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BWLD - Q1 2014 Buffalo Wild Wings, Inc. Earnings Conference Call

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OVERVIEW:

BWLD reported 1Q14 revenue of $367.9m, net earnings of $28.3m and diluted EPS of $1.49.

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Buffalo Wild Wings First Quarter 2014 conference call.

At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question and answer session.

(Operator Instructions)

I would like to remind everyone that this conference call is being recorded. I will now turn the conference over to Heather Pribyl, Investor Relations of Buffalo Wild Wings.

Please go ahead.

Heather Pribyl - *Buffalo Wild Wings Inc - IR*

Good afternoon, and thank you for joining us as we review our First-Quarter 2014 Results.

I'm Heather Pribyl, Investor Relations for Buffalo Wild Wings. Joining me today is Sally Smith, President and Chief Executive Officer, and Mary Twinem, Executive Vice President and Chief Financial Officer. By now everyone should have access to our First-Quarter Earnings Release, and copies are available on our investor website at IR. BuffaloWildWings.com.

Before we get started, I remind you that during the course of today's call various remarks we make about future expectations, plans, and prospects for the Company constitute forward-looking statements.

Actual results may vary materially from those contained in forward-looking statements based on a number of factors, including but not limited to, our ability to achieve and manage our planned expansion; the sales and other growth factors at our Company-owned and franchise locations; our ability to successfully operate in new markets, including non-US markets.

Unforeseen obstacles in developing sites, including non-traditional and non-US locations; success of acquired restaurants; success of investments in new or emerging concepts; the cost of commodities; the success of our key initiatives and our advertising and marketing campaigns.

Our ability to control restaurant labor and other restaurant operating costs; economic conditions, including changes in consumer preferences or consumer discretionary spending; and other factors disclosed from time to time in our filings with the US Securities and Exchange Commission.

On today's call, Sally will provide an overview of our performance for the first quarter. After that, Mary will provide further detail on the quarter and comment on trends to date in the second quarter. Finally, Sally will share some additional thoughts about the second quarter and year ahead. We will then answer questions.

So with that, I'll turn things over to Sally.

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

Good afternoon everyone.

Our first quarter was a great start to 2014. We're pleased with our strong revenue growth of 20.9%.

For the quarter, same-store sales at Company-owned restaurants increased 6.6% and same-store sales at franchise locations increased 5%. Sales momentum grew during February and March with the excitement of the Winter Olympics and March Madness, bringing guests into our restaurant.

Our net earnings increased 72.9%, outpacing the topline growth. Strong net earnings growth is primarily attributable to 46 additional Company-owned restaurants compared to the prior year.

The strength of same-store sales and a 40-basis-point improvement in cost of sales that was the result of significantly lower traditional chicken wing prices and our July 2013 transition to selling wings by portion.

In the first quarter, our teams focused on engaging our guests, particularly during major sporting events like the NFL playoffs and Super Bowl, college football bowl games, and college basketball. We launched a unique approach to March Madness brackets this year, where guests picked their bracket online, receiving points for wins and additional points for checking in at a restaurant. The Blazin' or Bust Bracket Challenge winner received a trip to the 2015 NCAA final four tournament.

Our restaurant growth continued in the first quarter with the opening of 19 new Company-owned and franchise Buffalo Wild Wings restaurants. A restaurant opened in Rhode Island, marking our 50th state. And two new franchise partners in Mexico each opened their first restaurant.

The guest experience business model provides a vehicle for our teams to deliver the ultimate social experience for our guests and further differentiates our brands. In 2014, we will continue to roll out the guest experience business model to our Company-owned restaurants, and our franchise partners will begin to roll it out as well.

At the end of the first quarter, the guest experience management structure and guest experience captains were in place at about 240 Company-owned restaurants.

We had tabletop tablets in 200 Company-owned and 55 franchise locations. Tablets currently have trivia, arcade, and newsstand and poker functionality. We're testing music and premium arcade, and will begin testing tablet ordering in the third quarter.

2014 is a year filled with many exciting initiatives, like continued implementation of the guest experience business model. All future Company-owned restaurants will open with the Stadia restaurant design. And our partnerships with Pepsi and the NCAA will provide exciting marketing opportunities.

Mary will now provide additional details on the first quarter, as well as the second quarter to date. Then I'll return to talk more about the second quarter and the remainder of the year.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

Thank you, Sally.

Our revenue in the first quarter reached $367.9 million, increasing 20.9% over last year. System-wide, sales at our Company-owned and franchise restaurants were $804.3 million for the quarter, an increase of 17.9% over the first quarter of 2013.

Company-owned restaurant sales for the first quarter increased to $344.9 million, a 21.3% increase over the same period in the prior year. Same-store sales at our Company-owned restaurants were 6.6% for the first quarter, compared to 1.4% for the comparable period last year. Easter shifting out of the quarter and after the NCAA tournament benefited same-store sales by 60 basis points.

Menu price increases and adjustments taken during the past 12 months at Company-owned restaurants were about 2.1%, which includes a 1.1% increase on our February 24 menu rollout. We had 46 additional Company-owned restaurants in operation at the end of this quarter versus first quarter last year, an 11.6% unit increase.

Average weekly sales increased by 7% in the first quarter, 40 basis points higher than the same-store sales percentage. The average weekly sales calculation benefited by 30 basis points for newly-opened locations during the last 15 months. And the remaining 10-basis-point increase was from the closing of older, lower-volume locations during the last 12 months.

Our royalty and franchise fee revenue for the first quarter grew by nearly 15%, to $22.9 million, versus $19.9 million last year, with an additional 55 franchise units in operation at the end of the first quarter versus a year ago. Same-store sales at franchise locations increased by 5% in the quarter, compared to a 2.2% increase in first quarter last year.

Average weekly sales volumes for the quarter increased by 6.3%, 130 basis points higher than the same-store sales percentage. The average weekly sales calculation benefited by 100 basis points from newly-opened franchise locations during the last 15 months. And the remaining 30-basis-point increase is from the closing of older, lower-volume franchise locations during the last 12 months.

The following comments will focus on the performance of our Company-owned restaurants. Cost of sales for the first quarter was 28.3% of restaurant sales, compared to 32.7% in first quarter last year, a 440-basis-point improvement.

Traditional wings were $1.36 per pound this quarter, $0.74 or 35% lower than last year's average of $2.10. Cost of sales also benefited from our July 2013 transition to selling wings by portion.

Traditional and boneless wings each accounted for 21% of our restaurant sales this quarter, both up from 20% last year. Food and nonalcoholic beverage sales were 79% of restaurant sales in the first quarter, up from 78% last year.

Cost of labor for the first quarter was 30.5% of restaurant sales, 30 basis points higher than first quarter last year. Labor expense as a percentage of restaurant sales was higher than last year, as we incurred higher management incentive compensation.

We added guest experience captains at 57 existing Company-owned restaurants. And hourly wages as a percentage of restaurant sales were flat as we optimized hourly labor at restaurants that rolled out captains last year.

In the first quarter, restaurant operating expenses as a percentage of restaurant sales was 14.2%, a decrease of 30 basis points from the prior year. Occupancy costs were 5.5% as a percentage of restaurant sales, compared to 5.7% last year.

In summary, restaurant-level cash flow, which is calculated before depreciation and pre-opening expenses, was $74.1 million, or 21.5% of restaurant sales, versus $48.3 million, or 17% in the first quarter last year. This 450-basis-point increase in cash flow is primarily a reflection of strong same-store sales and lower traditional wing prices. Our goal for restaurant level cash flow is 20%, and we were clearly over this target for the quarter.

Depreciation and amortization for the first quarter was 6.2% of total revenue, 40 basis points lower than the prior year. General and administrative expenses were $28.2 million in the first quarter, or 7.7% of total revenue, compared to $21.3 million or 7% in the prior year. Excluding stock-based compensation of $3.6 million in the first quarter and $870,000 in the prior year, G&A expenses for the first quarter would have totaled $24.5 million, or 6.7% of total revenue, the same percentage as last year.

Given our strong financial performance in the first quarter, we accrued additional expenses for our incentive compensation plans as compared to the first quarter last year.

We opened 9 Company-owned restaurants during the first quarter, compared to 14 new locations in the first quarter of 2013. Pre-opening expenses for the quarter totaled $2.6 million versus $4.3 million last year.

The $2.6 million includes $446,000 of pre-opening expenses for future openings that are under construction. And in the first quarter last year we incurred $1.1 million related to future openings.

Pre-opening costs averaged $330,000 per new restaurant during the quarter, compared to $285,000 in the first quarter last year. Five of the nine openings were in California and Washington, and we incurred higher pre-opening costs for these states. We estimate that average pre-opening expenses for openings in second quarter through the end of the year will be about $290,000.

The loss on asset disposals and impairment for the first quarter totaled $787,000, compared to $571,000 last year. We reported an Other Loss of $127,000 for the quarter, compared to Other Income of $345,000 in 2013. Included in the Other Loss line is a loss from our minority investment in PizzaRev. In the prior year, Other Income benefited from higher investment income from our deferred compensation plan.

Our effective tax rate during the first quarter was 33.4%, compared to 26.5% in the prior year, which included the favorable impact of the American Taxpayer Relief Tax Act of 2012 that was enacted in early 2013. We estimate our effective tax rate in 2014 will be about 33% based on current tax law, and would decrease to 32% if Congress renews the employment credit, similar to last year. As of today, the House has passed the employment credit but the Senate has yet to vote.

In summary, our net earnings in the first quarter of 2014 grew an impressive 72.9% to $28.3 million, producing earnings per diluted share of $1.49, compared to $0.87 in the prior year.

On our balance sheet on March 30, 2014, our cash and cash equivalents totaled $72.5 million, compared to $57.5 million at the end of 2013. We ended the quarter with $696 million of total assets and $497 million in stockholders' equity. Cash flow from operations was $48.1 million for the quarter, a 72.9% increase over last year.

We spent $26 million for capital expenditures in the first quarter of 2014. And we estimate that our annual capital spending will be $146 million, which does not include funds that we may spend for franchise acquisitions or emerging brand investment. We also have available a $100 million unsecured line of credit through January of 2016 that provides us flexibility for future acquisitions and investments.

Now I will highlight trends and provide some comments on the second quarter of 2014.

For the first four weeks of the second quarter, our same-store sales are trending at about 5.7% at Company-owned restaurants and 4.4% at our franchise locations, as compared to same-store sales trends for the first four weeks in the second quarter last year of 5.2% at Company-owned restaurants and 5.8% at franchise locations. We estimate that Easter occurring in the first four weeks of the second quarter of 2014 had a negative impact of 90 basis points.

For the full second quarter of 2013, our same-store sales were 3.8% at Company-owned and 4.1% at franchise locations. The potential menu price benefit for increases and adjustments taken in the last 12 months is about 2.6% for Company-owned restaurants in the quarter.

In the second quarter, we expect to open seven new Company-owned restaurants with two of these already opened. One older Company-owned location closed at the beginning of the quarter. As a reference point in the second quarter of 2013, we opened ten new Company-owned locations. We also expect that our franchisees in the United States will open about ten restaurants during the second quarter.

For cost of sales, the traditional wing market has risen slightly since February, resulting in our cost of chicken wings for the first two months of the second quarter to average about $1.41 per pound. This compares to last year's average cost for the second quarter of $1.61. As a reminder, the cost per pound that we pay is calculated on the average of the prior month's wing market plus markup for processing and distribution.

The second quarter of 2014 is the final quarter we will have the year-over-year cost-of-sales benefit from the July 2013 launch of wings by portion. We anticipate flat labor costs as a percentage of restaurant sales compared to prior year.

We are adding guest experience captains at 85 existing Company-owned restaurants in the second quarter. And we believe this cost will be offset by optimization in hourly labor for restaurants that added guest experience captains last year, and the continued rollout of our guest experience management structure.

We anticipate that our G&A expenses in the second quarter, exclusive of stock-based compensation expense, will be approximately $24.5 million. Second-quarter stock-based compensation expense is estimated to be $4.4 million, compared to $3.1 million in second quarter last year.

Stock-based compensation expense for the year is estimated to be approximately $15 million, and will vary depending on the level of net earnings achieved for 2014, as well as for estimates of net earnings in future years.

Based on our first-quarter results, second-quarter trends in same-store sales, and anticipated food costs, we believe we will achieve net earnings growth of 25% for 2014, an increase from our previous goal for the year. Please review the risk sections outlined in our SEC filings, including our 10-Q for the first quarter, which will be filed shortly, as well as our Safe Harbor statement for factors affecting our forward-looking statements.

Now, Sally will share some additional thoughts about the second quarter and the year.

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

Thank you, Mary.

As we shared at our first Analyst Day that we hosted in New York City at the beginning of April, we're committed to being a growth Company. Our net earnings expectations for 2014 are a clear illustration of this commitment. And we are building for long-term earnings growth by investing in Buffalo Wild Wings in the United States and Canada, international franchising, and emerging brands.

These investments will allow us to achieve our vision of being a Company of 3,000 restaurants worldwide, creating the ultimate experience for our guests and providing sustained growth for our shareholders.

In the United States and Canada, we continue to open new Buffalo Wild Wings restaurants and anticipate opening 45 Company-owned restaurants, and that our franchise partners will open 40 locations in 2014. To help drive guest traffic and engage our guests in the second quarter, we have several limited time offerings.

B-Dubs Sauce Labs will launch two flavors, starting with Honey Ginger Kick, which is currently in our restaurants. Limited-time offerings also include a Buffalo Grilled Cheese Sandwich and a Prime Rib Philly and other flavorful sandwiches. We're featuring unique beer cocktails, including a Dos Equis Margarita.

Our popular Dads and Grads gift cards promotion is back and will run from May 5 through June 15. Guests who purchase a $30 gift card receive a $5 bonus card.

During the second quarter, sports fans continued their enthusiasm with the growing excitement around the NBA and NHL playoffs. Additionally, we'll have an opportunity to drive traffic that comes along once every four years, the World Cup.

We'll promote Buffalo Wild Wings as the place to watch the 2014 FIFA World Cup tournament through increased advertising spend. And we've partnered with Budweiser and Heineken to create two unique games centered on the World Cup.

International franchising for Buffalo Wild Wings continues. We anticipate that our franchise partners around the globe will open nine restaurants in Mexico, Saudi Arabia, United Arab Emirates, and the Philippines. We are in active discussions with potential franchise partners in other countries.

International opportunities for Buffalo Wild Wings is just beginning. And we believe that we will achieve 400 international Buffalo Wild Wings restaurants in the next ten years.

As part of our long-term growth strategy, we are actively looking for additional concepts to invest in to build a portfolio of emerging brands. Our first Company in the portfolio is California-based PizzaRev, and it's exciting to be part of their growth.

We're opening our first PizzaRev location next month in Minnesota, and are looking forward to sharing the brand with the Twin Cities market.

We thank our team members, our franchisees, and our vendor partners for their passion and their continued dedication to our success.

I'll now turn things back to Heather.

Heather Pribyl - *Buffalo Wild Wings Inc - IR*

Thank you, Sally.

We will now move to the question and answer session of our First-Quarter Earnings call. We will end the call promptly at the top of the hour.

In order to get to as many participants as possible, please limit yourself to one question and queue up again if you have additional questions.

Jim Schmidt, Chief Operating Officer of Buffalo Wild Wings, will join us for Q&A today.

Operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Our first question comes from the line of Keith Siegner with UBS. Please go ahead.

Keith Siegner - *UBS - Analyst*

Thank you very much. It sounds like, in the quarter, that some of the competitive gaming options around the online NCAA tournament was well received. I was just wondering if you could talk a little bit more about how you're going to approach the World Cup? You had mentioned at the Analyst Day some options for doing a similar type of fantasy World Cup.

What's the update on that? How else do you try or plan to leverage the Budweiser tie-in? Just some more details around the World Cup, and how you might approach it; that would be very helpful. Thank you.

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

Okay. Well, we're very excited about the opportunity to partner with Budweiser and Heineken for the World Cup. It's been four years, and we're certainly a different Company than we were four years ago. We think we have that same opportunity that we've had with March Madness or the Super Bowl or bowl games. We will have two dedicated games that can be played in-restaurant and online, certainly with prizes awarded.

I think what really helps this year is the fact that the hours -- or the games will be played very close to our time zone. Last year -- or four years ago, we had some benefit, but really look forward to being able to take advantage of what we offer our guests in terms of viewing. So, a lot of the same things that we do, but definitely focused on soccer.

Operator

Thank you. Our next question comes from the line of Jeff Farmer with Wells Fargo. Please go ahead.

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

Thank you. You guys did touch on it, but just looking at March and April trends, especially when controlling for the Easter headwind, same-store sales accelerated -- looks like on a one- and two-year basis. So, is there anything that you can point to in terms of media, promotions, even the guest experience captains -- anything else in terms of potentially a key same-store sales driver in play?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

From a same-store sales trends in the first four weeks of the second quarter, we did talk about the negative impact that Easter had -- about 90 basis points. And so, we have great same-store sales for the first four weeks.

We also have -- the NHL playoffs are two weeks earlier this year versus last year. So, a little bit of timing difference for the first four weeks versus what it was last year. As we go through the rest of the second quarter, most of our stuff lines up really well with the World Cup being the incremental 16 days at the end of June.

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

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Jeffrey Bernstein with Barclays. Please go ahead.

Jeffrey Bernstein - *Barclays Capital - Analyst*

Great. Thank you. Just two quick ones. One, the wing costs -- I'm just wondering whether there's any reason to believe there's going to be a meaningful change from current levels, either up or down -- was wondering what your industry contacts are saying for the balance of the year, and maybe what you're assuming, therefore, in your 2014 guidance?

Separately, just any incremental color on the tablets, whether you can directionally quantify the benefit to sales or labor costs based on any stores that have enough data to talk about, or what might be the most -- what's more meaningful to you, or good learnings from that would be great. Thanks.

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

On the tablets, I think -- we're just early in test on that. Obviously, as we -- in the second half of the year, we'll be introducing additional functionality. We've got revenue drivers. I think we're really excited about the opportunities for the tablets, but I don't think we're quite ready to give any projections on what we expect from revenue. But we definitely believe it will enhance the overall guest experience, which always helps to drive sales.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

As it relates to wings, in the first quarter, average was $1.36. And we shared: For the first two months of the second quarter, we're at $1.41. So, we have seen it go up a little bit. Historically, you do tend to see it go up as we get later into the year.

Hard to know what this year will look like. There are cost pressures on both beef and pork. And so, that may play well for holding wing prices down a little lower than we've seen in previous years. But we will have better insight into that in our next earnings call.

Jeffrey Bernstein - *Barclays Capital - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of David Tarantino with Robert W Baird. Please go ahead.

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

Hi. Good afternoon, and congratulations on a great start to 2014.

Mary, my question's about the full-year guidance for 25% net income growth or earnings growth. Given the strength you had in the first quarter, it implies fairly modest growth for the rest of the year -- I think about 11% is the math. So, could you talk about some of the factors that might weigh on that? Or would you characterize the guidance as being relatively conservative, given maybe how early we are in the year? Maybe talk about some of the puts and takes there.

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

Yes, I think -- this is Sally. I do think that the fact that we're one quarter in probably weighs heavily on what we want to give for guidance. We had great same-store sales, and we've seen some of the lowest cost of sales that we've seen in quite some time. Those factors can change.

And during our fourth-quarter earnings call, we did talk about that we expected things to moderate throughout this year. We still expect that. But we really did obviously have a very strong first quarter, and felt comfortable raising our guidance to 25%.

There's a lot of factors that go into how we could get there. If you have significantly strong same-store sales and very low wing prices, we probably could achieve that. But conversely, we think that with modest same-store sales gains and what we expect [in terms of] wing prices, we're comfortable at the 25%.

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

Got it. That's helpful.

And then, maybe one line in particular that you could help with is the G&A line. And I think the commentary suggested something around $29 million in the second quarter. Is that the type of run rate you're thinking maybe would carry over into the back half? Or is there anything unusual in that number that might lead to maybe less spending in the second half relative to that rate that you're expecting for the second quarter?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

Our guidance for second quarter on G&A, ex stock comp, is $24.5 million, and our stock-based comp guidance is $4.4 million. And then, as an overall for the year, we do anticipate leveraging on our G&A expenses.

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

So, Mary, so for the year, inclusive of stock comp, you would expect leverage as a percentage of sales? Is that -- ?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

Ex stock comp.

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

Ex stock comp. With stock comp, would you expect to get leverage or not?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

I haven't looked at it in that manner. We really focus on the G&A piece, ex stock comp.

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

Okay, that's helpful. Thank you very much.

Operator

Thank you. Our next question comes from the line of Brian Bittner with Oppenheimer and Company. Please go ahead.

Mike Tamas - *Oppenheimer & Co. - Analyst*

Great. Thanks. This is Mike Tamas on for Brian.

Just two quick questions. Can you just tell us what the basis-point impact was for selling wings by the portion?

And then the second question: Is there any impact from gift cards on the comp? Thank you.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

The impact on the wings by the portion was about 60 basis points to our cost of sales. And we have not separately stated any gift-card impact on our same-store sales.

Mike Tamas - *Oppenheimer & Co. - Analyst*

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Jason West with Deutsche Bank. Please go ahead.

Jason West - *Deutsche Bank - Analyst*

Yes, thanks. Just want to circle back to the comp strength, which you guys have seen -- has just been pretty remarkable, particularly going into April. Just didn't know if you could tease out any of the key things that have changed in your Business, whether it's just the weather getting better has been a big driver of the comp acceleration, or do you think something really clicked in terms of the marketing or other things you guys are doing?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

Well -- this is Mary. I'll talk about the event differences between 2014 and 2013, and then Jim and Sally will have some comments as it relates to guest experience.

But in the first quarter in 2014, obviously no Easter, so that was a positive 60 basis points for us. There was a few more bowl games earlier in the year over prior year. As it relates to USC, those were both equal year over year from an event standpoint. And then we had Winter Olympics this year, which did give us some positive additional same-store sales during the weeks that it ran.

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

I think during March Madness, we did some nice advertising. We had some great exposure through the overtime advertising that we did during the tournament.

We continue to roll the guest experience model to our Company restaurants. We're now at the point where almost half -- over half of our restaurants -- almost two-thirds have guest experience captains. We definitely think that is having an impact.

I think sports are lining up well, too. I think last week both the NBA playoffs and NHL playoffs have been off to a good start, which has helped to drive traffic. There's a lot of things coming together right now for us.

Jason West - *Deutsche Bank - Analyst*

Okay. That's helpful.

And then just one on the margins. I guess, if you could remind us, Mary, if the pricing outlook is still the same as it was on the last call? I think you said what it would be by quarter, based on where you are now. I'm assuming that's still unchanged unless you've got some more pricing coming.

And then, just a comment around the 20% restaurant margin, which kind of ties into the pricing question. I mean, is that a level you guys want to sort of hold at that kind of level? You don't want to see margins going significantly above 20%, or is that not really the way you think about it?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

First, on the menu price discussion, for second quarter, we shared that it would be 2.6%. And if we take no additional menu price when we roll our menu on September 1 -- without that, Q3 would be 1.7% and Q4 would be 1.6%.

As it relates to our goal to be at a 20% cash flow level at our restaurants, that is a goal for us more on an annual basis than on a quarterly basis. And obviously, in quarters where we have low cost of sales, we exceed it. In quarters last year when we had higher cost of sales, we didn't hit it. But I think for a long-term goal for us, we think it's pretty accurate, and we think we're getting very close to being there consistently.

Jason West - *Deutsche Bank - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of John Glass with Morgan Stanley. Please go ahead.

John Glass - *Morgan Stanley - Analyst*

Thanks. I wanted to just go back to the labor line. I wanted to make sure I understood the pushes and pulls. So, maybe Mary can just talk about what was the underlying labor, if you parsed out the guest experience? I don't know if you quantified the bonus piece -- how much was that as a pressure?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

We did talk about being -- so, in the second quarter -- or in the first quarter, we were up 30 basis points. And that really was as it relates to the management incentive compensation accrual year over year, based on the great results that we had in the first quarter.

When we added the additional guest experience captains in our restaurants -- in the first quarter that was the 57 locations that we talked about. We were able to hold our overall hourly labor flat. And so, we did see optimization for the units that had rolled last year with the guest experience captains. So, in total, we were able to hold that flat. And our guidance for the second quarter then is to be overall flat in cost of labor.

John Glass - *Morgan Stanley - Analyst*

And then just thinking forward, in the back half then, why wouldn't you get labor leverage, assuming comps are reasonable enough to do that? In other words, you're going to be more than halfway done. You should be getting the benefits from all that you've rolled out, the pricing -- is your assumption you get labor leverage after the second quarter?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

The one factor that will be affecting us as we go through the year is increases in tip credit and minimum wages, in two states in particular, California and Minnesota. Those don't go into effect until the third quarter. From an overall standpoint, that would have a $3-million impact on an annual basis, and a $2-million impact for us in 2014. And we're still deciding for our September 1 menu roll-out what kind of menu price we take, if any.

John Glass - *Morgan Stanley - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from the line of Matt DiFrisco with Buckingham Research. Please go ahead.

Matt DiFrisco - *Buckingham Research - Analyst*

Thank you. I was just wondering: As far as a little follow-up on that, could you just go into more of, I guess, where you see anything as far as in the other line items as well -- other operating expenses or anything? I think we're all seeing somewhat of a -- if you even took a slowdown in the comp, then it looks a little conservative there on the outlook. I just want to make sure that there's no timing of marketing dollars or anything else in the other operating expense line that might come through, or planning or conferences or anything of that nature that might be embedded in one of those numbers?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

There isn't, as it relates to what our operating expense leverage that we had in the first quarter of 30 basis points, and then occupancy cost as well. That really is a reflection of the leveraging on the same-store sales levels that we achieved. So, really, the leveraging on both of those lines is dependent on what we see in same-store sales in the future.

Matt DiFrisco - *Buckingham Research - Analyst*

And then, as far as D&A, was there anything unique in the quarter? It looked like, even on an absolute dollar basis, it was probably below what most had been expecting.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

No, it's trending very similar. We did see some leveraging on that, obviously, with the higher same-store sales percents. We still don't have standard depreciation and amortization going on.

Matt DiFrisco - *Buckingham Research - Analyst*

But there was no one-time benefit or anything of that nature in there?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

No.

Matt DiFrisco - *Buckingham Research - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Will Slabaugh with Stephens. Please go ahead.

Will Slabaugh - *Stephens Inc. - Analyst*

Thank you. Wonder if you could dig a little bit more into the guest experience captain program, and how you would gauge that impact sales-wise in the participating stores so far? And also, when do you think you'll be able to hit that point where it's going to be accretive at the restaurant level across the Company?

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

As far as the guest experience captains, again, I think we're in -- actually, as of the end of April, we'll be in about 280 Company restaurants. We are seeing, overall, a sales lift in restaurants with the guest experience captain, particularly those where I think we have the model fully implemented. We're very pleased with what we see.

I think we're pleased with our overall flow-through in those restaurants right now. So, I think all indicators are positive on the guest experience model for us.

Will Slabaugh - *Stephens Inc. - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Alvin Concepcion with Citigroup. Please go ahead.

Alvin Concepcion - *Citigroup - Analyst*

Hi, just a couple quick ones. Doesn't seem like you saw much pushback on the 2.6% price increase in the quarter. Does that make you feel good that there's more room for taking price if wing costs increase more significantly?

And second, in regards to the traffic drivers in the quarter, [and you're into] April, how impactful were the LTOs versus the core menu items in terms of driving that strong traffic?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

As it relates to the menu price that we took in February -- it was about a 1.1% at that time. So, cumulative we're in that 2 to 2.5% range. Same-store sales are strong, so I think we feel that we were very thoughtful in the amount of menu price increase that we took. We'll obviously look at our same-store sales trends, as well as other commodities and sales items as we go through the middle of the year, as we make our determination on what to do for the September 1 roll-off.

And then on the LTO -- that just started -- the LTO that we talked about in the call, that just started in April.

Alvin Concepcion - *Citigroup - Analyst*

Got it, thank you.

Operator

Thank you. Our next question comes from the line of Bob Derrington with Wunderlich Securities. Please go ahead.

Bob Derrington - *Wunderlich Securities, Inc - Analyst*

Thank you. Mary, can you give us a little bit more color on the cost, specifically the commodity outlook, not only as it relates to particularly beer costs and how those are fluctuating, and those things beyond wings. If you can give us any little bit of color there, that would be helpful.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

We have seen some increases in commodities, [season four]. But they're a pretty small part of our overall commodity basket. And then we have seen some declines in commodities like soy oil. So, overall, when you exclude bone-in wings, which we have contracted flat year over year through March of 2015 -- boneless wings, sorry -- boneless wings, our commodity basket is relatively flat year over year. And then, obviously we're pleased that our traditional wings are falling below where we saw the last year's highs.

Bob Derrington - *Wunderlich Securities, Inc - Analyst*

Are you pretty well contracted through the balance of the year for those things? Is it reasonable to expect that flat is a reasonable expectation?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

When you take everything else together, yes, we believe flat is reasonable for the year.

Bob Derrington - *Wunderlich Securities, Inc - Analyst*

Great. Thanks, Mary.

Operator

Thank you. Our next question comes from the line of Chris O'Cull with KeyBanc. Please go ahead.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

I just had a couple questions. Mary, you indicated the Company's targeting 20% store level margin. But I think in the past you also mentioned targeting 30% cost of sales. So, has the Company changed its gross margin target, or do you think other line items may see some cost improvements?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

On the cost of sales piece, we think somewhere between 29% and 30% is a longer-term range for us. And that's when we'd look at menu pricing; that's where we plan the cost of sales to be at.

As it relates to the 20% target, I think that it's a target we've had for several years. Again, we have quarters where we exceed it. We have quarters where we don't. And as we develop out on the coast and we have higher-volume locations and we continue to evolve our guest experience model, we'd sure like to be moving that 20% even higher.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Okay. And then last question was just related to the cash on hand. Our model shows the cash really building over the next couple of years. How does the Company plan to use excess cash?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

Well, we're fortunate that we do generate sufficient cash to fund our growth in the US and Canada to do what we want to do, and it's developing internationally, as well as investing in emerging brands. And we would use our line of credit, as necessary, to fund any franchise acquisitions or emerging brand investments that would come our way.

I think, longer term, if we do have excess cash and we don't need it for our growth strategies, we would consider either share buybacks or cash dividends. But for the current time, investing in our Business is where we think is appropriate.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Do you have a -- can you remind us what's the share buyback program today?

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

We don't have a buyback program in place.

Chris O'Cull - *KeyBanc Capital Markets - Analyst*

Okay. Thanks.

Operator

Thank you. Our next question comes from the line of Greg McKinley with Dougherty. Please go ahead.

Greg McKinley - *Dougherty & Company - Analyst*

Thank you. I'm wondering if you can give us some color on how the guest experience captain roll-outs that you're doing today differ at all from what that program may have looked like 6 to 12 months ago? Have there been any learnings or changes there?

And then, regarding the tablets, what are you seeing in terms of either average ticket or maybe duration that a customer spends in the store when that program is available to them? And what's your opinion of the changes you're seeing?

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

Well, as far as guest experience captains, we've continued to refine that program since rolling it, and we'll continue to refine it in the future. We certainly -- we started out with guest experience captains working more hours because we wanted to have them available during all shifts and all day parts, and over time we've refined that and optimized it. And again, we continue to refine the program, and get better at the program and its execution. And I think an important part of the program is that we're also now delivering the tools to the guest experience captains through our guest experience technology.

As far as the tablets, they're still in test. And the functionality -- we're still testing additional functionality. What I can tell you though is we've seen a dramatic increase in the usage of the new Buzztime tablets versus the old Buzztime tablets, and how long a guest utilizes them while in restaurant. So, that does tell us that I think as we add functionality, we believe there's a real opportunity for them to enhance our guest experience and ultimately drive traffic.

Greg McKinley - *Dougherty & Company - Analyst*

Okay. Thank you.

And then, maybe just some historical context. How important potentially is a World Cup event, given changing interests in soccer in the US? I don't know if you can share with us what you've seen in the past? And what were your wings as a percentage of COGS in Q1? Thank you.

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

I can address with regard to the World Cup. We haven't spent a lot of time looking back at what happened four years ago. Again, it's very hard to call out, unless it's a one-day event -- Super Bowl over Super Bowl -- very difficult to call out what the impact of certain sporting events are. Depends on the matchup; it depends on the day of the week.

What World Cup gives us is another reason for people to come in -- for our guests to come in and experience Buffalo Wild Wings. I certainly think that the increased interest in soccer across the United States doesn't hurt, nor the fact that we're on this time much closer to this time zone than we were four years ago. So, we're excited about it.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

As it relates to the question on what were wings as a percent of our cost of sales dollars in the first quarter, they were 20.5%.

Greg McKinley - *Dougherty & Company - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Keith Siegner with UBS. Please go ahead.

Keith Siegner - *UBS - Analyst*

Thanks. Just one follow-up. At the Analyst Day, one thing I thought was interesting was hearing a little bit about the lunch and happy hour focus that was in the plans. Just wondering if you could talk a little bit about maybe what's going on there now? And how are those day parts doing, lunch and happy hour specifically, in terms of contributions to same-store sales? Thanks.

Mary Twinem - *Buffalo Wild Wings, Inc. - EVP and CFO*

We do have happy hour and lunch programs remaining in test, and we're further refining those -- looking for something that we could roll out later this year. From a day part strategy, we didn't separate out any of our same-store sales by day part, but with the kind of trends that we have, I would assume all of them are pretty good.

Keith Siegner - *UBS - Analyst*

Thank you much.

Operator

Thank you. Our next question comes from the line of Diane Geissler with CLSA. Please go ahead.

Diane Geissler - *CLSA Limited - Analyst*

Hello. I wanted to ask about your cash position. When you talk about your store openings for this year on a Company-operated basis, I know you're looking for additional brands to invest in, but the cash position is building pretty meaningfully here. Can we talk a little bit about the market for repurchasing some of your franchisees or even accelerating some of your Company openings this year above the level that you've already telegraphed?

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

We are always interested in acquiring franchisees. We are in constant discussion with franchisees, so we certainly will look as appropriate at acquiring franchisee restaurants. I think you'll see more of that occurring throughout the year this year. That is one opportunity to deploy the cash. As far as accelerating Company restaurants, there we're probably moving about as fast as we feel we reasonably can on (inaudible).

Diane Geissler - *CLSA Limited - Analyst*

Is that a function of personnel? You require a certain number of people in-house to develop it? Or is it more a function of available real estate and the right locations?

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

It's more of a function of the time it takes to go through the entire process from finding the site, negotiating the lease, and then the permitting and getting approval from various cities. That can really be the unknown.

With regard to the number of people we have on a team doing that, I think we're appropriately staffed. And at this point, even if we doubled that staff, you couldn't add more restaurants in 2014 into the buildout.

Diane Geissler - *CLSA Limited - Analyst*

Okay. Thanks for those comments.

And then I just wanted to ask about loyalty program -- what you envision in terms of building a loyalty program?

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

Well, I think we believe that's a real opportunity for us. We're right now in the design stages of that. I think we'll be doing limited testing later this year, and with the expectation we'll be rolling out a loyalty program across the system in the back half of 2015.

Diane Geissler - *CLSA Limited - Analyst*

Would that be solely limited to stores that have tablets, or can you do a -- are you thinking about it in terms of having some kind of app or whatever on your phone that has some kind of functionality in the restaurants?

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

I think it will be a multi-channel loyalty program, and it will be available at system-wide by the time (inaudible).

Diane Geissler - *CLSA Limited - Analyst*

Okay. Great. Thank you.

Operator

Thank you. Our next question comes from the line of Mark Smith with Sutherland Company. Please go ahead.

Mark Smith - *Sutherland Company - Analyst*

Hi, guys, just wanted to look at alcohol sales. First want to confirm that you're at 21% versus 22% last year. And wanted to see -- can you get that back to the mid-20%s where that ran maybe five years ago?

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

I don't think we have any specific goal to return it to a particular level. I mean, we always try to make sure that we're meeting our guest needs when it comes to -- and that we keep a vibrant bar business. We think that's part of the overall guest experience that drives our Business. But we don't have a specific goal to increase the alcohol percentage.

I think it's just naturally a decline really with the increase in our sales. So, I don't think it's based on -- we're selling less alcohol. I think it's a case that we're really seeing food sales increase as our volumes go up.

Mark Smith - *Sutherland Company - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Jeff Farmer with Wells Fargo. Please go ahead.

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

Thanks. Just following up on development, I think at the Analyst Day you acknowledged that, with 1,000 restaurants in operation, it's become increasingly challenging to find sites. Is there really any reason to believe that that might change? Or is it realistic to think that the absolute number of unit openings that we're seeing this year might be sort of the high-water mark, and it could potentially just slow down steadily as we move forward?

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

I don't think it's so much that it's all that difficult finding sites. It's just the number of opportunities. Obviously, the pool isn't quite as great as it once was. But we're able to find sites.

It does get a little more challenging when you're on the coast. We're developing the Boston area. In areas like that, they're a little more challenging to find sites. But we're doing a great job of finding good sites, and we're opening really strong restaurants.

I really think the pace -- I think it will stabilize now for the next several years. I don't think you'll see any dramatic decline over the next few years. Right now, we believe we can sustain the current pace for the foreseeable -- at least the next few years.

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

Thank you.

Operator

Thank you.

(Operator Instructions)

Our next question comes from the line of Greg McKinley with Dougherty. Please go ahead.

Greg McKinley - *Dougherty & Company - Analyst*

Thanks. Sally, you made a comment about nine international franchise locations opening. Over what period of time was that referring to?

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

That's this year. That's between now and the end of 2014.

Greg McKinley - *Dougherty & Company - Analyst*

Okay. And then, as you look back to Q1, are there any regional comments that you can make that -- in terms of things you thought stood out? Obviously, people focused a lot on weather, but whether it was regional impacts from the basketball tournament or other conditions, anything worth noting there?

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

We don't make typically comments regionally. We usually keep our comments about weather to a pretty much minimum because weather happens every year. Just great matchups. I think the fact that there have been some great overtime games, both during the NCAA, and as we've gone into hockey and some real close games with NBA playoffs -- all bodes well for us. But nothing stands out from a regional standpoint.

Greg McKinley - *Dougherty & Company - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Matt DiFrisco with Buckingham Research. Please go ahead.

Matt DiFrisco - *Buckingham Research - Analyst*

Thank you. There's been a couple questions about the use of cash, and I think also at the Analyst Day you talked about a goal of getting to 50/50 Company-owned and franchised. I guess, can you give us an update on that -- sort of that time frame?

I'm curious if -- how the strong comparable sales and the strong profitability probably being shared by the franchisees as well, maybe reduces their appetite to sell or changes that dynamic? Should we still be expecting, I guess, over the next two years or so, the skew to change, so you are 50/50 Company-operated and franchised?

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

I think that's not a goal we have set in stone. I think it's more of just the natural progression that we see when you look at what development we have going on, on the Company side and the franchise side. And then our expectation that we will be acquiring a certain number of franchisees along the way.

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

I think the fact that the sales and profitability maybe marks a good time that they'll think about liquidating. There's different life stages that our franchisees are in. They've been with us for -- some of them for well over 20 years now, and maybe don't have that next generation to pass it on to.

And we're open to it, and they know that we're a good acquirer. The franchisees that we have acquired, talked about the process, talked about our ability to go in and assume operations, and work with the teams they have. So, I think that casts a favorable light on some potential acquisitions coming up.

Matt DiFrisco - *Buckingham Research - Analyst*

And your guidance does not include any acquisitions; correct?

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

No, it does not.

Matt DiFrisco - *Buckingham Research - Analyst*

Thank you.

Operator

Thank you. I'd like to turn the conference back over to Sally Smith for any closing remarks. Please go ahead.

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

All right. Well, we're very excited to share with you our first-quarter results. As I said at the beginning, we're off to a great start. We look forward to talking with you at the end of July when we share our second-quarter results. Thank you so much for your questions and your interest in Buffalo Wild Wings.

Operator

Thank you. Ladies and gentlemen, this does conclude our conference for today. Thank you for your participation. You may now disconnect.
