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BWLD - Q3 2016 Buffalo Wild Wings Inc Earnings Call

EVENT DATE/TIME: OCTOBER 26, 2016 / 9:00PM GMT

## OVERVIEW:

Co. reported 3Q16 revenues of \$494.2m, net earnings of \$22.7m and diluted EPS of \$1.23. Expects full-year 2016 diluted EPS to be slightly below low-end of prior guidance range of \$5.65-5.85.



## CORPORATE PARTICIPANTS

**Heather Pribyl** *Buffalo Wild Wings, Inc. - Director of IR*

**Sally Smith** *Buffalo Wild Wings, Inc. - CEO and President*

**James Schmidt** *Buffalo Wild Wings, Inc. - COO*

## CONFERENCE CALL PARTICIPANTS

**Brian Bittner** *Oppenheimer & Co. - Analyst*

**John Glass** *Morgan Stanley - Analyst*

**Will Slabaugh** *Stephens Inc. - Analyst*

**David Tarantino** *Robert W. Baird & Company, Inc. - Analyst*

**Brett Levy** *Deutsche Bank - Analyst*

**Andrew Charles** *Cowen and Company - Analyst*

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## PRESENTATION

### Operator

Good day, ladies and gentlemen. Welcome to Buffalo Wild Wings third quarter 2016 conference call. At this time all participants are in a listen-only mode. Following the presentation we will contact a question-and-answer session. Instructions will be provided at the time for you to queue up for questions. I would like to remind everyone this conference is being recorded. I will now turn this call over to Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Please go ahead.

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### Heather Pribyl - Buffalo Wild Wings, Inc. - Director of IR

Good afternoon, and thank you for joining us as we review our third quarter 2016 results. I'm Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Joining me is Sally Smith, President and Chief Executive Officer, Jim Schmidt, Chief Operating Officer and Jeff Sorum, Senior Vice President and Corporate Controller. By now everyone should have access to our third quarter earnings release. Copies are available on our investor website at [ir.buffalowildwings.com](http://ir.buffalowildwings.com).

Before get started, I remind you today's call will contain forward-looking statements and actual results may vary materially from those (inaudible) in forward-looking statements due to many factors including the risks and uncertainties identified in today's earnings release which we filed and a Form 8-K concurrent with this release and in our other filings with the Securities and Exchange Commission. On today's call, Sally will provide insight on our recent announcement and overview of our performance for the third quarter, along with our near-term priorities. After that, Jim will provide further detail on the third quarter and comment on trends to date in the fourth quarter. Sally will then provide some final thoughts and then we will answer questions. So with that, I will turn things over to Sally.



**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

Thank you, Heather and good afternoon, everyone. As I'm sure you have all read, Alex Ware will join Buffalo Wild Wings as Executive Vice President and Chief Financial Officer. I'm thrilled with Alex's appointment and his background as a large public company CFO in the food and beverage industry is complemented by his experience in growth management, M&A strategy and strategic planning. His experience is an ideal fit to help Buffalo Wild Wings prioritize our capital allocation strategies, execute ongoing cost efficiency plans, and contribute perspective to our strategic initiatives. This is a pivotal time in Buffalo Wild Wings' history, and Alex will play an important role of achieving our goal of providing sustained value for all of our shareholders. Alex joins Buffalo Wild Wings next week, and you will hear from him on our fourth quarter conference call in February when we expect to provide financial guidance for 2017. We look forward to introducing Alex to you in person at investor meetings over the next year.

We also recently announced the appointments of Andre Fernandez, Hal Lawton and Harmit Singh to our Board of Directors, the latest step in our continual process of proactive forward refreshment. These Board members bring significant financial, media and technology expertise to our Board, including experience at retail restaurant and hospitality companies. We look forward to working with them as we continue to deliver long-term shareholder value creation. As part of the refreshment process, existing directors Warren Mack and Dale Applequist accelerated their planned retirement. We thank Warren and Dale for their many years of service that oversaw more than a 1,500% total shareholder return since our initial public offering.

Now, turning to the third quarter, our total revenue increased by 8.5% from new restaurant openings and franchise acquisitions over the last year. We saw continued pressure on same-store sales this quarter, reflecting the current challenging restaurant environment. Same-store sales decreased 1.8% at company-owned restaurants and 1.6% at franchise locations. For each month in the third quarter we experienced improvement in same-store sales for NFL game days in September and October. Same-store sales have trended in line with non-NFL days. We effectively managed cost and expenses during the quarter and when combined with our share repurchase activity over the last year, we generated earnings per diluted share of \$1.23, a 23% increase compared to prior year's third quarter. Our focus is to return to industry-leading same-store sales and to achieve restaurant level margins of 20%.

Year term sales initiatives include the 15 minute guarantee for Fast Break Lunch, half-price Wing Tuesdays and our Blazin' Rewards loyalty program, along with take-out and delivery. We initiated the 15 minute guarantee for Fast Break Lunch at the beginning of the third quarter, and we're pleased with the improvement in our lunch sales. In addition, half-price Wing Tuesdays began in September and is already driving positive traffic. We're making progress in the rollout of our Blazin' Rewards loyalty program across the system.

In addition to gaining valuable insight on fan behavior, we have seen a same-store sales lift up of up to 2% in our initial rollout. Blazin' Rewards is in approximately 25% of the US Buffalo Wild Wings system and full implementation is expected to be completed by mid-2017. This is a primary restaurant level initiative for the first half of 2017 and is the platform upon which other initiatives will build. Strong take-out sales continue, and take-out accounted for 16% of company-owned restaurant sales in the third quarter. We are focused on staffing the take-out area with our best team members and improving operational execution. In addition, we plan to launch updated versions of our mobile app and online ordering platforms this quarter to improve the digital user experience.

Buffalo Wild Wings is exploring delivery to meet the needs of fans who are choosing an in-home dining experience. We're working with third-party delivery providers in 90 company-owned restaurants. While we're only three weeks into the pilot, we are already seeing great topline momentum in delivery. Our goal is to achieve a 20% restaurant level margin by the end of 2018, and we've identified several opportunities in cost of sales, labor and operating expenses for 2017. We negotiated reduced pricing on our boneless wings and other chicken that will improve our cost of sales as a percent of restaurant sales by 20 basis points in 2017. Our cost of sales, we are focusing on waste reduction at the restaurant level, and this will improve cost of sales as a percentage of restaurant sales by another 20 basis points. We're optimizing the hours per guest experience captains based on restaurant level -- restaurant sales levels. We estimate this will improve our labor as a percent of restaurant sales by 30 basis points in the fourth quarter of 2016 and 20 basis points for the FY17.

Other near-term labor efficiencies include scheduling improvements. We're targeting several areas of reduction in operating expense including programming fees and uniform cost. As we are early in the process on these initiatives, expect to have a quantifiable update on our February earnings call.

At the beginning of October we increased our credit facility to \$500 million, allowing us to begin to lower our weighted average cost of capital to fund capital improvements for growth and continue to return capital to shareholders through our expanded share repurchase authorization. We're targeting a 1.5 times debt to EBITDA leverage ratio and we'll toward that goal by the end of 2018. Our Board continues to review the initiation of the dividend policy. Jim will now provide additional details on the third and fourth quarters.

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**James Schmidt** - Buffalo Wild Wings, Inc. - COO

Thank you, Sally. Our revenue in the third quarter reached \$494.2 million, increasing 8.5% over the same period last year. Systemwide sales at our company-owned and franchise restaurant were \$937.6 million for the quarter, an increase of 4.5% over the third quarter of 2015. Company-owned restaurant sales for the third quarter increased to \$470.6 million, a 9% increase over the same period in the prior year. Same-store sales at company-owned Buffalo Wild Wings decreased 1.8% for the third quarter compared to an increase of 3.9% for the same period last year.

Menu price increases and adjustments taken during the past 12 months at company-owned restaurants were about 3.4%. We had 40 additional company-owned Buffalo Wild Wings restaurants in operation at the end of this quarter versus third quarter last year. The 7% unit increase. Average weekly sales decreased by 3.5% in the third quarter, 170 basis points lower than the same-store sales percentage. This is attributed to 150 basis point decline from company-owned locations opened during the last 15 months and a 20 basis point decline from locations acquired from franchisees in the past year.

Our royalty and franchise fee revenue for the third quarter decreased 1% to \$23.5 million versus \$23.8 million in the same period last year. Same-store sales at franchise Buffalo Wild Wings locations decreased by 1.6% compared to a 1.2% increase in third quarter last year. Franchise average weekly sales volume of Buffalo Wild Wings locations in the United States for the quarter decreased by 2.1%, 50 basis points lower compared to the same-store sales percentage. A 120 basis point decline from franchise location opened during the last 15 months was partially offset by a 40 basis point benefit from franchise locations sold to the Company and a 30 basis point benefit from the closing of lower order volume locations in the last 12 months.

Cost of sales for the third quarter was 28.9% of restaurant sales compared to 29.4% in the third quarter last year, a 50 basis point decrease. Traditional wings were \$1.72 per pound in the third quarter, \$0.07, or 4% lower than last year's third quarter average of \$1.79. Traditional wings as a percentage of cost of sales in the first quarter was 24.9% traditional wings were 21% of restaurant sales, the same as the third quarter last year. Boneless wings were 22% of restaurant sales, up from 21% in the same period last year. Food and nonalcoholic beverage sales were 80% of restaurant sales in the third quarter, same as the prior year.

Cost of labor for the third quarter was 32% of restaurant sales, 10 basis points lower than third quarter last year due to lower restaurant bonus expense and benefit costs. Average rate of pay increases of 5% for our hourly team members in the third quarter were offset by a reduction in management bonuses compared to the prior year. In the third quarter restaurant operating expenses as a percentage of restaurant sales were 15.6%, an increase of 90 basis points resulting from increases in general liability insurance, fees for an additional pay-per-view event and higher repairs and maintenance costs. Occupancy costs were 5.8% as a percentage of restaurant sales, 20 basis points higher compared to the same quarter last year, deleveraging on same-store sales.

In summary, restaurant level profit, which is calculated before depreciation, amortization and preopening expenses, was \$82.8 million, or 17.6% of restaurant sales. This compares to restaurant level profit of \$78.4 million, or 18.2% in the third quarter last year. Depreciation and amortization for the third quarter was \$38.3 million, or 7.8% of total revenue, 40 basis points higher than the prior year resulting from deleveraging. General and administrative expenses were \$32.3 million in the third quarter, or 6.5% of total revenue compared to \$33.7 million and 7.4% in the prior year. Excluding stock-based compensation of \$345,000 in the third quarter and \$4.5 million in the prior year, G&A expenses for the third quarter would have totaled \$31.9 million, or 6.5% of total revenue compared to 6.4% last year. We opened eight new company owned Buffalo Wild Wings during the third quarter and one R Taco. This compares to 17 new Buffalo Wild Wings restaurants opened in the third quarter of 2015.



Preopening expenses for the quarter totaled \$1.5 million versus \$4.8 million last year. The \$1.5 million includes \$300,000 of preopening expenses for future openings that are under construction. And in the third quarter last year we incurred \$1.5 million related to future openings. Preopening costs for company-owned Buffalo Wild Wings averaged \$276,000 per new restaurant during the quarter compared to \$253,000 in the third quarter last year. Loss on asset disposal for the third quarter totaled \$1.4 million compared to last year of \$1.3 million. We reported interest and other expense of \$528,000 for the quarter compared to \$1.4 million in 2015. Our effective tax rate during the quarter was 30.4% compared to 30.1% in the prior year. We estimate our effective tax rate in 2016 will be about 30.3% based on federal and state tax rates and credits currently in effect.

In summary, our net earnings in the third quarter of 2016 increased 17.8% to \$22.7 million, producing earnings per diluted share of \$1.23 compared to \$1 in the prior year. On our balance sheet September 25, 2016 our cash and cash equivalents totaled \$14.8 million compared to \$11.2 million at the end of 2015. Our credit facility had a balance of \$58.6 million as of the end of the quarter. We repurchased 36,600 BWLD shares during the third quarter of 2016 for \$5.9 million. We expect to meet our 150 million share repurchase commitment for 2016.

We ended the quarter with 984 million in total assets and 632 million in total equity. Cash flow from operations was \$64.5 million for the quarter, a 2.2% decrease over third quarter last year. We spent \$47.2 million for property and equipment capital expenditures in the third quarter of 2016. We estimate that our annual capital spending will be approximately \$158 million. Free cash flow in the third quarter, which is cash flow from operations less capital expenditures and acquisitions, was \$17.3 million compared to negative \$151.6 million in the prior year.

Now I will highlight a few trends and provide some comments on the fourth quarter of 2016 and 2017. Menu price increase and adjustments taken in the last 12 months are expected to be 1.3% in the fourth quarter. Pricing taken in 2016 is mostly offset by the incremental half-price Wing Tuesday discount and 2017 pricing is currently expected to be minimal. In fourth quarter we expect to open 16 company-owned Buffalo Wild Wings restaurants. As a reference point, in fourth quarter 2015 we opened 22 new company owned Buffalo Wild Wings locations.

Given our October same-store sales and a 60 basis point headwind from the shift in holidays in December, we currently expect fourth-quarter same-store sales to be slightly negative. We also expect that Buffalo Wild Wings franchisees in the United States will open nine restaurants during the first -- fourth quarter and our international B-Dubs franchisees should open one restaurant. For cost of sales, our cost for traditional chicken wings for the first two months of the fourth quarter averages \$1.96 per pound and cost of sales should be approximately 30% for fourth quarter. This compares to the average cost for the full fourth quarter last year of \$1.81 per pound.

We anticipate labor as a percentage of restaurant sales in the fourth quarter to be approximately 32%. In the fourth quarter we anticipate that G&A expense, exclusive of stock-based compensation, will be approximately \$32 million. Fourth-quarter stock-based compensation expense is estimated to be \$2.3 million and will vary depending on the level of net earnings achieved for 2016, as well as for estimates of net earnings in future years. Depreciation and amortization is expected to be \$38.5 million in the fourth quarter.

Turning to the full-year 2016, traditional wing prices are significantly higher than we estimated for the fourth quarter, and we anticipate coming in slightly below the low end of our prior guidance range of \$5.65 to \$5.85. Please review the risk sections outlined in our SEC filings, including our Form 10-Q for the third quarter which will be filed shortly, as well as our Safe Harbor statement of factors affecting our forward-looking statements. Now, Sally will share some thoughts on our Company initiatives.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Thank you, Jim. Our fall menu comes to restaurants next week, and we've made significant enhancements to our burgers. In addition to removing additives and artificial ingredients there's a new bun, new bacon and new toppings to create a better burger choice. Our menu panel features the Buffalo Blue Burger as well as Kickin' Honey Garlic and Havana Heat as our limited time sauce lab sauces.

We've teamed up with Lagunitas for a limited time collaboration beer Fandom Ale created with the sports fan in mind. Fandom is a hoppy pale wheat ale that is balanced and easy drinking. As part of our commitment to E-Sports, our E-League partnerships have continued in our fourth quarter. Buffalo Wild Wings is airing the action of E-League's second season, which began last week. We saw initial success attracting new fans into our restaurants to watch this emerging sport. We have partnered with Electronic Arts to his serve as the exclusive restaurant partner for the highly



anticipated release of Titanfall 2 to launching Friday. Fans that visit Buffalo Wild Wings October 28 through November 30 for dine-in or take out will receive a unique code that can be redeemed for in-game Titanfall content.

Buffalo Wild Wings is proud to serve the men and women of the armed forces every day and our restaurants. As a thank you for their service, we are offering all veterans and active duty service members a free small wing and fries all day on Veteran's Day, Friday, November 11. We thank our team members, our franchisees and our vendor partners for their passion and their continued dedication to our success. We thank our shareholders for their confidence in our Company and our fans for their passion for Buffalo Wild Wings. I will now turn it back to Heather.

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

Thank you, Sally. We will now move to the question-and-answer session of our third quarter earnings call. Jeff Sorum, Senior Vice President and Corporate Controller will be joining us in a minute. We will end the call promptly at the top of the hour. In order to get to as many participants as possible that are in the queue, please limit yourself to one question and queue up again if you have additional questions. Operator, please open the call for questions.

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## QUESTIONS AND ANSWERS

### Operator

Of course, ma'am. And first, we'll hear from Brian Bittner with Oppenheimer.

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**Brian Bittner** - *Oppenheimer & Co. - Analyst*

Thank you. Just a couple of questions. When you think about the 2017 comps, I think that you said you expect to have no pricing in that comp. Is that what you said? And is the no pricing going to begin in the first quarter? Or do you have pricing that starts and it tails off as we go throughout the year?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

I think, Brian, right now, we're anticipating minimal price increases and I think what we're probably anticipating will be a market-by-market analysis. I do know certain areas, such as California, you've got a significant minimum wage price increase going in, taking effect mid next year. So I would anticipate in that scenario we'll look at taking some pricing. So it will be more, I think, targeted and strategic rather than across-the-board pricing.

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**Brian Bittner** - *Oppenheimer & Co. - Analyst*

Okay. And it sounds like you guys have some new margin initiatives that you're going to try to work through the system that could impact the model in 2017. I know you're not giving formal guidance today, obviously, on 2017, but as you think about it today, is there any way you can help us understand maybe what type of comp you think you're going to need to drive double-digit EPS growth next year? Is there any way we can start to get a view on how to think about that?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Brian, as we did say on the call, we really are working on 2017 and we'll have more guidance. Of course, it's our hope that we will have positive comps in 2017. We've got some great initiatives which, as we said, have great momentum.



And I don't think we'll have to have significant comp increase. We've done a nice job of controlling expenses. We mentioned some of the expense reductions that we're going to be very focused on in 2017. So I think we'll be, as I said, giving more guidance in February, but it shouldn't take significant comp growth.

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**Brian Bittner** - *Oppenheimer & Co. - Analyst*

Okay. Thank you.

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

I'd just add a point of clarification, 2017 is a 53-week year for us, so that will be an additional week to add.

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**Brian Bittner** - *Oppenheimer & Co. - Analyst*

Thanks.

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**Operator**

It looks like, moving on, from Morgan Stanley, we have John Glass.

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**John Glass** - *Morgan Stanley - Analyst*

Thanks very much. First just, now that you do have a new CFO on board, maybe could you update us on your thoughts and maybe a timetable for thinking about some of the proposals around refranchising? I think last time you spoke that you'd hired some advisors to look at it, so where are they in that process? And if I could just sneak in, just a follow-up, just to make sure I understand the fourth quarter or the full year guidance; the lower guidance is weaker sales, higher wing prices? Or is there a bigger dynamic in there or something else in there besides those two factors that we're not seeing?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

No, it really is just that with what we saw in October, which we were impacted by Hurricane Matthew fairly significantly in October, so we saw a little softer on the comps than we anticipated in October. So, it's just we're seeing some good momentum from our initiatives, but that has us a little cautious about reaching our goal of getting to flat same-store sales for the quarter. And then traditional wing prices are higher than anticipated, and that's a combination of factors that started with the heat wave in late summer, compounded by supply chain disruption from Hurricane Matthew, and slightly higher demand than anticipated has driven traditional wing prices higher than anticipated.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

I'll answer the question, John, on looking at refranchising, and we are continuing to review our various options. As we said at Analyst Day, we weren't going to be announcing anything in terms of a major refranchising until we had a CFO on board who had an opportunity to review that information along with our strategic initiatives, and it will be one of his top priorities in his first 60 days.

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**Operator**

And our next question comes from Will Slabaugh with Stephens.



**Will Slabaugh** - *Stephens Inc. - Analyst*

Yes. Thanks. I wanted to ask a little more about the Half-Price Wing Tuesdays promotion and how that worked out. You mentioned you had seen positive traffic from that, so I just wanted to clarify if that was just on Tuesdays or if you're getting some sort of brand benefit from that as well? And sort of how those Tuesdays are stacking up versus the prior Tuesdays which you were already running the Wing Tuesday on, just not with the explicit half-price?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

We are seeing very good momentum on Half-Price Wing Tuesdays. We're seeing significant traffic increase and also a nice lift in sales and good sales momentum on that day. As of right now, we can't identify any additional traffic being driven on other days and, at the same time, we don't believe we're cannibalizing the other days. But it's still early in the promotion, but results so far are very favorable.

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**Will Slabaugh** - *Stephens Inc. - Analyst*

If I could just follow up on that, does that sort of lead you to believe there's room on the menu for other value initiatives or other introductions of additional everyday value elements of the menu that maybe could spark additional traffic to the stores?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

That's something that we always look at. We have Boneless Thursdays, and we think that provides a great value. I think one of the key things to remember about our Half-Price Wing Tuesdays is we did put media behind it. We've tagged our TV and our radio, and we hadn't advertised Wing Tuesdays in quite a while, so I think that gives you some momentum on sales and awareness as well. But it's definitely something we'll look at. We do research around our value scores and they've improved very nicely and, of course, we will continue I think certainly with a minimal price increase throughout 2017. I think we'll be right in line with where we want to be for what our guests are looking for, for value.

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**Will Slabaugh** - *Stephens Inc. - Analyst*

Thank you.

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**Operator**

Moving on, we have David Tarantino with Robert W. Baird.

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**David Tarantino** - *Robert W. Baird & Company, Inc. - Analyst*

Hi. Good afternoon. I just want to clarify a couple of the comments that you made on same-store sales. First, Sally, I think you mentioned that same-store sales improved as the quarter progressed. So, first, can you confirm that's correct, that September was the highest month? And then I just want to understand, I know there was a hurricane impact and you mentioned a calendar impact in Q4 but, I guess, is the underlying business improving in your mind as you enter Q4? And would we have otherwise seen you get to flat had it not been for those two issues you called out?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Yes, I think we'd have been close. Hurricane Matthew, when a store is closed for three days, you take it out of the comp group. That's kind of our standard rule. We had a number of stores that were closed for two days.

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As an offset, though, for that, some of those stores opened first in the market and saw nice sales gains, so it's really hard to say, okay, the total effect had we -- had they all been closed. And we did say that sales were improving throughout the third quarter, month-over-month, and we expect that to continue throughout the fourth quarter.

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**David Tarantino** - *Robert W. Baird & Company, Inc. - Analyst*

Got it. And then just so I'm clear on the weather impact, what would you estimate the weather impact to be if you looked at that on a quarterly basis for the Hurricane Matthew?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

For those stores that truly fell out of the comp group, we estimate -- or that would have, we estimate it to be about 20 basis points.

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**David Tarantino** - *Robert W. Baird & Company, Inc. - Analyst*

Okay. Thank you.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

But you also asked about the holiday, right, and that 20 basis points was for the month of October, not the entire quarter.

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**David Tarantino** - *Robert W. Baird & Company, Inc. - Analyst*

Got it. Thank you.

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**Operator**

Our next question comes from Brett Levy with Deutsche Bank.

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**Brett Levy** - *Deutsche Bank - Analyst*

Good afternoon. You talked a little bit about the cost savings initiatives and the internal focus on labor. Can you give just a little bit more clarity on what you're doing, what you think you're going to see in terms of wages, where you are in retention and turnover and just any additional training costs? How should we be thinking about the labor line?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Well, a couple of things. One, we mentioned that we would expect to see wage inflation of 4% to 5%. And that holds pretty consistent throughout the year. We do think we have some opportunity on scheduling efficiency to take a look at all of our day parts. It may mean spending a little bit more during some peak times and a little bit less. So that's a big focus of ours in the first half of 2017. Also taking a look at guest experience captain's hours, so they more closely align with sales and during our busy period. Those are really the two big focuses that we have around labor for the first part of 2017.



**Brett Levy** - *Deutsche Bank - Analyst*

And retention, turnover?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Well, it's significantly unchanged is what I would say. It's been a real focus. With regard to training, we have some training initiatives going on. For the fourth quarter, we'll be training on beer, but that is already baked into our forecast and the guidance that we gave.

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**Brett Levy** - *Deutsche Bank - Analyst*

Thank you.

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**Operator**

And our next question comes from Andrew Charles with Cowen and Company. Andrew, your line is open, sir. We're unable to hear you, your phone may be on mute.

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**Andrew Charles** - *Cowen and Company - Analyst*

Sorry about that. It was on mute. Thank you for taking the question. On the decision to reduce the unit growth guidance, how much of that was impacted, would you say, by the growing wedge between the AWS and the same-store sales growth, just given that a lot of the difference is coming from those new restaurant sales?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

I think as far as the unit growth, that is due to development delays and in our effort even to say we didn't want to pack Q4 with openings. So that was not impacted by our current sales performance at all. As we look at moving forward into 2017, I think you do see a little bit of impact on growth as a result of there are some higher development costs, which really just has reduced the rate of approval of sites that meet our financial criteria. So we're staying very disciplined in our financial analysis of sites, but there's not an intentional effort to slow development.

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**Andrew Charles** - *Cowen and Company - Analyst*

Let me ask you a follow-up that's related then. When Alex starts, and if he and the team were to conclude that it makes sense to sell some Company stores to franchisees, just between the reduction in franchise openings where it's a little bit more out of your control, I understand your desire obviously to do less in the fourth quarter, but just doing introduction and openings on the franchise side as well as the numerous number of Company purchases of stores from franchisees in recent years, can you talk about what's driving the demand then of existing franchisees to buy Company stores?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

So, well, right now we don't have any franchisees that have approached us about Company stores. We do have some franchisees that are acquiring other franchisees. We actually had, I think there have been three deals this year that we passed on our right of first refusal. It didn't meet our financial criteria, but it did for our franchisees. So we have several groups buying other groups. But we've not had an offer by our current franchisees to buy any Company stores. I'm not sure if I understand your question 100%.

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**Andrew Charles** - *Cowen and Company - Analyst*

Yes. No, I think you got it. I was just trying to figure out just given the reduction in the unit openings and just obviously we've seen a lot of franchise sales to the Company of stores. I just want to see the appetite for franchise growth, but I think that satisfies it.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Okay. Thanks.

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**Andrew Charles** - *Cowen and Company - Analyst*

Thank you.

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**Operator**

And moving on. From Guggenheim Securities, we have Matthew DiFrisco.

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**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

I have a two-part question. One is first on the guidance. I think the question was just asked also about the labor line in the fourth quarter. 32% I think is what you said within the guidance, if that's correct. That seems in line with the third quarter where the last couple of years, despite having softer comps, in the fourth quarter, you've actually gotten somewhere close to 100 basis points or more of sequentially lower relative labor costs. So in this environment where it appears as though you're guiding to slightly negative, which sounds better than the down 1.8% on the Company-owned side, why wouldn't you see greater labor leverage in the fourth quarter?

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

Matt, you could certainly see some labor leverage in the fourth quarter. What we've seen a little bit this year is on a year-over-year basis some of our health and benefit costs have been down versus the prior year. There is some accrual in there to take a look at that again, as well as continued wage pressure, too.

And then, two, we've gotten a little bit of benefit as well this year from some lower management bonuses. We're certainly hoping to be able to pay higher bonuses to our restaurant-level managers in fourth quarter based on better sales.

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**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

But you're guiding to negative comps, so wouldn't that tell you that you probably on a year-over-year basis would be more flattish on the store-level compensation?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Well, we were pretty negative in both Q2 and Q3 from being able to pay bonuses based on sales and flow-through and so forth. And with the improving trends that Sally had alluded to earlier on the sales side, we anticipate more robustly paying those bonuses in Q4.



**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

Okay. So I guess I'm looking also on a year-over-year basis where you had relative labor at 30.9% last year. And it sounds like you've got momentum now behind digging a little harder to reduce some cost and manage the guest captain a little more efficiently. I would have thought you would have been at minimum probably flat with fourth quarter of 2015 on a relative labor basis?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

If you take a look, we still have lower same-store sales than we did in the fourth quarter last year. So that's part of it. And you've had wage inflation in the year since of about 4% to 5%. If there's opportunity there, we will certainly be taking it.

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**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

Okay. And then I guess if you could just dig into a little bit of the initiatives? I think earlier in the year you were talking a lot about looking forward to the back half of this year with the marketing campaign heading into the football season. I wondered how you could -- could you -- what has been the Have you been able to buck the trend that we've seen with football being poor as far as Nielsen ratings at home viewership? Have you seen similar weakness? I think you said in one of your color commentary about the comp here that it sounds like you said non-football days you were talking about versus football days. Is there a difference? Are you seeing weakness on football days?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Well, if you look at our trends so far, now, we're still early in the season; you really don't see a different sales performance when you look at NFL days versus non-NFL days. So that would at least suggest we're not seeing anything dramatic impact. Also for us, it can also depend our sales on what teams are playing well and what markets they're in.

This year we've got Minnesota playing well; Dallas is playing well; and out in LA, you've got the Rams having moved back to LA and Oakland Raiders are having a good season. So that helps to lift some of our bigger markets. So we aren't seeing that impact. As far as marketing, I think we're pleased with our football campaign that we have. But our media, to be honest, is a little more weighted to December. So I really think that's when we hope to have the greatest impact from our advertising campaign is a little later in the season.

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**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

Excellent. And then did you, I might have missed this, did you specify what the average cost of wings will be or have been for the first couple of weeks of the fourth quarter?

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

They're \$1.96 for the first two months of the fourth quarter and that compares to \$1.81 for the full fourth quarter of 2015.

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**Matthew DiFrisco** - *Guggenheim Securities LLC - Analyst*

Thank you so much.

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**Operator**

And our next question comes from Jason West with Credit Suisse.



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**Jason West** - *Credit Suisse - Analyst*

Yes. Thanks. I just want to switch gears a little bit to the balance sheet. I think you guys talked about \$500 million authorization now on the credit facility with about \$58 million drawn on that. What's your plan in terms of getting the leverage up to the target? You talked about 1.5, and would you then put that money to work in buybacks in the near term? Or how are we thinking about getting to that target? Thanks.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

We did say in the script that we anticipate getting to the 1.5 times target by the end of 2018. As opportunities arise in stock repurchases, we're going to take them. We do anticipate meeting what we said at Analyst Day of \$150 million of stock buybacks for 2016, which was an increase from the \$100 million that we had through the first half of the year. So you know, 2018 is the target, but we could achieve that before then. Again, we'll have Alex weigh in on our capital allocation. And as I mentioned also on Analyst Day and again in the script, our Board is looking at a dividend policy as well.

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**Jason West** - *Credit Suisse - Analyst*

Okay. Sorry I missed that. And then just a separate question around the guidance for the fourth quarter comps being slightly negative. Can you tell us when the pricing rolls off in the quarter? Have you already kind of rolled off to that lower pricing level already in October? Or is that something that happens later in the quarter and so you need a little bit more of a pick-up in traffic or mix to get there?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Yes I think we took the pricing last year around November 1 last year, so the first month of the fourth quarter would have the higher pricing, and then it does roll off. And then we just have a new menu going out and that price increase was minimal, less -- if you round down, it would be zero.

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**Jason West** - *Credit Suisse - Analyst*

Got it. Thank you.

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**Operator**

Next from Goldman Sachs we have Karen Holthouse.

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**Karen Holthouse** - *Goldman Sachs - Analyst*

Hi. Thanks for taking the question. So on that continued growth on take-out sales, is there anything to suggest that's actually transferring sales out of the store? Like is, are, is in store where we're seeing stronger growth in that business or in-store sales at all weaker there or do you think it's entirely incremental to what you can do in-store?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

I mean, our take-out sales have continued to be very strong. I don't think though it's a matter of choosing between an in-restaurant visit and take-out visit. I mean, our view of take-out is that the consumer is looking for take-out experience and so our approach is to embrace take-out and so we think there's a great opportunity in take-out. We're focused on it. We're enhancing our digital ordering experience so take-out does continue to grow for us and it's an area of focus.



**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Karen, I think you'll also hear that kind of throughout the industry that take-out is growing for everybody and so I don't know that it's replacing in-restaurant sales, but certainly when that guest is coming for take-out, they're coming for take-out. It isn't a, gee, I might eat here, but no, I think I'll get take-out. Definitely they, it's fast, it's convenient and so we want to make sure we do it well.

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**Karen Holthouse** - *Goldman Sachs - Analyst*

And then, on the delivery side of things, is there any sort of guard rails you could put around how quickly you could ramp into a broader roll-out? And based on what you know now, do you think it's something that could be applicable to the entire store base or only a portion of it?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Well, no. I think eventually it could be applicable to the entire store base. Right now there are a number of delivery partners. There is no national partner out there, so that's sorting out as well. How that happens within each delivery partner is a little bit different. We know where it's in 90 company restaurants, and we're pleased with the sales results. I think you have to figure out the cost or the margin pressure, which we will along with everybody else.

We do have franchisees that can partner in their market with whoever their strongest local provider is, and in some cases it's just a matter of that delivery company growing their customer base as well. So we do think, I suppose there's some very small rural markets that don't have one of the big players. But I would say it could roll out, as we learn more, throughout the entire system.

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**Karen Holthouse** - *Goldman Sachs - Analyst*

Great. Thank you for taking the question.

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**Operator**

And moving on, from Barclays, we have Jeffrey Bernstein.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

Great. Thank you very much. Two follow-up questions, I guess. First just on the comp. I can appreciate it sounds like the sales trends improved through the third quarter. I was wondering whether that you thought was on a one or two-year basis.

So assessing based on the year ago whether you were comfortable with the trends continuing to improve through the third quarter into the fourth quarter? And I know at the Analyst Day, the excitement was highest it seemed like on value at lunch. So I'm just wondering how'd you define success on both the value and lunch, whether you look at the mix as a percentage of the total or profit contribution or guest satisfaction? How would you define ultimate success on value and lunch? And then I had one follow-up.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Sure. Well, I'll answer that last part, all of the above. So I think you want to have guest satisfaction and you want to meet that speed, that convenience, and that value. I think getting to positive traffic and positive same-store sales is a measure of success. And then certainly on Half Price Wings, you want that volume because it is a little bit more of a discount.

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

And then, Jeff, I think your other questions that you had about the two-year stack, I mean, certainly for our company-owned restaurants, our two-year stack from Q2 to Q3 was flat. So that was a positive sign that, that decline had stopped. And then looking at fourth quarter, if you really adjust for the 50 basis points of the holiday shift, we'll certainly see where the two-year stack ends up by some. I don't think you're going to see the erosion that you saw through early 2016.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

Okay. But within the third quarter? I know you had said trends improved throughout the third. I just wanted to make sure it wasn't a comparison benefit rather than actual fundamental improvement.

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

No. It certainly, you can have some comparison misalignments within our months, just given the organic event nature of our business. But when we're looking at our trends, we're definitely seeing some positive momentum in our sales.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

Got it. And then the other question was just on the follow-up on the unit growth side. It seems like we're tempering the company operate even more so I guess the franchise. And I'm talking more about 2017. So on the franchise side, I was just wondering whether you think it's just led based on the challenging top line or cost pressures and conversations you're having with those franchisees or whether we should read anything into maybe penetration concerns? Or how we should think about what the constraints are that would leave the franchisees to maybe only open up 15 next year versus what should be 30 this year?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

I think a little bit of that. I'm sure there is some cost pressure that they're seeing. A lot of it is just the comparison of opportunities for trade area development between Company and franchise. Company has a little more territory available for developing currently than franchisees do. So I really think it's a combination of those two factors.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

Okay. But in conversations with franchisees, there's no other -- I'm wondering what the greatest pushback you hear, if there's any, whether there's any sign of less enthusiasm for growth of the brand or whether that's not a concern of yours?

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

No. No, I'm not aware of anything along those lines.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

No. I think they're just as particular as we are on sites. They're seeing that sites are expensive to develop, and the availability of sites, it's very competitive out there, and they have models that they'll follow as well.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Yes. And also, I think the fact that we continue to have franchisees buying other franchisees suggests that they're still happy with the brand and want to expand and grow with us.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

And our international side is growing as well from a franchisee perspective.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Yes. Correct.

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**Jeffrey Bernstein** - *Barclays Capital - Analyst*

Great. Thank you.

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**Operator**

And our next question comes from Jeff Farmer with Wells Fargo.

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**Jeff Farmer** - *Wells Fargo Securities, LLC - Analyst*

Great. Thanks. Just following up on Jeff's last question. Have you guys performed any new restaurant development cannibalization studies for the system recently? And, if so, I'm just curious what some of the results you are seeing are.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Yes. We have an ongoing analysis of cannibalization that we do. We just recently reviewed it. I would say cannibalization is, obviously, as you go lap markets, you're going to see some impact. All of the impact that we have seen has been within acceptable ranges to us. It's very rare that we see an impact greater than we would be comfortable with. And in most cases, stores recover within a year from an impact as a result of opening additional restaurants.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Jeff, we do go back and look at what we anticipated for cannibalization and then what actually happened and then how fast it took to recover. Sometimes it depends on if they were most recently remodeled, but, again, no big changes from past analysis.

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**Jeff Farmer** - *Wells Fargo Securities, LLC - Analyst*

All right. And then just one more follow-up, Sally, based on a similar question. But in terms of competitive encroachment studies, just trying to get a nice idea as to what the landscape looks like today versus five years, versus 10 years ago. Again, a lot of questions from investors trying to better understand where potentially some of the transaction headwinds that you guys have seen are coming from.





**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

When you talk about encroachment, you're talking about other brands?

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**Jeff Farmer** - Wells Fargo Securities, LLC - Analyst

Competitive encroachment. Yes.

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**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

I think it's across the board. There are so many restaurant seats out there, certainly the proliferation of fast casual as compared to 10 years ago and even five years ago. And I would say not just in major metropolitan areas, but as you get down in size to the 50,000 to 75,000 population towns, you just see, you do, as I travel, a proliferation primarily of fast casual. And I think part of it is fairly cheap money that has really fueled that over the last few years.

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**James Schmidt** - Buffalo Wild Wings, Inc. - COO

And we did some very in-depth research with our consumer earlier this year. And what that research revealed was that we're not seeing any significant erosion of our core target customer. That customer comes to us for the great experience around sports. It's been more competing for that more casual customer who is more value sensitive, is attracted more by takeout and delivery. And that's really why we then focused on the initiatives for Fast Break Lunch and the Half-Price Wings on Tuesday.

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**Jeff Farmer** - Wells Fargo Securities, LLC - Analyst

I appreciate that. I know I'm pushing my luck with this third one here. But just as it relates to overall site selection, both Company and franchise, it sounds like it's fair to say that it's just become, for not only you guys, but most other concepts out there right now, just far more challenging to find sites that actually meet your return criteria. Is that a fair statement?

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**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

Absolutely. Yes.

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**James Schmidt** - Buffalo Wild Wings, Inc. - COO

That is accurate. You've seen a rise in both occupancy costs and probably a more significant rise in development costs.

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**Jeff Farmer** - Wells Fargo Securities, LLC - Analyst

All right. Thank you.

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**Operator**

Moving on. From CLSA, we have Jeremy Scott.

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**Jeremy Scott** - CLSA - Analyst

Hey. Thanks. Good afternoon. So I appreciate your waiting until Alex is in the seat until you make a number of decisions. However, the refranchising initiatives that's on the table is a major structural change outside of just the financing aspect of it. So if I could just revisit that question from a top-down perspective, Sally.

Where do you see Buffalo Wild Wings brand in its growth cycle? Does a higher franchising rate make sense at this stage, given all the initiatives that you're currently driving? And can you talk about some of the factors that are driving your views on this matter, whether favorably or unfavorably? And I just have a follow-up to that.

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**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

We don't target a specific percentage mix. We look at opportunities. We do that whether we're repurchasing franchise locations or if we would decide to sell off some Company stores. We're going to continue to do that where maybe it makes sense in some higher-cost states if there are franchisees that operate well.

We do believe that we operate restaurants really, really well. We're able to take advantage of vendor partnerships that come our way very quickly by having that large percentage of Company stores. We have great franchisees and they've expressed an interest to grow, as evidenced by their purchases of some franchise locations.

It is a fundamental shift and we want to make sure we take our time in determining what the right approach is. It has implications for employees, for team members out there, not so much that, gee, you're not going to have those same positions at the home office, but really, out in the field. If you talk about refranchising or selling off territories or areas of the country in any specificity, you're going to lose talented great people out there who may say, gee, I don't want to stick around. So I think you need to be very thoughtful about it.

That said, we are open to looking at it. We, of course, want to continue to drive shareholder value and enhance value, and we like to think it's not just for today but three, five and 10 years from now. And I think it deserves thoughtful consideration.

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**Jeremy Scott** - CLSA - Analyst

Got it. And then a different line, but the 25% of system stores that have Blazin' Rewards, are those mostly Company stores? And are franchisees taking up the program at the rate that you expect?

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**Sally Smith** - Buffalo Wild Wings, Inc. - CEO and President

It's both. We started the test with Company stores. The first five markets were Company markets. And then with the next roll-out was out to franchisees as well.

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**Jeremy Scott** - CLSA - Analyst

Thank you.

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**Operator**

All right. And for our final question for today's session, we have Jeremy Hamblin with Dougherty & Company.



**Jeremy Hamblin** - *Dougherty & Co. - Analyst*

Good evening. Thanks for taking the question. Just first on the Fast Break Lunch, it sounds like you're pretty pleased with the initial results from that. I wanted to just understand what type of impact it's having on ticket during that day part. Is that something where you're seeing a little lower ticket, but you're making it up on traffic? Or can you just speak and elaborate on that?

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

Certainly, the Fast Break Lunch, it is the same variation of price points on the menu that we had on our prior lunch menu. So there is not really a ticket change in there. And certainly we haven't seen -- we're really pleased where our comps are at for those that do not need the 15-minute guarantee. Those are about a third of what we would have expected initially. So that has not really had a negative impact on traffic during our lunch business.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

And one of the kind of --

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**Heather Pribyl** - *Buffalo Wild Wings, Inc. - Director of IR*

Or ticket. Sorry.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

One of the kind of interesting and attractive side benefits of it has been that the execution from the Heart of House for lunch has really then had an impact on execution throughout the day. So I think we've seen improved Heart of House execution really throughout all day parts.

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**Jeremy Hamblin** - *Dougherty & Co. - Analyst*

That's good to hear. One other question, just on the commentary on restaurant level margins trying to achieve 20% by 2018. I don't know if that is like a slight shift of where you were previously thinking or when you were thinking that you could get back to those 20% restaurant level margins. Is that just a function of a little bit lower AUVs and maybe labor pressures and wing prices being a little bit higher? Can you just comment on that?

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

At Analyst Day, we really didn't specify when we thought we could achieve that 20%, so we wanted to go back, look at specific costs, the programs that it would take to take those costs out, and we think there's opportunity, as I said, in a variety of areas. Again, wish you could just slam everything right into stores, but you do have to pay some of the things in. So, I think certainly at today's wing prices, it's going to take a little bit longer to get to that 20%, but if we see any kind of fall-off in prices, that's really the variable we have is wing prices.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

And also, we always focus first on the guest experience. I think one of the things we've really done a good job of, even with the sales softening in the last year, is to have maintained that focus. And because of that, we had a significant increase year-over-year in guest satisfaction and value score in third quarter. So that focus prevents us -- really tells us to be thoughtful about how we reduce costs and reduce labor in the restaurant. So we will achieve it; we just want to make sure we don't damage the guest experience in attempting to gain cost efficiencies.

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**Jeremy Hamblin** - *Dougherty & Co. - Analyst*

Great. Understood. Thanks for taking the questions, and best of luck.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Thanks.

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**James Schmidt** - *Buffalo Wild Wings, Inc. - COO*

Okay. Thank you very much.

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**Sally Smith** - *Buffalo Wild Wings, Inc. - CEO and President*

Well, thank you, everyone, for joining us on the third quarter conference call. As usual, great questions. We're looking forward to providing you with our final year 2016 results in February along with our forecast for 2017. We will talk to you then, if not before.

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**Operator**

And once again, ladies and gentlemen, that does conclude today's conference. We appreciate your participation, and you may now disconnect.

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