

Del Frisco's Restaurant Group, Inc.

Form 10-Q

July 21, 2016

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

FORM 10-Q

---

(Mark One)

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

For the quarterly period ended June 14, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-35611

Del Frisco's Restaurant Group, Inc.

(Exact name of registrant as specified in its charter)

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
920 S. Kimball Ave., Suite 100,  Southlake, TX (Address of principal executive offices)	76092 (Zip code)

(817) 601-3421

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

As of July 20, 2016, the latest practicable date, 23,352,814 shares of the registrant's common stock, \$0.001 par value per share, were issued and outstanding.

Table of Contents

Table of Contents:

<u>Part I – Financial Information</u>	3
<u>Item 1. Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Income and Comprehensive Income</u>	4
<u>Condensed Consolidated Statement of Changes in Stockholders' Equity</u>	5
<u>Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>Item 4. Controls and Procedures</u>	20
 <u>Part II – Other Information</u>	 23
<u>Item 1. Legal Proceedings</u>	23
<u>Item 1A. Risk Factors</u>	23
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	20
<u>Item 3. Defaults Upon Senior Securities</u>	20
<u>Item 4. Mine Safety Disclosures</u>	20
<u>Item 5. Other Information</u>	20
<u>Item 6. Exhibits</u>	21
 <u>Signatures</u>	 22

Table of Contents

## PART I

## FINANCIAL INFORMATION

## Financial Statements

## Item 1.

## DEL FRISCO'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(Dollars in thousands, except per share data)

	June 14, 2016 (unaudited)	December 29, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,635	\$ 5,176
Inventory	16,193	17,308
Income taxes receivable	4,315	5,487
Prepaid expenses and other assets	5,557	9,026
Total current assets	30,700	36,997
Property and equipment, net of accumulated depreciation of \$79,064 and \$70,759 at June 14, 2016 (unaudited) and December 29, 2015, respectively	186,239	183,191
Goodwill	75,365	75,365
Intangible assets, net	37,418	36,865
Other assets	14,568	14,237
Total assets	\$ 344,290	\$ 346,655
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	9,939	16,486
Deferred revenue	13,555	17,635
Other current liabilities	15,008	13,266
Total current liabilities	38,502	47,387
Long-term debt	—	4,500
Deferred rent obligations	34,325	34,336
Deferred income taxes	16,578	16,550
Other liabilities	15,932	16,183
Total liabilities	105,337	118,956
Commitments and contingencies		

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Stockholders' equity:

Preferred stock, \$0.001 par value, 10,000,000 shares authorized, no shares issued and outstanding at June 14, 2016 (unaudited) or December 29, 2015	—	—
Common stock, \$0.001 par value, 190,000,000 shares authorized, 24,007,337 shares issued and 23,352,814 shares outstanding at June 14, 2016 (unaudited) and 23,967,692 shares issued and 23,313,169 shares outstanding at December 29, 2015	24	24
Treasury stock at cost: 654,523 shares at June 14, 2016 (unaudited) and December 29, 2015	(13,000)	(13,000)
Additional paid in capital	139,000	137,601
Retained earnings	112,929	103,074
Total stockholders' equity	238,953	227,699
Total liabilities and stockholders' equity	\$ 344,290	\$ 346,655

See notes to condensed consolidated financial statements.

Table of Contents

## DEL FRISCO'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Income and Comprehensive Income—Unaudited

(Dollars in thousands, except per share data)

	12 Weeks Ended		24 Weeks Ended	
	June 14, 2016	June 16, 2015	June 14, 2016	June 16, 2015
Revenues	\$ 79,916	\$ 73,776	\$ 161,110	\$ 148,878
Costs and expenses:				
Costs of sales	22,637	21,276	45,855	42,938
Restaurant operating expenses	38,017	34,260	76,643	69,207
Marketing and advertising costs	2,133	1,746	3,454	3,117
Pre-opening costs	591	1,479	685	1,746
General and administrative costs	6,030	5,908	11,780	11,386
Lease termination and closing costs	20	—	41	—
Depreciation and amortization	4,163	3,613	8,448	7,190
Operating income	6,325	5,494	14,204	13,294
Other income (expense), net:				
Interest expense, net of capitalized interest	(24)	(7)	(55)	(32)
Other	(5)	(88)	(5)	(177)
Net income before income taxes	6,296	5,399	14,144	13,085
Income tax expense	1,852	1,686	4,289	3,978
Net income	\$ 4,444	\$ 3,713	\$ 9,855	\$ 9,107
Basic earnings per common share	\$ 0.19	\$ 0.16	\$ 0.42	\$ 0.39
Diluted earnings per common share	\$ 0.19	\$ 0.16	\$ 0.42	\$ 0.39
Shares used in computing earnings per common share:				
Basic	23,349,718	23,445,716	23,332,397	23,444,381
Diluted	23,436,983	23,672,028	23,418,735	23,599,213
Comprehensive income	\$ 4,444	\$ 3,713	\$ 9,855	\$ 9,107

See notes to condensed consolidated financial statements.



Table of Contents

DEL FRISCO'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Changes in Stockholders' Equity—Unaudited

(Dollars in thousands)

	Common Stock	Additional		Treasury	Retained	
	Shares	Par Value	In Capital	Stock	Earnings	Total
Balance at December 29, 2015	23,313,169	\$ 24	\$ 137,601	\$ (13,000)	\$ 103,074	\$ 227,699
Net income	—	—	—	—	9,855	9,855
Share-based compensation costs	—	—	1,340	—	—	1,340
Stock option exercises, including tax effects	10,750	—	140	—	—	140
Shares issued under stock compensation plan, net of shares withheld for tax effects	28,895	—	(81)	—	—	(81)
Balance at June 14, 2016	23,352,814	\$ 24	\$ 139,000	\$ (13,000)	\$ 112,929	\$ 238,953

See notes to condensed consolidated financial statements.



Table of Contents

## DEL FRISCO'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows—Unaudited

(Dollars in thousands)

	24 Weeks Ended June 14, 2016	June 16, 2015
Cash flows from operating activities:		
Net income	\$ 9,855	\$ 9,107
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,448	7,190
Loss on disposal of restaurant property	—	25
Loan cost amortization	1	8
Non-cash equity based compensation	1,386	1,382
Deferred income taxes	(18)	(282)
Amortization of deferred lease incentives	(496)	(475)
Changes in operating assets and liabilities:		
Inventory	1,115	924
Prepaid expenses and other assets	3,286	3,467
Accounts payable	(4,733)	(865)
Income taxes	1,172	658
Deferred rent obligations	(1,469)	1,009
Deferred revenue	(4,080)	(3,726)
Other liabilities	3,096	894
Net cash provided by operating activities	17,563	19,316

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Cash flows from investing activities:			
Purchase of trade name	(400)		—
Purchases of property and equipment	(13,263)		(21,044)
Other investing activities	—		35
Net cash used in investing activities	(13,663)		(21,009)
Cash flows from financing activities:			
Net payments of credit facility	(4,500)		—
Cash settlement for share-based awards	(81)		—
Proceeds from exercise of stock options	140		101
Net cash (used in) provided by financing activities	(4,441)		101
Net change in cash and cash equivalents	(541)		(1,592)
Cash and cash equivalents at beginning of period	5,176		3,520
Cash and cash equivalents at end of period	\$ 4,635	\$	1,928
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 54	\$	43
Income taxes	\$ 3,203	\$	1,778
Capital expenditures included in accounts payable at end of period	\$ 183	\$	1,425
Non cash operating and investing activities:			
Acquisition of trade name financed by current liabilities	\$ 200		—

See notes to condensed consolidated financial statements.

Table of Contents

DEL FRISCO'S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements—Unaudited

1. BUSINESS AND BASIS OF PRESENTATION

As of June 14, 2016, Del Frisco's Restaurant Group, Inc. (the "Company") owned and operated 50 restaurants under the concept names of Del Frisco's Double Eagle Steak House ("Del Frisco's"), Sullivan's Steakhouse ("Sullivan's"), and Del Frisco's Grille ("Grille"). Of the 50 restaurants the Company operated at the end of the period covered by this report, there were 12 Del Frisco's restaurants, 18 Sullivan's restaurants and 20 Grille restaurants in operation in 23 states and the District of Columbia.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all the information and disclosures required by GAAP for complete financial statements. Operating results for the 24 weeks ended June 14, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending December 27, 2016. In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation. These unaudited condensed consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2015 filed with the SEC on March 3, 2016 (the "2015 10-K").

The Company operates on a 52- or 53-week fiscal year ending the last Tuesday in December. The fiscal quarters ended June 14, 2016 and June 16, 2015 each contained 12 weeks and are referred to herein as the second quarter of fiscal year 2016 and the second quarter of fiscal year 2015, respectively. Fiscal year 2016 will be a 52-week fiscal year as was fiscal year 2015.

Accounting Estimates

The preparation of the unaudited condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances at the time. Actual amounts may differ from those estimates.

There have been no material changes to the significant accounting policies from what was previously reported in the 2015 10-K.

Reclassifications

Certain amounts from the prior year have been reclassified to conform with the current year presentation.

Intangible Assets

On March 17, 2016, the Company entered into an agreement to obtain and clarify ownership of all naming rights for Del Frisco's in certain counties of Kentucky, Indiana and Ohio for aggregate consideration of \$600,000. Under the terms of the agreement, the Company made a payment of \$400,000 in April 2016, with the remaining \$200,000 to be paid in two equal installments on August 1, 2016 and August 1, 2017. This intangible asset has been recorded as a trade name with an indefinite life.

#### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which will supersede Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition. In August 2015, the FASB deferred the effective date of this new standard by one year. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on an amount that depicts the consideration to which the entity expects to be entitled in exchange for each of those goods and services. For a contract that involves more than one performance obligation, the entity must (a) determine or, if necessary, estimate the standalone selling price at inception of the contract for the distinct goods or services underlying each performance obligation and (b) allocate the transaction price to each performance obligation on the basis of the relative standalone selling prices. In addition, under the new guidance, an entity should recognize revenue when (or as) it satisfies each performance obligation under the contract by transferring the promised good or service to the customer. A good or service is deemed transferred when (or as) the customer obtains control of that good or service. The new standard permits the use of either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, but no earlier than fiscal years beginning after December 16, 2016. The Company is currently assessing the potential impact of this ASU on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory: Simplifying the Measurement of Inventory, which is intended to limit the alternative methods available for valuing inventory. The new guidance does not apply to inventory currently measured using the last-in-first-out (LIFO) or the retail inventory valuation methods. Under the new standard, inventory valued using other methods, including the first-in-first-out (FIFO) method, must be valued at the lower of cost or net realizable value. This new guidance must be applied on a

Table of Contents

prospective basis and is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the impact of adopting this ASU to be material to the Company's financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU is intended to improve the reporting of leasing transactions to provide users of financial statements with more decision-useful information. This ASU will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the potential impact of this ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606) – Principal versus Agent Considerations. This ASU is intended to clarify revenue recognition accounting when a third party is involved in providing goods or services to a customer. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and early application is permitted, but no earlier than fiscal years beginning after December 16, 2016. The Company is currently assessing the impact of this ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718) – Improvements to Employee Share-Based Payment Accounting. This ASU is intended to simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2016, including interim periods within those annual periods, and early application is permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the impact of this ASU on its consolidated financial statements.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing. This ASU is intended to clarify two aspects of Topic 606: identifying performance obligations and licensing implementation guidance. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and early application is permitted, but no earlier than fiscal years beginning after December 16, 2016. The Company is currently assessing the impact of this ASU on its consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) – Narrow-Scope Improvements and Practical Expedients. This ASU is intended to clarify two aspects of Topic 606: first, assessing the collectability criterion, options for the presentation of sales and similar taxes, noncash consideration, transition contract modifications, transition contract completion and secondly, technical corrections. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and early application is permitted, but no earlier than fiscal years beginning after December 16, 2016. The Company is currently assessing the impact of this ASU on its consolidated financial statements.



Table of Contents

## 2. EARNINGS PER SHARE

Basic earnings per share ("EPS") data is computed based on the weighted average number of shares of common stock outstanding during the periods. Diluted EPS data is computed based on the weighted average number of shares of common stock outstanding, including all potentially issuable shares of common stock. Diluted EPS for the 12 and 24 weeks ended June 14, 2016 excludes 189,054 and 130,729 shares of restricted stock, respectively, and options to purchase 634,177 and 643,923 shares of common stock, respectively, which were outstanding during the period, but were antidilutive. Diluted EPS for the 12 and 24 weeks ended June 16, 2015 excludes options to purchase 760,457 and 829,332 shares of common stock, respectively, which were outstanding during the period but were antidilutive.

(dollars in thousands, except per share data)

	12 Weeks Ended		24 Weeks Ended	
	June 14, 2016	June 16, 2015	June 14, 2016	June 16, 2015
Net income	\$ 4,444	\$ 3,713	\$ 9,855	\$ 9,107
Shares:				
Weighted average number of common shares outstanding	23,349,718	23,445,716	23,332,397	23,444,381
Dilutive shares	87,265	226,312	86,338	154,832
Total Diluted Shares	23,436,983	23,672,028	23,418,735	23,599,213
Basic earnings per common share	\$ 0.19	\$ 0.16	\$ 0.42	\$ 0.39
Diluted earnings per common share	\$ 0.19	\$ 0.16	\$ 0.42	\$ 0.39

### 3. STOCK-BASED EMPLOYEE COMPENSATION

#### 2012 Long-Term Equity Incentive Plan

On July 16, 2012, the Company adopted the Del Frisco's Restaurant Group, Inc. 2012 Long-Term Equity Incentive Plan (the "2012 Plan"), which allows the Company to grant stock options, restricted stock, restricted stock units, deferred stock units and other equity-based awards to directors, officers, key employees and other key individuals performing services for the Company. The 2012 Plan provides for granting of options to purchase shares of common stock at an exercise price not less than the fair value of the stock on the date of grant. Equity-based awards vest or become exercisable at various periods ranging from one to four years from the date of grant. The 2012 Plan has 2,232,800 shares of common stock authorized for issuance under the plan. There were 1,168,600 shares of common stock issuable upon exercise of outstanding options and 202,043 shares of unvested restricted stock outstanding at June 14, 2016 with 644,562 shares of common stock available for future grants.

The following table details the Company's total stock-based compensation cost during the 12 and 24 weeks ended June 14, 2016 and June 16, 2015 as well as where the costs were expensed (in thousands):

	12 Weeks Ended		24 Weeks Ended	
	June 14, 2016	June 16, 2015	June 14, 2016	June 16, 2015
Restaurant operating expenses	\$ 103	\$ 115	\$ 197	\$ 223
General and administrative costs	632	687	1,189	1,159
Total stock compensation cost	\$ 735	\$ 802	\$ 1,386	\$ 1,382





Table of Contents

## Restricted Stock

The following table summarizes restricted stock activity during the 24 weeks ended June 14, 2016:

24 Weeks Ended June 14, 2016			
	Shares	Weighted average grant date fair value	Aggregate intrinsic value (\$000's)
Outstanding at beginning of period	90,379	\$ 19.96	
Granted	153,229	16.54	
Vested	(33,820)	20.30	
Forfeited	(7,745)	19.63	
Outstanding at end of period	202,043	\$ 17.33	\$ 3,150

As of June 14, 2016, there was \$3.0 million of total unrecognized compensation cost related to non-vested restricted stock. This cost is expected to be recognized over a period of approximately 3.2 years.

## Stock Options

The following table summarizes stock option activity during the 24 weeks ended June 14, 2016:

24 Weeks Ended June 14, 2016			
	Shares	Weighted average exercise price	Weighted average remaining contractual term
Outstanding at beginning of period	1,221,100	\$ 17.44	Aggregate intrinsic value (\$000's)
Granted	—	—	
Exercised	(10,750)	13.00	

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Forfeited	(41,750)	19.89		
Outstanding at end of period	1,168,600	\$ 17.40	6.7 years	\$ 1,399
Options exercisable at end of period	698,100	\$ 16.69	6.6 years	\$ 986

A summary of the status of non-vested stock options as of June 14, 2016 and changes during the 24 weeks ended June 14, 2016 is presented below:

	24 Weeks Ended June 14, 2016	
	Shares	Weighted average grant-date fair value
Non-vested stock options at beginning of period	506,500	\$ 7.25
Vested	(11,250)	7.99
Forfeited	(24,750)	7.64
Non-vested stock options at end of period	470,500	\$ 7.22

As of June 14, 2016, there was \$1.5 million of total unrecognized compensation cost related to non-vested stock options. This cost is expected to be recognized over a period of approximately 1.1 years.

Table of Contents

#### 4. LONG-TERM DEBT

On October 15, 2012, the Company entered into a credit facility that, as last amended on June 30, 2015, provides for an unsecured credit facility with a credit commitment of \$25.0 million, subject to increases in increments of \$5.0 million, with a maximum amount of \$30.0 million. The credit facility expires on October 15, 2017. Borrowings under the credit facility bear interest, at the option of the Company, based on (i) LIBOR plus 1.50% or (ii) the prime rate as defined in the credit facility. The Company is required to pay a commitment fee equal to 0.25% per annum on the available but unused credit facility. The credit facility is guaranteed by certain subsidiaries of the Company. The credit facility contains various financial covenants, including a maximum ratio of total indebtedness to EBITDA and minimum fixed charge coverage, both as defined in the credit agreement. The credit facility also contains covenants restricting certain corporate actions, including asset dispositions, acquisitions, the payment of dividends, the incurrence of indebtedness and providing financing or other transactions with affiliates.

As of June 14, 2016, there were no outstanding borrowings on the Company's credit facility and the Company had approximately \$28.8 million of borrowings available, with \$1.2 million in outstanding letters of credit commitments. As of December 29, 2015, there was \$4.5 million in outstanding borrowings on the Company's credit facility. The Company was in compliance with all of the financial debt covenants as of June 14, 2016 and December 29, 2015.

#### 5. INCOME TAXES

The effective income tax rate for the 12 and 24 weeks ended June 14, 2016 was 29.4% and 30.3%, respectively, compared to 31.2% and 30.4% for the 12 and 24 weeks ended June 16, 2015. The factors that cause the effective tax rates to vary from the federal statutory rate of 35% include the impact of FICA tip and other credits, partially offset by state income taxes and certain non-deductible expenses.

## 6. FAIR VALUE MEASUREMENT

Under GAAP, the Company is required to measure certain assets and liabilities at fair value, or to disclose the fair value of certain assets and liabilities recorded at cost. Pursuant to these fair value measurement and disclosure requirements, fair value is defined as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value is calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities includes consideration of non-performance risk, including the Company's own credit risk. Each fair value measurement is reported in one of the following three levels:

Level 1—valuation inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

Level 2—valuation inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—valuation inputs are unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

The following table presents the Company's financial assets and liabilities measured at fair value on a recurring basis at June 14, 2016 and December 29, 2015, respectively (in thousands):

	Fair Value Measurements		
		June 14, 2016	December 29, 2015
Deferred compensation plan investments (included in Other assets)	2	\$ 14,287	\$ 13,955
Deferred compensation plan liabilities (included in Other liabilities)	2	\$ (13,527)	\$ (14,083)

There were no transfers among levels within the fair-value hierarchy during the first two quarters of fiscal 2016 and fiscal 2015. The carrying value of the Company's cash and cash equivalents, receivables and accounts payable approximate fair value due to their short term nature.



Table of Contents

## 7. SEGMENT REPORTING

The Company operates the Del Frisco's, Sullivan's, and Grille brands as operating segments. The restaurant concepts operate solely in the U.S. within the full-service dining industry, providing similar products to similar customers. Sales from external customers are derived principally from food and beverage sales, and the Company does not rely on any major customers as a source of sales. The restaurant concepts also possess similar economic characteristics, resulting in similar long-term expected financial performance characteristics. However, as Del Frisco's restaurants typically have higher revenues, driven by their larger physical presence and higher average check, the Del Frisco's, Sullivan's, and Grille operating segments have varying operating income and restaurant-level EBITDA margins due to the leveraging of higher revenues on certain fixed operating costs such as management labor, rent, utilities, and building maintenance.

The following tables present information about reportable segments (in thousands):

12 Weeks Ended June 14, 2016					
	Del				
	Frisco's	Sullivan's	Grille	Corporate	Consolidated
Revenues	\$ 37,945	\$ 17,575	\$ 24,396	\$ —	\$ 79,916
Restaurant-level EBITDA	10,692	2,642	3,795	—	17,129
Capital expenditures	3,898	388	4,356	40	8,682
Property and equipment	109,652	48,156	104,997	2,498	265,303

12 Weeks Ended June 16, 2015					
	Del				
	Frisco's	Sullivan's	Grille	Corporate	Consolidated
Revenues	\$ 37,175	\$ 17,477	\$ 19,124	\$ —	\$ 73,776
Restaurant-level EBITDA	11,129	2,385	2,980	—	16,494
Capital expenditures	4,192	985	9,174	29	14,380
Property and equipment	98,907	45,846	84,542	2,376	231,671

24 Weeks Ended June 14, 2016					
	Del				
	Frisco's	Sullivan's	Grille	Corporate	Consolidated
Revenues	\$ 76,288	\$ 36,476	\$ 48,346	\$ —	\$ 161,110
Restaurant-level EBITDA	21,405	6,190	7,563	—	35,158
Capital expenditures	5,182	596	5,626	47	11,451
Property and equipment	109,652	48,156	104,997	2,498	265,303

24 Weeks Ended June 16, 2015					
	Del				
	Frisco's	Sullivan's	Grille	Corporate	Consolidated

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Revenues	\$ 73,196	\$ 37,315	\$ 38,367	\$ —	\$ 148,878
Restaurant-level EBITDA	21,451	6,262	5,903	—	33,616
Capital expenditures	5,647	1,378	12,477	118	19,620
Property and equipment	98,907	45,846	84,542	2,376	231,671

In addition to using consolidated results in evaluating the Company's performance and allocating its resources, the Company's chief operating decision maker uses restaurant-level EBITDA, which is not a measure defined by GAAP. The Company defines restaurant-level EBITDA as net income before income taxes, other income (expenses), net, pre-opening costs, general and administrative costs, lease termination and closure costs and depreciation and amortization. Pre-opening costs are excluded because they vary in timing and magnitude and are not related to the health of ongoing operations. General and administrative costs are only included in the Company's consolidated financial results as they are generally not specifically identifiable to individual operating segments as these costs relate to supporting all of the restaurant operations of the Company and the extension of the Company's concepts into new markets. Lease termination and closure costs and depreciation and amortization are excluded because they are not ongoing controllable cash expenses, and they are not related to the health of ongoing operations. Property and equipment is the only balance sheet measure used by the Company's chief operating decision maker in allocating resources.



Table of Contents

The following table reconciles restaurant-level EBITDA to net income (in thousands).

	12 Weeks Ended		24 Weeks Ended	
	June 14, 2016	June 16, 2015	June 14, 2016	June 16, 2015
Restaurant-level EBITDA	\$ 17,129	\$ 16,494	\$ 35,158	\$ 33,616
Less:				
Pre-opening costs	591	1,479	685	1,746
General and administrative costs	6,030	5,908	11,780	11,386
Lease termination and closing costs	20	—	41	—
Depreciation and amortization	4,163	3,613	8,448	7,190
Operating income	6,325	5,494	14,204	13,294
Less:				
Interest expense, net of capitalized interest	24	7	55	32
Other	5	88	5	177
Net income before income taxes	6,296	5,399	14,144	13,085
Less income tax expense	1,852	1,686	4,289	3,978
Net income	\$ 4,444	\$ 3,713	\$ 9,855	\$ 9,107

## 8. COMMITMENTS AND CONTINGENCIES

The Company is subject to various claims, possible legal actions, and other matters arising out of the normal course of business. While it is not possible to predict the outcome of these issues, management is of the opinion that adequate

provision for potential losses has been made in the accompanying condensed consolidated financial statements and that the ultimate resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Prior to the acquisition of Lone Star Steakhouse & Saloon, Inc. by Lone Star Fund, the Company's predecessor guaranteed certain lease payments of certain non-Company restaurants in connection with the leasing of real estate for restaurant locations. As of June 14, 2016, the Company was responsible as guarantor for one remaining lease of its former affiliate. The lease expires at the end of 2016. This guarantee will require payment by the Company only in an event of default by the former affiliate where it is unable or unwilling to make the required lease payments. Management believes that the likelihood is remote that material payments will be required under the guarantee. At June 14, 2016 and December 29, 2015 the maximum potential amount of future lease payments the Company could be required to make as a result of the guarantees was approximately \$0.1 million and \$0.2 million, respectively.

At June 14, 2016 and December 29, 2015, the Company had outstanding letters of credit of \$1.2 million and \$1.3 million, respectively, which were drawn on the Company's credit facility (see Note 4, Long-Term Debt). The letters of credit typically act as guarantee of payment to certain third parties in accordance with specified terms and conditions.

Table of Contents

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

Cautionary Statement

Certain statements made or incorporated by reference in this report and our other filings with the Securities and Exchange Commission, in our press releases and in statements made by or with the approval of authorized personnel constitute forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and are subject to the safe harbor created thereby. Forward looking statements reflect intent, belief, current expectations, estimates or projections about, among other things, our industry, management's beliefs, and future events and financial trends affecting us. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "may," "will" and variations of words or similar expressions are intended to identify forward looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward looking statements. Although we believe the expectations reflected in any forward looking statements are reasonable, such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward looking statements as a result of various factors. These differences can arise as a result of the risks described in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 29, 2015, filed March 3, 2016, or the 2015 10-K, as well as other factors that may affect our business, results of operations, or financial condition. Forward looking statements in this report speak only as of the date hereof, and forward looking statements in documents incorporated by reference speak only as of the date of those documents. Unless otherwise required by law, we undertake no obligation to publicly update or revise these forward looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, we cannot assure you that the forward looking statements contained in this report will, in fact, transpire.

Overview

Del Frisco's Restaurant Group develops, owns and operates three contemporary, high-end, complementary restaurants: Del Frisco's Double Eagle Steak House, or Del Frisco's, Sullivan's Steakhouse, or Sullivan's, and Del Frisco's Grille, or the Grille. We currently operate 50 restaurants in 23 states and the District of Columbia. Of the 50 restaurants we operated as of the end of the period covered by this report, there were 12 Del Frisco's restaurants, 18 Sullivan's restaurants and 20 Grille restaurants.

Unless the context otherwise indicates, all references to "we," "our," "us," or the "Company" refer to Del Frisco's Restaurant Group, Inc. and its subsidiaries.

Our Growth Strategies and Outlook. Our growth model is comprised of the following three primary drivers:

-

Pursue Disciplined Restaurant Growth. We believe that there are significant opportunities to grow our concepts on a nationwide basis in both existing and new markets where we believe we can generate attractive unit-level economics. We are presented with many development opportunities, and we carefully evaluate each opportunity to determine that sites selected for development have a high probability of meeting our return on investment targets. Our disciplined growth strategy includes accepting only those sites that we believe present attractive rent and tenant allowance structures as well as reasonable construction costs given the sales potential of the site. We believe our concepts' complementary market positioning and ability to coexist in the same markets, coupled with our flexible unit models, will allow us to expand each of our three concepts into a greater number of locations.

- **Grow Existing Revenue.** We will continue to pursue opportunities to increase the sales at our existing restaurants, pursue targeted local marketing efforts and evaluate operational initiatives, including growth in private dining, designed to increase restaurant unit volumes.
- **Maintain Margins Throughout Our Growth.** We will continue to aggressively protect our margins using economies of scale, including marketing and purchasing synergies between our concepts and leveraging our corporate infrastructure as we continue to open new restaurants.

In general, we believe there are opportunities to open four to six restaurants annually, generally composed of one Del Frisco's and three to five Sullivan's and/or Grilles, with new openings of our Grille concept likely serving as the primary driver of new unit growth in the near term. During 2016, we expect to open three Grille restaurants and relocate one Del Frisco's restaurant.

Table of Contents

Performance Indicators. We use the following key metrics in evaluating the performance of our restaurants:

- **Comparable Restaurant Sales.** Effective beginning with the first quarter of fiscal 2016, we consider a restaurant to be comparable during the first full fiscal quarter following the eighteenth month of operations. Previously, we considered a restaurant to be comparable during the first full fiscal period following the eighteenth month of operations. This change in methodology did not result in any material changes in comparable restaurant metrics. Changes in comparable restaurant sales reflect changes in sales for the comparable group of restaurants over a specified period of time. Changes in comparable restaurant sales reflect changes in customer count trends as well as changes in average check. Our comparable restaurant base consisted of 40 and 34 restaurants at June 14, 2016 and June 16, 2015, respectively.
- **Average Check.** Average check is calculated by dividing total restaurant sales by customer counts for a given time period. Average check is influenced by menu prices and menu mix. Management uses this indicator to analyze trends in customers' preferences, the effectiveness of menu changes and price increases and per customer expenditures.
- **Average Weekly Volume.** Average weekly volume, or AWV, consists of the average weekly sales of our restaurants over a certain period of time. This measure is calculated by dividing total revenues within a period by the number of restaurants' operating weeks during the relevant period. This indicator assists management in measuring changes in customer traffic, pricing and development of our concepts.
- **Customer Counts.** Customer counts are measured by the number of entrées ordered at our restaurants over a given time period.
- **Restaurant-Level EBITDA Margin.** Restaurant-level EBITDA margin, a non-GAAP financial measure, represents net income before income taxes, other income (expenses), net, pre-opening costs, general and administrative costs, lease termination and closing costs and depreciation and amortization as a percentage of revenues. By monitoring and controlling our restaurant-level EBITDA margins, we can gauge the overall profitability of our core restaurant operations. See Note 7, Segment Reporting in the notes to our condensed consolidated financial statements for additional information on restaurant-level EBITDA.

## Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Our business is subject to seasonal fluctuations. Historically, the percentage of our annual revenues earned during the first and fourth fiscal quarters has been higher due, in part, to increased gift card redemptions and increased private dining during the year-end holiday season, respectively. In addition, our first, second and third quarters each contain 12 operating weeks with the fourth quarter containing 16 or 17 operating weeks. As many of our operating expenses have a fixed component, our operating income and operating income margin have historically varied significantly from quarter to quarter. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year.

### Results of Operations

The following table shows our operating results (in thousands), as well as our operating results as a percentage of revenues, for the 12 and 24 weeks ended June 14, 2016 and June 16, 2015.

	12 Weeks Ended June 14, 2016			June 16, 2015			24 Weeks Ended June 14, 2016			June 16, 2015		
Revenues	\$ 79,916	100.0%		\$ 73,776	100.0%		\$ 161,110	100.0%		\$ 148,878	100.0%	
Costs and expenses:												
Costs of sales	22,637	28.3%		21,276	28.8%		45,855	28.5%		42,938	28.8%	
Restaurant operating expenses	38,017	47.6%		34,260	46.4%		76,643	47.6%		69,207	46.5%	
Marketing and advertising costs	2,133	2.7%		1,746	2.4%		3,454	2.1%		3,117	2.1%	
Pre-opening costs	591	0.7%		1,479	2.0%		685	0.4%		1,746	1.2%	
General and administrative costs	6,030	7.5%		5,908	8.0%		11,780	7.3%		11,386	7.6%	
Lease termination and closing costs	20	0.0%		—	0.0%		41	0.0%		—	0.0%	
Depreciation and amortization	4,163	5.2%		3,613	4.9%		8,448	5.2%		7,190	4.8%	
Operating income	6,325	7.9%		5,494	7.4%		14,204	8.8%		13,294	8.9%	
Other income (expense), net:												
Interest expense, net of capitalized interest	(24)	0.0%		(7)	0.0%		(55)	0.0%		(32)	0.0%	
Other	(5)	0.0%		(88)	-0.1%		(5)	0.0%		(177)	-0.1%	
Income before income taxes	6,296	7.9%		5,399	7.3%		14,144	8.8%		13,085	8.8%	
Income tax expense	1,852	2.3%		1,686	2.3%		4,289	2.7%		3,978	2.7%	
Net income	\$ 4,444	5.6%		\$ 3,713	5.0%		\$ 9,855	6.1%		\$ 9,107	6.1%	



Table of Contents

Fiscal Quarter Ended June 14, 2016 (12 weeks) Compared to the Fiscal Quarter Ended June 16, 2015 (12 weeks)

The following tables show our operating results (in thousands) by segment, as well as our operating results as a percentage of revenues, for the 12 weeks ended June 14, 2016 and June 16, 2015.

	12 Weeks Ended June 14, 2016							
	Del Frisco's		Sullivan's		Grille		Consolidated	
Revenues	\$ 37,945	100.0%	\$ 17,575	100.0%	\$ 24,396	100.0%	\$ 79,916	100.0%
Costs and expenses:								
Cost of sales	11,236	29.6%	5,215	29.7%	6,186	25.4%	22,637	28.3%
Restaurant operating expenses:								
Labor	8,430	22.2%	5,237	29.8%	7,836	32.1%	21,503	26.9%
Operating expenses	4,395	11.6%	2,612	14.9%	3,266	13.4%	10,273	12.9%
Occupancy	2,371	6.2%	1,289	7.3%	2,581	10.6%	6,241	7.8%
Restaurant operating expenses	15,196	40.0%	9,138	52.0%	13,683	56.1%	38,017	47.6%
Marketing and advertising costs	821	2.2%	580	3.3%	732	3.0%	2,133	2.7%
Restaurant-level EBITDA	\$ 10,692	28.2%	\$ 2,642	15.0%	\$ 3,795	15.6%	\$ 17,129	21.4%
Restaurant operating weeks	144		216		240		600	
Average weekly volume	\$ 264		\$ 81		\$ 102		\$ 133	

	12 Weeks Ended June 16, 2015							
	Del Frisco's		Sullivan's		Grille		Consolidated	
Revenues	\$ 37,175	100.0%	\$ 17,477	100.0%	\$ 19,124	100.0%	\$ 73,776	100.0%
Costs and expenses:								
Cost of sales	11,004	29.6%	5,366	30.7%	4,906	25.7%	21,276	28.8%
Restaurant operating expenses:								
Labor	8,295	22.3%	5,303	30.3%	5,949	31.1%	19,547	26.5%
Operating expenses	3,607	9.7%	2,719	15.6%	2,512	13.1%	8,838	12.0%
Occupancy	2,525	6.8%	1,168	6.7%	2,182	11.4%	5,875	8.0%
Restaurant operating expenses	14,427	38.8%	9,190	52.6%	10,643	55.7%	34,260	46.4%
Marketing and advertising costs	615	1.7%	536	3.1%	595	3.1%	1,746	2.4%
Restaurant-level EBITDA	\$ 11,129	29.9%	\$ 2,385	13.6%	\$ 2,980	15.6%	\$ 16,494	22.4%
Restaurant operating weeks	132		226		195		553	
Average weekly volume	\$ 282		\$ 77		\$ 98		\$ 133	



Revenues. Consolidated revenues increased \$6.1 million, or 8.3%, to \$79.9 million in the second quarter of fiscal 2016 from \$73.8 million in the second quarter of fiscal 2015. This increase was primarily driven by \$7.9 million in incremental revenue from an additional 81 operating weeks provided by seven new restaurants opened during and subsequent to the second quarter of fiscal 2015, partially offset by decreased revenue at our comparable restaurants and the loss of 34 operating weeks due to the closing of the Denver Sullivan's restaurant at the end of the second quarter of 2015 and the Palm Beach and Phoenix Grille restaurants in the fourth quarter of 2015. Comparable restaurant sales decreased 0.7% for the second quarter of fiscal 2016 driven by a 0.7% decrease in average check, while customer counts were flat. During the second quarter of 2016, comparable restaurant sales experienced a 140 basis point drag from three locations most affected by energy-related challenges.

Del Frisco's revenues increased \$0.8 million, or 2.1%, to \$37.9 million in the second quarter of fiscal 2016 from \$37.2 million in the second quarter of fiscal 2015. The increase in revenues was driven by \$1.5 million in incremental revenue from an additional 12 operating weeks provided by one new restaurant opened subsequent to the second quarter of fiscal 2015, partially offset by a decrease in comparable restaurant sales. Comparable restaurant sales decreased 1.9% for the second quarter of fiscal 2016, comprised of a 0.7% decrease in average check and a 1.2% decrease in customer counts.

Sullivan's revenues increased \$0.1 million, or 0.6%, to \$17.6 million in the second quarter of fiscal 2016 from \$17.5 million in the second quarter of fiscal 2015. The increase in revenues was due to a 2.9% increase in comparable restaurant sales driven by a 1.8% increase in customer counts and a 1.1% increase in average check. This increase was partially offset by 10 fewer operating weeks during the second

Table of Contents

quarter of fiscal 2016, resulting from the closing of the Denver Sullivan's restaurant (which contributed \$0.5 million in revenues during the second quarter of 2015).

Grille revenues increased \$5.3 million, or 27.6%, to \$24.4 million in the second quarter of fiscal 2016 from \$19.1 million in the second quarter of fiscal 2015. This increase was primarily driven by \$6.4 million in incremental revenue from an additional 69 operating weeks provided by six new restaurants opened during and subsequent to the second quarter of fiscal 2015, partially offset by 24 fewer operating weeks due to the closing of two restaurants (which contributed \$0.8 million in revenues during the second quarter of 2015), as well as a comparable restaurant sales decrease of 2.0% in the second quarter of fiscal 2016, which was comprised of a 1.7% decrease in average check and a 0.3% decrease in customer counts.

Cost of Sales. Consolidated cost of sales increased \$1.4 million, or 6.4%, to \$22.6 million in the second quarter of fiscal 2016 from \$21.3 million in the second quarter of fiscal 2015. This increase was primarily due to a net additional 47 operating weeks provided by the opening of seven restaurants during and subsequent to the second quarter of fiscal 2015. As a percentage of consolidated revenues, consolidated cost of sales decreased to 28.3% during the second quarter of fiscal 2016 from 28.8% in the second quarter of fiscal 2015.

As a percentage of revenues, Del Frisco's cost of sales remained at 29.6% during the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 in which decreased food costs were offset by increased beverage costs.

As a percentage of revenues, Sullivan's cost of sales decreased to 29.7% during the second quarter of fiscal 2016 from 30.7% in the second quarter of fiscal 2015. This decrease in cost of sales, as a percentage of revenues, was primarily due to decreased beef and wine costs.

As a percentage of revenues, Grille cost of sales decreased to 25.4% during the second quarter of fiscal 2016 from 25.7% in the second quarter of fiscal 2015. This decrease in cost of sales, as a percentage of revenues, was primarily due to decreased beef and seafood costs.

Restaurant Operating Expenses. Consolidated restaurant operating expenses increased \$3.8 million, or 11.0%, to \$38.0 million in the second quarter of fiscal 2016 from \$34.3 million in the second quarter of fiscal 2015. This increase was primarily due to a net additional 47 operating weeks provided by the opening of seven restaurants during and subsequent to the second quarter of fiscal 2015. As a percentage of consolidated revenues, consolidated restaurant operating expenses increased to 47.6% in the second quarter of fiscal 2016 from 46.4% in the second quarter of fiscal 2015.

As a percentage of revenues, Del Frisco's restaurant operating expenses increased to 40.0% during the second quarter of fiscal 2016 from 38.8% during the second quarter of fiscal 2015. This increase in restaurant operating expenses, as a percentage of revenues, was primarily due to higher other restaurant operating expenses, partially offset by lower occupancy costs as well as the deleveraging effect of certain fixed and semi-variable costs in relation to reduced comparable sales in certain restaurants.

As a percentage of revenues, Sullivan's restaurant operating expenses decreased to 52.0% during the second quarter of fiscal 2016 from 52.6% in the second quarter of fiscal 2015. This decrease in restaurant operating expenses, as a percentage of revenues, was primarily due to lower labor and benefits costs and other restaurant operating expenses, partially offset by higher occupancy costs.

As a percentage of revenues, Grille restaurant operating expenses increased to 56.1% during the second quarter of fiscal 2016 from 55.7% in the second quarter of fiscal 2015. This increase in restaurant operating expenses, as a percentage of revenues, was primarily due to higher labor and benefits costs and other restaurant operating expenses, partially offset by lower occupancy costs.

**Marketing and Advertising Costs.** Consolidated marketing and advertising costs increased \$0.4 million, or 22.2%, to \$2.1 million in the second quarter of fiscal 2016 from \$1.7 million in the second quarter of fiscal 2015. As a percentage of consolidated revenues, consolidated marketing and advertising costs increased to 2.7% in the second quarter of fiscal 2016 from 2.4% in the second quarter of fiscal 2015.

As a percentage of revenues, Del Frisco's marketing and advertising costs increased to 2.2% during the second quarter of fiscal 2016 from 1.7% in the second quarter of fiscal 2015. Marketing and advertising costs, as a percentage of revenues, increased primarily due to higher print media and other marketing costs.

As a percentage of revenues, Sullivan's marketing and advertising costs increased to 3.3% during the second quarter of fiscal 2016 from 3.1% in second quarter of fiscal 2015. Marketing and advertising costs, as a percentage of revenues, increased primarily due to higher print media and other marketing costs.

As a percentage of revenues, Grille marketing and advertising costs decreased to 3.0% during the second quarter of fiscal 2016 compared to 3.1% in the second quarter of fiscal 2015. The decrease in marketing and advertising costs, as a percentage of revenues, was primarily due to lower public relations fees and print media costs.

**Pre-opening Costs.** Pre-opening costs decreased by \$0.9 million to \$0.6 million in the second quarter of fiscal 2016 from \$1.5 million in the second quarter of fiscal 2015 due primarily the timing of new restaurants under construction versus the prior year comparable period. Pre-opening costs include non-cash straight line rent, which is incurred during construction and can precede a restaurant opening by four to six months.

Table of Contents

General and Administrative Costs. General and administrative costs increased \$0.1 million, or 2.1%, to \$6.0 million in the second quarter of fiscal 2016 from \$5.9 million in the second quarter of fiscal 2015. As a percentage of revenues, general and administrative costs decreased to 7.5% in the second quarter of fiscal 2016 compared to 8.0% in the second quarter of fiscal 2015. General and administrative costs are expected to continue to increase as a result of costs related to our anticipated growth, including further investments in our infrastructure. As we are able to leverage these investments made in our people and systems, we expect these expenses to decrease as a percentage of total revenues over time.

Lease Termination and Closing Costs. During the second quarter of fiscal 2016, we incurred approximately \$20,000 in charges related to previously closed restaurants. No such charges were incurred in the comparable period in fiscal 2015.

Depreciation and Amortization. Depreciation and amortization increased \$0.6 million, or 15.2%, to \$4.2 million in the second quarter of fiscal 2016 from \$3.6 million in the second quarter of fiscal 2015. The increase in depreciation and amortization expense primarily resulted from new assets placed in service during 2015 and during the year in fiscal 2016 as well as from existing restaurants that were remodeled during 2015.

Income Tax Expense. The effective income tax rate for the second quarter of fiscal 2016 was 29.4% compared to 31.2% for the second quarter of fiscal 2015. The factors that cause the effective tax rates to vary from the federal statutory rate of 35% include the impact of FICA tip and other credits, partially offset by state income taxes and certain non-deductible expenses.

# Table of Contents

## Twenty-Four Weeks Ended June 14, 2016 Compared to the Twenty-Four Weeks Ended June 16, 2015

The following tables show our operating results (in thousands) by segment, as well as our operating results as a percentage of revenues, for the 24 weeks ended June 14, 2016 and June 16, 2015.

	24 Weeks Ended June 14, 2016							
	Del Frisco's		Sullivan's		Grille		Consolidated	
Revenues	\$ 76,288	100.0%	\$ 36,476	100.0%	\$ 48,346	100.0%	\$ 161,110	100.0%
Costs and expenses:								
Cost of sales	22,633	29.7%	10,781	29.6%	12,441	25.7%	45,855	28.5%
Restaurant operating expenses:								
Labor	17,554	23.0%	10,766	29.5%	15,831	32.7%	44,151	27.4%
Operating expenses	8,325	10.9%	5,314	14.6%	6,357	13.1%	19,996	12.4%
Occupancy	4,932	6.5%	2,487	6.8%	5,077	10.5%	12,496	7.8%
Restaurant operating expenses	30,811	40.4%	18,567	50.9%	27,265	56.4%	76,643	47.6%
Marketing and advertising costs	1,439	1.9%	938	2.6%	1,077	2.2%	3,454	2.1%
Restaurant-level EBITDA	\$ 21,405	28.1%	\$ 6,190	17.0%	\$ 7,563	15.6%	\$ 35,158	21.8%
Restaurant operating weeks	288		432		480		1,200	
Average weekly volume	\$ 265		\$ 84		\$ 101		\$ 134	

	24 Weeks Ended June 16, 2015							
	Del Frisco's		Sullivan's		Grille		Consolidated	
Revenues	\$ 73,196	100.0%	\$ 37,315	100.0%	\$ 38,367	100.0%	\$ 148,878	100.0%
Costs and expenses:								
Cost of sales	21,738	29.7%	11,191	30.0%	10,009	26.1%	42,938	28.8%
Restaurant operating expenses:								
Labor	16,842	23.0%	10,959	29.4%	12,179	31.7%	39,980	26.9%
Operating expenses	7,077	9.7%	5,490	14.7%	4,942	12.9%	17,509	11.8%
Occupancy	5,014	6.9%	2,437	6.5%	4,267	11.1%	11,718	7.9%
Restaurant operating expenses	28,933	39.5%	18,886	50.6%	21,388	55.7%	69,207	46.5%
Marketing and advertising costs	1,074	1.5%	976	2.6%	1,067	2.8%	3,117	2.1%
Restaurant-level EBITDA	\$ 21,451	29.3%	\$ 6,262	16.8%	\$ 5,903	15.4%	\$ 33,616	22.6%
Restaurant operating weeks	264		454		387		1,105	
Average weekly volume	\$ 277		\$ 82		\$ 99		\$ 135	

Revenues. Consolidated revenues increased \$12.2 million, or 8.2%, to \$161.1 million in the first two quarters of fiscal 2016 from \$148.9 million in the first two quarters of fiscal 2015. This increase was primarily driven by \$16.7 million in incremental revenue from an additional 165 operating weeks provided by seven new restaurants opened during and subsequent to the first two quarters of fiscal 2015, partially offset by 70 fewer operating weeks due to the closing of the Denver Sullivan's restaurant in the second quarter of 2015 and the Palm Beach and Phoenix Grille restaurants in the fourth quarter of 2015 and decreased comparable restaurant sales. Comparable restaurant sales decreased 0.9% for the first two quarters of fiscal 2016 driven by a 0.2% decrease in customer counts and a 0.7% decrease in average check.

Del Frisco's revenues increased \$3.1 million, or 4.2%, to \$76.3 million in the first two quarters of fiscal 2016 from \$73.2 million in the first two quarters of fiscal 2015. The increase in revenues was driven by \$3.6 million in incremental revenue from an additional 24 operating weeks provided by one new restaurant opened subsequent to the second quarter of fiscal 2015 and partially offset by a decrease in comparable restaurant sales. Comparable restaurant sales decreased 1.0% for the first two quarters of fiscal 2016, comprised of a 1.1% decrease in average check, partially offset by a 0.1% increase in customer counts.

Sullivan's revenues decreased \$0.9 million, or 2.2%, to \$36.5 million in the first two quarters of fiscal 2016 from \$37.3 million in the first two quarters of fiscal 2015. The decrease in revenues was the result of 22 fewer operating weeks during the first two quarters of fiscal 2016, resulting from the closing of the Denver Sullivan's restaurant (which contributed \$1.1 million in revenues during the first two quarters of 2015), partially offset by an increase in comparable restaurant sales. Comparable restaurant sales increased 0.4% for the first two quarters of fiscal 2016 driven by a 1.9% increase in average check, partially offset by a 1.5% decrease in customer counts.

Table of Contents

Grille revenues increased \$10.0 million, or 26.0%, to \$48.3 million in the first two quarters of fiscal 2016 from \$38.4 million in the first two quarters of fiscal 2015. This increase was primarily driven by \$13.1 million in incremental revenue from an additional 141 operating weeks provided by six new restaurants opened during and subsequent to the first two quarters of fiscal 2015, partially offset by 48 fewer operating weeks due to the closing of two restaurants (which contributed \$2.2 million in revenues during the first two quarters of 2015), as well as a comparable restaurant sales decrease of 2.4% in the first two quarters of fiscal 2016, which was comprised of a 3.2% decrease in average check, partially offset by a 0.8% increase in customer counts.

Cost of Sales. Consolidated cost of sales increased \$2.9 million, or 6.8%, to \$45.9 million in the first two quarters of fiscal 2016 from \$42.9 million in the first two quarters of fiscal 2015. This increase was primarily due to a net additional 95 operating weeks provided by the opening of seven restaurants during and subsequent to the first two quarters of fiscal 2015. As a percentage of consolidated revenues, consolidated cost of sales decreased to 28.5% during the first two quarters of fiscal 2016 from 28.8% in the first two quarters of fiscal 2015.

As a percentage of revenues, Del Frisco's cost of sales remained at 29.7% during the first two quarters of fiscal 2016, compared to the first two quarters of fiscal 2015.

As a percentage of revenues, Sullivan's cost of sales decreased to 29.6% during the first two quarters of fiscal 2016 from 30.0% in the first two quarters of fiscal 2015. This decrease in cost of sales, as a percentage of revenues, was primarily due to decreased beef and wine costs.

As a percentage of revenues, Grille cost of sales decreased to 25.7% during the first two quarters of fiscal 2016 from 26.1% in the first two quarters of fiscal 2015. This decrease in cost of sales, as a percentage of revenues, was primarily due to decreased beef and seafood costs.

Restaurant Operating Expenses. Consolidated restaurant operating expenses increased \$7.4 million, or 10.7%, to \$76.6 million in the first two quarters of fiscal 2016 from \$69.2 million in the first two quarters of fiscal 2015. This increase was primarily due to a net additional 95 operating weeks provided by the opening of seven restaurants during and subsequent to the first two quarters of fiscal 2015. As a percentage of consolidated revenues, consolidated restaurant operating expenses increased to 47.6% in the first two quarters of fiscal 2016 from 46.5% in the first two quarters of fiscal 2015.

As a percentage of revenues, Del Frisco's restaurant operating expenses increased to 40.4% during the first two quarters of fiscal 2016 from 39.5% during the first two quarters of fiscal 2015. This increase in restaurant operating expenses, as a percentage of revenues, was primarily due to higher other restaurant operating expenses, partially offset by lower occupancy costs as well as the deleveraging effect of certain fixed and semi-variable costs in relation to reduced comparable sales in certain restaurants.

As a percentage of revenues, Sullivan's restaurant operating expenses increased to 50.9% during the first two quarters of fiscal 2016 from 50.6% in the first two quarters of fiscal 2015. This increase in restaurant operating expenses, as a percentage of revenues, was primarily due to higher occupancy costs.

As a percentage of revenues, Grille restaurant operating expenses increased to 56.4% during the first two quarters of fiscal 2016 from 55.7% in the first two quarters of fiscal 2015. This increase in restaurant operating expenses, as a percentage of revenues, was primarily due to higher labor and other restaurant operating expenses, partially offset by

lower occupancy costs.

**Marketing and Advertising Costs.** Consolidated marketing and advertising costs increased \$0.3 million, or 10.8%, to \$3.5 million in the first two quarters of fiscal 2016 from \$3.1 million in the first two quarters of fiscal 2015. As a percentage of consolidated revenues, consolidated marketing and advertising costs remained at 2.1% during the first two quarters of fiscal 2016 compared to the first two quarters of fiscal 2015.

As a percentage of revenues, Del Frisco's marketing and advertising costs increased to 1.9% during the first two quarters of fiscal 2016 from 1.5% in the first two quarters of fiscal 2015. Marketing and advertising costs, as a percentage of revenues, increased primarily due to higher print media and other marketing costs.

As a percentage of revenues, Sullivan's marketing and advertising costs remained at 2.6% during the first two quarters of fiscal 2016, compared to the first two quarters of fiscal 2015.

As a percentage of revenues, Grille marketing and advertising costs decreased to 2.2% during the first two quarters of fiscal 2016 compared to 2.8% in the first two quarters of fiscal 2015. The decrease in marketing and advertising costs, as a percentage of revenues, was primarily due to lower public relations fees and print media costs.

**Pre-opening Costs.** Pre-opening costs decreased by \$1.1 million to \$0.7 million in the first two quarters of fiscal 2016 from \$1.7 million in the first two quarters of fiscal 2015 due primarily the timing of new restaurants under construction versus the prior year comparable period. Pre-opening costs include non-cash straight line rent, which is incurred during construction and can precede a restaurant opening by four to six months.

**General and Administrative Costs.** General and administrative costs increased \$0.4 million, or 3.5%, to \$11.8 million in the first two quarters of fiscal 2016 from \$11.4 million in the first two quarters of fiscal 2015. This increase was primarily related to additional costs related to growth in the number of corporate and regional management-level personnel to support recent and anticipated growth. As a percentage of revenues, general and administrative costs decreased to 7.3% in the first two quarters of fiscal 2016 compared to 7.6% in the first two quarters of fiscal 2015. General and administrative costs are expected to continue to increase as a result of costs related to our anticipated growth,



## Table of Contents

including further investments in our infrastructure. As we are able to leverage these investments made in our people and systems, we expect these expenses to decrease as a percentage of total revenues over time.

**Lease Termination and Closing Costs.** During the first two quarters of fiscal 2016, we incurred approximately \$41,000 in charges related to previously closed restaurants. No such charges were incurred in the comparable period in fiscal 2015.

**Depreciation and Amortization.** Depreciation and amortization increased \$1.3 million, or 17.5%, to \$8.4 million in the first two quarters of fiscal 2016 from \$7.2 million in the first two quarters of fiscal 2015. This increase primarily resulted from new assets placed in service during 2015 and the first two quarters of fiscal 2016 as well as from existing restaurants that were remodeled during 2015.

**Income Tax Expense.** The effective income tax rate for the first two quarters of fiscal 2016 was 30.3% compared to 30.4% for the first two quarters of fiscal 2015. The factors that cause the effective tax rates to vary from the federal statutory rate of 35% include the impact of FICA tip and other credits, partially offset by state income taxes and certain non-deductible expenses.

## Liquidity and Capital Resources

Our principal liquidity requirements are our lease obligations and capital expenditure needs. We expect to finance our operations for at least the next several years, including costs of opening currently planned new restaurants, through cash provided by operations and borrowings available under our credit facility. However, we cannot be sure that these sources will be sufficient to finance our operations, and we may seek additional financing in the future. As of June 14, 2016, we had cash and cash equivalents of approximately \$4.6 million.

Our operations have not required significant working capital and, like many restaurant companies, we may at times have negative working capital. Revenues are received primarily in cash or by credit card, and restaurant operations do not require significant receivables or inventories, other than our wine inventory. In addition, we receive trade credit for the purchase of food, beverages and supplies, thereby reducing the need for incremental working capital to support growth.

The following table presents a summary of our cash flows for the 24 weeks ended June 14, 2016 and June 16, 2015 (in thousands):

	24 Weeks Ended	
	June 14, 2016	June 16, 2015
Net cash provided by operating activities	\$ 17,563	\$ 19,316
Net cash used in investing activities	(13,663)	(21,009)

Edgar Filing: Del Frisco's Restaurant Group, Inc. - Form 10-Q

Net cash (used in) provided by financing activities	(4,441)	101
Net change in cash and cash equivalents	\$ (541)	\$ (1,592)

Operating Activities. Net cash flows provided by operating activities decreased \$1.8 million during the 24 weeks ended June 14, 2016 as compared to the 24 weeks ended June 16, 2015, primarily due to a \$3.9 million decrease related to the timing of payables and a \$2.5 million decrease in deferred rent obligations, partially offset by a \$2.2 million increase in other liabilities, a \$1.3 million increase in depreciation, a \$0.5 million increase in income taxes receivable and a \$0.7 million increase in net income.

Investing Activities. Net cash used in investing activities for the 24 weeks ended June 14, 2016 was \$13.7 million, consisting of purchases of property and equipment and a trade name acquisition. The property and equipment purchases primarily related to construction in progress of two Grille restaurants and one Del Frisco's restaurant. Net cash used in investing activities for the 24 weeks ended June 16, 2015 was \$21.0 million, consisting primarily of purchases of property and equipment. These purchases primarily related to construction of five Grille restaurants and one Del Frisco's restaurant in progress at the end of the period and remodel activity of existing restaurants.

Financing Activities. Net cash used in financing activities for the 24 weeks ended June 14, 2016 was \$4.4 million, which was primarily due to \$4.5 million of payments on the outstanding balance under our credit facility. Net cash provided by financing activities for the 24 weeks ended June 16, 2015 consisted solely of \$0.1 million of proceeds from the exercise of stock options.

Capital Expenditures. We typically target an average cash investment of approximately \$7.0 million to \$9.0 million per restaurant for a Del Frisco's restaurant and \$3.0 million to \$4.5 million for a Sullivan's restaurant or a Grille restaurant, in each case net of landlord contributions and equipment financing and including pre-opening costs. In addition, we are currently "refreshing" a number of our Sullivan's and Del Frisco's restaurants. These capital expenditures will primarily be funded by cash flows from operations and, if necessary, by the use of our credit facility, depending upon the timing of expenditures.

Credit Facility. See Note 4, Long-Term Debt in the notes to our condensed consolidated financial statements for information regarding our credit facility.

## Table of Contents

We believe that net cash provided by operating activities and available borrowings under our credit facility will be sufficient to fund currently anticipated working capital, planned capital expenditures and debt service requirements for the next 24 months. We regularly review acquisitions and other strategic opportunities, which may require additional debt or equity financing.

**Common Stock Repurchase Program.** On October 14, 2014, our Board of Directors approved a stock repurchase program authorizing us to repurchase up to \$25 million of our common stock through October 14, 2017. Under this program, we may from time to time purchase our outstanding common stock in the open market at management's discretion, subject to share price, market conditions and other factors. The common stock repurchase program does not obligate us to repurchase any dollar amount or number of shares. As of June 14, 2016, we had repurchased 189,027 shares of our common stock at an aggregate cost of approximately \$3.0 million under this program.

There was no common stock repurchase activity during the 24 weeks ended June 14, 2016.

## Off-Balance Sheet Arrangements

Prior to the acquisition of Lone Star Steakhouse & Saloon, Inc. by Lone Star Fund, the Company's predecessor guaranteed certain lease payments of certain non-Company restaurants in connection with the leasing of real estate for restaurant locations. See Note 8, Commitments and Contingencies in the notes to our condensed consolidated financial statements for information regarding these guarantees.

## Accounting Policies

There have been no material changes to the significant accounting policies from what was previously reported in the 2015 10-K. The effects of new accounting pronouncements are discussed in Note 1, Business and Basis of Presentation in the notes to our condensed consolidated financial statements.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

### Interest Rate Risk

We are exposed to market risk from fluctuations in interest rates. For fixed rate debt, interest rate changes affect the fair market value of the debt but do not impact earnings or cash flows. Conversely for variable rate debt, including borrowings available under our credit facility, interest rate changes generally do not affect the fair market value of the debt, but do impact future earnings and cash flows, assuming other factors are held constant. As of June 14, 2016, there were no outstanding borrowings on the Company's credit facility. Holding other variables constant, a hypothetical immediate one percentage point change in interest rates would be expected to have an impact on pre-tax earnings and cash flows of approximately \$10,000 per \$1.0 million of outstanding debt.

## Commodity Price Risk

We are exposed to market price fluctuations in beef, seafood, produce and other food product prices. Given the historical volatility of beef, seafood, produce and other food product prices, these fluctuations can materially impact our food and beverage costs. While we have taken steps to qualify multiple suppliers who meet our standards as suppliers for our restaurants and enter into agreements with suppliers for some of the commodities used in our restaurant operations, there can be no assurance that future supplies and costs for such commodities will not fluctuate due to weather and other market conditions outside of our control. We are currently unable to contract for some of our commodities, such as fresh seafood and certain produce, for periods longer than one week. Consequently, such commodities can be subject to unforeseen supply and cost fluctuations. Dairy costs can also fluctuate due to government regulation. Because we typically set our menu prices in advance of our food product prices, our menu prices cannot immediately take into account changing costs of food items. To the extent that we are unable or unwilling to pass the increased costs on to our customers through price increases, our results of operations would be adversely affected. We do not use financial instruments to hedge our risk to market price fluctuations in beef, seafood, produce and other food product prices at this time.

## Table of Contents

### Inflation

Over the past five years, inflation has not significantly affected our operations. However, the impact of inflation on labor, food and occupancy costs could, in the future, significantly affect our operations. We pay many of our tipped employees hourly rates related to the applicable federal or state minimum wage. Food costs as a percentage of revenues have been somewhat stable due to procurement efficiencies and menu price adjustments, although no assurance can be made that our procurement will continue to be efficient or that we will be able to raise menu prices in the future. Costs for construction, taxes, repairs, maintenance and insurance all impact our occupancy costs. We believe that our current strategy, which is to seek to maintain operating margins through a combination of menu price increases, cost controls, careful evaluation of property and equipment needs, and efficient purchasing practices, has been an effective tool for dealing with inflation. There can be no assurance, however, that future inflationary or other cost pressure will be effectively offset by this strategy.

### Item 4.Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

The design of any system of control is based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all future events, no matter how remote, or that the degree of compliance with the policies or procedures may not deteriorate. Because of its inherent limitations, disclosure controls and procedures may not prevent or detect all misstatements. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

#### Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – Other Information

### Item 1.Legal Proceedings

We are subject to various claims and legal actions, including class actions, arising in the ordinary course of business from time to time, including claims related to food quality, personal injury, contract matters, health, wage and employment and other issues. None of these types of litigation, most of which are covered by insurance, has had a material effect on us, and as of the date of this report, we are not a party to any material pending legal proceedings and are not aware of any claims that we believe could have a materially adverse effect on our consolidated financial position, results of operations, or cash flows.

Item 1A. Risk Factors

There have been no material changes from our risk factors as previously reported in our 2015 10-K.

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

On October 14, 2014, our Board of Directors approved a stock repurchase program authorizing the Company to repurchase up to \$25 million of its common stock through October 14, 2017. Under this program, we may from time to time purchase our outstanding common stock in the open market at management's discretion, subject to share price, market conditions and other factors. The common stock repurchase program does not obligate us to repurchase any dollar amount or number of shares. As of June 14, 2016, we had repurchased 189,027 shares of our common stock at an aggregate cost of approximately \$3.0 million under this program.

There was no common stock repurchase activity during the 12 weeks ended June 14, 2016.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents

Item 5. Other Information  
None.

Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

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

Date: July 21, 2016

Del Frisco's  
Restaurant Group,  
Inc.

By: /s/ Mark S.  
Mednansky  
Mark S.  
Mednansky  
Chief  
Executive  
Officer and  
Director

(Principal  
Executive  
Officer)

By: /s/ Thomas  
J. Pennison,  
Jr.  
Thomas J.  
Pennison,  
Jr.  
Chief  
Financial  
Officer,

(Principal  
Financial  
Officer)



