

Zoe's Kitchen, Inc.  
Form 10-Q  
November 19, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarter ended October 5, 2015

or

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

For the transition period from to  
Commission File No. 001-36411

ZOE'S KITCHEN, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

51-0653504  
(IRS Employer  
Identification No.)

5760 State Highway 121, Suite 250  
Plano, Texas

75024

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (214) 436-8765

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 and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

On November 19, 2015, there were 19,383,744 shares of common stock outstanding.

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## Part I - Financial Information

## Item 1. Financial Statements

## Zoe's Kitchen, Inc. and Subsidiaries

## Unaudited Consolidated Balance Sheets

(in thousands, except share and per share data)

	October 5, 2015	December 29, 2014
Assets		
Current Assets:		
Cash and cash equivalents	\$20,393	\$29,390
Trade accounts receivable, net of allowance for doubtful accounts	1,140	678
Other accounts receivable	1,724	1,164
Inventory	1,614	1,295
Prepaid expenses and other	2,269	1,168
Total current assets	27,140	33,695
Property and equipment, net	128,766	103,945
Goodwill	29,528	29,528
Intangibles, net	9,943	11,206
Other long-term assets, net	474	287
Total long-term assets	168,711	144,966
Total assets	\$195,851	\$178,661
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$6,682	\$6,131
Accrued expenses and other	13,463	10,175
Total current liabilities	20,145	16,306
Long-term liabilities:		
Deemed landlord financing	26,584	23,266
Deferred rent	19,185	13,701
Deferred income taxes	7,600	3,784
Other long-term liabilities, net	296	335
Total long-term liabilities	53,665	41,086
Total liabilities	73,810	57,392
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock: \$0.01 par value, 135,000,000 shares authorized as of October 5, 2015 and December 29, 2014; 19,383,744 and 19,292,246 issued and outstanding as of October 5, 2015 and December 29, 2014, respectively.	\$194	\$193
Additional paid-in capital	144,929	142,714
Accumulated deficit	(23,082)	(21,638)
Total stockholders' equity	122,041	121,269
Total liabilities and stockholders' equity	\$195,851	\$178,661

The accompanying notes are an integral part of these consolidated financial statements.



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Zoe's Kitchen, Inc. and Subsidiaries  
 Unaudited Consolidated Statements of Operations  
 (in thousands, except share and per share data)

	Twelve Weeks Ended		Forty Weeks Ended	
	October 5, 2015	October 6, 2014	October 5, 2015	October 6, 2014
Revenue:				
Restaurant sales	\$56,333	\$43,437	\$173,706	\$131,316
Royalty fees	51	128	160	403
Total revenue	56,384	43,565	173,866	131,719
Operating expenses:				
Restaurant operating costs (excluding depreciation and amortization):				
Cost of sales	17,729	14,638	54,716	43,801
Labor	15,861	11,871	48,686	36,338
Store operating expenses	10,589	8,306	32,890	24,368
General and administrative expenses	6,394	4,973	19,897	21,706
Depreciation	2,761	2,138	8,540	6,639
Amortization	375	377	1,262	1,159
Pre-opening costs	689	345	2,174	1,604
Casualty loss	351	—	351	—
Loss from disposal of equipment	50	42	197	93
Total operating expenses	54,799	42,690	168,713	135,708
Income (loss) from operations	1,585	875	5,153	(3,989 )
Other income and expenses:				
Interest expense, net	767	605	2,449	2,885
Loss on extinguishment of debt	—	—	—	978
Other income	(20 )	—	(51 )	—
Loss on interest cap	—	—	—	6
Total other income and expenses	747	605	2,398	3,869
Income (loss) before provision for income taxes	838	270	2,755	(7,858 )
Provision (benefit) for income taxes	3,094	(178 )	4,199	563
Net income (loss)	\$(2,256 )	\$448	\$(1,444 )	\$(8,421 )
Net income (loss) per share:				
Basic	\$(0.12 )	\$0.02	\$(0.07 )	\$(0.50 )
Diluted	\$(0.12 )	\$0.02	\$(0.07 )	\$(0.50 )
Weighted average shares of common stock outstanding:				
Basic	19,379,907	19,269,746	19,333,138	16,849,955
Diluted	19,379,907	19,478,261	19,333,138	16,849,955

The accompanying notes are an integral part of these consolidated financial statements.

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Zoe's Kitchen, Inc. and Subsidiaries  
 Unaudited Consolidated Statements of Cash Flows  
 (in thousands)

	Forty Weeks Ended	
	October 5, 2015	October 6, 2014
Cash flows from operating activities:		
Net income (loss)	\$(1,444	) \$(8,421 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	8,540	6,639
Amortization of intangible assets	1,262	1,159
Equity-based compensation	877	6,245
Deferred income taxes	4,116	563
Amortization of loan costs	15	77
Bad debt expense	5	11
Casualty loss	351	—
Loss from disposal of equipment	197	93
Accretion of deemed landlord financing	201	172
Loss on extinguishment of debt	—	978
Changes in operating assets and liabilities:		
Trade accounts receivable	(466	) (357 )
Other accounts receivable	(559	) 228
Inventory	(332	) (326 )
Prepaid expenses and other	(1,207	) (1,088 )
Accounts payable	714	2,201
Accrued expenses and other	2,167	2,072
Deferred rent	5,512	4,554
Net cash provided by operating activities	19,949	14,800
Cash flows from investing activities:		
Purchase of property and equipment	(30,705	) (24,154 )
Acquisition purchase price, net of cash acquired	—	(1,145 )
Proceeds from sale of property and equipment	108	150
Net cash used in investing activities	(30,597	) (25,149 )
Cash flows from financing activities:		
Proceeds from line of credit	—	7,900
Payments on long-term debt	—	(49,300 )
Proceeds from issuance of common stock, net of underwriter fees	—	96,314
Payments of costs associated with initial public offering	—	(2,538 )
Proceeds from deemed landlord financing	409	286
Proceeds from exercise of stock options	1,339	—
Payments of loan acquisition fees	(97	) —
Repurchase of common stock	—	(2,733 )
Net cash provided by financing activities	1,651	49,929
Net change in cash and cash equivalents	(8,997	) 39,580
Cash and cash equivalents:		
Beginning of year	29,390	1,149
End of period	\$20,393	\$40,729
Supplemental disclosure of cash flow information:		

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Cash paid for interest related to long-term debt	\$ 16	\$ 812	
Cash paid for interest related to deemed landlord financing	2,450	2,072	
Non-cash deemed landlord financing	2,750	1,450	
Change in accrued purchases of property and equipment	637	(289	)
The accompanying notes are an integral part of these consolidated financial statements.			

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Zoe's Kitchen, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation

Nature of Operations

Zoe's Kitchen, Inc. (the "Company", "Zoës", "we" or "us"), primarily develops and operates fast-casual restaurants serving a distinct menu of freshly prepared Mediterranean-inspired dishes. As of October 5, 2015, we operated 158 Company-owned restaurants and three franchise restaurants in 17 states across the United States. We have determined that we have one operating and reportable segment. All of our revenues are derived in the United States. All of our assets are located in the United States.

On April 16, 2014, we completed an initial public offering (the "IPO") of 6,708,332 shares of common stock at a price to the public of \$15.00 per share, which included 874,999 shares sold to the underwriters pursuant to their over-allotment option. All share and per share data have been retroactively restated in the accompanying financial statements to give effect to a 125,614.14:1 stock split, which became effective on April 14, 2014. After underwriter discounts and commissions and offering expenses, we received net proceeds from the offering of approximately \$91.0 million. A portion of these proceeds were used to repay all of the outstanding borrowings under our 2011 Credit Facility (as defined herein, see Note 4).

On August 19, 2014, we completed a follow-on offering of 5,175,000 shares of common stock at a public offering price of \$30.25 per share, which included 675,000 shares sold to the underwriters pursuant to their over-allotment option. All of the shares in the offering were offered by selling stockholders, except for 94,100 shares offered by us, the proceeds of which were used to repurchase the same number of shares from certain of our officers at the public offering price per share. We did not receive any net proceeds from the sale of shares of common stock by the selling stockholders. The repurchased shares were constructively retired as we do not intend to reissue the shares within a reasonable period of time.

On November 19, 2014, we completed a follow-on offering of 4,370,000 shares of common stock at a price of \$32.00 per share, which included 570,000 shares sold to the underwriters pursuant to their over-allotment option. All of the shares in the offering were offered by the selling stockholders. We did not receive any proceeds from the offering.

New Executive Officer

Effective October 2, 2015, we hired Sunil Doshi as our Chief Financial Officer ("CFO").

Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles and practices of the United States of America ("GAAP") for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of the results for interim periods have been included.

Certain information and footnote disclosures normally included in audited consolidated financial statements presented in accordance with GAAP have been omitted pursuant to rules and regulations of the Securities and Exchange Commission (the "SEC"). Due to the seasonality of our business, results for any interim financial period are not necessarily indicative of the results that may be achieved for a full fiscal year. In addition, quarterly results of operations may be impacted by the timing and amount of sales and costs associated with the opening of new restaurants. These interim unaudited consolidated financial statements do not represent complete financial statements and should be read in conjunction with our annual financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2014 (the "2014 Form 10-K"). While the consolidated balance sheet data as of December 29, 2014 was derived from audited financial statements, it does not include all disclosures required by GAAP.





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Comprehensive Income (Loss)

Comprehensive income (loss) is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) is the same as net income (loss) for all periods presented. Therefore, a separate statement of comprehensive income (loss) is not included in the accompanying consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Zoe's Kitchen, Inc. and its wholly owned subsidiaries, Zoe's Kitchen USA, LLC and Soho Franchising, LLC. All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements presented herein reflect our financial position, results of operations and cash flows in conformity with GAAP.

Fiscal Year

We operate on a 52- or 53-week fiscal year that ends on the last Monday of the calendar year. Fiscal years ended December 28, 2015 and December 29, 2014 consist of 52 weeks. Our first fiscal quarter consists of 16 weeks, and each of our second, third and fourth fiscal quarters consists of 12 weeks, except for a 53-week year when the fourth quarter has 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, such as valuation of long-lived, definite and indefinite-lived assets, estimated useful lives of assets, the reasonably assured lease terms of operating leases, the construction costs of leases where the Company is considered the owner during and after the construction period, allowance for doubtful accounts, the fair value and forfeiture rates related to equity-based compensation, insurance reserves, and deferred tax valuation allowances, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Recently Issued Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory", which applies to inventory that is measured using first-in, first-out ("FIFO") or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost or net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The update is effective for us prospectively for annual periods beginning after December 15, 2016, and interim periods therein, with early adoption permitted. The adoption of ASU 2015-11 is not expected to have a material impact on our consolidated financial position or results of operations.

In April 2015, the FASB issued ASU No. 2015-05, "Internal-Use Software (Subtopic 350-40)." This update was issued to provide guidance related to the accounting for fees in a cloud computing arrangement. This update is effective for annual and interim periods in fiscal years beginning after December 15, 2015. The adoption of ASU 2015-05 is not expected to have a material impact on our consolidated financial position or results of operations.

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation: Amendments to the Consolidation Analysis." This update improves targeted areas of the consolidation guidance and reduces the number of consolidation models. This update is effective for annual and interim periods in fiscal years beginning after December 15, 2015, with early adoption permitted. The adoption of ASU 2015-02 is not expected to have a material impact on our consolidated financial position or results of operations.

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In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements - Going Concern: Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern." This update requires management of the Company to evaluate whether there is substantial doubt about the Company's ability to continue as a going concern. This update is effective for the annual period after December 15, 2016, and for annual and interim periods thereafter. The adoption of ASU 2014-15 is not expected to have a material impact on our consolidated financial position or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." This update was issued to replace the current revenue recognition guidance, creating a more comprehensive revenue model. The update was deferred and is effective for reporting periods beginning after December 15, 2017. We are currently evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial position or results of operations.

## 2. Supplemental Information

Property and equipment, net consisted of the following (in thousands):

	October 5, 2015	December 29, 2014
Land	\$806	\$—
Buildings under deemed landlord financing	21,450	18,700
Leasehold improvements	93,055	73,096
Machinery and equipment	23,021	17,596
Furniture and fixtures	4,969	3,948
Automobiles	3,853	3,141
Computer equipment	6,011	4,825
Construction in progress	6,667	6,047
Property and equipment, gross	159,832	127,353
Less: Accumulated depreciation	(31,066)	(23,408)
Total Property and equipment, net	\$128,766	\$103,945

Accrued expenses and other consisted of the following (in thousands):

	October 5, 2015	December 29, 2014
Accrued payroll and payroll taxes	\$4,821	\$3,935
Accrued capital purchases	2,404	1,604
Sales tax payable	1,760	1,061
Gift certificate payable	430	896
Other accrued expenses	4,048	2,679
Total Accrued expenses and other	\$13,463	\$10,175

## 3. Fair Value Measurements

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate fair values due to the short maturities of these instruments.

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## 4. Bank Line of Credit and Term Loan

On April 16, 2014, we repaid in full our outstanding \$37.5 million term loan and \$2.9 million line of credit (the "2011 Credit Facility") with a portion of the proceeds from our IPO. Upon repayment, the 2011 Credit Facility and all related agreements were terminated. In addition, we wrote-off all unamortized loan costs, resulting in a loss on extinguishment of debt of \$1.0 million.

On February 6, 2015, we entered into a credit facility with Wells Fargo Bank, National Association (the "2015 Credit Facility"). The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, together with an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of October 5, 2015, we have no indebtedness under the 2015 Credit Facility.

Revolving credit loans under the 2015 Credit Facility bear interest, at the Company's election, at either the base rate plus an applicable margin, or LIBOR plus an applicable margin. The base rate consists of the highest of the prime rate, the federal funds rate plus 0.5% and LIBOR plus 1.0%. The applicable margin and associated loan commitment fee consists of two pricing levels based on the Company's consolidated total debt ratio. If this debt ratio is greater than or equal to 2.50 to 1, then the unused commitment fee is 0.15% per annum, and the applicable margin is LIBOR plus 1.5% or the base rate plus 0.5%. If this debt ratio is less than 2.50 to 1, then the unused commitment fee is 0.125% per annum and the applicable margin is LIBOR plus 1.0% or the base rate.

The 2015 Credit Facility includes specific financial covenants such as a leverage ratio and an interest coverage ratio. We are also subject to other customary covenants, including limitations on additional borrowings, dividend payments and acquisitions. As of October 5, 2015, we are in compliance with these financial and other customary covenants.

## 5. Equity-based Compensation

In connection with the IPO, we adopted the 2014 Omnibus Incentive Plan (the "2014 Incentive Plan"), which provides for grants of stock options, stock appreciation rights, restricted stock, other stock-based awards and other cash-based awards available to directors, officers and other employees of us and our subsidiaries, as well as others performing consulting or advisory services to us. The number of shares of common stock available for issuance under the 2014 Incentive Plan may not exceed 1,905,799.

The following table summarizes our stock option plan:

	Stock Options	Weighted Average Exercise Price
Stock Options outstanding as of December 29, 2014	521,470	\$16.64
Granted	357,750	35.79
Forfeited	(71,383)	) 26.82
Exercised	(89,276)	) 15.00
Expired	(2,342)	) \$35.01
Stock Options outstanding as of October 5, 2015	716,219	\$25.33

For the forty weeks ended October 5, 2015, there were 33,480 stock options forfeited and 2,342 stock options expired in relation to the departure of our CFO and 42,000 stock options were granted to the newly appointed CFO.

There were 250,000 stock options granted in the prior year that vested immediately upon completion of the IPO and the remainder of the options will vest in four equal annual installments following the date of the grant.

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The weighted average fair market value of stock options granted in the forty weeks ended October 5, 2015 was \$13.54 per share, as estimated at the date of grant using the Black-Scholes model using the following weighted average assumptions:

	Forty Weeks Ended October 5, 2015
Dividend yield	0%
Expected volatility <sup>(1)</sup>	35.8%
Risk-free rate of return	1.6%
Expected life (in years) <sup>(2)</sup>	6.3

(1) Expected volatility was based on competitors within the industry.

(2) Expected life was calculated using the simplified method, which is an average of the contractual term of the option and its ordinary vesting period, as we do not have sufficient historical data for determining the expected term of our stock option awards.

There were 6,666 restricted stock units outstanding as of December 29, 2014 and 7,235 and 2,222 restricted stock units were granted and vested, respectively, during the forty weeks ended October 5, 2015. All of our outstanding restricted stock units vest in three equal annual installments following the date of the grant.

We recognized equity-based compensation as a component of general and administrative expenses of \$0.3 million and \$0.1 million during the twelve weeks ended October 5, 2015 and October 6, 2014, respectively, and \$0.9 million and \$6.2 million during the forty weeks ended October 5, 2015 and October 6, 2014, respectively. Of the total equity-based compensation recognized in the forty weeks ended October 6, 2014, \$4.9 million is related to accelerated vesting of outstanding equity awards at the IPO and \$1.2 million is related to stock options granted at the date of the IPO. As of October 5, 2015, total unrecognized compensation expense related to non-vested stock awards, including an estimate for pre-vesting forfeitures, was \$4.5 million, which is expected to be recognized over a weighted-average period of 3.3 years.

## 6. Earnings Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average shares outstanding during the period, without consideration of common stock equivalents. Diluted net income (loss) per share is calculated by adjusting weighted average shares outstanding for the dilutive effect of common stock equivalents outstanding for the period, determined using the treasury-stock method.

The following table presents the computation of basic and diluted net income (loss) per share for the period indicated:

	Twelve Weeks Ended		Forty Weeks Ended	
	October 5, 2015	October 6, 2014	October 5, 2015	October 6, 2014
Net income (loss) (in thousands):	\$ (2,256 )	\$ 448	\$ (1,444 )	\$ (8,421 )
Shares:				
Basic weighted average shares outstanding	19,379,907	19,269,746	19,333,138	16,849,955
Diluted weighted average shares outstanding	19,379,907	19,478,261	19,333,138	16,849,955
Earnings (loss) per share:				
Basic EPS	\$ (0.12 )	\$ 0.02	\$ (0.07 )	\$ (0.50 )
Diluted EPS	\$ (0.12 )	\$ 0.02	\$ (0.07 )	\$ (0.50 )

During the twelve weeks ended October 5, 2015, there were 493,039 stock options and 4,619 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive. During the twelve weeks ended October 6, 2014 there were no stock options excluded from the diluted earnings per share calculation.



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During the forty weeks ended October 5, 2015, there were 482,435 stock options and 4,302 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive. During the forty weeks ended October 6, 2014, there were 130,504 stock options and 2,275 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive.

7. Income Taxes

Provision for income taxes was \$3.1 million for the twelve weeks ended October 5, 2015 and benefit for income taxes was \$0.2 million for the twelve weeks ended October 6, 2014. Provision for income taxes was \$4.2 million and \$0.6 million for the forty weeks ended October 5, 2015 and October 6, 2014, respectively. The effective tax rate was 152.4% and (7.2)% for the forty weeks ended October 5, 2015 and October 6, 2014, respectively. Our quarterly provision for income taxes is measured using an annual estimated effective tax rate for the full year applied to period earnings. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year, which for the forty weeks ended October 6, 2014 was impacted by additional expenses incurred as a result of our IPO completed in April 2014. In addition, our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resultant effective tax rate quarter over quarter and year over year.

We continue to monitor and evaluate the rationale for recording a valuation allowance against our deferred tax assets. As the Company increases earnings and utilizes deferred tax assets, it is possible the valuation allowance could be reduced or eliminated.

8. Related Party Transactions

Corporate Development and Administrative Services Agreement

Prior to the IPO, we terminated the Corporate Development and Administrative Services Agreement dated October 31, 2007 (the "Corporate Services Agreement") with Brentwood Private Equity IV, LLC ("Brentwood"), our former controlling shareholder. Under the terms of the agreement, Brentwood provided assistance in our corporate development activities and our business growth efforts. As consideration for Brentwood's services, we provided reimbursement for business expenses related to performance of this agreement and an annual consulting fee based on Adjusted EBITDA as defined in the agreement. We had no expenses related to this agreement during the forty weeks ended October 5, 2015 and \$0.1 million during the forty weeks ended October 6, 2014.

9. Casualty loss

During the twelve weeks and forty weeks ended ended October 5, 2015, we recognized a \$0.4 million write-off of long-lived assets associated with a restaurant in South Carolina affected by extreme flooding resulting from Hurricane Joaquin. We expect to reopen the restaurant in the upcoming year in the same location.

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10. Commitments and Contingencies

Franchise Agreement

Our franchise agreement requires franchisees to remit continuing royalty fees at a specified percentage of the franchisee's gross sales revenue, provides that we as franchisor, or our authorized representative, will: (a) provide franchisee with written schedules of all foods, food products, beverages, and other items for sale, and the furniture, fixtures, supplies and equipment necessary and required for the operation of the restaurant; (b) provide franchisee with a list of approved suppliers for the products and services necessary and required for the restaurant; (c) upon the reasonable written request of franchisee, render reasonable advisory services by telephone or in writing pertaining to the operation of the restaurant; (d) provide franchisee with a sample of the standard Zoës Kitchen menu, and any modifications to the menu; (e) loan franchisee a copy of the system's operating manual and any supplements to the manual that may be published by us; and, (f) provide franchisee the opportunity to participate in group purchasing programs that we may use, develop, sponsor or provide on terms and conditions determined solely by us. In addition, as a condition to the commencement of business by the franchisee, the franchisee must attend and successfully complete our training program.

Litigation

On October 31, 2014, Forsyth Consulting, Inc. ("Forsyth"), a former music vendor for the Company, filed a complaint against the Company in the Circuit Court of Jefferson County, Alabama alleging breach of contract with respect to its prior music service contract. We have removed the action to federal court and, on December 19, 2014, we filed a counterclaim in the United States District Court for the Northern District of Alabama, alleging breach of contract and tortious interference with business relations claims against Forsyth. The Company believes that Forsyth's claims are without merit and intends to vigorously pursue this action.

We are currently involved in various claims and legal actions that arise in the ordinary course of our business, including claims resulting from employment related matters. None of these claims, most of which are covered by insurance, has had a material effect on us. As of the date of this report, other than as set forth above, we are not party to any material pending legal proceedings and are not aware of any claims that could have a material adverse effect on our business, financial condition, results of operations or cash flows. However, a significant increase in the number of these claims or an increase in amounts owing under successful claims could materially and adversely affect our business, financial condition, results of operations or cash flows.

Other Commitments

In connection with the IPO, the Company entered into an employment agreement with our Chief Executive Officer ("CEO"), superseding his existing employment agreement as discussed in our definitive proxy statement filed with the SEC on April 27, 2015. This employment agreement has an initial term of three years, with subsequent one year extensions unless terminated by the Company or the executive. If the executive's employment is terminated without "cause" or by the executive with "good reason", the executive is entitled to, among other benefits, 12 months of continued base salary, a prorated bonus and prorated vesting of any incentive equity shares that would have otherwise vested in the 12-month period following termination.

Effective June 18, 2015, our former CFO concluded his employment with the Company. The Company agreed to pay our former CFO \$0.5 million pursuant to the terms of his employment agreement and a transition agreement.

The Company entered into a severance agreement with Sunil Doshi, our new CFO, effective October 2, 2015. Under this agreement, if the executive's employment is terminated without "cause" or by the executive with "good reason", the executive is entitled to, among other benefits, of 12 months continued base salary and a prorated annual bonus (based on actual performance).



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and cash flows as of and for the periods presented below. The following discussion and analysis should be read in conjunction with the accompanying unaudited consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our 2014 Form 10-K. In addition to historical information, this discussion and analysis contains forward-looking statements based on current expectations that involve risks, uncertainties and assumptions, such as our plans, objectives, expectations, and intentions set forth under the sections entitled "Risk Factors" and "Forward-Looking Statements" as filed in our 2014 Form 10-K.

Overview

Zoës Kitchen is a fast growing, fast-casual restaurant concept serving a distinct menu of fresh, wholesome, Mediterranean-inspired dishes delivered with Southern hospitality. Founded in 1995 by Zoë and Marcus Cassimus in Birmingham, Alabama, Zoës Kitchen is a natural extension of Zoë Cassimus' lifetime passion for cooking Mediterranean meals for family and friends. Since opening our first restaurant, we have never wavered from our commitment to make our food fresh daily and to serve our customers in a warm and welcoming environment. We believe our brand delivers on our customers' desire for freshly-prepared food, convenient, unique and high-quality experiences and their commitment to family, friends and enjoying every moment.

Growth Strategies and Outlook

We plan to execute the following strategies to continue to enhance our brand awareness and grow our revenue and achieve profitability:

- grow our restaurant base;
- increase our comparable restaurant sales; and
- improve our margins and leverage infrastructure.

We have expanded our restaurant base from 21 restaurants in seven states in 2008 to 161 restaurants in 17 states as of October 5, 2015, including three franchise restaurants. We opened 29 Company-owned restaurants during the forty weeks ended October 5, 2015. In addition, we have relocated one Company-owned store during the forty weeks ended October 5, 2015. We plan to open 33 restaurants in 2015, including the restaurants opened in the forty weeks ended October 5, 2015. We have opened 33 restaurants as of November 19, 2015. We expect to nearly double our restaurant base in the next four years. To increase comparable restaurant sales, we plan to heighten brand awareness to drive new customer traffic, increase existing customer frequency and grow our catering business. We believe we are well positioned for future growth with a developed infrastructure capable of supporting a restaurant base that is greater than our existing footprint. Additionally, we believe we have an opportunity to optimize costs and achieve profitability as we benefit from economies of scale.

Key Events

Franchise acquisitions. Since the beginning of 2009, we have acquired 11 franchise locations. In November 2011, we acquired three franchise restaurants in Houston, Texas; in August 2012, we acquired three franchise restaurants in South Carolina, with two restaurants located in Columbia and one restaurant in Greenville; in January 2014, we acquired two franchise restaurants, with one located in Mobile, Alabama and one located in Destin, Florida; and in November 2014, we acquired from our Louisiana franchisee three franchise restaurants, two restaurants under development, and area development rights in Louisiana.

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**Initial Public Offering.** On April 16, 2014, we completed our IPO of 6,708,332 shares of common stock at a price to the public of \$15.00 per share, which included 874,999 shares of common stock sold to the underwriters pursuant to their over-allotment option. After underwriters discounts and commissions and offering expenses, we received net proceeds from the offering of approximately \$91.0 million. A portion of these proceeds were used to repay the outstanding indebtedness under our 2011 Credit Facility, which at the time of the IPO had an outstanding balance of approximately \$48.3 million. We have used the remainder of the proceeds to support our growth, primarily through opening new restaurants and for working capital and general corporate expenses.

As a result of our IPO and the repayment of our outstanding debt, we have benefited from savings on interest expense and management fees that we incurred as a private company. We also expect to incur incremental costs as a public company including legal, accounting, insurance, information technology and other compliance costs. We will continue to use our operating cash flows to fund capital expenditures to support restaurant growth as well as to invest in our existing restaurants, infrastructure and information technology. See "Liquidity and Capital Resources."

Further, in connection with our IPO, we incurred \$6.1 million of equity-based compensation expenses, which includes \$4.9 million related to accelerated vesting of outstanding equity awards at the IPO and \$1.2 million related to stock options granted at the date of the IPO. The financial impact of the IPO affects the comparability of our post-IPO financial performance to our pre-IPO financial performance.

**Follow-on Offerings.** On August 19, 2014, we completed our follow-on offering of 5,175,000 shares of the Company's common stock at a price of \$30.25 per share, which included 675,000 shares sold to the underwriters pursuant to their over-allotment option. All of these shares were offered by the selling stockholders, except for 94,100 shares offered by the Company, the proceeds of which were used by the Company to repurchase the same number of shares from certain of its officers. We did not receive any net proceeds from the offering.

On November 19, 2014, we completed another follow-on offering of 4,370,000 shares of the Company's common stock at a price of \$32.00 per share, which included 570,000 shares sold to the underwriters pursuant to their over-allotment option. All of these shares were offered by the selling stockholders. We did not receive any proceeds from the offering.

**Executive Officer Transition.** Effective June 18, 2015, our former CFO concluded his employment with the Company. Effective October 2, 2015, we hired Sunil Doshi as our CFO.

### **Key Measures We Use to Evaluate Our Performance**

In assessing the performance of our business, we consider a variety of performance and financial measures. The key measures for determining how our business is performing are restaurant sales, comparable restaurant sales growth, AUVs, restaurant contribution, number of new restaurant openings and Adjusted EBITDA.

### **Restaurant Sales**

Restaurant sales represents sales of food and beverages in Company-owned restaurants. Several factors affect our restaurant sales in any given period including the number of restaurants in operation and per restaurant sales.

### **Comparable Restaurant Sales Growth**

Comparable restaurant sales refers to year-over-year sales comparisons for the comparable Company-owned restaurant base. We define the comparable restaurant base to include those restaurants open for 18 fiscal periods or longer. As of October 5, 2015 and October 6, 2014, there were 112 and 78 restaurants, respectively, in our comparable Company-owned restaurant base. This measure highlights performance of existing restaurants, as the impact of new Company-owned restaurant openings is excluded.

Comparable restaurant sales growth is generated by an increase in customer traffic or changes in per customer spend. Per customer spend can be influenced by changes in menu prices and/or the mix and number of items sold per check.

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Measuring our comparable restaurant sales allows us to evaluate the performance of our existing restaurant base.

Various factors impact comparable restaurant sales, including:

- consumer recognition of our brand and our ability to respond to changing consumer preferences;
- overall economic trends, particularly those related to consumer spending;
- our ability to operate restaurants effectively and efficiently to meet consumer expectations;
- pricing;
- customer traffic;
- per customer spend and average check amount;
- marketing and promotional efforts;
- local competition;
- trade area dynamics;
- introduction of new menu items; and
- opening of new restaurants in the vicinity of existing locations.

Consistent with common industry practice, we present comparable restaurant sales on a fiscal calendar basis that aligns current year sales weeks with comparable periods in the prior year, regardless of whether they belong to the same calendar period or not. Since opening new Company-owned restaurants will be a significant component of our revenue growth, comparable restaurant sales is only one measure of how we evaluate our performance.

**Average Unit Volumes (AUVs)**

AUVs consist of the average sales of all Company-owned restaurants that have been open for a trailing 52-week period or longer. AUVs allow management to assess changes in consumer traffic and per-customer spending patterns at our restaurants.

**Restaurant Contribution**

Restaurant contribution is defined as restaurant sales less restaurant operating costs, which are cost of sales, labor and store operating expenses. We expect restaurant contribution to increase in proportion to the number of new Company-owned restaurants we open and our comparable restaurant sales growth. Fluctuations in restaurant contribution margin can also be attributed to those factors discussed below for the components of restaurant operating costs.

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## Number of New Restaurant Openings

The number of Company-owned restaurant openings reflects the number of restaurants opened during a particular reporting period. Before we open new Company-owned restaurants, we incur pre-opening costs. Some of our restaurants open with an initial start-up period of higher than normal sales volumes, which subsequently decrease to stabilized levels. Typically, our new restaurants have stabilized sales after approximately 12 to 24 weeks of operation, at which time the restaurant's sales typically begin to grow on a consistent basis. In new markets, the length of time before average sales for new restaurants stabilize is less predictable and can be longer as a result of our limited knowledge of these markets and consumers' limited awareness of our brand. New restaurants may not be profitable, and their sales performance may not follow historical patterns. The number and timing of restaurant openings has had, and is expected to continue to have, an impact on our results of operations. The following table shows the growth in our Company-owned and franchise restaurant base:

	Twelve Weeks Ended		Forty Weeks Ended	
	October 5, 2015	October 6, 2014	October 5, 2015	October 6, 2014
Company-owned Restaurant Base				
Beginning of period	148	116	129	94
Openings	10	4	29	24
Franchisee acquisitions	—	—	—	2
Restaurants at end of period	158	120	158	120
Franchise Restaurant Base				
Beginning of period	3	6	3	8
Franchisee acquisitions	—	—	—	(2)
Restaurants at end of period	3	6	3	6
Total restaurants	161	126	161	126

## Key Financial Definitions

**Restaurant sales.** Restaurant sales represent sales of food and beverages in Company-owned restaurants, net of promotional allowances and employee meals. Restaurant sales in a given period are directly impacted by the number of operating weeks in the period, the number of restaurants we operate and comparable restaurant sales growth.

**Royalty fees.** Royalty fees represent royalty income from franchisees.

**Cost of sales.** Cost of sales consists primarily of food, beverage and packaging costs. The components of cost of sales are variable in nature, change with sales volume and are influenced by menu mix and subject to increases or decreases based on fluctuations in commodity costs.

**Labor.** Labor includes all restaurant-level management and hourly labor costs, including salaries, wages, benefits and bonuses, payroll taxes and other indirect labor costs.

**Store operating expenses.** Store operating expenses include all other restaurant-level operating expenses, such as supplies, utilities, repairs and maintenance, travel costs, credit card fees, recruiting, delivery service, restaurant-level marketing costs, security and occupancy expenses.

**General and administrative expenses.** General and administrative expenses include expenses associated with corporate and regional functions that support the development and operations of restaurants, including compensation and benefits, travel expenses, stock compensation costs, legal and professional fees, advertising costs, information systems, corporate office rent and other related corporate costs.

**Depreciation.** Depreciation consists of depreciation of fixed assets, including equipment and capitalized leasehold improvements.

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Amortization. Amortization consists of amortization of certain intangible assets including franchise agreements, trademarks, reacquired rights and favorable leases.

Pre-opening costs. Pre-opening costs consist of expenses incurred prior to opening a new restaurant and are made up primarily of manager salaries, relocation costs, supplies, recruiting expenses, employee payroll and training costs. Pre-opening costs also include occupancy costs recorded during the period between date of possession and the restaurant's opening date.

Casualty loss. Casualty loss consists of the loss recognized on the write-off of long-lived assets.

Loss from disposal of equipment. Loss from disposal of equipment is composed of the loss on disposal of assets related to retirements and replacements of leasehold improvements or equipment. These losses are related to normal disposals in the ordinary course of business, along with disposals related to selected restaurant remodeling activities.

Loss on extinguishment of debt. Loss on extinguishment of debt consists of the write-off of unamortized loan costs and other fees, following the repayment of our 2011 Credit Facility.

Interest expense, net. Interest expense includes cash and imputed non-cash charges related to our deemed landlord financing, non-cash charges related to our residual value obligations, amortization of debt issue costs as well as cash payments and accrued charges related to our 2011 Credit Facility.

Provision for income taxes. Provision for income taxes represents federal, state and local current and deferred income tax expense.

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## Consolidated Results of Operations

The following table summarizes key components of our results of operations for the periods indicated as a percentage of our total revenue, except for the components of restaurant operating costs, which are expressed as a percentage of restaurant sales.

	Twelve Weeks Ended		Forty Weeks Ended	
	October 5, 2015	October 6, 2014	October 5, 2015	October 6, 2014
Revenue:				
Restaurant sales	99.9	% 99.7	% 99.9	% 99.7
Royalty fees	0.1	% 0.3	% 0.1	% 0.3
Total revenue	100.0	% 100.0	% 100.0	% 100.0
Operating expenses:				
Restaurant operating costs (1):				
Cost of sales	31.5	% 33.7	% 31.5	% 33.4
Labor	28.2	% 27.3	% 28.0	% 27.7
Store operating expenses	18.8	% 19.1	% 18.9	% 18.6
General and administrative expenses	11.3	% 11.4	% 11.4	% 16.5
Depreciation	4.9	% 4.9	% 4.9	% 5.0
Amortization	0.7	% 0.9	% 0.7	% 0.9
Pre-opening costs	1.2	% 0.8	% 1.3	% 1.2
Casualty loss	0.6	% —	0.2	% —
Loss from disposal of equipment	0.1	% 0.1	% 0.1	% 0.1
Total operating expenses	97.2	% 98.0	% 97.0	% 103.0
Income (loss) from operations	2.8	% 2.0	% 3.0	% (3.0)
Other income and expenses:				
Interest expense, net	1.4	% 1.4	% 1.4	% 2.2
Loss on extinguishment of debt	—	—	—	0.7
Other income	(0.0)	)% —	(0.0)	)% —
Loss on interest cap	—	—	—	0.0
Total other income and expenses	1.3	% 1.4	% 1.4	% 2.9
Income (loss) before provision for income taxes	1.5	% 0.6	% 1.6	% (6.0)
Provision (benefit) for income taxes	5.5	% (0.4)	)% 2.4	% 0.4
Net income (loss)	(4.0)	)% 1.0	% (0.8)	% (6.4)

(1) As a percentage of restaurant sales.

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Twelve Weeks Ended October 5, 2015 compared to Twelve Weeks Ended October 6, 2014

The following table presents selected consolidated comparative results of operations from our unaudited consolidated financial statements for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014.

	Twelve Weeks Ended		Increase / (Decrease)		
	October 5, 2015	October 6, 2014	Dollars	Percentage	
(Dollars in thousands)					
Consolidated Statement of Operations Data:					
Revenue					
Restaurant sales	\$56,333	\$43,437	\$12,896	29.7	%
Royalty fees	51	128	(77)	(60.2)	)%
Total revenue	56,384	43,565	12,819	29.4	%
Operating expenses:					
Restaurant operating costs (excluding depreciation and amortization):					
Cost of sales	17,729	14,638	3,091	21.1	%
Labor	15,861	11,871	3,990	33.6	%
Store operating expenses	10,589	8,306	2,283	27.5	%
General and administrative expenses	6,394	4,973	1,421	28.6	%
Depreciation	2,761	2,138	623	29.1	%
Amortization	375	377	(2)	(0.5)	)%
Pre-opening costs	689	345	344	99.7	%
Casualty loss	351	—	351	*	
Loss (gain) from disposal of equipment	50	42	8	19.0	%
Total operating expenses	54,799	42,690	12,109	28.4	%
Income from operations	1,585	875	710	81.1	%
Other expenses					
Interest expense, net	767	605	162	26.8	%
Other Income	(20)	—	(20)	*	
Total other expenses	747	605	142	23.5	%
Income before provision for income taxes	838	270	568	210.4	%
Provision (benefit) for income taxes	3,094	(178)	3,272	*	
Net income	\$(2,256)	\$448	\$(2,704)	(603.6)	)%

\*Not meaningful.

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Restaurant sales. The following table summarizes the growth in restaurant sales from the twelve weeks ended October 6, 2014 to the twelve weeks ended October 5, 2015:

(in thousands)	Net Sales
Restaurant sales for twelve weeks ended October 6, 2014	\$43,437
Incremental restaurant sales increase due to:	
Comparable restaurant sales	1,787
Restaurants not in comparable restaurant base	11,109
Restaurant sales for the twelve weeks ended October 5, 2015	\$56,333

Restaurant sales increased by \$12.9 million, or 29.7%, for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014. Restaurants not in the comparable restaurant base and other sales accounted for \$11.1 million of this increase. The balance of the growth was due to an increase in comparable restaurant sales of \$1.8 million, or 4.5%, in the twelve weeks ended October 5, 2015, comprised primarily of a 0.3% increase in price, 0.4% decrease in customer traffic, and a 4.6% increase in product mix at our comparable restaurants.

Franchise and royalty fees. Royalty fees decreased by \$0.1 million, or 60.2%, for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014. The decrease was primarily attributable to the acquisition of the Louisiana franchise restaurants in November 2014, which resulted in lower royalty fees in the twelve weeks ended October 5, 2015 as the stores are now Company-owned. We recognized no franchise fees for the twelve weeks ended October 5, 2015 or October 6, 2014.

Cost of sales. Cost of sales increased \$3.1 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 33.7% in the twelve weeks ended October 6, 2014 to 31.5% in the twelve weeks ended October 5, 2015. This decrease was primarily driven by lower raw material costs in poultry, dairy, dry goods and paper products.

Labor. Labor increased by \$4.0 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of restaurant sales, labor increased from 27.3% in the twelve weeks ended October 6, 2014 to 28.2% in the twelve weeks ended October 5, 2015. This increase was primarily driven by an increase in training stores to support our current growth and wage inflation.

Store operating expenses. Store operating expenses increased by \$2.3 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of restaurant sales, store operating expense decreased from 19.1% in the twelve weeks ended October 6, 2014 to 18.8% in the twelve weeks ended October 5, 2015. This decrease was primarily attributable to lower repair and maintenance costs and store marketing initiatives when compared to the prior year. In addition, store supply costs have decreased due to better management of such costs in 2015.

General and administrative expenses. General and administrative expenses increased by \$1.4 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014. As a percentage of revenue, general and administrative expenses decreased from 11.4% in the twelve weeks ended October 6, 2014 to 11.3% in twelve weeks ended October 5, 2015. This decrease was driven primarily by costs in the twelve weeks ended October 6, 2014 related to our August 2014 follow-on offering offset by increased non-cash equity-based compensation due to high fair value associated with our current year equity awards.

Depreciation. Depreciation increased by \$0.6 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of revenue, depreciation remained flat for the twelve weeks ended October 5, 2015 and October 6, 2014.



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Amortization. Amortization was flat for the twelve weeks ended October 5, 2015 and October 6, 2014.

Pre-opening costs. Pre-opening costs increased by \$0.3 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014. As a percent of revenue, pre-opening costs increased from 0.8% in the twelve weeks ended October 6, 2014 to 1.2% in the twelve weeks ended October 5, 2015. This increase was driven by opening ten new Company- owned restaurants in the twelve weeks ended October 5, 2015 compared to four in the twelve weeks ended October 6, 2014.

Casualty loss. During the twelve weeks ended October 5, 2015, we recognized a \$0.4 million write-off of long-lived assets associated with a restaurant in Columbia, South Carolina affected by extreme flooding resulting from Hurricane Joaquin. We expect to reopen the restaurant in the upcoming year in the same location.

Interest expense. Interest expense increased by \$0.2 million for the twelve weeks ended October 5, 2015 compared to the twelve weeks ended October 6, 2014.

Provision for income taxes. Provision for income taxes was \$3.1 million for the twelve weeks ended October 5, 2015 compared to a benefit of \$0.2 million for the twelve weeks ended October 6, 2014. Tax expense for the year typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year, which in 2014 was impacted by additional expenses incurred as a result of our IPO completed in April 2014. In addition, our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resultant effective tax rate quarter over quarter and year over year.

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Forty Weeks Ended October 5, 2015 compared to Forty Weeks Ended October 6, 2014

The following table presents selected consolidated comparative results of operations from our unaudited consolidated financial statements for the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014:

Forty Weeks Ended

	October 5, 2015	October 6, 2014	Increase / (Decrease)		
			Dollars	Percentage	
(Dollars in thousands)					
Consolidated Statement of Operations Data:					
Revenue:					
Restaurant sales	\$173,706	\$131,316	\$42,390	32.3	%
Royalty fees	160	403	(243)	(60.3)	)%
Total revenue	173,866	131,719	42,147	32.0	%
Operating expenses:					
Restaurant operating costs (excluding depreciation and amortization):					
Cost of sales	54,716	43,801	10,915	24.9	%
Labor	48,686	36,338	12,348	34.0	%
Store operating expenses	32,890	24,368	8,522	35.0	%
General and administrative expenses	19,897	21,706	(1,809)	(8.3)	)%
Depreciation	8,540	6,639	1,901	28.6	%
Amortization	1,262	1,159	103	8.9	%
Pre-opening costs	2,174	1,604	570	35.5	%
Casualty loss	351	—	351	*	
Loss from disposal of equipment	197	93	104	111.8	%
Total operating expenses	168,713	135,708	33,005	24.3	%
Income (loss) from operations	5,153	(3,989)	) 9,142	*	
Other income and expenses:					
Interest expense, net	2,449	2,885	(436)	(15.1)	)%
Loss on extinguishment of debt	—	978	(978)	*	
Other income	(51)	) —	(51)	*	
Loss on interest cap	—	6	(6)	*	
Total other income and expenses	2,398	3,869	(1,471)	(38.0)	)%
Income (loss) before provision for income taxes	2,755	(7,858)	) 10,613	(135.1)	)%
Provision (benefit) for income taxes	4,199	563	3,636	645.8	%
Net income (loss)	\$(1,444)	) \$(8,421)	) \$6,977	(82.9)	)%

\*Not meaningful.

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Restaurant sales. The following table summarizes the growth in restaurant sales from the forty weeks ended October 6, 2014 to the forty weeks ended October 5, 2015:

(in thousands)	Net Sales
Restaurant sales for the forty weeks ended October 6, 2014	\$131,316
Incremental restaurant sales increase due to:	
Comparable restaurant sales	6,839
Restaurants not in comparable restaurant base	35,551
Restaurant sales for the forty weeks ended October 5, 2015	\$173,706

Restaurant sales increased by \$42.4 million, or 32.3%, in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014. Restaurants not in the comparable restaurant base and other sales accounted for \$35.6 million of this increase. The balance of the growth was due to an increase in comparable restaurant sales of \$6.8 million, or 5.9%, in the forty weeks ended October 5, 2015 comprised primarily of a 1.5% increase in customer traffic, 0.8% increase in price and 3.6% increase in product mix at our comparable restaurants.

Royalty fees. Royalty fees decreased by \$0.2 million, or 60.3%, in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014. The decrease was primarily attributable to the acquisition of the Louisiana franchise restaurants in November 2014, which resulted in lower royalty fees in the forty weeks ended October 5, 2015.

Cost of sales. Cost of sales increased \$10.9 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 33.4% in the forty weeks ended October 6, 2014 to 31.5% in the forty weeks ended October 5, 2015. This decrease was primarily driven by lower costs in poultry, dairy, paper products and dry goods, offset by higher costs in beef and seafood.

Labor. Labor increased by \$12.3 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of restaurant sales, labor increased from 27.7% in the forty weeks ended October 6, 2014 to 28.0% in the forty weeks ended October 5, 2015. The increase was primarily driven by an increase in training stores to support our current growth and wage inflation.

Store operating expenses. Store operating expenses increased by \$8.5 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of restaurant sales, store operating expense increased from 18.6% in the forty weeks ended October 6, 2014 to 18.9% in the forty weeks ended October 5, 2015. This increase was primarily attributable to higher repair and maintenance costs and occupancy from lower sales leverage on new stores offset by lower store supplies costs and store marketing initiatives.

General and administrative expenses. General and administrative expenses decreased by \$1.8 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014. As a percentage of revenue, general and administrative expenses decreased from 16.5% in the forty weeks ended October 6, 2014 to 11.4% in the forty weeks ended October 5, 2015. The decrease was primarily driven by a \$5.4 million decrease in equity-based compensation expense due to the accelerated vesting of stock and stock options as of the date of the IPO and \$1.2 million of non-capitalized IPO and follow-on offering related expenses in 2014. These decreases are offset by increased corporate payroll and related expenses associated with supporting an increased number of restaurants, incremental public company costs and costs associated with our executive transition.

Depreciation. Depreciation increased by \$1.9 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014, due primarily to opening 35 new Company-owned restaurants and acquiring three franchise restaurants since October 6, 2014. As a percentage of revenue, depreciation decreased from 5.0% in the forty weeks ended October 6, 2014 to 4.9% in the forty weeks ended October 5, 2015.

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**Amortization.** Amortization increased by \$0.1 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014.

**Pre-opening costs.** Pre-opening costs increased by \$0.6 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014. As a percent of revenue, pre-opening costs increased from 1.2% in the forty weeks ended October 6, 2014 to 1.3% in the forty weeks ended October 5, 2015.

**Casualty loss.** During the forty weeks ended October 5, 2015, we recognized a \$0.4 million write-off of long-lived assets associated with a restaurant in Columbia, South Carolina affected by extreme flooding resulting from Hurricane Joaquin. We expect to reopen the restaurant in the upcoming year in the same location.

**Interest expense.** Interest expense decreased by \$0.4 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014, due primarily to lower interest and amortization of deferred financing costs of \$0.8 million after repaying all outstanding borrowings under our 2011 Credit Facility on April 16, 2014, offset by interest from deemed landlord financing increasing \$0.4 million.

**Loss on extinguishment of debt.** Loss on extinguishment of debt was \$1.0 million for the forty weeks ended October 6, 2014 due to the repayment of the entire amount of outstanding borrowings under our 2011 Credit Facility.

**Provision for income taxes.** Provision for income taxes increased by \$3.6 million in the forty weeks ended October 5, 2015 compared to the forty weeks ended October 6, 2014. Our tax expense typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year, which in 2014 was primarily impacted by additional expenses incurred as a result of our IPO in April 2014. In addition, our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resultant effective tax rate quarter over quarter and year over year.

### **Adjusted EBITDA**

EBITDA is defined as net income (loss) before interest, income taxes and depreciation and amortization.

Adjusted EBITDA is defined as EBITDA plus equity-based compensation expense, management and consulting fees, asset disposals, loss on interest cap, loss on extinguishment of debt, non-capitalized offering-related expenses, executive transition and relocation costs, casualty loss and pre-opening costs. Adjusted EBITDA is intended as a supplemental measure of our performance that is not required by, or presented in accordance with GAAP. We believe that EBITDA and Adjusted EBITDA provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and operating results. Our management uses EBITDA and Adjusted EBITDA (i) as a factor in evaluating management's performance when determining incentive compensation and (ii) to evaluate the effectiveness of our business strategies.

We believe that the use of EBITDA and Adjusted EBITDA provides an additional tool for investors to use in evaluating ongoing operating results and trends and in comparing the Company's financial measures with other fast casual restaurants, which may present similar non-GAAP financial measures to investors. In addition, you should be aware when evaluating EBITDA and Adjusted EBITDA that in the future we may incur expenses similar to those excluded when calculating these measures. Our presentation of these measures should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Our computation of Adjusted EBITDA may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate Adjusted EBITDA in the same fashion.

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Our management does not consider EBITDA or Adjusted EBITDA in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of EBITDA and Adjusted EBITDA is that they exclude significant expenses and income that are required by GAAP to be recorded in the Company's financial statements. Some of these limitations are:

• Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

• Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

• Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debts;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;

• equity-based compensation expense is and will remain a key element of our overall long-term incentive compensation package, although we exclude it as an expense when evaluating our ongoing performance for a particular period;

• Adjusted EBITDA does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing operations; and

• other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should not be considered in isolation or as a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA only supplementally. You should review the reconciliation of net loss to EBITDA and Adjusted EBITDA below and not rely on any single financial measure to evaluate our business.

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The following table reconciles net income (loss) to EBITDA and Adjusted EBITDA:

	Twelve Weeks Ended		Forty Weeks Ended	
	October 5, 2015	October 6, 2014	October 5, 2015	October 6, 2014
	(Dollars in thousands)			
Adjusted EBITDA:				
Net income (loss), as reported	\$(2,256 )	\$448	\$(1,444 )	\$(8,421 )
Depreciation and amortization	3,136	2,515	9,802	7,798
Interest expense, net	767	605	2,449	2,885
Provision (benefit) for income taxes	3,094	(178 )	4,199	563
EBITDA	4,741	3,390	15,006	2,825
Asset disposals and loss on interest cap (1)	50	42	197	99
Management and consulting fees (2)	—	—	—	113
Equity-based compensation expense (3)	—	—	—	6,111
Loss on extinguishment of debt (4)	—	—	—	978
Pre-opening costs (5)	689	345	2,174	1,604
Casualty loss (6)	351	—	351	—
Offering related expenses (7)	—	650	—	1,176
Executive transition costs (8)	319	—	868	—
Executive relocation costs (9)	—	170	—	170
Adjusted EBITDA	\$6,150	\$4,597	\$18,596	\$13,076

(1) Represents costs related to loss on disposal of equipment and loss on interest cap.

(2) Represents fees payable to Brentwood Private Equity IV, LLC ("Brentwood"), our former controlling stockholder, pursuant to the Corporate Development and Administrative Services Agreement dated October 31, 2007 ("Corporate Services Agreement"), and fees payable to Greg Dollarhyde pursuant to a consulting agreement entered into on March 22, 2011. Both agreements were terminated prior to the completion of the IPO.

(3) Represents non-cash equity-based compensation expense associated with the accelerated vesting of stock and stock options at our IPO in April 2014. Amounts previously disclosed for the twelve and forty weeks ended October 6, 2014 included an additional \$54,000 and \$134,000, respectively, related to post- IPO non-cash equity-based compensation.

(4) Represents the remaining deferred financing costs, loan administrative fee, and interest rate contract that were written off with the repayment of our 2011 Credit Facility.

(5) Represents expenses directly associated with the opening of new restaurants that are incurred prior to opening, including pre-opening rent.

(6) Represents write-off of long-lived assets associated with a restaurant in Columbia, South Carolina as described in Note 9 to our unaudited consolidated financial statements.

(7) Represents fees and expenses that were incurred, but not capitalized, in relation to our IPO completed on April 16, 2014 and our follow-on offering completed on August 19, 2014

(8) Represents costs associated with our former CFO's departure pursuant to his employment and transition agreement and costs associated with our new CFO pursuant to executive recruiter costs and his employment agreement.

(9) Represents costs associated with the relocation packages of an executive.

## Liquidity and Capital Resources

### Potential Impacts of Market Conditions on Capital Resources

We have continued to experience increases in comparable restaurant sales, operating cash flows and restaurant contribution margin. However, the restaurant industry continues to be competitive, and uncertainty exists as to the

sustainability of these favorable trends. We have continued to implement various cost savings initiatives, including savings in our food costs through waste reduction and efficiency initiatives in our supply chain and labor costs. We have developed new menu items to appeal to consumers and used marketing campaigns to promote these items.

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We believe that cash and cash equivalents and expected cash flow from operations are adequate to fund operating lease obligations, capital expenditures and working capital obligations for at least the next 12 months. However, our ability to continue to meet these requirements and obligations will depend on, among other things, our ability to achieve anticipated levels of revenue and cash flow from operations and our ability to manage costs and working capital successfully.

**Summary of Cash Flows**

Following the IPO, our primary sources of liquidity and cash flows are operating cash flows and the net proceeds from the IPO not used for repayment of our 2011 Credit Facility. We are using these sources to fund capital expenditures for new Company-owned restaurant openings, reinvest in our existing restaurants, repurchase restaurants from our franchisees, invest in infrastructure and information technology and maintain working capital. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day, or in the case of credit or debit card transactions, within several days of the related sale, and we typically have at least 20 days to pay our vendors.

	Forty Weeks Ended	
	October 5, 2015	October 6, 2014
	(Dollars in thousands)	
Consolidated Statement of Cash Flows Data:		
Net cash provided by operating activities	\$19,949	\$14,800
Net cash used in investing activities	(30,597)	(25,149)
Net cash provided by financing activities	1,651	49,929

**Cash Flows Provided by Operating Activities**

Net cash provided by operating activities increased to \$19.9 million for the forty weeks ended October 5, 2015 from \$14.8 million for the forty weeks ended October 6, 2014. Net cash provided by operating activities consists primarily of net income, adjusted for non-cash expenses such as depreciation and amortization, and the net change in operating assets and liabilities.

Net cash provided by operating activities for the forty weeks ended October 5, 2015 consisted primarily of net income adjusted for non-cash expenses and an increase in accounts payable, accrued expenses and other and deferred rent.

The increase in accounts payable and accrued expenses and other was primarily related to seasonality, timing of new restaurant openings and the timing of several corporate invoices. The increase in deferred rent was primarily related to new store openings.

Net cash provided by operating activities for the forty weeks ended October 6, 2014 consisted primarily of net income adjusted for non-cash expenses, including charges related to accelerated vesting of stock and stock options in connection with our IPO, and increases in accounts payable, accrued expenses and other and deferred rent. The increase in accounts payable and accrued expenses and other was primarily due to seasonality and the timing of new restaurant openings. The increase in deferred rent was primarily related to new store openings.

**Cash Flows Used in Investing Activities**

Net cash used in investing activities increased to \$30.6 million for the forty weeks ended October 5, 2015 from \$25.1 million for the forty weeks ended October 6, 2014. The increase was primarily due to the timing of new store openings offset by the acquisition of two franchise stores in the forty weeks ended October 5, 2014 for \$1.1 million.

**Cash Flows Provided by Financing Activities**

Cash flows provided by financing activities decreased to \$1.7 million for the forty weeks ended October 5, 2015 from \$49.9 million for the forty weeks ended October 6, 2014, primarily due to \$91.0 million in net proceeds from the sale of common stock in our IPO and follow-on offering offset by a change of \$41.4 million in net payments on our 2011 Credit Facility which was repaid in full following the IPO in 2014. In addition, the forty weeks ended October 5, 2015 included \$1.3 million of proceeds from the exercise of stock options.





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### Credit Facility

On April 16, 2014, we repaid all outstanding borrowings under the 2011 Credit Facility with a portion of the proceeds from our IPO and subsequently terminated our 2011 Credit Agreement.

On February 6, 2015, we entered into the 2015 Credit Facility with Wells Fargo Bank, National Association. The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, together with an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of October 5, 2015, we have no indebtedness under the 2015 Credit Facility.

### Off-Balance Sheet Arrangements

As of October 5, 2015, we did not have any off-balance sheet arrangements.

### Critical Accounting Policies and Estimates

Our discussion and analysis of operating results and financial condition are based upon our financial statements. The preparation of our financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. Our critical accounting policies are those that materially affect our financial statements and involve difficult, subjective or complex judgments by management. Although these estimates are based on management's best knowledge of current events and actions that may impact us in the future, actual results may be materially different from the estimates.

We believe our critical accounting policies are affected by significant judgments and estimates used in the preparation of our consolidated financial statements and that the judgments and estimates are reasonable. Our critical accounting policies and estimates are described in our annual consolidated financial statements and the related notes in our 2014 Form 10-K.

### JOBS Act

On April 5, 2012, the JOBS Act was enacted. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, as a result, we will adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other non-emerging growth companies.

As an emerging growth company, we have relied on certain exemptions and reduced reporting requirements provided by the JOBS Act. As of the end of our second fiscal quarter in the current year (or July 13, 2015), the market value of our common stock held by non-affiliates exceeded \$700 million. Accordingly, we qualify as a large accelerated filer beginning with our Annual Report on Form 10-K for the fiscal year ending December 28, 2015 and will be subject to the reporting and filing requirements applicable to such filers. These requirements include, among other things, (i) providing an auditor's attestation report on our systems of internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, (ii) providing compensation disclosure required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and (iii) complying with applicable requirements adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements (auditor discussion and analysis). To comply with these requirements, we expect to incur additional general and administrative costs related to incremental audit requirements as well as resource needs. While we expect to comply with these requirements in a timely manner, any failure to do so could have a material adverse effect on our business and results of operations.



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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

We are exposed to interest rate risk through fluctuations of interest rates on our investments and debt, as applicable. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations.

Commodity Price Risk

We purchase certain products that are affected by commodity prices and are, therefore, subject to price volatility caused by weather, market conditions and other factors which are not considered predictable or within our control. Although these products are subject to changes in commodity prices, certain purchasing contracts or pricing arrangements we use contain risk management techniques designed to minimize price volatility. In many cases, we believe we will be able to address material commodity cost increases by adjusting our menu pricing or changing our product delivery strategy. However, increases in commodity prices, without adjustments to our menu prices, could increase restaurant operating costs as a percentage of restaurant sales.

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Item 4. Controls and Procedures

Our management establishes and maintains disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Such information is accumulated and communicated to our management, including our President and Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of our disclosure controls and procedures (as defined in the Exchange Act) as of the end of the period covered by this report, with the participation of our CEO and CFO, as well as other key members of our management. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered in this report.

The design of any system of control is based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all future events, no matter how remote, or that the degree of compliance with the policies or procedures may not deteriorate. Because of its inherent limitations, disclosure controls and procedures may not prevent or detect all misstatements. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II - Other Information

Item 1. Legal Proceedings

Refer to Note 10, Commitments and Contingencies, of the Notes to the Unaudited Consolidated Financial Statements.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 29, 2014.

Item 2. Unregistered Sales of Equity and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Index

Exhibit Number	Description of Exhibit
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\* This certification is deemed not filed for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

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SIGNATURES

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

Date: November 19, 2015

ZOE'S KITCHEN, INC.

By: /s/ Kevin Miles  
Name: Kevin Miles  
Title: President and Chief Executive Officer

By: /s/ Sunil Doshi  
Name: Sunil Doshi  
Title: Chief Financial Officer