$10.6 million unrealized loss and a corresponding decline in their fair value. This hypothetical decline would not affect our cash flows until the securities were disposed of.

We purchase food and other commodities for use in our operations, based upon market prices established with our suppliers. Many of the commodities purchased by us can be subject to volatility due to market supply and demand factors outside of our control. To manage this risk in part, we attempt to enter into fixed price purchase commitments, with terms typically up to one year, for many of our commodity requirements. However, we are currently unable to contract for many of our fresh commodities such as fish and dairy items (except for cream cheese used in our bakery operations) for periods longer than 30 days. Dairy costs can also fluctuate due to government regulation. Substantially all of our food and supplies are available from several sources, which assists in diversifying our overall commodity cost risk. In addition, we have the ability to increase certain menu prices, or vary certain menu items offered, in response to food commodity price increases. Some of our commodity purchase arrangements may contain contractual features that limit the price paid by establishing certain price floors or caps. We do not use financial instruments to hedge commodity prices, since our purchase arrangements with suppliers, to the extent that we can enter into such arrangements, help control the ultimate cost that we pay.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

We have established and maintain disclosure controls and procedures that are designed to ensure that material information relating to the Company and our subsidiaries required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only a reasonable assurance of achieving the desired control objectives, and management was necessarily required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of October 3, 2006.

*Changes In Internal Control over Financial Reporting*

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the quarter ended October 3, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

On August 1, 2006, we received final approval by the Superior Court of the State of California of a negotiated settlement of consolidated class action wage and hour lawsuits originally filed in December 2002 by two former hourly restaurant employees in California alleging violations of California labor laws with respect to providing meal and rest breaks. Notices of the settlement were sent to all class members, the claims period has expired, and the administration of claims has been completed. A number of former and current employees also filed individual wage and hour claims, based upon alleged similar violations, directly with various offices of the California Division of Labor Standards Enforcement ( DLSE ). The DLSE claims filed by employees who joined the approved settlement also will be resolved by such settlement.

On February 22, 2006, a current employee filed a claim in the General Court of Justice - Superior Court Division, Durham County, North Carolina (Chandler v. The Cheesecake Factory Restaurants, Inc. et al.; Case No. 6CVS00724), alleging that the Company unlawfully failed to pay the named plaintiff and similarly situated tipped employees certain wages and tips in violation of the tip pooling provisions of the North Carolina wage and hour laws. The Plaintiff seeks class certification and recovery of back wages and liquidated damages under the North Carolina Wage and Hour Act. It is the Company's position that the Plaintiff and any other purported class members have been paid all wages and tips owed, the Company does not have any tip pooling arrangement, and the Company's suggested tip-out guidelines, which are voluntary, comply with all federal, state and local laws. The Company intends to vigorously defend this action.

On June 23, 2006, three current restaurant management employees in Ohio filed a charge of discrimination with the U.S. Equal Employment Opportunity Commission (EEOC) against The Cheesecake Factory Restaurants, Inc. alleging violations of Title VII of the Civil Rights Act resulting from alleged sex discrimination in the Company's promotion process. The claimants seek unspecified amounts of penalties and other monetary payments. The Company is cooperating with the EEOC's investigation of this matter. The Company intends to vigorously defend against this matter.

On August 29, 2006, five present and former hourly restaurant employees in the States of Tennessee, Texas and Arizona filed a lawsuit in the U.S. District Court for the Middle District of Tennessee against the Company alleging violations of the Fair Labor Standards Act with respect to alleged minimum wage violations, improper payroll deductions, and requiring work off the clock, among others claims (Smith v. The Cheesecake Factory Restaurants, Inc. et. al. Case No. 3 06 0829). The lawsuit seeks unspecified amounts of penalties and other monetary payments on behalf of the plaintiffs and other purported class members. The plaintiffs also seek attorneys fees for themselves. Discovery is currently continuing in this matter. The Company intends to vigorously defend its position.

Following our announcement on July 18, 2006 of the Audit Committee of our Board of Directors' review of our historical stock option granting practices, a number of purported Company shareholders brought eight separate putative shareholder derivative actions (the Options Derivative Actions) against the Company, our entire Board of Directors, and certain of our current and former officers alleging that the defendants improperly dated certain historical stock option grants. The plaintiffs in these cases, filed in Los Angeles County Superior Court and styled as Siebles v. Deitchle et al. (Case No. BC355872) (subsequently re-filed in federal court), McGee v. Overton et al. (Case No. BC355953); Rigotti v. Overton, et al. (Case No. BC356850), Cullen v. Overton, et al. (Case No. BC356851), Sachs v. Overton et al. (Case No. BC357065), and filed in United States District Court for the Central District and styled as Siebles v. Deitchle et.al. (Case No. CV06 6234), Kuhns v. Deitchle et al. (Case No. SACV06917) and Freed v. Overton et al. (Case No. CV 06 06486) contend, among other things, that the defendants conduct violated the California and/or federal securities laws, breached defendants fiduciary duties, wasted corporate assets, unjustly enriched the defendants, and caused errors in the Company's financial statements. The plaintiffs seek, among other things, unspecified damages and disgorgement of profits from the alleged conduct to be paid to the Company. The plaintiffs also seek attorneys fees for themselves. The Options Derivative Actions are in the preliminary stages of litigation. We intend to vigorously defend these actions.

We are subject to various legal proceedings that are discussed in our Annual Report on Form 10-K/A for the fiscal year ended January 3, 2006.

**Item 1A. Risk Factors**

A description of the risk factors associated with our business is contained in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K/A for the fiscal year ended January, 3 2006 filed with the Securities and Exchange Commission. These cautionary statements are to be used as a reference in connection with any forward-looking statements. The factors, risks and uncertainties identified in these cautionary statements are in addition to those contained in any other cautionary statements, written or oral, which may be made or otherwise addressed in connection with a forward-looking statement or contained in any of our subsequent filings with the Securities and Exchange Commission.

**Item 6. Exhibits**

- Exhibit 2.1 Form of Reorganization Agreement (1)
- Exhibit 3.1 Certificate of Incorporation (2)
- Exhibit 3.2 Certificate of Designation of Series A Junior Participating Cumulative Preferred Stock, \$.01 Par Value (2)
- Exhibit 3.3 Certificate of Amendment of Certificate of Incorporation (2)
- Exhibit 3.4 Form of Rights Agreement dated as of August 4, 1998 between The Cheesecake Factory Incorporated and U.S. Stock Transfer Corporation (3)
- Exhibit 3.5 Amendment No. 1 to Rights Agreement dated as of November 4, 2003 between The Cheesecake Factory Incorporated and U.S. Stock Transfer Corporation (4)
- Exhibit 3.6 Bylaws (5)
- Exhibit 10.1 Second Amendment to 1992 Performance Employee Stock Option Plan
- Exhibit 10.2 First Amendment to Amended and Restated Year 2000 Omnibus Performance Stock Incentive Plan
- Exhibit 31.1 Rule 13a-14(a) Certification of Principal Executive Officer
- Exhibit 31.2 Rule 13a-14(a) Certification of Principal Financial Officer
- Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Previously filed and incorporated by reference herein from the Registrant's Registration Statement on Form S-1 (No. 33-47936).
- (2) Previously filed and incorporated by reference herein from the Registrant's Form 10-Q for the quarterly period ended June 28, 2005.
- (3) Previously filed and incorporated by reference herein from the Registrant's Form 8-A dated August 19, 1998.
- (4) Previously filed and incorporated by reference herein from the Registrant's post-effective Amendment No. 1 to its Registration Statement on Form 8-A.
- (5) Previously filed and incorporated by reference herein from the Registrant's Form 10-Q for the quarterly period ended September 30, 2003.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: December 8, 2006

**THE CHEESECAKE FACTORY INCORPORATED**

By:

/s/ DAVID OVERTON  
David Overton  
*Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)*

By:

/s/ MICHAEL J. DIXON  
Michael J. Dixon  
*Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)*

By:

/s/ CHERYL M. SLOMANN  
Cheryl M. Sloman  
*Vice President, Controller and Chief Accounting  
Officer  
(Principal Accounting Officer)*

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