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BWLD - Q2 2016 Buffalo Wild Wings Inc Earnings Call

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OVERVIEW:

Co. reported 2Q16 revenues of $490.2m, net earnings of $23.7m and diluted EPS of $1.27. Expects full-year 2016 diluted EPS to be $5.65-5.85.

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Buffalo Wild Wings second-quarter 2016 conference call.

(Operator Instructions)

I would like to remind everyone that this conference is being recorded. I'd now like to turn the call over to Ms. Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Please go ahead, ma'am.

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

Good afternoon and thank you for joining us as we review our second-quarter 2016 results. I'm Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Joining me today 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 second-quarter earnings release. Copies are available on our investor website at IR.Buffalowildwings.com.

Before we get started, I remind you that today's call will contain forward-looking statements, and actual results may vary materially from those discussed in forward-looking statements due to many factors, including the risks and uncertainties identified in today's earnings release, which we filed on a Form 8-K concurrent with its release, and in our other filings with the Securities and Exchange Commission. We will be hosting our 2016 Analyst Day on August 16th. An audio webcast of the event will be available on our investor website at IR.Buffalowildwings.com.

On today's call, Sally will provide an overview of our performance for the second quarter and our initiatives. After that, Jim will provide further detail on the quarter and comment on trends to date in the third quarter, and our outlook for 2016. Sally will provide some final thoughts and we will then answer questions. So with that, I'll turn things over to Sally.

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

Thank you, Heather, and good afternoon, everyone. Our total revenue increased by 15% from new restaurant openings and franchise acquisitions over the last year. We controlled costs and expenses well in a challenging sales environment, and this discipline, along with our earnings growth, helped us to achieve earnings per diluted share of $1.27, a 13.1% increase compared to the prior year.

Buffalo Wild Wings remained strong and we're continuing to differentiate our brand for the long term by embracing two emerging spots, soccer and e-sports. We're establishing B-Dubs as the place for soccer fans, as we believe winning that market will provide growth in the future.

Our partnerships with Heineken and Pepsi gave us access to incremental marketing dollars to support our messages around soccer this summer. While we've had success in driving traffic around the UEFA Championship, COPA America, and the Euro Cup tournaments, we were also lapping over the success of last year's US women's team winning the World Cup.

We're seizing the opportunity of e-sports, or competitive video gaming, as it attracts a young, digitally connected, and engaged fan. Buffalo Wild Wings is an initial sponsor of Turner's ELeague, and we're featuring the Friday night competition in our restaurants.

While still a nascent sport, we're seeing early positive signs of this emerging opportunity. For example, we've had viewing parties of over 60 fans at our Buffalo Wild Wings location in Sherman Oaks, California.

We're confident about our long-term opportunities while continuing to focus on the near- term sales environment. Same-store sales at Company-owned Buffalo Wild Wings declined 2.1% in the second quarter, impacted by industry- and Company-specific items.

On the latter, for the second quarter, match-ups mattered in the NBA and NHL playoffs. The NBA finals between the Cavaliers and Golden State resulted in an incremental and exciting game seven. But it didn't offset the fact that the Chicago Blackhawks and the Chicago Bulls, who have a national following and reside in a strong Buffalo Wild Wings market, had 28 fewer playoff games compared to the prior year.

Regarding the broader restaurant industry, our detailed analysis of consumer behavior shows that our target customers remain loyal to Buffalo Wild Wings. Our analysis also shows that in the current environment, there's a focus on value and convenience, and we have an opportunity to better compete for the casual guest who is shifting to delivery and QSR.

To address the fan who decides to eat at home, we have our takeout program, which continued its positive momentum this quarter. Takeout sales were 15.7% in the quarter, increasing 25% over the prior year on a dollar basis.

Our digital ordering platform continues to see great adoption, with 16% of takeout orders coming from digital, and they had a 7% higher average check in the second quarter. In fact, we recently achieved a record $2 million week in digital takeout sales. We've improved takeout operations to enhance our fan experience by placing the appropriate management focus on take out, which improves order accuracy and ensures our takeout fans have the same engaging experience as our dine-in fans.

In addition, we know there is demand for Buffalo Wild Wings in the delivery format. This is a unique opportunity for our brand, and Buffalo Wild Wings was ranked fourth behind pizza and sandwich concepts as the Company consumers most wanted delivery from in a recent sales-side research report from Morgan Stanley. We have begun delivery in two restaurants and plan to diligently test and evaluate this opportunity. We'll keep you posted on our progress.

We launched our FastBreak lunch guarantee at the beginning of the third quarter. As speed of service is a critical component of a lunch visit, fans who order off the FastBreak lunch menu receive their lunch in 15 minutes or it's free.

I'm pleased to report we are executing this program exceptionally well. We're encouraged by the sales we've seen from the program, as it addresses a key day part. The FastBreak lunch guarantee promotes team member and fan engagement in a fun and competitive way and also engages our fans with our tablet technology.

Highlighting our existing value offering is also something we believe is important to drive traffic in the current environment. We've always offered traditional wings at a discount on Tuesdays, and we're in an 80-restaurant test to strengthen the offer with half-price wings on Tuesday. It's easier for our restaurant teams to execute and simpler for our fans to understand. We've seen a significant traffic lift with the half-price offer.

We're working with an external consulting firm to better understand our target customer and the casual restaurant guest. We're developing strategies that will continue to differentiate Buffalo Wild Wings in the industry by creating a unique experience for our fans. We're confident Buffalo Wild Wings will regain sales momentum by focusing on near-term sales-driving initiatives and our long-term areas of distinction.

Buffalo Wild Wings is also in the process of evolving our capital strategy. We'll have more details regarding leverage and return to shareholders at our Analyst Day in three weeks. Jim will now provide additional details on the second and third quarters.

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

Thank you, Sally. Our revenue in the second quarter reached $490.2 million, increasing 15% over the same period last year. System-wide sales at our Company-owned and franchise restaurants were $936 million for the quarter, an increase of 5.3% over the second quarter of 2015.

Company-owned restaurant sales for the second quarter increased to $466.6 million, a 16.1% increase over the same period in the prior year. Same-store sales of Company-owned Buffalo Wild Wings restaurants decreased 2.1% for the second quarter, compared to an increase of 4.2% for the same period last year. Menu price increases and adjustments taken during the past 12 months at Company-owned restaurants were about 3.5%.

We had 89 additional Company-owned Buffalo Wild Wings restaurants in operation at the end of this quarter versus second quarter last year, a 17% unit increase. Average weekly sales decreased by 3.3% in the second quarter, 120 basis points lower than the same-store sales percentage. This is attributed to a 60-basis-point decline from Company-owned locations opened during the last 12 months and a 60-basis-point decline from locations acquired from franchisees in the past year. Our new locations opened in the last 12 months had anticipated lower volumes overall as a greater number are located in smaller markets compared to the prior year's class.

Our royalty and franchise fee revenue for the second quarter decreased 3.8% to $23.6 million, versus $24.5 million last year. Same-store sales at franchise Buffalo Wild Wings locations decreased by 2.6%, compared to a 2.5% increase in the second quarter last year. Franchise average weekly sales volumes at Buffalo Wild Wings locations in the United States for the quarter decreased by 2.3%, 30 basis points higher compared to the same-store sales percentage.

There was a 50-basis-point benefit from franchise locations sold to the Company in the last 12 months and a 20-basis-point benefit from the closing of lower, older volume locations. These benefits were partially offset by 40 basis points from franchise locations opened during the last 12 months. Cost of sales for the second quarter was 29.7% of restaurant sales, compared to 29.3% in second quarter last year, a 40-basis-point increase.

Traditional wings were $1.94 per pound in the second quarter, $0.15, or 8% higher than last year's average of $1.79. Traditional wings as a percentage of cost of sales in the first quarter was 26.6%. Our pricing agreement on traditional wings provided a savings of over $600,000 for the Buffalo Wild Wings system in the second quarter.

Traditional boneless wings were each 21% of restaurant sales. Food and nonalcoholic beverage sales were 80% of restaurant sales in the second quarter, all flat compared to the same period last year.

Cost of labor for the second quarter was 32% of restaurant sales, 20 basis points lower than second quarter last year, due to lower restaurant bonus expense and benefit costs. In addition, we are pleased with our management of hourly labor. While management salaries delevered, as expected, with lower sales.

In the second quarter, restaurant operating expenses as a percentage of restaurant sales were 14.6%, an increase of 50 of basis points resulting from deleverage on the same-store sales decline. Occupancy costs were 5.8% of restaurant sales, 20 basis points higher compared to the same quarter last year. Also, deleveraging on same-store sales.

In summary, restaurant-level cash flow, which is calculated before depreciation, amortization, and pre-opening expense, was $83.3 million, or 17.9% of restaurant sales. This compares to restaurant-level cash flow of $75.5 million, or 18.8% in the second quarter last year.

Depreciation and amortization for the second quarter was $38 million, or 7.7% of total revenue, 90 basis points higher than the prior year, resulting from increased amortization of reacquired franchise rights, higher depreciation, and deleveraging. General and administrative expenses were $29.8 million in the second quarter, or 6.1% of total revenue, compared to $33.7 million, and 7.9% in the prior year.

Excluding stock-based compensation of $704,000 in the second quarter and $4.5 million in the prior year, G&A expenses for the -- (technical difficulty) includes $958,000 of pre-opening expenses for future openings that are under construction. And in the second quarter last year, we incurred $1.1 million related to (inaudible.) Pre-openings costs for Company-owned Buffalo Wild Wings averaged $252,000 per new restaurant during the quarter, compared to $291,000 in the second quarter last year.

The loss on asset disposals for the second quarter totaled $1.9 million, compared to last year of $2.3 million. We reported other expense of $1.9 million for the quarter, compared to other income of $41,000 in 2015. The $1.9 million expense includes a loss on investment, capitalized lease deemed landlord financing, and interest expense from our line of credit.

Our effective tax rate during the second quarter was 29.9%, compared to 32.4% in the prior year. We estimate our effective tax rate for 2016 will be about 30% based on federal and state tax rates and credits currently in effect.

In summary, our net earnings for the second quarter of 2016 increased 10.2% to $23.7 million, produced earnings per diluted share of $1.27, compared to $1.12 in the prior year. Our balance sheet on June 26, 2016, our cash and cash equivalents totaled $13.6 million compared to $11.2 million at the end of 2015. Our unsecured line of credit had a balance of $58.1 million as of the end of the quarter.

We opportunistically repurchased 548,000 Bwild shares during the second quarter of 2016 for $75 million, extending our commitment to deliver value to our shareholders. We expect to repurchase at least $150 million worth of Buffalo Wild Wings shares in 2016.

We ended the quarter with $978 billion in total assets and $615 million in total equity. Cash flow from operations was $72.3 million for the quarter, a 35.1% increase over second quarter last year. We spent $35.8 million for property and equipment capital expenditures in the second quarter of 2016, and we estimate that our annual capital spending will be $170 million. Free cash flow in the second quarter, which is cash flow from operations less capital expenditures and acquisitions, was $35.8 million, compared to negative $23.2 million in the prior year.

Now, I will highlight a few trends and provide some comments on the third quarter of 2016. Menu price increases and adjustments taken in the last 12 months are expected to be 3.6% in the third quarter. For our October menu, we do not anticipate a general price increase.

In third quarter, we expect to open eight Company-owned Buffalo Wild Wings restaurants and one Company-owned R Taco. As a reference point, in the third quarter of 2015, we opened 17 new Company-owned Buffalo Wild Wings locations. We also expect that Buffalo Wild Wings franchises in the United States will open nine restaurants during the third quarter, and our international B-Dubs franchisees should open three restaurants.

For cost of sales, our costs for traditional chicken wings for the first two months of third quarter averages $1.69 per pound. This compares to the average cost for the full third quarter last year of $1.79 per pound. Given our known wing prices for the first eight months of the year and our outlook for the remainder of 2016, we estimate that wings prices will be slightly higher on an annual basis in 2016 compared to 2015. The remainder of our commodity basket is expected to be deflationary compared to last year.

We anticipate labor as a percentage of restaurant sales in the third quarter to be approximately 32%. In the third quarter, we anticipate that G&A expenses, exclusive of stock-based compensation expense, will be approximately $32.5 million. This sequential increase from the second quarter is primarily driven by increased consulting and legal fees.

Third-quarter stock-based compensation expense is estimated to be $2 million, a $2.4 million decrease compared to third quarter last year, and will vary depending on the level of net earnings achieved for 2016, as well as estimates of net earnings in future years. Depreciation and amortization is expected to be $38.5 million in the third quarter. Interest and other expenses is estimated to be $1.5 million in the third quarter for capital lease interest expense and interest expense on our line of credit.

Turning to the full-year 2016, our expectations for earnings per diluted share in 2016 remains at $5.65 to $5.85. Please review the risk sections outlined in our SEC filings including our Form 10-Q for the second 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 thoughts on our Company initiatives.

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

Thank you, Jim. This Friday, July 29th, we're celebrating National Chicken Wing Day with half-price wings, and letting our fans know about it with an engaging video on social media. Bring your friends to Buffalo Wild Wings on Friday to enjoy hot wings and a cold beer, and while there, take a picture with your friends and post to Instagram or Twitter with the hash tag B-Dubs Wings Day for a chance to win a Buffalo Wild Wings gift card.

We're looking forward to the summer Olympics in Rio this August, and Buffalo Wild Wings will be the place to watch your favorite athletes and teams go for the gold. Our fans, of course, are eagerly awaiting the return of football, and Buffalo Wild Wings is the place to watch all the action with our unparalleled audio/visual experience.

We've ordered a record number of fantasy draft kits based on restaurant demand. Our fantasy football draft kit is available beginning next week for fans who host their draft parties and B-Dubs or who order $100 or more in takeout. We'll also have a suggested takeout package for at-home draft parties including wings, shareables, and sides.

While there for draft parties, fans can savor one of our flavorful limited-time-only offers. Our featured items will include barbecue street tacos, barbecue bacon turkey burger, and loaded potato wedge with smoked aioli. Sauce Lab will feature two sauces: last year's fan favorite Blue Moon Barbecue, and Music City Fire, the B-Dubs version of Tennessee hot sauce.

The power of the Buffalo Wild Wings brand creates authentic and engaging interactions between our fans and professional athletes, such as our live events. Recently, David Ortiz of the Red Sox made an unannounced appearance at the New York Buffalo Wild Wings, surprising trash-talking Yankee fans. You.gov, an internet-based market research firm, noted that our general impressions quality and recommendation metrics are at an eight-year high.

Our fall media campaign kicks off in August and highlights our brand truths. We're showcasing what's unique about the Buffalo Wild Wings experience in wings, beer, and sports. We're excited because this is a new way to talk about our products and the experience in our restaurants. Buffalo Wild Wings will spend more in all forms of media each month through the rest of the year.

Blazin' Rewards is currently in over 200 restaurants and 12 markets, including franchise locations. After reviewing results, we have decided to accelerate the rollout to additional markets in 2016. By the end of the year, Blazin' Rewards, our loyalty program, will be in one-fourth of US Buffalo Wild Wings.

Our test of tablet ordering and payment is progressing well. We're seeing good adoption on payment, and menu ordering is picking up. We believe system-wide implementation will occur in 2017.

Franchising of Buffalo Wild Wings internationally continues in our second quarter, and in our second quarter, our first location in Panama opened. We expect to double the number of our franchise locations internationally in 2016.

We opened 1 Company-owned R Taco in the second quarter, and there are you now 12 R Tacos in Dallas, Denver, Minneapolis/St. Paul, and Omaha. We're looking forward to sharing more details on these and other long-term initiatives at our Analyst Day on August 16th in Denver.

We thank our team members, our franchisees, and vendor partners for their passion and their continued dedication to our success. We thank our shareholders for the confidence in our Company and our fans for their passion for Buffalo Wild Wings.

Before turning the call back over to Heather to open up the call for Q&A, I'd also like to take a brief moment to address a recent public filing by one of our shareholders. Our Board of Directors and management team welcome input from all shareholders and are open to re-evaluating and evaluating ideas that can help us achieve our mutual goal of creating shareholder value. We'll continue to [maintain a] dialogue with our shareholders and are committed to acting in the best interest of the Company, our shareholders, and all our stakeholders.

As a reminder, the purpose of today's call is to discuss our earnings results, and we'd appreciate it if you would keep your questions focused on that topic. We don't intend to make any further comments or statements during this call on these matters, and we thank you for your cooperation in this regard. I'll now turn it back to Heather.

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

Thank you, Sally. We will now move to the question-and-answer session of our second quarter earnings call. Jeff Sorum, Senior Vice President and Corporate Controller will be joining us for Q&A today. 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. Operator, please open the call to questions.

QUESTIONS AND ANSWERS

Operator

Of course, ma'am.

(Operator Instructions)

First we'll hear from John Glass with Morgan Stanley.

John Glass - *Morgan Stanley - Analyst*

Thanks very much. I didn't -- and forgive me if I missed this, but I didn't hear you talk about your updated view on comp store sales in the light of the second quarter for the balance of the year. I think you had said flat and progressing to positive in the fourth quarter. So if you could talk about how this quarter changes that or doesn't change that, maybe talk a little bit more about initiatives specifically in the third quarter that you think might drive comps. I think you talked about a few in the commentary. Maybe a little bit more detail.

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

Yes, you bet. A couple of things, while we certainly would have liked to have been at flat comps in the second quarter, as you know, we were negative. And in our forecast as we model out the remainder of 2016, we have modeled in slightly negative third-quarter comps reaching flat by the end of the fourth quarter. We're still able to reiterate our guidance of $5.65 to $5.85 per share.

We're really excited about some of our initiatives. We're seeing sales lift at lunch with our 15-minute lunch guarantee, great adoption of our Wing Tuesdays and seeing lift there as well. And we do think that, with a great advertising schedule coming up in the third and fourth quarter -- well, primarily the fourth quarter for football, will in the short term really help us drive sales.

We're also going to be going over reduced comps as we continue through the year. It's sometime in September where we're -- comps moderate from 2015. Jim, any thoughts.

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

No, just that I think we really feel good that throughout the organization I think we're focused. We're working hard, working collaboratively. I think we're focused on the right things. As Sally said, we're seeing -- we just started the lunch program; initial results are favorable. We're in test on the half-price wings. Again, we're seeing really nice traffic lift as a result of that promotion.

Loyalty continues to expand. We feel good about the advertising programs. Sally mentioned we just saw some record high metrics for our social media. So we're seeing a lot of positive indicators. We just have to see them take hold and reverse the momentum.

John Glass - *Morgan Stanley - Analyst*

Thank you.

Operator

Next from Guggenheim Securities we'll hear from Matthew DiFrisco. All right. With no response from Matthew we'll move on to Karen Holthouse from Goldman Sachs.

Karen Holthouse - *Goldman Sachs - Analyst*

Thank you for taking the question. So just thinking more specifically about loyalty as a traffic driver, can you share any early results from test markets helping us think about the sales lift you might see from it, how long you think it takes to build into that -- the database of customer information that you can use to drive sales? What's the total potential and how do we think about the ramp is what I'm trying to get at? Thanks.

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

Well, we are accelerating the rollout. We are seeing some lift in comps in some of the markets that we're already in and we're gathering very rich data. As you gather more and more data, I think we will then be able to refine the program and then determine what we think its full potential is as we continue the rollout.

It's an [iterative] process that as you continue to rollout, you gather more data, you're then able to better customize your offering. And so it's difficult at this time to make any projections yet. But all indicators we see we're very pleased with the program.

Karen Holthouse - *Goldman Sachs - Analyst*

Well and as a follow-up to that, even in the early stages of refining it, are you comfortable with the tradeoff between the effective discount and the lift you're seeing is profit accretive out of the gate? Or is there an upfront cost to build that database of information?

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

Most of the upfront cost has been already incurred as we develop the program. We'll learn more on the redemption component, and remember, it is -- we're not thinking of it -- you have to think of it certainly as a discount. But the customer data that we're gathering from it really allows us to see when that guest comes in, what they use us for, who they come in with. That's worth of lot, just in thinking about the metrics. We do -- we expect it to be a driver of sales and not be a cost to the Company overall.

Karen Holthouse - *Goldman Sachs - Analyst*

Great. Thank you.

Operator

We'll move on to Brian [Ider] with Oppenheimer.

Brian Ider - *Oppenheimer & Co. - Analyst*

Thanks. Just taking a step back for a second, the industry debt has been weak all year, that's for sure. But the last two quarters it's really the first time in a really, really long time that you've underperformed the industry.

So when you really take a step back and you look at what's going on, what about the brand you think has caused comps to go to underperforming the benchmark the last two quarters? What's your diagnosis of that when you look at the Company?

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

Well, it's been -- what, 2010 was the last time we had negative comp sales, and it took us -- it was almost a year before we fully turned that around. So I think we're seeing comp sales in the current trend. We feel really good about the brand, though.

The consumer research that we've done, we've really dug deep on what's happening with our consumer. And what it's told us is our target customer, that customer who comes to us for the entire experience: wings, beer, and sports, and is attracted to that, we're not seeing an erosion in that customer base. Where we have an opportunity is in this current environment, what we would refer to more as the casual guest, someone who really views us more as just another restaurant option. That's where we see the opportunity to drive additional traffic in this current environment.

So we're not too focused on a comparison to casual dining. We feel comfortable if we regain momentum that we'll be able to once again outperform the rest of the casual dining industry.

Brian Ider - *Oppenheimer & Co. - Analyst*

And just a quick follow-up, if I could. With the sales underperforming your initial expectation, you guys did keep EPS guidance in place. It seems like at least this quarter, the ability to do that came from a huge reduction in the G&A. What was it within the G&A? What was the lever pulled there that allowed that to be such a tailwind year over year in the quarter?

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

I think there was a handful of things that were certainly the stock-based compensation was lighter than what we had had in previous quarters, which was a reflection of the three-year financial performance. But then we also had to pull back on the bonus and incentive compensations as well within the G&A.

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

And significant focus on controllable costs within G&A.

Brian Ider - *Oppenheimer & Co. - Analyst*

Got it. Thanks.

Operator

Next from Robert W Baird we'll hear from David Tarantino.

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

Hi. Good afternoon. I want to come back to diagnosing some of the issues you've had with comps, and one of the theories that has been cast is that perhaps you've taken too much pricing and have a value proposition issue. I know this has been talked about on prior calls, but it sounds like you might have done some additional consumer research.

Could you address that question? Do you think you've taken too much pricing and now have a value issue as a result of that? Or do you think it's other issues that may have led to some of the softness in the traffic?

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

Well, as I mentioned, for our target customer, our guest satisfaction scores and value scores remain very high. So for that customer, our core group, the people who come in for that whole experience, we're not seeing any erosion or, again, in our value scores. It is more for that casual guest who I think right now in this current environment is value-sensitive and convenience-focused. That is where I think we have an opportunity related to both value and convenience, and that's where we are -- that's why we have focused on some traffic-driving opportunities with the FastBreak lunch and the half-price wings and then also focusing on takeout.

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

I'd also say that as we think about pricing, we took minimal, less than 0.5% and for our first menu price in May and our menu price in the fourth quarter will be negligible. We don't plan on a price increase in October. So I think that we will soon be lapping over our price increase from November of 2015.

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

And then perhaps maybe a secondary question for Jim. You did acquire quite a few restaurants over the last 12 months or so. So could you talk about how you think the operations teams are handling all of those new restaurants and whether there's an opportunity to improve the execution across the base.

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

Overall, I would say very well, particularly the restaurants we acquired in last July. It was 38 restaurants, a couple under construction. Looking at their performance, I'm very pleased with what I'm seeing in execution in the restaurants, the cash flow is very solid, and I think they're performing well. As with the entire system sales aren't quite where we had originally anticipated, but they're performing well.

I think the fact that we have fewer new restaurant opening this year has really allowed us the opportunity and we haven't had any further acquisitions this year, has allowed us the opportunity to really stabilize operations throughout the system.

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

Great. Thank you very much.

Operator

All right. Now we'll circle back to Matthew DiFrisco with Guggenheim.

Matthew DiFrisco - *Guggenheim Securities LLC - Analyst*

Thank you. Sorry about that. Had a little technical difficulties. Just a follow-up question, actually, with respect to those Texas stores. It looks as though from what we can see from some of the data we follow with respect to those Texas stores that they've improved, and they're actually, even though Texas still is probably not one of the stronger regions in the country, those stores in particular look like they might be doing a little bit better than the rest of the region down there sequentially. So would it be correct to assume that that's somewhat factored into your fourth-quarter guidance of improving same-store sales when they roll into the comp base in November?

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

I don't know that we've specifically modeled in those 38 stores in our improving comps, 38, I'm not sure that those would have much opportunity to move the needle. Part of the factor that we did look at was sports matchups as well as the lower comps that we're going over for prior year.

Matthew DiFrisco - *Guggenheim Securities LLC - Analyst*

With respect to the sports calendar also, wouldn't the third quarter somewhat look favorable? Are we missing anything as far as UFC fights or uneven boxing? But with the Olympics, wouldn't that have an improving factor towards the number of events versus what you just encounter in the first half of the year?

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

Matt, Olympics certainly don't hurt us. They are incremental events and times when people gather to watch sporting events. However, with the summer Olympics, you see pockets of good performance and that's usually centered around a particular athlete or a team doing well.

So for example, last summer Olympics we saw both more DC-area sales bump-up as Michael Phelps was swimming for his seventh gold in the London Olympics. But overall, summer is not as big of a driver of sales as winter Olympics for us.

And then taking a look at the fourth quarter, just in terms of matchups, we have very similar NFL college weekends. There are a couple calendar nuances in fourth quarter. You have Halloween shifting to a Monday this year, which is favorable compared to being on a weekend last year. But then you have the Christmas holiday falls on a Sunday. So what the NFL has done is basically all but two games to that Saturday for the NFL games. So we you view that as a slight incremental negative.

Matthew DiFrisco - *Guggenheim Securities LLC - Analyst*

Okay. But I just wanted to make sure that we're not missing anything in the third quarter that was a big sporting event last year that you're cycling with respect to UFC or boxing.

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

No.

Matthew DiFrisco - *Guggenheim Securities LLC - Analyst*

Thank you.

Operator

Next in the queue we'll hear from Andrew Charles with Cowen and Company.

Andrew Charles - *Cowen and Company - Analyst*

Thanks. Just want to ask about the dynamics of the CapEx guidance. I know you reduced it slightly, but unit growth as well as depreciation targets are intact. Can you walk through the background of the change?

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

Some of it is the cost for our new restaurant openings as well as the timing of them. We did share on our last call that we had moved some of our openings to January of 2017, so we weren't having as many in 2016 in December, in particular, in the last period of the year. So that is part of it, as well as some of the remodel costs.

Andrew Charles - *Cowen and Company - Analyst*

Okay. And then just following up on that, you talked about how the new store sales have been a drag on AWS growth as these open in smaller markets. But how would you size up the ROI on these stores, just given the lower investment costs you were just talking about relative to the class of 2014 and 2015 store openings?

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

Sure, as we look at whether it's a small market or a large metro market, we put each site through an analysis where we're looking at our ROIC as well as our internal rate of return and the expected cash flow that we're going to get and a restaurant operating margin. And be it small town or larger city, we expect the same from both.

Andrew Charles - *Cowen and Company - Analyst*

Are you seeing that as well as well as modeling it?

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

Yes.

Andrew Charles - *Cowen and Company - Analyst*

Thank you.

Operator

Next we'll hear from Brett Levy with Deutsche Bank.

Brett Levy - *Deutsche Bank - Analyst*

Good afternoon. Can you do us a little bit of a favor and give us a little bit of more incremental on what you're seeing from the technology, the handhelds, the tabletops, any incremental data? Also, as it pertains to what can you do on the labor front, what are you seeing in terms of wage rate inflation and turnover, either at the hourly or the managerial level?

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

On the handhelds, I think we're currently in about 50 restaurants with the server handhelds, and those are in primarily very high labor cost states. So we do see some savings on labor there, which exceeds the cost, gives us a positive rate of return on our investment in those handhelds. We're looking at expanding to about another 50 restaurants, but there's only a limited set where it's a fairly expensive investment in those handhelds, so it only makes sense in those restaurants in particularly high labor areas.

As far as the tablets, I think we've seen increasing rates of usage for both ordering and particularly for pay. Right now, I would say it's primarily a guest enhancement vehicle. I think potential labor savings for tablets are somewhere down the line, as you see a higher rate of adoption, overall adoption and usage. I think at that point, we then may be able to look for labor savings.

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

And Brett, when we're looking at our average wage inflation that we're seeing in restaurants, it is within that 4.5% to 5% increase that we anticipated at the beginning of the year. We did see a slight year-over-year benefit in healthcare costs this particular quarter, and that will vary quarter to quarter, depending on claim level and expected payouts.

Brett Levy - *Deutsche Bank - Analyst*

Thank you.

Operator

Next from Stephens we have Will Slabaugh.

Will Slabaugh - *Stephens Inc. - Analyst*

Yes, thank you. I was wondering how we could think about cost of sales in the back half of the year in light of a few things happening at once. There I'm including the lower wings which you've seen recently. It sounds like a little bit more aggressive value on the menu which could play into that cost of sales number.

And then also, what I'm assuming could be slightly higher food waste at lunch if you're anticipating demand and maybe dropping wings early to hit that 15-minute mark. With all that combined, and then it sounds like some deflation outside of wings, what that might look like versus what we just saw during 2Q.

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

What we're seeing for -- our outlook for wing prices, Will, is that third quarter we should be down slightly and then fourth quarter remains to be seen where they end up, but it could be down slightly. However, that will not make up for the increases we saw in wing prices in the first half of the year. So we're still anticipating a slightly higher wing price year over year versus 2015's $1.81 per wing for the full average year.

And as we look at the different programs, we know what the levels of same-store sale is needed to achieve a margin-neutral both dollar and percent is on the half price wings. We have seen that in some of the test restaurants, but not necessarily all of them yet. And we'll update you as we move forward with the evaluation of that program and eventual rollout.

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

And then on lunch, I'm happy to report really we aren't seeing much additional waste, and in particular on comps for giving away free lunches, they're only about one-half of what we had budgeted for. We've really been pleased with the execution around lunch, and it's been kind of exciting that our teams have really embraced it and been very competitive, and a lot of -- taking a lot of pride in meeting that 15-minute guarantee.

Will Slabaugh - *Stephens Inc. - Analyst*

If I could follow up on that very quickly, would that mean that something around a 29% of sales would be realistic as we come off the 29.7% from this quarter? Or is there another range you might point us to?

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

Just given where wings are at around $1.69 per pound for the first two months of Q3, 29% would be a realistic COGS.

Will Slabaugh - *Stephens Inc. - Analyst*

Thank you very much.

Operator

Next in queue we'll hear from Jason West with Credit Suisse.

Jason West - *Credit Suisse - Analyst*

Yes, thanks. Just one question again going back to the comp trends. You guys talked about the casual versus your targeted guest. Can you try to frame how large those buckets are, what percentage of your business would you describe as more casual guest?

And then can you just go through again what's happening on the Wing Tuesday? I know there was a promotion this quarter on that, and then you talked about going to a half-price consistent. What is that price today relative to the listed price and what would be the change that you're thinking about making there? Thanks.

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

Well, on the -- as far as the guest, while I don't have an exact breakdown, the target customer segment is significantly larger than what we would put into the casual guest segment. But I don't have an exact breakdown on that.

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

With regard to the wings, the pricing tier or the menu pricing for half-price wings varies across the country, depending on what that regular order is. And so it represents a slight discount to our $0.60 or $0.65 wing promotion that we had going on in the restaurants. So it is really driving that value message with the guest, and we're seeing -- again, we rolled it out, I think it's been four weeks now and that adoption and driving traffic really continues to grow as you move into that fourth week of the promotion.

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

And also some additional benefits with the half-off wings are it's easy for the customer to understand, very easy for the customer to understand, and it's easy for us to execute in a restaurant than our traditional wing by the each promotion.

Jason West - *Credit Suisse - Analyst*

Got it. Thank you.

Operator

Our next question comes from Jeffrey Bernstein with Barclays.

Jeffrey Bernstein - *Barclays Capital - Analyst*

Great. Thank you very much. Just a question on -- Sally, I think in your prepared remarks you talked about evolving the capital structure between leverage and return of cash. I'm just wondering any color in terms of what drove that change of heart, especially any update on the CFO search would be great. Just wondering how that came about.

And separately, whether the Board has any thoughts on -- we often talk about the right rate of growth and whether there's any refranchising opportunity. I'm wondering whether those discussions come up as you talk to the Board on a regular basis.

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

Sure. I think a couple of things. One, I'll point you to Analyst Day on August 16th. This -- as we speak with shareholders all the time, whether we're at an investor conference or out doing an on-deal road show, we're always asking and finding out about their preference for enhancing shareholder return. And we do know that we've entered into a stage where we generate a lot of cash.

We have -- our franchise acquisitions, quickly repay themselves and we knew that despite using cash for acquiring those restaurants last year, they would generate additional cash. And so we know that in addition to opening restaurants, which we're still doing, that we have an ability to return value to our shareholders through either stock repurchases or dividends.

So we've spent a fair amount of time this last quarter talking with shareholders and we'll have a better idea or be able to share in more concrete terms at Analyst Day in three weeks. And we do anticipate talking about leverage targets as well as how we, besides growth, will plan on delivering value.

Jeffrey Bernstein - *Barclays Capital - Analyst*

And any update on the search for the --

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

The CFO, I'm sorry.

Jeffrey Bernstein - *Barclays Capital - Analyst*

CFO.

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

Got so carried you away about Analyst Day that I forgot. We are continuing our search. We have narrowed it down to a couple of candidates, and we hope that in the next two to four weeks, we'll be able to make some sort of an announcement.

Jeffrey Bernstein - *Barclays Capital - Analyst*

Great. Thank you.

Operator

Next from Wells Fargo we have Jeff Farmer.

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

Thank you. You guys stated that you'll spend more on all forms of media in the back half of the year. Can you just elaborate on that? How big of a step-up are you guys looking for?

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

Well, it varies by month. Overall spending increases between 3% and over 12%, depending on the particular month. TV is either flat or up each month in the back half of the year. Then we've got -- we're really seeing a shift in dollars from radio in most of the months, although it's up a couple months. But from radio to digital and social is up in each of the months.

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

Does the dollar increase correlate with TRP increase this year?

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

Well, obviously the way -- that would be our goal. The way we buy media would you allow for that. We do know that we'll be up against the election in November, so we're buying on stations certainly surrounding sports where we have a better opportunity that actually have our message appear or play during that sporting event.

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

Just one more. So a lot of questions about increased focus on the launch value, takeout sales, loyalty. A bunch of strategies that quite a few restaurant companies are pursuing or plan to pursue. So I'm just curious, how can you make sure that your efforts are differentiated when it seems like a lot of people are trying to pull some very similar drivers to stimulate those top-line sales?

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

Well, again, our -- initially we're seeing a very good response to our lunch promotion. We're seeing an exceptional initial response in driving traffic to our wings. Those are core to us. We're known for particularly the wings. So I think that's what differentiates us there.

But I also don't want to leave anyone with the impression that we're just focused on these traffic-driving initiatives. We continue to focus on things that differentiate us, which is the e-sports, the soccer, where we've -- as we mentioned, we're working with an outside consultant on evolving our strategy around that guest experience and our areas of differentiation, both near term and long term.

There's some additional promotions and things we hope to be able to talk to you about in the back half of the year. We're not yet at that point. But we really continue our focus on things that differentiate us long term.

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

Thank you.

Operator

All right. Our next question comes from Dennis Geiger with UBS.

Dennis Geiger - *UBS - Analyst*

Great. Thanks for the question. The Wing Tuesday value initiative sounds particularly promising, but against this challenging industry backdrop and heightened price sensitivity among consumers, can you talk about whether there are other value initiatives beyond Wing Tuesdays, beyond happy hour currently under consideration to more broadly support traffic? If the results from Wing Tuesday continue to be favorable, might you look to extend this offering or something similar across different days?

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

We certainly have a number of value occasions guests can use us that have been existing in the business for some time. And we've talk about some of those on other calls. So in addition to Wing Tuesday, we have our Boneless Thursday promotion. We also launched our new Happy Hour menu on May 2nd, which expands the offering on the drinks and has some great shareables for guests.

Our lunch occasion is also value priced compared to our core menu and has been for quite some time. So I think there are certainly a number of dayparts across the week where people can use us in a more value-sensitive occasion.

Dennis Geiger - *UBS - Analyst*

Thank you.

Operator

Next from KeyBanc we have David Carlson.

David Carlson - *KeyBanc Capital Markets - Analyst*

Just following up on that last question. At these 80 stores that are testing the 50% off message, you indicated the meaningful traffic increases that you guys are seeing there. Can you discuss maybe the gap of traffic at these stores relative to the balance of the system? And my apologies up front if I missed this, but wouldn't you expect to expand that program to the remainder of the system?

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

You asked about the gap of traffic to the remainder of the system?

David Carlson - *KeyBanc Capital Markets - Analyst*

Right, in the stores with the 50s% off message.

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

I'm not sure I understand the question.

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

How quickly --

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

How quickly? Oh. When we introduced, our goal was to test this for 90 days. And we're seeing -- in our test restaurants, and we are seeing some really nice increases in those restaurants we decided to accelerate the rollout. We typically will see, as I mentioned in the first part of the call or the first question, it takes about four weeks for us to really see that traffic start to pick up and it builds each week. It seems to be for those stores that have had it in place for four weeks to be at a nice sales lift.

David Carlson - *KeyBanc Capital Markets - Analyst*

And when are you accelerating that rollout, Sally? Will it be in the -- is it something in the third quarter, will be in the remainder of the system?

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

We're adding restaurants throughout the third and fourth quarter.

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

We'll make a determination I think sometime within the next several weeks as to whether or not we want to try to move up that 90-day start date.

David Carlson - *KeyBanc Capital Markets - Analyst*

Thank you.

Operator

Next we'll move to Andrew Strelzik with BMO Capital Markets.

Andrew Strelzik - *BMO Capital Markets - Analyst*

Good afternoon. Appreciate the guidance on the third-quarter G&A. Is there any reason to think that there would be a meaningful delta relative to the trajectory for this year relative to last year in the fourth quarter? And also wanted to ask about recently you made some comments about a grain-based wing contract and how that might be an opportunity going forward. Has there been any development on that front? Is that viable? Maybe how that would work, any color around that would be helpful.

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

On the grain-based wing contract, it's something we're exploring. We aren't at a point yet that we feel it would make sense, but we are working on it. So really no further development there at this point in time.

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

The first part of your question was what?

Andrew Strelzik - *BMO Capital Markets - Analyst*

The G&A for the front half of the year it was down just a touch. Third quarter looks like it's going to be up just a touch. For the fourth quarter, is there any reason to think it wouldn't be largely in line with last year? Is there a reason that the trajectory would change meaningfully on a year over year?

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

On a year-over-year basis, excluding stock-based compensation, Andrew, you probably should have a little bit of leverage in G&A in total for the year as well as fourth quarter.

Andrew Strelzik - *BMO Capital Markets - Analyst*

Great. Thank you very much.

Operator

Next we'll move to John Zolidis with Buckingham Research Group.

John Zolidis - *Buckingham Research Group - Analyst*

Hi. Good evening. A question about the comment you made at several points that the environment is very difficult. Certainly, there's some industry data supporting that. But on the other hand, unemployment is at 5%, wages are going up, gas prices are down. So in your opinion, what is it about the environment that's making things so difficult for restaurant companies such as Buffalo Wild Wings?

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

Well, I think a couple of things. One, we are lapping over low gas prices from last year at the time. I think they were low and coming down. It's not -- some of it's anecdotal, that the savings in gas prices really goes to a better brand of cigarettes or a better brand of soda, and it's not that they're necessarily saving that but it's happening at the convenience store.

Yes, unemployment is at an all-time low and wages are going up. But I think whether it's retail or restaurants, you are just seeing people very reluctant to spend a lot of discretionary dollars. I don't think anybody can point to one thing, but rather that whole macro environment and you're seeing it in retail as well.

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

The research we did, the detailed read -- the research that we did on our customer showed that our target customer is generally spending less at retail, not just spending less at a Buffalo Wild Wings.

John Zolidis - *Buckingham Research Group - Analyst*

Okay. Thanks. And I look forward to the analyst event.

Operator

Ladies and gentlemen, with that, that does exhaust the time we have for questions this afternoon. I'd like to turn things back to Ms. Sally Smith for any additional or closing remarks.

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

Great. Well, thank you all for listening in on the conference call. We do welcome the opportunity to speak with you in three weeks in person. I think we've got a great day planned, and if you haven't contacted Heather about being part of the day, please do. We'll see you then.

Operator

And once again, ladies and gentlemen, that does conclude today's conference. We thank you for your participation.
