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Wingstop Inc.
Form 10-Q
October 29, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 29, 2018

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. 001-37425

WINGSTOP INC.

(Exact name of registrant as specified in its charter)

Delaware 47-3494862
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

5501 LBJ Freeway, 5th Floor, 75240
Dallas, Texas
(Address of principal executive offices) (Zip Code)
(972) 686-6500
(Registrant's telephone number, including area code)

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

On October 29, 2018 there were 29,296,047 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WINGSTOP INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(amounts in thousands, except share and per share amounts)

	September 29, 2018 (Unaudited)	December 30, 2017 As adjusted*
Assets		
Current assets		
Cash and cash equivalents	\$ 3,023	\$ 4,063
Accounts receivable, net	3,918	4,567
Prepaid expenses and other current assets	3,313	4,334
Advertising fund assets, restricted	7,484	2,944
Total current assets	17,738	15,908
Property and equipment, net	7,363	5,826
Goodwill	49,655	46,557
Trademarks	32,700	32,700
Customer relationships, net	14,566	15,567
Other non-current assets	5,814	3,278
Total assets	\$ 127,836	\$ 119,836
Liabilities and stockholders' deficit		
Current liabilities		
Accounts payable	\$ 2,133	\$ 1,752
Other current liabilities	10,107	10,929
Current portion of debt	3,750	3,500
Advertising fund liabilities	7,484	2,944
Total current liabilities	23,474	19,125
Long-term debt, net	211,100	129,841
Deferred revenues, net of current	21,866	21,226
Deferred income tax liabilities, net	5,642	5,920
Other non-current liabilities	2,013	2,142
Total liabilities	264,095	178,254
Commitments and contingencies (see Note 7)		
Stockholders' deficit		
Common stock, \$0.01 par value; 100,000,000 shares authorized; 29,296,047 and 29,092,669 shares issued and outstanding as of September 29, 2018 and December 30, 2017, respectively	293	291
Additional paid-in-capital	100	262
Accumulated deficit	(136,652)	(58,971)
Total stockholders' deficit	(136,259)	(58,418)
Total liabilities and stockholders' deficit	\$ 127,836	\$ 119,836

*See Note 1.

See accompanying notes to consolidated financial statements.

WINGSTOP INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(amounts in thousands, except per share data)

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
		As adjusted*		As adjusted*
Revenue:				
Royalty revenue, franchise fees and other	\$ 17,787	\$ 15,872	\$ 52,772	\$ 48,735
Advertising fees and related income	8,614	7,579	25,574	22,313
Company-owned restaurant sales	11,845	9,672	34,326	27,063
Total revenue	38,246	33,123	112,672	98,111
Costs and expenses:				
Cost of sales ⁽¹⁾	8,040	7,823	23,182	21,290
Advertising expenses	8,431	7,665	25,283	24,522
Selling, general and administrative	10,285	8,058	31,196	24,485
Depreciation and amortization	1,134	881	3,163	2,407
Total costs and expenses	27,890	24,427	82,824	72,704
Operating income	10,356	8,696	29,848	25,407
Interest expense, net	2,545	1,302	6,623	3,908
Income before income tax expense	7,811	7,394	23,225	21,499
Income tax expense	1,518	2,690	3,925	5,631
Net income	\$ 6,293	\$ 4,704	\$ 19,300	\$ 15,868
Earnings per share				
Basic	\$ 0.21	\$ 0.16	\$ 0.66	\$ 0.55
Diluted	\$ 0.21	\$ 0.16	\$ 0.65	\$ 0.54
Weighted average shares outstanding				
Basic	29,284	29,081	29,210	29,003
Diluted	29,584	29,384	29,561	29,362
Dividends per share	\$ 0.09	\$ 0.07	\$ 3.40	\$ 0.07

⁽¹⁾ Cost of sales excludes depreciation and amortization, which are presented separately, and includes advertising expenses incurred at company-owned restaurants.

* See Note 1.

See accompanying notes to consolidated financial statements.

WINGSTOP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(amounts in thousands)

(Unaudited)

	Thirty-Nine Weeks Ended	
	September 30, 2018	September 30, 2017 As adjusted*
Operating activities		
Net income	\$ 19,300	\$ 15,868
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	3,163	2,407
Deferred income taxes	(278)	(797)
Stock-based compensation expense	2,012	894
Amortization of debt issuance costs	265	219
Changes in operating assets and liabilities:		
Accounts receivable	649	(1,442)
Prepaid expenses and other assets	(280)	(951)
Advertising fund assets and liabilities, net	4,457	1,887
Accounts payable and other current liabilities	587	(331)
Deferred revenue	877	2,240
Other non-current liabilities	(129)	(127)
Cash provided by operating activities	30,623	19,867
Investing activities		
Purchases of property and equipment	(2,883)	(1,834)
Acquisition of restaurants from franchisees	(5,996)	(3,949)
Cash used in investing activities	(8,879)	(5,783)
Financing activities		
Proceeds from exercise of stock options	506	1,301
Borrowings of long-term debt	231,108	3,500
Repayments of long-term debt	(149,500)	(14,125)
Payment of deferred financing costs	(782)	—
Tax payments for restricted stock upon vesting	(182)	—
Dividends paid	(99,476)	(2,034)
Cash used in financing activities	(18,326)	(11,358)
Net change in cash, cash equivalents, and restricted cash	3,418	2,726
Cash, cash equivalents, and restricted cash at beginning of period	6,392	5,693
Cash, cash equivalents, and restricted cash at end of period	\$ 9,810	\$ 8,419

*See [Note 1](#).

See accompanying notes to consolidated financial statements.

WINGSTOP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation

Basis of Presentation

Wingstop Inc., through its primary operating subsidiary, Wingstop Restaurants Inc. (“WRI”), collectively referred to as “Wingstop” or the “Company,” is in the business of franchising and operating Wingstop restaurants. As of September 29, 2018, 1,059 franchised restaurants were in operation domestically, and 130 international franchised restaurants were in operation across nine countries. As of September 29, 2018, the Company owned and operated 26 restaurants. The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information. Consequently, financial information and disclosures normally included in financial statements prepared annually in accordance with accounting principles generally accepted in the United States have been condensed or omitted. Balance sheet amounts are as of September 29, 2018 and December 30, 2017 and operating results are for the thirteen and thirty-nine weeks ended September 29, 2018 and September 30, 2017.

In the Company’s opinion, all necessary adjustments have been made for the fair presentation of the results of the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year. The accompanying interim unaudited consolidated financial statements should be read in conjunction with the audited financial statements and the related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

The Company uses a 52/53-week fiscal year that ends on the last Saturday of the calendar year. Fiscal years 2018 and 2017 have 52 weeks.

The Company has reclassified certain prior period amounts due to the adoption of ASU 2014-09 and ASU 2016-18, as defined below.

Advertising Fund

The Company administers the Wingstop Restaurants Advertising Fund (“Ad Fund”), which is used for various forms of advertising for the Wingstop brand. Advertising fund contributions and expenditures are reported on a gross basis in the Consolidated Statements of Operations, which are largely offsetting and therefore do not significantly impact our reported net income. Advertising expenses incurred by company-owned restaurants are included within cost of sales in the Consolidated Statements of Operations. Administrative support services and compensation expenses of employees that provide services directly to the Ad Fund, are included in selling, general and administrative expenses (“SG&A”) in the Consolidated Statements of Operations.

The Ad Fund contribution collected from Wingstop restaurant franchisees and company-owned and operated restaurants during the thirty-nine weeks ended September 29, 2018 and September 30, 2017 was equal to 3% of gross sales. For the thirty-nine weeks ended September 29, 2018 and September 30, 2017, the Company contributed \$2.8 million and \$4.8 million, respectively, for the purpose of supplementing the national advertising campaign, which amounts were included in Advertising expenses in the Consolidated Statements of Operations.

The Company consolidates and reports all assets and liabilities of the Ad Fund as restricted assets of the Ad Fund and liabilities of the Ad Fund within current assets and current liabilities, respectively, in the Consolidated Balance Sheets. The assets and liabilities of the Ad Fund consist primarily of cash, receivables, accrued expenses, other liabilities, and any cumulative surplus related to the Ad Fund. Pursuant to the Company’s franchise agreements, use of Ad Fund contributions is restricted to advertising, public relations, merchandising, similar activities, and administrative expenses to increase sales and further enhance the public reputation of the Wingstop brand. The aforementioned administrative expenses may also include personnel expenses and allocated costs incurred by the Company that are directly associated with administering the Ad Fund, as outlined in the provisions of the applicable franchise agreements. Total cash balances related to the Ad Fund as of September 29, 2018 and December 30, 2017 were \$6.8 million and \$2.3 million, respectively.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 amends the existing accounting standards for lease accounting, including

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WINGSTOP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Unaudited)

requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective beginning in the first quarter of fiscal year 2019. Early adoption of ASU 2016-02 as of its issuance is permitted. This new guidance requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company expects to adopt this new guidance in fiscal year 2019 without restating comparative periods. The discounted minimum remaining rental payments will be the starting point for determining the right-of-use asset and lease liability. The Company expects that adoption of the new guidance will have a material impact on the consolidated balance sheets due to the recognition of the right-of-use asset and lease liability related to our current operating leases.

Though the majority of the assessment is complete, the Company continues to evaluate the impact the adoption of this new guidance will have on the Company's consolidated financial statements, as well as the impact on accounting policies and related disclosures. Additionally, the Company is in the process of implementing new accounting systems, business processes, and internal controls related to lease accounting to assist in the application of the new guidance.

In March 2018, the FASB issued ASU 2018-05, Income Taxes (Topic 740) ("ASU 2018-05"). ASU 2018-05 provides guidance on accounting for the income tax effects of the Tax Cuts and Jobs Act of 2017 (the "Act"), which impacts U.S. corporate tax rates, business-related exclusions, and deductions and credits. The Act also has tax consequences for many companies that operate internationally. The Company recognized the income tax effects of the Act in its 2017 financial statements in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of Accounting Standards Codification ("ASC") Topic 740, "Income Taxes," in the reporting period in which the Act was signed into law. As such, the Company's financial results reflect the income tax effects of the Act for which the accounting under ASC Topic 740 is complete and provisional amounts for those specific income tax effects of the Act for which the accounting under ASC Topic 740 is incomplete but a reasonable estimate could be determined.

The Company will continue to analyze additional information and guidance related to the Act as supplemental legislation, regulatory guidance, or evolving technical interpretations become available. The final impacts may differ from the recorded amounts as of September 29, 2018, and we will continue to refine such amounts within the measurement period provided by Staff Accounting Bulletin No. 118. We expect to complete our analysis no later than the fourth quarter of 2018.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which superseded nearly all existing revenue recognition guidance. The new guidance provided a single framework in which revenue is required to be recognized to depict the transfer of goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services.

The Company adopted this new guidance effective the first day of fiscal year 2018, using the full retrospective transition method, which resulted in adjusting each prior reporting period presented and a cumulative effect adjustment, which was recorded as of the first day of 2016. The adoption changed the timing of recognition of initial franchise fees, development fees, territory fees for our international business and renewal and transfer fees, as well as the reporting of Ad Fund contributions and related expenditures. See Note 11 to our consolidated financial statements, Revenue from Contracts with Customers, for further discussion.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), which requires that restricted cash and cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. ASU 2016-18 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017 and a retrospective transition method is required. The Company adopted this new guidance effective the first day of fiscal year 2018, using the full retrospective transition

method, which resulted in adjusting the Statement of Cash Flows for each prior period presented.

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WINGSTOP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Unaudited)

The following table presents the effect of the adoption of ASU 2014-09 on our consolidated balance sheets as of December 30, 2017 (in thousands):

	As reported	Adjustments for adoption of ASU 2014-09	As Adjusted
Assets			
Current assets			
Cash and cash equivalents	\$ 4,063	\$ —	—\$ 4,063
Accounts receivable, net	4,567	—	4,567
Prepaid expenses and other current assets	4,334	—	4,334
Advertising fund assets, restricted	2,944	—	2,944
Total current assets	15,908	—	15,908
Property and equipment, net	5,826	—	5,826
Goodwill	46,557	—	46,557
Trademarks	32,700	—	32,700
Customer relationships, net	15,567	—	