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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 | — | 15,567 |
| Other non-current assets | 3,278 | — | 3,278 |
| Total assets | \$119,836 | \$ — | \$119,836 |
| Liabilities and stockholders' deficit | | | |
| Current liabilities | | | |
| Accounts payable | \$1,752 | \$ — | \$1,752 |
| Other current liabilities | 10,683 | 246 | 10,929 |
| Current portion of debt | 3,500 | — | 3,500 |
| Advertising fund liabilities | 2,944 | — | 2,944 |
| Total current liabilities | 18,879 | 246 | 19,125 |
| Long-term debt, net | 129,841 | — | 129,841 |
| Deferred revenues, net of current | 8,427 | 12,799 | 21,226 |
| Deferred income tax liabilities, net | 8,799 | (2,879) | 5,920 |
| Other non-current liabilities | 2,142 | — | 2,142 |
| Total liabilities | 168,088 | 10,166 | 178,254 |
| Commitments and contingencies (see Note 7) | | | |
| Stockholders' deficit | | | |
| Common stock | 291 | — | 291 |
| Additional paid-in-capital | 262 | — | 262 |
| Accumulated deficit | (48,805) | (10,166) | (58,971) |
| Total stockholders' deficit | (48,252) | (10,166) | (58,418) |
| Total liabilities and stockholders' deficit | \$119,836 | \$ — | \$119,836 |

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 statements of operations for the thirteen weeks ended September 30, 2017 (in thousands, except per share amounts):

| | Adjustments for adoption of ASU 2014-09 | | | |
|---|---|-------------------|-------------|----------------|
| | As reported | Franchise Fees | Advertising | As Adjusted |
| Revenue: | | | | |
| Royalty revenue, franchise fees and other | \$ 16,354 | \$(482) | \$ — | \$ 15,872 |
| Advertising fees and related income | — | — | 7,579 | 7,579 |
| Company-owned restaurant sales | 9,672 | — | — | 9,672 |
| Total revenue | 26,026 | (482) | 7,579 | 33,123 |
| Costs and expenses: | | | | |
| Cost of sales ⁽¹⁾ | 7,823 | — | — | 7,823 |
| Advertising expenses | — | — | 7,665 | 7,665 |
| Selling, general and administrative | 8,144 | — | (86) | 8,058 |
| Depreciation and amortization | 881 | — | — | 881 |
| Total costs and expenses | 16,848 | — | 7,579 | 24,427 |
| Operating income | 9,178 | (482) | — | 8,696 |
| Interest expense, net | 1,302 | — | — | 1,302 |
| Income before income tax expense | 7,876 | (482) | — | 7,394 |
| Income tax expense | 2,864 | (174) | — | 2,690 |
| Net income | \$ 5,012 | \$(308) | \$ — | \$ 4,704 |
| Earnings per share | | | | |
| Basic | \$ 0.17 | \$(0.01) | \$ — | \$ 0.16 |
| Diluted | \$ 0.17 | \$(0.01) | \$ — | \$ 0.16 |

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

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 statements of operations for the thirty-nine weeks ended September 30, 2017 (in thousands, except per share amounts):

| | As reported | Adjustments for adoption of ASU 2014-09 | As Adjusted |
|---|----------------|---|----------------|
| | | Franchise Fees Advertising | |
| Revenue: | | | |
| Royalty revenue, franchise fees and other | \$ 50,204 | \$(1,469) | \$ 48,735 |
| Advertising fees and related income | — | — | 22,313 |
| Company-owned restaurant sales | 27,063 | — | 27,063 |
| Total revenue | 77,267 | (1,469) | 98,111 |
| Costs and expenses: | | | |
| Cost of sales ⁽¹⁾ | 21,290 | — | 21,290 |
| Advertising expenses | — | — | 24,522 |
| Selling, general and administrative | 26,694 | — | (2,209) |
| Depreciation and amortization | 2,407 | — | 2,407 |
| Total costs and expenses | 50,391 | — | 22,313 |
| Operating income | 26,876 | (1,469) | — |
| Interest expense, net | 3,908 | — | — |
| Income before income tax expense | 22,968 | (1,469) | — |
| Income tax expense | 6,161 | (530) | — |
| Net income | \$ 16,807 | \$(939) | \$ — |
| Earnings per share | | | |
| Basic | \$ 0.58 | \$(0.03) | \$ — |
| Diluted | \$ 0.57 | \$(0.03) | \$ — |

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

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

The following table presents the effect of the adoption of ASU 2014-09 and ASU 2016-18 on our consolidated statements of cash flows for the thirty-nine weeks ended September 30, 2017 (in thousands):

| | As reported | Adjustments for adoption of ASU 2014-09 | Adjustments for adoption of ASU 2016-18 | As adjusted |
|---|-------------|---|---|-------------|
| Operating activities | | | | |
| Net income | \$16,807 | \$ (939) | \$ — | \$15,868 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | | |
| Depreciation and amortization | 2,407 | — | — | 2,407 |
| Deferred income taxes | (265) | (532) | — | (797) |
| Stock-based compensation expense | 894 | — | — | 894 |
| Amortization of debt issuance costs | 219 | — | — | 219 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (1,442) | — | — | (1,442) |
| Prepaid expenses and other assets | (951) | — | — | (951) |
| Advertising fund assets and liabilities, net | — | — | 1,887 | 1,887 |
| Accounts payable and other current liabilities | (331) | — | — | (331) |
| Deferred revenue | 769 | 1,471 | — | 2,240 |
| Other non-current liabilities | (127) | — | — | (127) |
| Cash provided by operating activities | 17,980 | — | 1,887 | 19,867 |
| Investing activities | | | | |
| Purchases of property and equipment | (1,834) | — | — | (1,834) |
| Acquisition of restaurant from franchisee | (3,949) | — | — | (3,949) |
| Cash used in investing activities | (5,783) | — | — | (5,783) |
| Financing activities | | | | |
| Proceeds from exercise of stock options | 1,301 | — | — | 1,301 |
| Borrowings of long-term debt | 3,500 | — | — | 3,500 |
| Repayments of long-term debt | (14,125) | — | — | (14,125) |
| Dividends paid | (2,034) | — | — | (2,034) |
| Cash used in financing activities | (11,358) | — | — | (11,358) |
| Net change in cash, cash equivalents, and restricted cash | 839 | — | 1,887 | 2,726 |
| Cash, cash equivalents, and restricted cash at beginning of period | 3,750 | — | 1,943 | 5,693 |
| Cash, cash equivalents, and restricted cash at end of period | \$4,589 | — | \$ 3,830 | \$8,419 |

(2) Earnings per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities convertible into or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted earnings per share, the basic weighted average number of shares is increased by the dilutive effect of stock options and restricted stock units, determined using the treasury stock method.

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

Basic weighted average shares outstanding is reconciled to diluted weighted average shares outstanding as follows (in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|---|----------------------|--------------------|-------------------------|--------------------|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| Basic weighted average shares outstanding | 29,284 | 29,081 | 29,210 | 29,003 |
| Dilutive shares | 300 | 303 | 351 | 359 |
| Diluted weighted average shares outstanding | 29,584 | 29,384 | 29,561 | 29,362 |

For the thirteen weeks ended September 29, 2018 and September 30, 2017, equity awards representing approximately 1,000 and 3,000 shares, respectively, were excluded from the dilutive earnings per share calculation because the effect would have been anti-dilutive.

For the thirty-nine weeks ended September 29, 2018 and September 30, 2017, equity awards representing approximately 4,000 and 11,000 shares, respectively, were excluded from the dilutive earnings per share calculation because the effect would have been anti-dilutive.

(3) Dividends

During 2018, the Company's Board of Directors approved a quarterly dividend of \$0.07 per share of common stock in each of the first two quarters, and a quarterly dividend of \$0.09 per share of common stock in the third quarter, with aggregate dividends of \$6.8 million, or \$0.23 per common share, which were paid during the thirty-nine weeks ended September 29, 2018. On January 30, 2018, the Company's Board of Directors declared a special cash dividend of \$3.17 per share, which was paid on February 14, 2018, totaling \$92.7 million.

Subsequent to the third quarter, on October 26, 2018, the Company's Board of Directors declared a quarterly dividend of \$0.09 per share of common stock for stockholders of record as of December 4, 2018, to be paid on December 18, 2018, totaling approximately \$2.6 million.

(4) Fair Value Measurements

Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. Assets and liabilities are classified using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value as follows:

Level 1 — Unadjusted quoted prices for identical instruments traded in active markets.

Level 2 — Observable market-based inputs or unobservable inputs corroborated by market data.

Level 3 — Unobservable inputs reflecting management's estimates and assumptions.

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to their short-term nature. Fair value of debt is determined on a non-recurring basis, which results are summarized as follows (in thousands):

| | Fair Value Hierarchy | September 29, 2018 | | December 30, 2017 | |
|---------------------------------|----------------------|--------------------|----------------|--------------------|----------------|
| | | Carrying Value (1) | Fair Value (2) | Carrying Value (1) | Fair Value (2) |
| Senior Secured Credit Facility: | | | | | |
| Term loan facility | Level 2 | \$96,250 | \$96,250 | \$64,750 | \$64,750 |
| Revolving credit facility | Level 2 | \$119,108 | \$119,108 | \$69,000 | \$69,000 |

(1) Excluding issuance costs netted on the Consolidated Balance Sheet.

(2) The fair value of long-term debt was estimated using available market information.

The Company also measures certain non-financial assets (primarily long-lived assets, intangible assets, and goodwill) at fair value on a non-recurring basis in connection with its periodic evaluations of such assets for potential

impairment.

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(5) Income Taxes

Income tax expense and the effective tax rate were \$1.5 million and 19.4%, respectively, for the thirteen weeks ended September 29, 2018, and \$2.7 million and 36.4%, respectively, for the thirteen weeks ended September 30, 2017. Income tax expense and the effective tax rate were \$3.9 million and 16.9%, respectively, for the thirty-nine weeks ended September 29, 2018, and \$5.6 million and 26.2%, respectively, for the thirty-nine weeks ended September 30, 2017.

Income tax expense for the thirteen and thirty-nine weeks ended September 29, 2018 includes \$0.3 million and \$1.8 million, respectively, in tax benefits resulting from the recognition of excess tax benefits from stock-based compensation, compared to \$0.1 million and \$2.5 million of tax benefits recognized in the thirteen and thirty-nine weeks ended September 30, 2017, respectively. Income tax expense for the thirteen and thirty-nine weeks ended September 29, 2018 also reflects the reduction in the federal statutory rate from 35% to 21% effective the first day of fiscal 2018.

(6) Debt Obligations

On January 30, 2018, the Company entered into an amended senior secured credit facility (the “2018 Facility”), which replaced its senior secured credit facility dated June 30, 2016 (the “2016 Facility”). The 2018 Facility includes a term loan facility in an aggregate principal amount of \$100 million and a revolving credit facility up to an aggregate principal amount of \$150 million. The Company used the proceeds from the 2018 Facility to refinance \$133.8 million of indebtedness under the 2016 Facility and to pay a special dividend of \$92.7 million to its stockholders. Borrowings under the 2018 Facility bear interest, payable quarterly, at the Company’s option, at the base rate plus a margin (0.75% to 1.75%, dependent on the Company’s reported leverage ratio) or LIBOR plus a margin (1.75% to 2.75%, dependent on the Company’s reported leverage ratio). The 2018 Facility matures in January 2023. As of September 29, 2018, the term loan facility and the revolving credit facility under the 2018 Facility had outstanding balances of \$96.3 million and \$119.1 million, respectively, bearing interest at 4.49%. During the thirty-nine weeks ended September 29, 2018, the Company made payments of \$12.0 million and \$3.8 million on the outstanding principal balance of its revolving credit facility and term loan facility, respectively, under the 2018 Facility.

In conjunction with the 2018 Facility, the Company evaluated the refinancing of the 2016 Facility and determined \$202.5 million should be accounted for as a debt modification and \$47.5 million should be new debt issuance. The Company incurred \$1.0 million in financing costs of which \$0.2 million was expensed and \$0.8 million was capitalized and is being amortized using the effective interest rate method.

The 2018 Facility is secured by substantially all assets of the Company and requires compliance with certain financial and non-financial covenants. As of September 29, 2018, the Company was in compliance with all covenants.

As of September 29, 2018, the scheduled principal payments on debt outstanding under the 2018 Facility were as follows (in thousands):

| | |
|-------------------------------|-----------|
| Remainder of fiscal year 2018 | \$ 1,250 |
| Fiscal year 2019 | 3,750 |
| Fiscal year 2020 | 5,000 |
| Fiscal year 2021 | 5,000 |
| Fiscal year 2022 | 6,250 |
| Fiscal year 2023 | 194,108 |
| Total | \$215,358 |

(7) Commitments and Contingencies

WRI leases certain office and retail space and equipment under non-cancelable operating leases with terms expiring at various dates through March 2034.

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A schedule of future minimum rental payments required under our operating leases, excluding contingent rent, that have initial or remaining non-cancelable lease terms in excess of one year, as of September 29, 2018, is as follows (in thousands):

| | |
|-------------------------------|----------|
| Remainder of fiscal year 2018 | \$493 |
| Fiscal year 2019 | 1,970 |
| Fiscal year 2020 | 1,855 |
| Fiscal year 2021 | 1,703 |
| Fiscal year 2022 | 1,651 |
| Fiscal year 2023 | 1,451 |
| Thereafter | 4,979 |
| Total | \$14,102 |

Rent expense under cancelable and non-cancelable leases was \$556,000 and \$508,000 for the thirteen weeks ended September 29, 2018 and September 30, 2017, respectively, and \$1.7 million and \$1.5 million for the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively.

The Company is subject to legal proceedings, claims, and liabilities, such as employment-related claims and premises-liability cases, which arise in the ordinary course of business and are generally covered by insurance. In the opinion of management, the amount of ultimate liability with respect to such actions is not likely to have a material adverse impact on the Company's financial position, results of operations, or cash flows.

(8) Stock-Based Compensation

Stock-based compensation is measured at the date of grant, based on the calculated fair value of the award, and is recognized as expense over the requisite employee service period (generally the vesting period of the grant). The Company recognized \$2.0 million in stock-based compensation expense for the thirty-nine weeks ended September 29, 2018, with a corresponding increase to additional paid-in-capital. Stock-based compensation expense is included in SG&A in the Consolidated Statements of Operations.

Stock Options

The following table summarizes stock option activity (in thousands, except per share data):

| | Stock Options | Weighted Average Exercise Price | Aggregate Intrinsic Value | Weighted Average Remaining Term |
|----------------------------------|------------------|--|---------------------------------|---------------------------------|
| Outstanding - December 30, 2017 | 420 | \$ 5.45 | \$ 14,068 | 5.7 |
| Options granted | 2 | 44.03 | | |
| Options exercised | (157) | 3.22 | | |
| Options canceled | (27) | 6.68 | | |
| Outstanding - September 29, 2018 | 238 | \$ 6.18 | \$ 14,741 | 5.0 |

The total grant-date fair value of stock options vested during the thirty-nine weeks ended September 29, 2018 was \$0.5 million. The total intrinsic value of stock options exercised during the thirty-nine weeks ended September 29, 2018 was \$7.6 million. As of September 29, 2018, total unrecognized compensation expense related to unvested stock options was \$0.5 million, which is expected to be recognized over a weighted-average period of 1.3 years.

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Restricted Stock Units and Performance Stock Units

The following table summarizes activity related to restricted stock units (“RSUs”) and performance stock units (“PSUs”) (in thousands, except per share data):

| | Restricted Stock Units | Weighted Average Grant Date Fair Value | Performance Stock Units | Weighted Average Grant Date Fair Value |
|----------------------------------|------------------------------|--|----------------------------|--|
| Outstanding - December 30, 2017 | 94 | \$ 27.11 | 86 | \$ 27.63 |
| Units granted | 62 | 44.51 | 72 | 46.80 |
| Units vested | (31) | 27.12 | (14) | 26.25 |
| Units canceled | (19) | 31.19 | (15) | 31.65 |
| Outstanding - September 29, 2018 | 106 | \$ 36.58 | 129 | \$ 40.74 |

The fair value of the Company’s RSUs and PSUs is based on the closing market price of the stock on the date of grant. The RSUs granted during the thirty-nine weeks ended September 29, 2018 vest over a three year service period. As of September 29, 2018, total unrecognized compensation expense related to unvested RSUs was \$3.0 million, which is expected to be recognized over a weighted-average period of 2.0 years.

The Company granted 72,130 PSUs during the thirty-nine weeks ended September 29, 2018 that are based on the outcome of certain performance criteria. Of the total PSUs granted, 56,840 are subject to a service condition and a performance vesting condition based on the achievement of certain adjusted EBITDA targets, as defined by the plan, over a performance period of one to three years. The compensation expense related to these PSUs is recognized over the vesting period when the achievement of the performance conditions becomes probable. The total compensation cost for the PSUs is determined based on the most likely outcome of the performance condition and the number of awards expected to vest. The remaining 15,290 PSUs granted are subject to a service condition and a performance vesting condition based on the level of new sales growth achieved over the performance period. The maximum vesting percentage that could be realized for each of the PSUs is 500% based on the level of performance achieved for the respective awards, as well as a market vesting condition linked to the level of total stockholder return received by the Company’s stockholders during the performance period measured against the companies in the S&P 600 Restaurant Index (“TSR PSUs”). The TSR PSUs were valued based on a Monte Carlo simulation model to reflect the impact of the total stockholder return market condition, resulting in a grant-date fair value range of \$0.00 to \$179.27 per unit based on the outcome of the performance condition. The probability of satisfying a market condition is considered in the estimation of the grant-date fair value for TSR PSUs and the compensation cost is not reversed if the market condition is not achieved, provided the requisite service has been provided.

As of September 29, 2018, total unrecognized compensation expense related to unvested PSUs was \$4.5 million, which is expected to be recognized over a weighted-average period of 1.9 years.

Restricted Stock Awards

The fair value of the unvested restricted stock awards is based on the closing price on the date of grant. As of September 29, 2018, total unrecognized compensation expense related to unvested restricted stock awards was \$0.5 million, which will be recognized over a weighted average period of approximately 1.9 years.

(9) Business Segments

The Company’s business operates in two segments: the “Franchise” segment and the “Company” segment. The Franchise segment consists of domestic and international franchise restaurants, which represent the majority of our system-wide restaurants. As of September 29, 2018, the Franchise segment consisted of 1,189 restaurants operated by Wingstop franchisees in the United States and nine countries outside of the United States, compared to 1,065 franchised restaurants in operation as of September 30, 2017. Franchise segment revenue consists primarily of franchise royalty revenue, advertising fee revenue, franchise and development fees revenue, and international territory fees.

As of September 29, 2018, the Company segment consisted of 26 company-owned restaurants located in the United States, compared to 23 company-owned restaurants as of September 30, 2017. Company segment sales are comprised of food and beverage sales at company-owned restaurants. Company segment expenses consist of operating expenses at company-owned restaurants and include food, beverage, labor, benefits, utilities, rent, and other operating costs.

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The following table reflects revenue and profit information with respect to each segment and reconciles segment profits to income before taxes (in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|------------------------------------|----------------------|------------------------------------|-------------------------|------------------------------------|
| | September 29, 2018 | September 30, 2017 As adjusted* | September 29, 2018 | September 30, 2017 As adjusted* |
| Revenue: | | | | |
| Franchise segment | \$26,401 | \$ 23,451 | \$78,346 | \$ 71,048 |
| Company segment | 11,845 | 9,672 | 34,326 | 27,063 |
| Total segment revenue | \$38,246 | \$ 33,123 | \$112,672 | \$ 98,111 |
| Segment Profit: | | | | |
| Franchise segment | \$7,663 | \$ 7,763 | \$23,418 | \$ 22,317 |
| Company segment | 2,693 | 933 | 7,892 | 3,090 |
| Total segment profit | 10,356 | 8,696 | 31,310 | 25,407 |
| Corporate and other ⁽¹⁾ | — | — | 1,462 | — |
| Interest expense, net | 2,545 | 1,302 | 6,623 | 3,908 |
| Income before taxes | \$7,811 | \$ 7,394 | \$23,225 | \$ 21,499 |

⁽¹⁾ Corporate and other includes corporate related items not allocated to reportable segments and consists primarily of expenses associated with the refinancing of the 2016 Facility and payment of a special dividend.

* See Note 1.

(10) Restaurant Acquisitions

On February 19, 2018, April 16, 2018 and May 1, 2018, the Company acquired one existing restaurant each from three separate franchisees (the "Acquisitions"). The total purchase prices were \$1.9 million, \$1.9 million, and \$2.2 million, respectively, which were funded by cash flows from operations.

The following table summarizes the preliminary allocations of the purchase prices to the estimated fair values of assets acquired and liabilities assumed in connection with the Acquisitions, at the respective dates of such acquisitions (in thousands):

| | Purchase Price Allocation | | |
|-----------------------------|----------------------------------|-------------------------------|----------------------------|
| | February 19, 2018 Acquisition | April 16, 2018 Acquisition | May 1, 2018 Acquisition |
| Working capital | \$4 | \$ 20 | \$ 7 |
| Property and equipment | 26 | 160 | 28 |
| Reacquired franchise rights | 541 | 1,277 | 887 |
| Goodwill | 1,331 | 458 | 1,309 |
| Gift card liability | (2) | — | — |
| Total purchase price | \$1,900 | \$ 1,915 | \$ 2,231 |

The results of operations of the acquired restaurants beginning as of their respective dates of acquisition are included in our Consolidated Statements of Operations. The Acquisitions were accounted for as business combinations.

The estimates of fair value are preliminary, and are therefore subject to further refinement. The excess of the purchase price over the aggregate fair value of assets acquired was allocated to goodwill and is attributable to the benefits expected as a result of the Acquisitions, including sales and unit growth opportunities. As of September 29, 2018, \$3.1 million of the goodwill from the Acquisitions is expected to be deductible for federal income tax purposes.

Pro-forma financial information for the Acquisitions is not presented due to the immaterial impact of the financial results of the acquired restaurants on our consolidated financial statements.

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The fair value measurements of tangible and intangible assets and liabilities as of the respective dates of acquisition are based on significant inputs not observed in the market and thus represent Level 3 fair value measurements. Fair value measurements for reacquired franchise rights were determined using the income approach. Fair value measurements for property and equipment were determined using the cost approach.

(11) Revenue from Contracts with Customers

Revenue from contracts with customers consists primarily of royalties, Ad Fund contributions, initial and renewal franchise fees, and upfront fees from development agreements and international territory agreements. These performance obligations under franchise agreements consist of (a) a franchise license, (b) pre-opening services, such as training, and (c) ongoing services, such as management of the Ad Fund, development of training materials and menu items, and restaurant monitoring. These performance obligations are highly interrelated, so they are not considered to be individually distinct and therefore are accounted for as a single performance obligation, which is satisfied by providing a right to use our intellectual property over the term of each franchise agreement.

Royalties, including franchisee contributions to the Ad Fund, are calculated as a percentage of franchise restaurant sales over the term of the franchise agreement. Initial and renewal franchise fees are payable by the franchisee prior to the restaurant opening or at the time of a renewal of an existing franchise agreement. Franchise agreement royalties, inclusive of Ad Fund contributions, represent sales-based royalties that are related entirely to the performance obligation under the franchise agreement and are recognized as franchise sales occur. Additionally, initial and renewal franchise fees are recognized as revenue on a straight-line basis over the term of the respective agreement. The performance obligation under development agreements and international territory agreements generally consists of an obligation to grant exclusive development rights over a stated term. These development rights are not distinct from franchise agreements, so upfront fees paid by franchisees for development rights are deferred and apportioned to each franchise restaurant opened by the franchisee. The pro rata amount apportioned to each restaurant is accounted for as an initial franchise fee.

The following table represents a disaggregation of revenue from contracts with customers for the thirteen and thirty-nine weeks ended September 29, 2018 and September 30, 2017 (in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|-------------------------------------|----------------------|--------------------|-------------------------|--------------------|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| | | As adjusted* | | As adjusted* |
| Royalty revenue | \$ 15,461 | \$ 13,415 | \$ 45,797 | \$ 39,239 |
| Advertising fees and related income | 8,614 | 7,579 | 25,574 | 22,313 |
| Franchise fees | 656 | 598 | 1,959 | 1,865 |

* See [Note 1](#).

Franchise fee, development fee, and international territory fee payments received by the Company are recorded as deferred revenue on the Consolidated Balance Sheets, which represents a contract liability. Deferred revenue is reduced as fees are recognized in revenue over the term of the franchise license for the respective restaurant. Approximately \$9.6 million and \$10.1 million of deferred revenue as of September 29, 2018 and December 30, 2017, respectively, relates to restaurants that have not yet opened, so the fees are not yet being amortized. The weighted average remaining amortization period for deferred franchise and renewal fees related to open restaurants is 7.6 years. The Company does not have any material contract assets as of September 29, 2018.

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(12) Subsequent Events

Subsequent to the fiscal third quarter of 2018, the Company announced its intention to complete a refinancing transaction. A wholly owned subsidiary of the Company intends to issue approximately \$300 million of new, fixed rate notes and use the proceeds to prepay and retire all of the Company's existing debt, to pay transaction costs associated with the transaction, and for general corporate purposes. In connection therewith, the Company also expects to enter into a new \$25 million variable funding note facility. The Company anticipates that the refinancing transaction will close during the fiscal fourth quarter of 2018.

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

The following discussion and analysis of the financial condition and results of operations of Wingstop Inc.

(collectively with its direct and indirect subsidiaries on a consolidated basis, "Wingstop," the "Company," "we," "our," or "us") should be read in conjunction with the accompanying unaudited consolidated financial statements and related notes in Part I, Item 1 of this Quarterly Report on Form 10-Q (this "Quarterly Report") and with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017 (our "Annual Report"). The statements in this discussion regarding industry outlook, our expectations regarding our future performance, liquidity, and capital resources, and other non-historical statements are forward-looking statements. These forward-looking statements are subject to risks and uncertainties, including, but not limited to, the risks and uncertainties described in "Special Note Regarding Forward-Looking Statements," below, and "Risk Factors" on page 15 of our Annual Report. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

We operate on a 52 or 53 week fiscal year ending on the last Saturday of each calendar year. Our fiscal quarters are comprised of 13 weeks, with the exception of the fourth quarter of a 53 week year, which contains 14 weeks. Fiscal years 2018 and 2017 each contain 52 weeks.

Amounts presented in this Part I, Item 2 for the thirteen and thirty-nine weeks ended September 30, 2017 have been retrospectively adjusted to reflect the adoption of ASU 2014-09. See Note 1 to our consolidated financial statements, Basis of Presentation, for more information regarding such adjustment.

Overview

Wingstop is a high-growth franchisor and operator of restaurants that offer cooked-to-order, hand-sauced and tossed chicken wings.

We believe we pioneered the concept of wings as a "center-of-the-plate" item for all of our meal occasions. While other concepts include wings as add-on menu items or focus on wings in a bar or sports-centric setting, we are singularly focused on wings, fries, and sides, which generate approximately 92% of our system-wide sales.

We offer 11 bold, distinctive, and craveable flavors on our bone-in and boneless chicken wings, paired with hand-cut, seasoned fries and sides made fresh daily. Our menu is highly-customizable for different dining occasions, and we believe it delivers a compelling value proposition for groups, families, and individuals. We have broad and growing consumer appeal anchored by a sought after core demographic of 18-34 year old Millennials, which we believe is a loyal consumer group that dines at fast casual restaurants more frequently than other groups.

Wingstop is the largest fast casual chicken wings-focused restaurant chain in the world and has demonstrated strong, consistent growth. As of September 29, 2018, we had a total of 1,215 restaurants across ten countries in our global system (including 43 states in the United States). Our restaurant base is 98% franchised, with 1,189 franchised locations (including 130 international locations) and 26 company-owned restaurants as of September 29, 2018.

Key Performance Indicators

Key measures that we use in evaluating our restaurants and assessing our business include the following:

Number of restaurants. Management reviews the number of new restaurants, the number of closed restaurants, and the number of acquisitions and divestitures of restaurants to assess net new restaurant growth.

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|-------------------------------|----------------------|--------------------|-------------------------|--------------------|
| | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Domestic Franchised Activity: | | | | |
| Beginning of period | 1,040 | 946 | 1,004 | 901 |
| Openings | 21 | 28 | 64 | 79 |
| Closures | (2) | (1) | (6) | (7) |
| Acquired by Company | — | (2) | (3) | (2) |
| Restaurants end of period | 1,059 | 971 | 1,059 | 971 |

Domestic Company-Owned Activity:

| | | | | |
|---------------------------|----|----|----|----|
| Beginning of period | 26 | 21 | 23 | 21 |
| Openings | — | — | — | — |
| Closures | — | — | — | — |
| Acquired from franchisees | — | 2 | 3 | 2 |
| Restaurants end of period | 26 | 23 | 26 | 23 |

| | | | | |
|----------------------------|-------|-----|-------|-----|
| Total Domestic Restaurants | 1,085 | 994 | 1,085 | 994 |
|----------------------------|-------|-----|-------|-----|

International Franchised Activity:

| | | | | |
|---------------------------|-----|----|-----|------|
| Beginning of period | 122 | 89 | 106 | 76 |
| Openings | 8 | 5 | 24 | 20 |
| Closures | — | — | — | (2) |
| Restaurants end of period | 130 | 94 | 130 | 94 |

| | | | | |
|-------------------------------|-------|-------|-------|-------|
| Total System-wide Restaurants | 1,215 | 1,088 | 1,215 | 1,088 |
|-------------------------------|-------|-------|-------|-------|

System-wide sales. System-wide sales represents net sales for all of our company-owned and franchised restaurants, with franchised restaurant sales reported by franchisees. While we do not record franchised restaurant sales as revenue, our royalty revenue is calculated based on a percentage of franchised restaurant sales, which generally ranges from 5.0% to 6.0% of gross sales, net of discounts. This measure allows management to better assess changes in our royalty revenue, our overall store performance, the health of our brand, and the strength of our market position relative to competitors. Our system-wide sales growth is driven by new restaurant openings as well as increases in same store sales.

Average unit volume (“AUV”). AUV consists of the average annual sales of all restaurants that have been open for a trailing 52-week period or longer. This measure is calculated by dividing sales during the applicable period for all restaurants being measured by the number of restaurants being measured. Domestic AUV includes revenue from both company-owned and franchised restaurants. AUV allows management to assess our company-owned and franchised restaurant economics. Changes in AUV are primarily driven by increases in same store sales and are also influenced by opening new restaurants.

Same store sales. Same store sales reflects the change in year-over-year sales for the same store base. We define the same store base to include those restaurants open for at least 52 full weeks. This measure highlights the performance of existing restaurants, while excluding the impact of new restaurant openings and closures. We review same store sales for company-owned restaurants as well as franchised restaurants. Same store sales are driven by changes in transactions and average transaction size. Transaction size changes are driven by price changes or product mix shifts from either a change in the number of items purchased or shifts into higher or lower priced categories of items.

EBITDA and Adjusted EBITDA. We define EBITDA as net income before interest expense, net, income tax expense, and depreciation and amortization. We define Adjusted EBITDA as EBITDA further adjusted for transaction costs, gains and losses on the disposal of assets, and stock-based compensation expense. EBITDA and Adjusted EBITDA may not be comparable to other similarly titled measures of other companies due to differences in methods of calculation. For a reconciliation of net income to EBITDA and Adjusted EBITDA and for further discussion of EBITDA and Adjusted EBITDA as non-GAAP measures and how we utilize them, see footnote 2 below. The following table sets forth our key performance indicators as well as our total revenue and net income for the thirteen and thirty-nine weeks ended September 29, 2018 and September 30, 2017 (dollars in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|---|----------------------|--------------------|-------------------------|--------------------|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| Number of system-wide restaurants open at end of period | 1,215 | 1,088 | 1,215 | 1,088 |
| System-wide sales ⁽¹⁾ | \$315,312 | \$274,021 | \$933,250 | \$802,420 |
| Domestic restaurant AUV | \$1,131 | \$1,102 | \$1,131 | \$1,102 |
| System-wide domestic same store sales growth | 6.3 | % 4.1 | % 6.7 | % 1.7 |
| Company-owned domestic same store sales growth | 5.0 | % 5.5 | % 6.8 | % 0.5 |
| Total revenue | \$38,246 | \$33,123 | \$112,672 | \$98,111 |
| Net income | \$6,293 | \$4,704 | \$19,300 | \$15,868 |
| Adjusted EBITDA ⁽²⁾ | \$12,246 | \$9,930 | \$36,485 | \$28,708 |

(1) The percentage of system-wide sales attributable to company-owned restaurants was 3.8% and 3.5% for the thirteen weeks ended September 29, 2018 and September 30, 2017, respectively, and was 3.7% and 3.4% for the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively. The remainder was generated by franchised restaurants, as reported by our franchisees.

(2) EBITDA and Adjusted EBITDA are supplemental measures of our performance that are not required by, or presented in accordance with, accounting principles generally accepted in the United States (“GAAP”). EBITDA and Adjusted EBITDA are not measurements of our financial performance under GAAP and should not be considered as an alternative to net income or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of our liquidity.

We define “EBITDA” as net income before interest expense, net, income tax expense, and depreciation and amortization. We define “Adjusted EBITDA” as EBITDA further adjusted for transaction costs, gains and losses on the disposal of assets, and stock-based compensation expense. There were no gains or losses on disposal of assets during the thirteen and thirty-nine weeks ended September 29, 2018 and September 30, 2017. We caution investors that amounts presented in accordance with our definitions of EBITDA and Adjusted EBITDA may not be comparable to similar measures disclosed by our competitors, because not all companies and analysts calculate EBITDA and Adjusted EBITDA in the same manner. We present EBITDA and Adjusted EBITDA because we consider them to be important supplemental measures of our performance and believe they are frequently used by securities analysts, investors, and other interested parties in the evaluation of companies in our industry. Management believes that investors’ understanding of our performance is enhanced by including these non-GAAP financial measures as a reasonable basis for comparing our ongoing results of operations. Many investors are interested in understanding the performance of our business by comparing our results from ongoing operations on a period-over-period basis and would ordinarily add back non-cash expenses such as depreciation and amortization, as well as items that are not part of normal day-to-day operations of our business.

Management uses EBITDA and Adjusted EBITDA:

- as a measurement of operating performance because they assist us in comparing the operating performance of our restaurants on a consistent basis, as they remove the impact of items not directly resulting from our core operations;
- for planning purposes, including the preparation of our internal annual operating budget and financial projections;
- to evaluate the performance and effectiveness of our operational strategies;
- to evaluate our capacity to fund capital expenditures and expand our business; and

to calculate incentive compensation payments for our employees, including assessing performance under our annual incentive compensation plan and determining the vesting of performance-based equity awards.

By providing these non-GAAP financial measures, together with a reconciliation to the most comparable GAAP measure, we believe we are enhancing investors' understanding of our business and our results of operations, as well as assisting investors in evaluating how well we are executing our strategic initiatives. In addition, the instruments governing our indebtedness use EBITDA (with additional adjustments) to measure our compliance with covenants, such as our fixed charge coverage, lease adjusted leverage, and debt incurrence. EBITDA and Adjusted EBITDA have limitations as analytical tools and should not be considered in isolation, or as an alternative to, or a substitute for net income or other financial statement data presented in our consolidated financial statements as indicators of financial performance. Some of the limitations are:

- such measures do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- such measures do not reflect changes in, or cash requirements for, our working capital needs;
- such measures do not reflect the interest expense or the cash requirements necessary to service interest or principal payments on our debt;
- such measures do not reflect our tax expense or the cash requirements to pay our taxes;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future and such measures do not reflect any cash requirements for such replacements; and
- other companies in our industry may calculate such measures differently than we do, limiting their usefulness as comparative measures.

Due to these limitations, EBITDA and Adjusted EBITDA should not be considered as measures of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using these non-GAAP measures only supplementally. As noted in the table below, Adjusted EBITDA includes adjustments for transaction costs, gains and losses on disposal of assets, and stock-based compensation, among other items. It is reasonable to expect that these items will occur in future periods. However, we believe these adjustments are appropriate because the amounts recognized can vary significantly from period to period, do not directly relate to the ongoing operations of our restaurants, and complicate comparisons of our internal operating results and operating results of other restaurant companies over time. Each of the normal recurring adjustments and other adjustments described in this paragraph and in the reconciliation table below help management measure our core operating performance over time by removing items that are not related to day-to-day operations. The following table reconciles net income to EBITDA and Adjusted EBITDA for the thirteen and thirty-nine weeks ended September 29, 2018 and September 30, 2017 (in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|---|----------------------|--------------------|-------------------------|--------------------|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| Net income | \$6,293 | \$ 4,704 | \$19,300 | \$ 15,868 |
| Interest expense, net | 2,545 | 1,302 | 6,623 | 3,908 |
| Income tax expense | 1,518 | 2,690 | 3,925 | 5,631 |
| Depreciation and amortization | 1,134 | 881 | 3,163 | 2,407 |
| EBITDA | \$11,490 | \$ 9,577 | \$33,011 | \$ 27,814 |
| Additional adjustments: | | | | |
| Transaction costs ^(a) | — | — | 1,462 | — |
| Stock-based compensation expense ^(b) | 756 | 353 | 2,012 | 894 |
| Adjusted EBITDA | \$12,246 | \$ 9,930 | \$36,485 | \$ 28,708 |

(a) Represents costs and expenses related to the refinancing of the senior secured credit facility dated June 30, 2016 (the "2016 Facility") and payment of a special dividend; all transaction costs are included in selling, general and administrative expenses ("SG&A").

(b) Includes non-cash, stock-based compensation.

Results of Operations

Thirteen Weeks Ended September 29, 2018 compared to Thirteen Weeks Ended September 30, 2017

The following table sets forth our results of operations for the thirteen weeks ended September 29, 2018 and September 30, 2017 (dollars in thousands):

| | Thirteen Weeks Ended | | Increase / | |
|---|-----------------------|-----------------------|------------|---------|
| | September 29, 2018 | September 30, 2017 | \$ | % |
| Revenue: | | | | |
| Royalty revenue, franchise fees and other | \$17,787 | \$ 15,872 | \$1,915 | 12.1 % |
| Advertising fees and related income | 8,614 | 7,579 | 1,035 | 13.7 % |
| Company-owned restaurant sales | 11,845 | 9,672 | 2,173 | 22.5 % |
| Total revenue | 38,246 | 33,123 | 5,123 | 15.5 % |
| Costs and expenses: | | | | |
| Cost of sales ⁽¹⁾ | 8,040 | 7,823 | 217 | 2.8 % |
| Advertising expenses | 8,431 | 7,665 | 766 | 10.0 % |
| Selling, general and administrative | 10,285 | 8,058 | 2,227 | 27.6 % |
| Depreciation and amortization | 1,134 | 881 | 253 | 28.7 % |
| Total costs and expenses | 27,890 | 24,427 | 3,463 | 14.2 % |
| Operating income | 10,356 | 8,696 | 1,660 | 19.1 % |
| Interest expense, net | 2,545 | 1,302 | 1,243 | 95.5 % |
| Income before income tax expense | 7,811 | 7,394 | 417 | 5.6 % |
| Income tax expense | 1,518 | 2,690 | (1,172) | (43.6)% |
| Net income | \$6,293 | \$ 4,704 | \$1,589 | 33.8 % |

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

Total revenue. During the thirteen weeks ended September 29, 2018, total revenue was \$38.2 million, an increase of \$5.1 million, or 15.5%, compared to \$33.1 million in the comparable period in 2017.

Royalty revenue, franchise fees and other. During the thirteen weeks ended September 29, 2018, royalty revenue, franchise fees and other was \$17.8 million, an increase of \$1.9 million, or 12.1%, compared to \$15.9 million in the comparable period in 2017. The increase is due to 124 net franchise restaurant openings since September 30, 2017 and domestic same store sales growth of 6.3%.

Advertising fees and related income. During the thirteen weeks ended September 29, 2018, advertising fees and related income was \$8.6 million, an increase of \$1.0 million, or 13.7%, compared to \$7.6 million in the comparable period in 2017. Advertising fees increased primarily due to the increase in system-wide sales in the thirteen weeks ended September 29, 2018 compared to the thirteen weeks ended September 30, 2017.

Company-owned restaurant sales. During the thirteen weeks ended September 29, 2018, company-owned restaurant sales were \$11.8 million, an increase of \$2.2 million, or 22.5%, compared to \$9.7 million in the comparable period in 2017. The increase was primarily due to the acquisition of three franchised restaurants since the prior year comparable period resulting in additional sales of \$1.5 million and company-owned domestic same store sales growth of 5.0%, which was driven by both an increase in transactions and an increase in average transaction size.

Cost of sales. During the thirteen weeks ended September 29, 2018, cost of sales was \$8.0 million, an increase of \$0.2 million, or 2.8%, compared to \$7.8 million in the comparable period in 2017. Cost of sales as a percentage of company-owned restaurant sales was 67.9% in the thirteen weeks ended September 29, 2018, compared to 80.9% in the comparable period in 2017.

The table below presents the major components of cost of sales (dollars in thousands):

| | Thirteen Weeks Ended | | | | | | |
|-------------------------------------|-----------------------|--|----|----------|-----------------------|--|--|
| | September 29, 2018 | As a % of company-owned restaurant sales | | | September 30, 2017 | As a % of company-owned restaurant sales | |
| Cost of sales: | | | | | | | |
| Food, beverage and packaging costs | \$3,926 | 33.1 | % | \$ 4,136 | 42.8 | % | |
| Labor costs | 2,621 | 22.1 | % | 2,295 | 23.7 | % | |
| Other restaurant operating expenses | 1,795 | 15.2 | % | 1,634 | 16.9 | % | |
| Vendor rebates | (302) | (2.5 |)% | (242) | (2.5 |)% | |
| Total cost of sales | \$8,040 | 67.9 | % | \$ 7,823 | 80.9 | % | |

Food, beverage and packaging costs as a percentage of company-owned restaurant sales were 33.1% in the thirteen weeks ended September 29, 2018, compared to 42.8% in the comparable period in 2017. The decrease was primarily due to a 29.8% decrease in the cost of bone-in chicken wings as compared to the prior year period.

Labor costs as a percentage of company-owned restaurant sales were 22.1% for the thirteen weeks ended September 29, 2018, compared to 23.7% in the comparable period in 2017. The decrease as a percentage of company-owned restaurant sales was primarily due to our ability to leverage costs due to the company-owned domestic same store sales increase of 5.0%.

Other restaurant operating expenses as a percentage of company-owned restaurant sales were 15.2% for the thirteen weeks ended September 29, 2018, compared to 16.9% in the comparable period in 2017. The decrease as a percentage of company-owned restaurant sales was primarily due to our ability to leverage costs due to the company-owned domestic same store sales increase of 5.0%.

Advertising expenses. During the thirteen weeks ended September 29, 2018, advertising expenses were \$8.4 million, an increase of \$0.8 million compared to \$7.7 million in the comparable period in 2017. Under the new accounting guidance, advertising expenses are recognized at the same time the related revenue is recognized, which does not necessarily correlate to the actual timing of the related advertising spend.

Selling, general and administrative. During the thirteen weeks ended September 29, 2018, SG&A expense was \$10.3 million, an increase of \$2.2 million compared to \$8.1 million in the comparable period in 2017. The increase in SG&A expense was primarily due to an increase in payroll and benefit expenses related to planned headcount additions.

Depreciation and amortization. During the thirteen weeks ended September 29, 2018, depreciation expense was \$1.1 million, an increase of \$0.3 million compared to \$0.9 million in the comparable period in 2017. The increase in depreciation and amortization was primarily due to additional amortization associated with reacquired franchise rights resulting from the acquisition of franchised restaurants.

Interest expense, net. During the thirteen weeks ended September 29, 2018, interest expense was \$2.5 million, an increase of \$1.2 million compared to \$1.3 million in the comparable period in 2017. The increase was primarily due to an increase in the principal amount of indebtedness and applicable interest rate related to the refinancing of the 2016 Facility in January 2018.

Income tax expense. Income tax expense was \$1.5 million in the thirteen weeks ended September 29, 2018, yielding an effective tax rate of 19.4%, compared to an effective tax rate of 36.4% in the prior year. The decrease in the effective tax rate was due to the reduction in the federal statutory rate for the thirteen weeks ended September 29, 2018 from 35% to 21% effective the first day of fiscal 2018, as well as \$0.3 million in tax benefits resulting from the recognition of excess tax benefits from stock-based compensation in income tax expense compared to \$0.1 million of excess tax benefits in the prior year period.

Segment results. The following table sets forth our revenue and operating profit for each of our segments for the period presented (dollars in thousands):

| | Thirteen Weeks Ended | | Increase / | |
|-----------------------|-----------------------|-----------------------|------------|--------|
| | September 29, 2018 | September 30, 2017 | \$(| % |
| Revenue: | | | | |
| Franchise segment | \$26,401 | \$ 23,451 | \$2,950 | 12.6 % |
| Company segment | 11,845 | 9,672 | 2,173 | 22.5 % |
| Total segment revenue | \$38,246 | \$ 33,123 | \$5,123 | 15.5 % |

Segment Profit:

| | | | | |
|----------------------|----------|----------|----------|---------|
| Franchise segment | \$7,663 | \$ 7,763 | \$(100) | (1.3)% |
| Company segment | 2,693 | 933 | 1,760 | 188.6 % |
| Total segment profit | \$10,356 | \$ 8,696 | \$1,660 | 19.1 % |

Franchise segment. During the thirteen weeks ended September 29, 2018, franchise segment revenue was \$26.4 million, an increase of \$3.0 million, or 12.6%, compared to \$23.5 million in the comparable period in 2017. Royalty revenue increased \$2.0 million due to 124 net franchise restaurant openings since September 30, 2017 and domestic same store sales growth of 6.3%. Advertising fees and related income increased \$1.0 million due to the increase in system-wide sales from September 30, 2017 to September 29, 2018.

During the thirteen weeks ended September 29, 2018, franchise segment profit was \$7.7 million, a decrease of \$0.1 million, or 1.3%, compared to \$7.8 million in the comparable period in 2017, primarily due to increases in SG&A, primarily related to planned headcount additions.

Company segment. During the thirteen weeks ended September 29, 2018, company-owned restaurant sales were \$11.8 million, an increase of \$2.2 million, or 22.5%, compared to \$9.7 million in the comparable period in 2017. The increase was primarily due to the acquisition of three franchised restaurants since the prior year comparable period, resulting in additional sales of \$1.5 million and an increase in company-owned domestic same store sales of 5.0%, which was driven by both an increase in transactions and an increase in average transaction size.

During the thirteen weeks ended September 29, 2018, company segment profit was \$2.7 million, an increase of \$1.8 million, or 188.6%, compared to \$0.9 million in the comparable period in 2017. The increase was due to the leveraging of fixed costs due to company-owned same store sales growth of 5.0%, as well as a 29.8% decrease in the cost of bone-in chicken wings. Additionally, a combined profit of \$0.5 million from the three additional company-owned locations acquired from franchisees in the periods subsequent to September 30, 2017, further increased company segment profit in the thirteen weeks ended September 29, 2018 compared to the prior year period.

Thirty-Nine Weeks Ended September 29, 2018 compared to Thirty-Nine Weeks Ended September 30, 2017
The following table sets forth our results of operations for the thirty-nine weeks ended September 29, 2018 and September 30, 2017 (dollars in thousands):

| | Thirty-Nine Weeks Ended | | Increase / (Decrease) | | |
|---|-------------------------|--------------------|-----------------------|--------|---|
| | September 29, 2018 | September 30, 2017 | \$ | % | |
| Revenue: | | | | | |
| Royalty revenue, franchise fees and other | \$52,772 | \$ 48,735 | \$4,037 | 8.3 | % |
| Advertising fees and related income | 25,574 | 22,313 | 3,261 | 14.6 | % |
| Company-owned restaurant sales | 34,326 | 27,063 | 7,263 | 26.8 | % |
| Total revenue | 112,672 | 98,111 | 14,561 | 14.8 | % |
| Costs and expenses: | | | | | |
| Cost of sales ⁽¹⁾ | 23,182 | 21,290 | 1,892 | 8.9 | % |
| Advertising expenses | 25,283 | 24,522 | 761 | 3.1 | % |
| Selling, general and administrative | 31,196 | 24,485 | 6,711 | 27.4 | % |
| Depreciation and amortization | 3,163 | 2,407 | 756 | 31.4 | % |
| Total costs and expenses | 82,824 | 72,704 | 10,120 | 13.9 | % |
| Operating income | 29,848 | 25,407 | 4,441 | 17.5 | % |
| Interest expense, net | 6,623 | 3,908 | 2,715 | 69.5 | % |
| Income before income tax expense | 23,225 | 21,499 | 1,726 | 8.0 | % |
| Income tax expense | 3,925 | 5,631 | (1,706) | (30.3) | % |
| Net income | \$19,300 | \$ 15,868 | \$3,432 | 21.6 | % |

⁽¹⁾ Exclusive of depreciation and amortization, shown separately.

Total revenue. During the thirty-nine weeks ended September 29, 2018, total revenue was \$112.7 million, an increase of \$14.6 million, or 14.8%, compared to \$98.1 million in the comparable period in 2017.

Royalty revenue, franchise fees and other. During the thirty-nine weeks ended September 29, 2018, royalty revenue, franchise fees and other was \$52.8 million, an increase of \$4.0 million, or 8.3%, compared to \$48.7 million in the comparable period in 2017. Royalty revenue increased \$6.6 million due to 124 net franchise restaurant openings since September 30, 2017 and domestic same store sales growth of 6.7%. Other revenue decreased \$2.6 million, primarily due to a one-time payment received in conjunction with a new vendor agreement that was executed during the first quarter of 2017. The funding from this agreement was used to support our national advertising campaign.

Advertising fees and related income. During the thirty-nine weeks ended September 29, 2018, advertising fees and related income was \$25.6 million, an increase of \$3.3 million, or 14.6%, compared to \$22.3 million in the comparable period in 2017. Advertising fees increased primarily due to the increase in system-wide sales in the thirty-nine weeks ended September 29, 2018 compared to the thirty-nine weeks ended September 30, 2017.

Company-owned restaurant sales. During the thirty-nine weeks ended September 29, 2018, company-owned restaurant sales were \$34.3 million, an increase of \$7.3 million, compared to \$27.1 million in the comparable period in 2017. The increase was primarily due to the acquisition of five franchised restaurants since the prior year comparable period resulting in additional sales of \$5.0 million, and an increase in company-owned domestic same store sales of 6.8%, which was driven by both an increase in transactions and an increase in average transaction size.

Cost of sales. During the thirty-nine weeks ended September 29, 2018, cost of sales was \$23.2 million, an increase of \$1.9 million, or 8.9%, compared to \$21.3 million in the comparable period in 2017. Cost of sales as a percentage of company-owned restaurant sales was 67.5% in the thirty-nine weeks ended September 29, 2018 compared to 78.7% in the prior year period.

The table below presents the major components of cost of sales (dollars in thousands):

| | Thirty-Nine Weeks Ended | | | | | |
|-------------------------------------|-------------------------|--|---|--------------------|--|---|
| | September 29, 2018 | As a % of company-owned restaurant sales | | September 30, 2017 | As a % of company-owned restaurant sales | |
| Cost of sales: | | | | | | |
| Food, beverage and packaging costs | \$11,306 | 32.9 | % | \$ 11,002 | 40.7 | % |
| Labor costs | 7,555 | 22.0 | % | 6,535 | 24.1 | % |
| Other restaurant operating expenses | 5,190 | 15.1 | % | 4,431 | 16.4 | % |
| Vendor rebates | (869) | (2.5) | % | (678) | (2.5) | % |
| Total cost of sales | \$23,182 | 67.5 | % | \$ 21,290 | 78.7 | % |

Food, beverage and packaging costs as a percentage of company-owned restaurant sales were 32.9% in the thirty-nine weeks ended September 29, 2018, compared to 40.7% in the comparable period in 2017. The decrease is primarily due to a 21.5% decrease in the cost of bone-in chicken wings as compared to the prior year period.

Labor costs as a percentage of company-owned restaurant sales were 22.0% for the thirty-nine weeks ended September 29, 2018, compared to 24.1% in the comparable period in 2017. The decrease as a percentage of company-owned restaurant sales was primarily due to our ability to leverage costs as a result of the company-owned domestic same store sales increase of 6.8%.

Other restaurant operating expenses as a percentage of company-owned restaurant sales were 15.1% for the thirty-nine weeks ended September 29, 2018, compared to 16.4% in the comparable period in 2017. The decrease as a percentage of company-owned restaurant sales was primarily due to our ability to leverage costs as a result of the company-owned domestic same store sales increase of 6.8%.

Advertising expenses. During the thirty-nine weeks ended September 29, 2018, advertising expenses were \$25.3 million, an increase of \$0.8 million compared to \$24.5 million in the comparable period in 2017. Under the new accounting guidance, advertising expenses are recognized at the same time the related revenue is recognized, which does not necessarily correlate to the actual timing of the related advertising spend.

Selling, general and administrative. During the thirty-nine weeks ended September 29, 2018, SG&A expense was \$31.2 million, an increase of \$6.7 million compared to \$24.5 million in the comparable period in 2017. The increase in SG&A expense was primarily due to nonrecurring costs of \$1.5 million related to the refinancing of the 2016 Facility and subsequent special dividend payout, which occurred in the first quarter of 2018. Also contributing to the increase in SG&A were increases in payroll and benefits expenses associated with planned headcount additions.

Depreciation and amortization. During the thirty-nine weeks ended September 29, 2018, depreciation expense was \$3.2 million, an increase of \$0.8 million, compared to \$2.4 million in the comparable period in 2017. The increase in depreciation and amortization was primarily due to additional amortization associated with reacquired franchise rights resulting from the acquisition of franchised restaurants.

Interest expense, net. During the thirty-nine weeks ended September 29, 2018, interest expense was \$6.6 million, an increase of \$2.7 million compared to \$3.9 million in the comparable period in 2017. The increase was primarily due to an increase in the principal amount of indebtedness related to the refinancing of the 2016 Facility in January 2018 and an increase in the applicable interest rate.

Income tax expense. Income tax expense was \$3.9 million in the thirty-nine weeks ended September 29, 2018, yielding an annual effective tax rate of 16.9%, compared to an annual effective tax rate of 26.2% in the comparable period in 2017. The decrease in the effective tax rate was due to the reduction in the federal statutory rate from 35% to 21% effective the first day of fiscal 2018. The effective tax rate was further impacted by excess tax benefits of \$1.8 million during the thirty-nine weeks ended September 29, 2018, which is lower than the excess tax benefits in the prior year period of \$2.5 million.

Segment results. The following table sets forth our revenue and operating profit for each of our segments for the period presented (dollars in thousands):

| | Thirty-Nine Weeks Ended September 29, 2018 | | September 30, 2017 | | Increase / (Decrease) | |
|-----------------------|---|-----------|-----------------------|--|--------------------------|---|
| | | | \$ | | % | |
| Revenue: | | | | | | |
| Franchise segment | \$78,346 | \$ 71,048 | \$7,298 | | 10.3 | % |
| Company segment | 34,326 | 27,063 | 7,263 | | 26.8 | % |
| Total segment revenue | \$112,672 | \$ 98,111 | \$14,561 | | 14.8 | % |

Segment Profit:

| | | | | | | |
|----------------------|----------|-----------|---------|--|-------|---|
| Franchise segment | \$23,418 | \$ 22,317 | \$1,101 | | 4.9 | % |
| Company segment | 7,892 | 3,090 | 4,802 | | 155.4 | % |
| Total segment profit | \$31,310 | \$ 25,407 | \$5,903 | | 23.2 | % |

Franchise segment. During the thirty-nine weeks ended September 29, 2018, franchise segment revenue was \$78.3 million, an increase of \$7.3 million, or 10.3%, compared to \$71.0 million in the comparable period in 2017. Royalty revenue increased \$6.6 million, primarily due to 124 net franchise restaurant openings since September 30, 2017 and domestic same store sales growth of 6.7%. Other revenue decreased \$2.6 million, primarily due to an increase in vendor rebates related to a one-time payment received in conjunction with a vendor agreement executed during the first quarter of 2017.

During the thirty-nine weeks ended September 29, 2018, franchise segment profit was \$23.4 million, an increase of \$1.1 million, or 4.9%, compared to \$22.3 million in the comparable period in 2017, primarily due to increases in revenue, which was offset by increases in payroll and benefit expenses related to planned headcount additions.

Company segment. During the thirty-nine weeks ended September 29, 2018, company-owned restaurant sales were \$34.3 million, an increase of \$7.3 million, compared to \$27.1 million in the comparable period in 2017. The increase was primarily due to the acquisition of five franchised restaurants since the prior year comparable period resulting in additional sales of \$5.0 million and an increase in company-owned domestic same store sales of 6.8%, which was driven by both an increase in transactions and an increase in average transaction size.

During the thirty-nine weeks ended September 29, 2018, company segment profit was \$7.9 million, an increase of \$4.8 million, or 155.4%, compared to \$3.1 million in the comparable period in 2017. The increase was due to a combined profit of \$1.8 million from the five additional company-owned locations acquired from franchisees in the periods subsequent to September 30, 2017. Additionally, the 21.5% decrease in the cost of bone-in chicken wings, as well as the leveraging of fixed costs due to the company-owned same store sales growth of 6.8%, further increased company segment profit in the thirty-nine weeks ended September 29, 2018 compared to the prior year period.

Liquidity and Capital Resources

General. Our primary sources of liquidity and capital resources are cash provided from operating activities, cash and cash equivalents on hand, and proceeds from the incurrence of debt. Our primary requirements for liquidity and capital are working capital and general corporate needs. Historically, we have operated with minimal positive working capital or negative working capital. We believe that our sources of liquidity and capital will be sufficient to finance our continued operations and growth strategy over the next twelve months.

The following table shows summary cash flows information for the thirty-nine weeks ended September 29, 2018 and September 30, 2017 (in thousands):

| | Thirty-Nine Weeks Ended | |
|---|----------------------------|-----------------------|
| | September 29, 2018 | September 30, 2017 |
| Net cash provided by (used in): | | |
| Operating activities | \$30,623 | \$ 19,867 |
| Investing activities | (8,879) | (5,783) |
| Financing activities | (18,326) | (11,358) |
| Net change in cash and cash equivalents | \$3,418 | \$ 2,726 |

Operating activities. Our cash flows from operating activities are principally driven by sales at both franchise restaurants and company-owned restaurants, as well as franchise and development fees. We collect franchise royalties from our franchisees on a weekly basis. Restaurant-level operating costs at our company-owned restaurants, unearned franchise and development fees and corporate overhead costs also impact our cash flows from operating activities. Net cash provided by operating activities was \$30.6 million in the thirty-nine weeks ended September 29, 2018, an increase of \$10.8 million from \$19.9 million in 2017. The increase was primarily due to the increase in net income as well as timing of changes in working capital.

Investing activities. Our net cash used in investing activities was \$8.9 million in the thirty-nine weeks ended September 29, 2018, an increase of \$3.1 million from \$5.8 million used in investing activities in 2017. The increase was primarily due to the acquisition of three restaurants from franchisees during the thirty-nine weeks ended September 29, 2018 and a \$1.0 million increase in property and equipment purchases.

Financing activities. Our net cash used in financing activities was \$18.3 million in the thirty-nine weeks ended September 29, 2018, an increase of \$7.0 million from cash used in financing activities of \$11.4 million in 2017. The increase was due to the payment of regular quarterly dividends in the thirty-nine weeks ended September 29, 2018, a special dividend paid in the first quarter of 2018 totaling \$92.7 million. This was partially offset by net borrowings of long-term debt of \$81.6 million during the thirty-nine weeks ended September 29, 2018, compared to net payments of \$10.6 million in the comparable period in 2017.

Senior secured credit facility. On January 30, 2018, we entered into an amended \$250.0 million senior secured credit facility (the "2018 Facility"), which replaced the 2016 Facility. The 2018 Facility consists of a term loan facility in the aggregate amount of \$100.0 million and a revolving credit facility up to an aggregate amount of \$150.0 million. The 2018 Facility has a five year term and matures on January 30, 2023.

We utilized approximately \$230 million of proceeds from the 2018 Facility to refinance \$133.8 million of indebtedness under the 2016 Facility and to pay a special cash dividend of \$92.7 million to our stockholders. The 2018 Facility bears interest, at our option, at either the prime rate plus an applicable margin ranging from 0.75% to 1.75% or at an adjusted LIBOR rate plus an applicable margin ranging from 1.75% to 2.75%, in each case based on our lease adjusted leverage ratio.

The 2018 Facility is secured by a first-priority security interest in substantially all of our assets. Obligations under the 2018 Facility are guaranteed by the Company and its subsidiaries. The 2018 Facility also requires compliance with certain financial and non-financial covenants, including a specified lease adjusted leverage ratio and a specified fixed charge coverage ratio. Failure to comply with these covenants in the future could cause an acceleration of outstanding amounts under the term loan and revolver and restrict us from borrowing under the revolving credit facility to fund our liquidity requirements.

As of September 29, 2018, the term loan facility and the revolving credit facility had outstanding balances of \$96.3 million and \$119.1 million, respectively, bearing interest at 4.49%.

Refinancing. Subsequent to the fiscal third quarter of 2018, the Company announced its intention to complete a refinancing transaction. The Company intends to issue approximately \$300 million of new, fixed rate notes and use the proceeds to retire all of the Company's existing debt, to pay transaction costs associated with the refinancing, and for general corporate purposes. The Company also expects to enter into a new \$25 million variable funding note facility and anticipates that the refinancing transaction will close during the fiscal fourth quarter of 2018.

Dividends. In the third quarter of 2017, we announced that our Board of Directors authorized the initiation of a regular dividend program under which we intend to pay quarterly dividends on our common stock, subject to quarterly declarations by our Board of Directors. Dividends of \$0.07 per share were announced during the first and second quarters of 2018, and were paid on March 23, 2018 and June 18, 2018, respectively. The dividend was increased to \$0.09 per share during the third quarter and was paid on September 18, 2018. On October 26, 2018, the Company's Board of Directors approved a dividend of \$0.09 per share, to be paid on December 18, 2018.

Separate from our regular dividend program, during the first quarter of 2018, we paid a special cash dividend of \$3.17 per share in connection with the execution of the 2018 Facility.

We do not expect the restrictions in the 2018 Facility to impact our ability to make regular quarterly dividend payments pursuant to our regular dividend program. However, any future declarations of dividends, as well as the amount and timing of such dividends, is subject to capital availability and the discretion of our Board of Directors, which must evaluate, among other things, whether cash dividends are in the best interest of our stockholders.

Contractual Obligations

In connection with the 2018 Facility, principal payments of \$1,250,000 are due quarterly, with all unpaid amounts due at maturity in January 2023.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements or obligations, except for leases, as of September 29, 2018.

Critical Accounting Policies and Estimates

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by the application of our accounting policies. Critical accounting estimates are those that require application of management's most difficult, subjective, or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods. While we apply our judgment based on assumptions believed to be reasonable under the circumstances, actual results could vary from these assumptions. It is possible that materially different amounts would be reported using different assumptions. Our critical accounting policies and estimates are identified and described in our annual consolidated financial statements and the related notes included in our Annual Report, and there have been no material changes since the filing of our Annual Report.

Recent Accounting Pronouncements

See Note 1 to our consolidated financial statements, Basis of Presentation, for a summary of recent accounting pronouncements.

Special Note Regarding Forward-Looking Statements

This document contains statements about future events and expectations that constitute forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are based on the beliefs, assumptions, and expectations of management regarding our future financial and operating performance and growth plans, taking into account the information currently available to us. Such statements include, in particular, statements about our plans, strategies, and prospects. Words such as “expect,” “anticipate,” “intend,” “plan,” “believe,” “seek,” “estimate,” “could,” “will,” “project,” “may,” “target,” “potential,” “continue,” and variations of such words and similar expressions are intended to identify such forward-looking statements. Examples of forward-looking statements in this Quarterly Report may include, but are not limited to, our expectations with respect to our future revenue, system-wide sales, new restaurant openings, unit level performance, stockholder value, brand awareness, international expansion, liquidity, expenses and consumer appeal. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict and many of which are outside of our control. Therefore, actual outcomes and results may differ materially from what is expressed, implied, or forecasted in such forward-looking statements and you should not rely on such statements.

Factors that could cause actual results or outcomes to differ from the results expressed or implied by forward-looking statements include, among other things:

- our ability to effectively implement our growth strategy;

- risks associated with changes in food and supply costs;

- our relationships with, and the performance of, our franchisees, as well as actions by franchisees that could harm our business;

- our ability to identify, recruit and contract with a sufficient number of qualified franchisees;

- our ability to effectively compete within our industry;

- our ability to successfully expand into new markets;

- risks associated with food safety, food-borne illness and other health concerns;

- risks associated with interruptions in our supply chain;

- our ability to implement our domestic and international growth strategies;

- risks associated with data privacy, cyber security, and the use and implementation of information technology;

- risks associated with litigation against us or our franchisees;

- our ability to comply with government regulations relating to food products and franchising, including increased costs associated with new or changing regulations;

- risks associated with the geographic concentration of our business;

- our ability to maintain adequate insurance coverage for our business;

- our ability to successfully advertise and market our business;

- risks associated with changes in customer preferences and perceptions;
- our ability to protect our intellectual property, including trademarks and trade secrets; and
- our ability to comply with the covenants and restrictions in the 2018 Facility; and
- our ability to complete our planned recapitalization transaction.

The above list of factors is not exhaustive. Some of these and other factors are discussed in more detail under “Risk Factors” in our Annual Report. We assume no obligation to update or revise any forward-looking statements for any reason or to update the reasons actual results could differ materially from those anticipated in any forward-looking statements, except as required by applicable securities laws, even if new information becomes available in the future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Impact of Inflation. The primary inflationary factors affecting our and our franchisees' operations are food and beverage costs, labor costs, energy costs and the costs and materials used in the construction of new restaurants. Our restaurant operations are subject to federal and state minimum wage laws governing such matters as working conditions, overtime and tip credits. Significant numbers of our and our franchisees' restaurant personnel are paid at rates related to the federal and/or state minimum wage and, accordingly, increases in the minimum wage increase our and our franchisees' labor costs. To the extent permitted by competition and the economy, we have mitigated increased costs by increasing menu prices and may continue to do so if deemed necessary in future years. Substantial increases in costs and expenses could impact our operating results to the extent such increases cannot be passed through to our customers. Historically, inflation has not had a material effect on our results of operations. Severe increases in inflation, however, could affect the global and U.S. economies and could have an adverse impact on our business, financial condition and results of operations.

Commodity Price Risk. We are exposed to market risks from changes in commodity prices. Many of the food products purchased by us are affected by weather, production, availability and other factors outside our control. Although we attempt to minimize the effect of price volatility by negotiating fixed price contracts for the supply of key ingredients, there are no established fixed price markets for fresh bone-in chicken wings, so we are subject to prevailing market conditions. Bone-in chicken wings accounted for approximately 25.6% and 31.7% of our company-owned restaurant cost of sales during the thirty-nine weeks ended September 29, 2018 and September 30, 2017, respectively. A hypothetical 10% increase in the bone-in chicken wing costs would have increased costs of sales by approximately \$0.6 million during the thirty-nine weeks ended September 29, 2018. We do not engage in speculative financial transactions nor do we hold or issue financial instruments for trading purposes. In instances when we use fixed pricing arrangements with our suppliers, these arrangements cover our physical commodity needs, are not net-settled, and are accounted for as normal purchases.

Interest Rate Risk. We are subject to interest rate risk in connection with borrowings under the 2018 Facility, which bears interest at variable rates. As of September 29, 2018, we had \$215.4 million outstanding under the 2018 Facility. Derivative financial instruments, such as interest rate swap agreements and interest rate cap agreements, may be used for the purpose of managing fluctuating interest rate exposures that exist from our variable rate debt obligations that are expected to remain outstanding. Interest rate changes do not affect the market value of such debt, but could impact the amount of our interest payments, and accordingly, our future earnings and cash flows, assuming other factors are held constant. A hypothetical 1.0% percentage point increase or decrease in the interest rate associated with our credit facilities would have resulted in a \$2.2 million impact on interest expense on an annualized basis.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 29, 2018, pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no significant 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we may be involved in claims and legal actions that arise in the ordinary course of business. To our knowledge, there are no material pending legal proceedings to which we are a party or of which any of our property is the subject.

Item 1A. Risk Factors

A description of the risk factors associated with our business is contained in the “Risk Factors” section of our Annual Report.

There have been no material changes to our Risk Factors as previously reported.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Index to Exhibits

| Exhibit No. | Description |
|-------------|---|
| 3.1 | <u>Amended and Restated Certificate of Incorporation of Wingstop Inc., filed as exhibit 3.1 to the Registration Statement of the Company on Form S-1/A (Registration No. 333-203891) on June 2, 2015 and incorporated herein by reference</u> |
| 3.2 | <u>Amended and Restated Bylaws of Wingstop Inc., filed as exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 30, 2017 (File No. 001-37425) and incorporated herein by reference</u> |
| 10.1 | <u>Amended and Restated Form of Performance-based Restricted Stock Unit Award Agreement under the Wingstop Inc. 2015 Omnibus Incentive Compensation Plan, filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018 (File No. 001-37425) and incorporated herein by reference</u> |
| 10.2 | <u>Amended and Restated Form of Service-based Restricted Stock Unit Award Agreement under the Wingstop Inc. 2015 Omnibus Incentive Compensation Plan, filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018 (File No. 001-37425) and incorporated herein by reference</u> |
| 31.1* | <u>Certification of Principal Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 31.2* | <u>Certification of Principal Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1** | <u>Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 32.2** | <u>Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 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 |

* Filed herewith.

** Furnished, not filed.

Signatures

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

Wingstop Inc.
(Registrant)

Date: October 29, 2018 By: /s/ Charles R. Morrison
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: October 29, 2018 By: /s/ Michael J. Skipworth
Chief Financial Officer
(Principal Financial and Accounting Officer)