SONIC CORP
Form 10-K
October 23, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: August 31, 2018

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 0-18859

SONIC CORP.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	73-1371046 (I.R.S. Employer Identification No.)
300 Johnny Bench Drive Oklahoma City, Oklahoma (Address of principal executive offices)	73104 (Zip Code)

Registrant's telephone number, including area code: (405) 225-5000

Securities registered pursuant to section 12(b) of the Act:

None

Securities registered pursuant to section 12(g) of the Act:

Common Stock, Par Value $.01 (Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes   No

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 the reports), and (2) has been subject to the filing requirements for the past 90 days. Yes   No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do no check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 28, 2018, the aggregate market value of the 36,866,336 shares of common stock of the Company held by non-affiliates of the Company equaled $926,082,360 based on the closing sales price for the common stock as reported for that date.

As of October 12, 2018, the Registrant had 35,687,663 shares of common stock issued and outstanding.

Documents Incorporated by Reference
None

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FORM 10-K
SONIC CORP.
PART I
Item 1. Business

Overview

Sonic Corp., through its subsidiaries, operates and franchises the largest chain of drive-in restaurants ("Sonic Drive-Ins") in the United States. References to "Sonic Corp.," "Sonic," "the Company," "we," "us" and "our" in this Form 10- references to Sonic Corp. and its subsidiaries.

The first Sonic Drive-In restaurant opened in 1953. As of the end of our fiscal year on August 31, 2018, the Sonic system included 3,606 Sonic Drive-Ins in 45 states of which 3,427 were owned and operated by franchisees ("Franchise Drive-Ins") and 179 were owned and operated by Sonic Restaurants, Inc., the Company's operating subsidiary ("Company Drive-Ins").

Sonic Corp. was incorporated in the State of Delaware in 1990 in connection with its 1991 initial public offering of common stock. Sonic is publicly traded on the NASDAQ National Market Stock Exchange ("NASDAQ") (Ticker: SONC).

Restaurant Design and Construction

The typical Sonic Drive-In consists of a kitchen housed in a one-story building, which is approximately 1,500 square feet, flanked by canopy-covered rows of 16 to 24 parking spaces, with each space having its own payment terminal, intercom speaker system and menu board. At a typical Sonic Drive-In, a customer drives into one of the parking spaces, orders through the intercom speaker system and has the food delivered by a carhop. Many Sonic Drive Ins also include a drive-thru lane and patio seating to provide customers with alternative dining options.

Menu

Sonic maintains a highly diverse menu. The menu strategy is to provide a broad range of items that appeal to target customer segments across different day-parts. The menu includes a variety of traditional and healthier choices as well as creative and fun items. Sonic's signature food items include specialty drinks (such as cherry limeades and slushes), ice cream desserts, made-to-order cheeseburgers, chicken entrees ranging from sandwiches to boneless wings, a variety of hot dogs including six-inch premium beef hot dogs and footlong quarter-pound coneys, hand-made onion rings and tater tots. Sonic Drive-Ins also offer breakfast items that include a variety of breakfast burritos and serve the full menu all day.

Strategy

Sonic's strategy is to deliver a differentiated and high quality customer service experience. The key elements of our strategy are:

- A distinctive drive-in concept focusing on a unique menu of quality, made-to-order food products including several signature items and innovative technology;
- A commitment to customer service featuring the quick delivery of food by friendly carhops;
- Integrated national marketing programs across media channels, including broadcast, digital and mobile; and
- A commitment to strong franchisee relationships.

Sonic's brand growth strategies include the following:

- Same-store sales growth;
- Improved performance of Company Drive-Ins, including consistent operations execution and restaurant-level margins; and
- Expansion of Sonic Drive-Ins.

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Expansion

During fiscal year 2018, we opened 41 Sonic Drive-Ins, all of which were Franchise Drive-Ins. Expansion plans for fiscal year 2019 involve the opening of multiple Sonic Drive-Ins under development agreements, as well as single-store development by new and existing franchisees. We believe that our existing as well as newly opened markets offer significant growth opportunities over the long term.

Marketing

We have a fully integrated marketing strategy that includes a national advertising campaign. We have designed this marketing program to differentiate Sonic Drive-Ins from our competitors by emphasizing high-quality, distinctive, made-to-order menu items and personalized service featuring friendly carhops. We support promotions with television, radio, digital media, point-of-sale materials and other communications as appropriate. Those promotions generally highlight limited-time products and signature menu items.

Each year, Sonic develops a marketing plan with the involvement of the Sonic Franchise Advisory Council. (Information concerning the Sonic Franchise Advisory Council is set forth on page 3 under Franchise Program - Franchise Advisory Council.) Funding for our marketing plan is provided by the System Marketing Fund, the Sonic Brand Fund and local advertising expenditures. The System Marketing Fund primarily focuses on purchasing advertising on national cable and broadcast networks and other national media, digital media, sponsorship and brand enhancement opportunities. The Sonic Brand Fund supports national creative and content production as well as other programs designed to promote or enhance the Sonic brand. Our license agreements require advertising contributions of up to 5.9% of sales to these marketing funds and local advertising cooperatives.

Purchasing

We negotiate with suppliers for primary food products and packaging supplies for the system and seek competitive bids from suppliers on many of our food and packaging items. Approved suppliers of those products are required to adhere to our established product and food safety specifications. Suppliers manufacture several key products for Sonic under private label and sell them to authorized distributors for resale to Sonic Drive-Ins. All Sonic Drive-Ins are required to purchase from approved distributors.

Food Safety and Quality Assurance

To ensure the consistent delivery of safe, high-quality food, we created a food safety and quality assurance program. Sonic’s food safety program promotes the quality and safety of all products and procedures utilized by all Sonic Drive-Ins and provides certain requirements that must be adhered to by all suppliers, distributors and Sonic Drive-Ins. Our comprehensive, restaurant-based food safety program is called Sonic Safe. Sonic Safe is a risk-based system that utilizes Hazard Analysis & Critical Control Points (“HACCP”) principles for managing food safety and quality. Our food safety program includes components to monitor and ensure the safety and quality of Sonic’s products and procedures at every stage of the food preparation and production cycle including, but not limited to, employee training, supplier product inspections and testing and unannounced drive-in food safety audits by independent third parties. All Sonic Drive-In employees are required to receive food safety training, utilizing an internal training program. This program includes specific training on food safety information and requirements for every station in the drive-in. We also require our drive-in managers and assistant managers to pass and maintain the ServSafe® certification. ServSafe® is the most recognized food safety training certification in the restaurant industry.

Information Systems

Sonic Drive-Ins are equipped with information technology systems including point-of-sale systems and operational tools for sales, labor and inventory. This technology includes industry-specific, off-the-shelf systems as well as proprietary software that assist in managing food and beverage costs. These solutions are integrated with our point-of-sale systems to provide information that is important for managers to run efficient and effective operations. We have centralized financial and accounting systems for Company Drive-Ins. We also have systems that receive transaction-level data from Franchise Drive-Ins. We believe these systems are important in analyzing and improving sales and profit margins and accumulating marketing information. We are also making strategic investments in customer facing digital technologies, including interactive menu boards, a multi-functional mobile application and electronic payment at the stall and off-premises to enhance the customer's experience and drive sales. We have further invested in new point-of-sale systems. Our license agreements require a

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technology contribution of approximately 0.25% of sales to the Brand Technology Fund ("BTF"), which was established in the third quarter of fiscal year 2016 and administers cybersecurity and other technology programs for the Sonic system.

Franchise Program

General. As of August 31, 2018, we had 3,427 Franchise Drive-Ins in operation. A large number of successful multi-unit franchise groups have developed during the Sonic system's more than 60 years of operation. Those franchisees continue to develop new Franchise Drive-Ins either through development agreements or single-site development. Our franchisees opened 41 drive-ins during fiscal year 2018. We consider our franchisees a vital part of our continued growth and believe our relationship with our franchisees is good.

Franchise Agreements. For traditional drive-ins, the current franchise agreement provides for a franchise fee of $45,000 per drive-in, a royalty fee of up to 5% of sales on a graduated percentage basis and a 20-year term. For fiscal year 2018, Sonic's average royalty rate was 4.08%. The franchisee also pays advertising fees of up to 5.9% of sales and a technology fee of approximately 0.25% of sales.

Development Agreements. We use single- and multiple-unit development agreements for opening new drive-ins. During fiscal year 2018, almost all of our new Franchise Drive-In openings occurred as a result of existing development agreements. Each development agreement gives a developer the exclusive right to construct, own and operate Sonic Drive-Ins within a defined area. In exchange, each developer agrees to open a minimum number of Sonic Drive-Ins in the area within a prescribed time period. Franchisees who enter into development agreements typically pay a fee, which is credited against franchise fees due when Sonic Drive-Ins are opened in the future. Franchisees may forfeit such fees and lose their rights to future development if they do not maintain the required schedule of openings.

Franchise Drive-In Development. We assist each franchisee in selecting sites and developing Sonic Drive Ins. Each franchisee has responsibility for selecting the franchisee's drive-in location but must obtain our approval of each Sonic Drive-In design and each location based on accessibility and visibility of the site and targeted demographic factors, including population density, income, age and traffic. We provide our franchisees with the physical specifications for the typical Sonic Drive-In.

Franchise Advisory Council. Our Franchise Advisory Council provides advice, counsel and input to Sonic on important issues impacting the business, such as marketing and promotions, new products, operations, profitability, technology and training. The Franchise Advisory Council currently consists of 26 members selected by Sonic. We have seven executive committee members who are selected at large and 19 regional members representing all regions of the country. We also have four Franchise Advisory Council task groups comprised of 55 members who generally serve three-year terms and provide support on individual key priorities.

Franchise Drive-In Data. The following table provides certain financial information relating to Franchise Drive-Ins and the number of Franchise Drive-Ins opened, purchased from or sold to Sonic and closed during Sonic's last five fiscal years. The table should be read in conjunction with the information in our Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7.

	2018	2017	2016	2015	2014
Average sales per Franchise Drive-In (In thousands)	$1,260	$1,260	$1,301	$1,261	$1,170
Number of Franchise Drive-Ins:					
Total open at beginning of year	3,365	3,212	3,139	3,127	3,126
New Franchise Drive-Ins	41	63	52	38	37

Sold to the Company	—	—	—	(3)	—
Purchased from the Company	49	117	38	9	7
Closed (net of re-openings)	(28)	(27)	(17)	(32)	(43)
Total open at end of year	3,427	3,365	3,212	3,139	3,127

Company Operations

Management Structure. A typical Company Drive-In is operated by a manager, two to four assistant managers and approximately 25 hourly employees, some of whom work part-time. The manager has responsibility for the day-to-day operations of the Company Drive-In. Supervisors oversee several Company Drive-Ins and supervise the managers of those

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drive-ins. The employee compensation program at Company Drive-Ins for managers and supervisors is comprised of a guaranteed base compensation with additional incentive compensation based on customer satisfaction, employee staffing and training and drive-in level financial performance.

Company Drive-In Data. The following table provides certain financial information relating to Company Drive-Ins and the number of Company Drive-Ins opened, purchased from or sold to franchisees and closed during the past five fiscal years and should be read in conjunction with the information in our Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7.

	2018	2017	2016	2015	2014
Average sales per Company Drive-In	$1,155	$1,134	$1,142	$1,116	$1,043
(In thousands)					
Number of Company Drive-Ins:					
Total open at beginning of year	228	345	387	391	396
New Company Drive-Ins	—	3	1	3	3
Purchased from franchisees	—	—	—	3	—
Sold to franchisees	(49)	(117)	(38)	(9)	(7)
Closed (net of re-openings)	—	(3)	(5)	(1)	(1)
Total open at end of year	179	228	345	387	391

Competition

We compete in the restaurant industry, specifically in the segment known as quick-service restaurants ("QSR"), which is highly competitive in terms of price, service, location and food quality. The restaurant industry is often affected by changes in consumer trends, economic conditions, demographics and traffic patterns. We compete on the basis of distinctive food and service with signature food items, friendly carhops and the method of food preparation (made-to-order and personalized). Our drive-in format, combined with the quality of service featuring Sonic carhops, constitute a primary marketable point of difference from the competition. There are many well-established competitors with substantially greater financial and other resources. These competitors include a large number of national, regional and local food service establishments, including QSRs, casual-dining restaurants and convenience stores. A significant change in market conditions or in pricing or other marketing strategies by one or more of Sonic's competitors could have an adverse impact on Sonic's sales, earnings and growth. Furthermore, the restaurant industry has few barriers to entry, and new competitors may emerge at any time. In selling franchises, we compete with many franchisors of QSR and other restaurants, in addition to franchisors of other business opportunities.

Seasonality

Our sales and earnings results during Sonic's second fiscal quarter (the months of December, January and February) generally are lower than other quarters because of colder and more volatile weather in the locations of a number of Sonic Drive-Ins.

Employees

As of August 31, 2018, we had 391 full-time corporate employees and approximately 4,650 full-time and part-time employees at Company Drive-Ins. None of our employees are subject to a collective bargaining agreement. We believe that we have good labor relations with our employees.

Intellectual Property

Sonic owns or is licensed to use valuable intellectual property including trademarks, service marks, patents, copyrights, trade secrets and other proprietary information, including the "Sonic" logo and trademark, which are of material importance to our business. Depending on the jurisdiction, trademarks and service marks generally are valid as long as they are used and/or registered. Patents, copyrights and licenses are of varying durations.

Customers

Our business is not dependent upon either a single customer or a small group of customers.

Government Contracts

No portion of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. government.

Government Regulation

Our restaurants are subject to licensing and regulation by state and local health, safety, fire and other authorities, including licensing requirements and regulations for the sale of food. The development and construction of new restaurants is subject also to compliance with applicable zoning, land use and environmental regulations. We are also subject to federal regulation and state laws that regulate the offer and sale of franchises and substantive aspects of the franchisor-franchisee relationship. Various federal and state labor laws govern our relationship with our employees and affect operating costs. These laws govern minimum wage requirements, overtime pay, meal and rest breaks, unemployment tax rates, health care and benefits, workers' compensation rates, citizenship or residency requirements, child labor regulations and discriminatory conduct. Federal, state and local government agencies have established regulations requiring that we disclose to our customers nutritional information regarding our menu items. We have processes in place to monitor compliance with applicable laws and regulations governing our operations.

Environmental Matters

We are not aware of any federal, state or local environmental laws or regulations that will materially affect our earnings or competitive position or result in material capital expenditures. However, we cannot predict the effect on operations of possible future environmental legislation or regulations. During fiscal year 2018, there were no material capital expenditures for environmental control facilities and no such material expenditures are anticipated.

Available Information

We maintain a website with the address of www.sonicdrivein.com. Copies of the Company’s reports filed with, or furnished to, the Securities and Exchange Commission on Forms 10-K, 10-Q and 8-K and any amendments to such reports are available for viewing and copying at such website, free of charge, as soon as reasonably practicable after filing such material with, or furnishing it to, the Securities and Exchange Commission. In addition, copies of Sonic’s corporate governance materials, including the Corporate Governance Guidelines, Audit Committee Charter, Compensation Committee Charter, Nominating and Corporate Governance Committee Charter, Code of Ethics for Financial Officers and Code of Business Conduct and Ethics are available for viewing and copying at the website, free of charge.

Forward-Looking Information

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, principally in the sections captioned “Business,” “Legal Proceedings” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur. In some cases, forward-looking statements can be identified by words such as “anticipate,” “estimate,” “expect,” “goals,” “guidance,” “plan,” “may,” “will,” “would” and similar expressions. Investors should not place undue rel on the forward-looking statements, which speak only as of the date of this report. These forward-looking statements are all based on currently available operating, financial and competitive information and are subject to various risks and uncertainties. Our actual future results and trends may differ materially depending on a variety of factors including, but not limited to, the risks and uncertainties discussed below. We undertake no obligation to publicly update or revise them, except as may be required by law.

Item 1A. Risk Factors

We caution you that our business and operations are subject to a number of risks and uncertainties. The factors listed below are important factors that could cause our actual results to differ materially from our historical results and from projections in forward-looking statements contained in this report, in our other filings with the Securities and Exchange Commission, in our news releases and in oral statements by our representatives. However, other factors that we do not anticipate or that we do not consider significant based on currently available information may also have an adverse effect on our results.

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Events reported in the media, including social media, such as incidents involving food-borne illnesses, food contamination or food tampering, whether or not accurate, can cause damage to our reputation and rapidly affect sales and profitability.

Reports, whether true or not, of food-borne illnesses, food contamination or food tampering have in the past severely injured the reputations of participants in the restaurant industry and could affect us in the future. The potential for terrorism affecting our nation's food supply also exists and, if such an event occurs, it could have a negative impact on our brand's reputation and could severely hurt sales, revenues and profits. Our ability to remain a trusted brand and increase sales and profits depends on our ability to manage the potential impact on Sonic of actual or reports of food safety issues. Our food safety and quality assurance program minimizes food safety risks. Nevertheless, these risks cannot be completely eliminated. Any food safety incident attributed to our restaurants or within the food service industry, or any widespread negative publicity regarding our brand or the restaurant industry in general, could materially harm our brand, including sales and profitability.

The restaurant industry is highly competitive, and that competition could lower our revenues, margins and market share.

The restaurant industry is intensely competitive with respect to price, service, location, personnel, dietary trends, including nutritional content of quick-service foods, and quality of food and is often affected by changes in consumer tastes and preferences, economic conditions, population and traffic patterns. We compete with international, regional and local restaurants, some of which operate more restaurants and have greater financial resources. We compete primarily through the quality, price, variety and value of food products offered and our distinctive service experience. Other key competitive factors include the number and location of restaurants, speed of service, attractiveness of facilities, effectiveness of advertising and marketing programs and new product development by us and our competitors. We cannot ensure that we will compete successfully in the restaurant industry on these factors. In addition, some of our competitors have substantially larger marketing budgets, which may provide them with a competitive advantage. Our system also competes within the QSR industry not only for customers but also for management and hourly employees, suitable real estate sites and qualified franchisees.

Changing dietary preferences may cause consumers to avoid our products in favor of alternative foods.

The restaurant industry is affected by consumer preferences and perceptions. Although we monitor these changing preferences and strive to adapt to meet changing consumer needs, the growth of our brand and, ultimately, system sales depend on the sustained demand for our products. If dietary preferences and perceptions cause consumers to avoid certain products offered by Sonic Drive-Ins in favor of different foods, demand for our products may be reduced and our business could be harmed.

Our earnings and business growth strategy depends in large part on the success of our franchisees, who exercise independent control of their businesses.

A large proportion of Sonic Drive-Ins are owned and operated by our franchisees. A significant portion of our earnings comes from royalties, rents and other amounts paid by our franchisees. Franchisees are independent businesses, and their employees are not our employees. To help ensure compliance with brand standards we provide appropriate training and support to, and monitor the operations of, our franchisees, but the quality of their drive-in operations may be diminished by any number of factors beyond our control. Franchisees may not successfully operate drive-ins in a manner consistent with our high standards and requirements, and they may not invest in facilities and initiatives as necessary to compete successfully in the restaurant industry. In addition, franchisees may not hire and train qualified managers and other restaurant personnel and may not adequately plan for and train their own successors. Consumers could perceive an operational shortcoming of a Franchise Drive-In as a reflection of the entire Sonic brand, thus damaging our reputation and potentially affecting revenues and profitability.

Changes in economic, market and other conditions could adversely affect Sonic and its franchisees, and thereby Sonic's operating results.

The QSR industry is affected by changes in economic conditions, consumer tastes and preferences, spending patterns, demographic trends, consumer perceptions of food safety, weather, traffic patterns, the type, number and location of competing restaurants and the effects of war or terrorist activities and any governmental responses thereto. We are also affected by these factors, and the concentration of approximately 35% of our drive-ins in Texas and Oklahoma further subjects us to risk particularly if these factors impact those states. Factors such as interest rates, inflation, gasoline prices, energy costs, food and

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packaging costs, labor and benefit costs, legal claims and the availability of management and hourly employees also affect restaurant operations and administrative expenses for all drive-ins. Economic conditions, including disruptions in the financial markets, interest rates and other government policies impacting land and construction costs and the cost and availability of borrowed funds, affect our ability and our franchisees' ability to finance new restaurant development, improvements and additions to existing restaurants, and the acquisition of restaurants from, and sale of restaurants to, franchisees. Inflation can cause increased food, labor and benefits costs and can increase our operating expenses. As operating expenses increase, we recover increased costs by increasing menu prices, to the extent permitted by competition and the consumer environment, or by implementing alternative products or processes, or by implementing other cost reduction procedures. We cannot ensure, however, that we will be able to recover increases in operating expenses in this manner.

Our financial results may fluctuate depending on various factors, many of which are beyond our control.

Our sales and operating results can vary from quarter to quarter and year to year depending on various factors, many of which are beyond our control. Certain events and factors may directly and immediately decrease demand for our products, and we cannot ensure that we will be able to respond to or address the events and factors sufficiently. If customer demand decreases rapidly, our results of operations, including store-level sales and profits, would also decline precipitously. These events and factors include:

- sales promotions and product offerings by Sonic and its competitors;
- changes in average same-store sales and customer visits;
- the inability to purchase sufficient levels of media;
- variations in the price, availability and shipping costs of supplies such as food products;
- seasonal effects on demand for Sonic's products;
- slowdowns in new drive-in development or franchise agreement renewals;
- changes in competitive conditions;
- changes in economic conditions generally, including consumer spending;
- consumer sensitivity to price and value;
- changes in consumer tastes and preferences;
- changes in the cost of labor; and
- weather and other acts of God.

Shortages or interruptions in the supply or delivery of perishable food products or rapid price increases could adversely affect our operating results.

We are dependent on frequent deliveries of perishable food products that meet certain specifications. Shortages or interruptions in the supply of perishable food products may be caused by unanticipated demand, problems in production or distribution, acts of terrorism, financial or other difficulties of suppliers, disease or food-borne illnesses, droughts, inclement weather or other conditions. We source large quantities of food and supplies, which can be subject to significant price fluctuations due to seasonal shifts, climate conditions, industry demand, energy costs, changes in international commodity markets and other factors. These shortages or rapid price increases could adversely affect the availability, quality and cost of ingredients, which would likely lower revenues and reduce our profitability.

Failure to successfully implement our growth strategy could reduce, or reduce the growth of, our revenue and net income.

We plan to continue to increase the number of Sonic Drive-Ins, but may not be able to achieve our growth objectives, and new drive-ins may not be profitable or provide a sufficient return on investment. The opening and success of drive-ins depends on various factors, including:

- competition from other restaurants in current and future markets;
- the degree of saturation in existing markets;
- consumer interest in and acceptance of the Sonic brand in existing and new markets;
- the identification and availability of suitable and economically viable locations;
- sales and profit levels at existing drive-ins;
- the negotiation of acceptable lease or purchase terms for new locations;
- permitting and regulatory requirements;
- the cost and availability of construction resources and financing;
- the ability to meet construction schedules;

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- the availability of qualified franchisees and their financial and other development capabilities, including their desire and ability to access and commit capital;
- the ability to hire and train qualified management personnel;
- sufficient marketing efforts;
- weather; and
- general economic and business conditions.

If we are unable to open as many new drive-ins as planned, if the drive-ins are less profitable than anticipated or if we are otherwise unable to successfully implement our growth strategy, revenue and profitability may grow more slowly or even decrease.

Our outstanding and future leverage could have an effect on our operations.

The Company employs securitized financing in the form of fixed rate notes and variable rate notes. As of August 31, 2018, we had three outstanding series of fixed rate notes: 1) $147.6 million in debt including accrued interest at an interest rate of 3.75%, with an anticipated repayment date of July 2020, and 2) $400.4 million in debt including accrued interest at an interest rate of 4.47%, with an anticipated repayment date of May 2023, and 3) $170.2 million in debt including accrued interest at an interest rate of 4.03%, with an anticipated repayment date of February 2025. In addition, as of August 31, 2018, we had no outstanding balance under the variable rate notes. Interest on the variable notes is based on the one-month London Interbank Offered Rate or Commercial Paper, depending on the funding source, plus 2.0%, per annum. The variable rate notes have an anticipated repayment date of May 2021, with two one-year options available under certain conditions. We believe our current leverage ratio is moderate. We have historically generated net operating cash flows significantly in excess of our debt service requirements. In the event that we default on our debt obligations, the following consequences could apply:

- Our flexibility may be reduced in responding to changes in business, industry, regulatory or economic conditions.
- Our ability to obtain additional financing in the future for acquisitions, working capital, capital expenditures and general corporate or other purposes could be impaired or any such financing may not be available on terms favorable to us.
- Any substantial decrease in net operating cash flows or any substantial increase in expenses could make it difficult for us to meet our debt service requirements or force us to modify our operations or sell assets; as a result a substantial portion of our cash flows could be required for debt service and might not be available for our operations or other purposes.
- Unpaid amounts outstanding could become immediately due and payable.

Sonic Drive-Ins are subject to health, employment, environmental and other government regulations, and failure to comply with existing or future government regulations could expose us to litigation, damage to our reputation and lower profits.

Sonic and its franchisees are subject to various federal, state and local laws affecting their businesses. The successful development and operation of restaurants depends to a significant extent on the selection and acquisition of suitable sites, which are subject to zoning, land use (including the placement of drive-thru windows), environmental (including litter), traffic and other regulations. More stringent requirements of local and state governmental bodies with respect to zoning, land use and environmental factors could delay, prevent or make cost prohibitive the continuing operations of an existing restaurant or the development of new restaurants in particular locations. Restaurant operations are also subject to licensing and regulation by state and local departments relating to health, food preparation, sanitation and safety standards, federal and state labor and immigration laws (including applicable minimum wage requirements, overtime, working and safety conditions and work authorization requirements), federal and state laws prohibiting discrimination and other laws regulating the design and operation of facilities, such as the Americans with Disabilities

Act. If we or our franchisees fail to comply with any of these laws, we or they may be subject to governmental action or litigation, and our reputation could be accordingly harmed. Injury to our reputation would, in turn, likely reduce revenues and profits.

In recent years, there has been an increased legislative, regulatory and consumer focus on nutrition and advertising practices in the food industry, particularly among restaurants. As a result, we have and will become subject to regulatory initiatives in the area of nutritional content, disclosure and advertising, such as requirements to provide information about the nutritional content of our food products, which could increase expenses. The operation of our franchise system is also subject to franchise laws and regulations enacted by a number of states and rules promulgated by the U.S. Federal Trade Commission. Any future legislation or legal changes regarding franchise relationships may negatively affect our operations, particularly our relationship with our franchisees and may increase our potential liability for franchisee practices and our costs. Failure to comply with new or existing franchise laws and regulations in any jurisdiction or to obtain required government

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approvals could result in a ban or temporary suspension on future franchise sales. Changes in applicable accounting rules imposed by governmental regulators or private governing bodies could also affect our reported results of operations.

We are subject to the Fair Labor Standards Act, which governs such matters as minimum wage, overtime and other working conditions, along with the Americans with Disabilities Act, various family leave mandates and a variety of other laws enacted, or rules and regulations promulgated, by federal, state and local governmental authorities that govern these and other employment matters. We have experienced and expect further increases in payroll expenses as a result of government-mandated increases in the minimum wage and future increases may be material. Enactment and enforcement of various federal, state and local laws, rules and regulations on immigration and labor organizations may adversely impact the availability and costs of labor for our restaurants in a particular area or across the United States. In addition, our vendors may be affected by higher minimum wage standards or availability of labor, which may increase the price of goods and services they supply to us.

We have implemented various aspects of the Affordable Care Act in our business, and the law or other related requirements may change. There are no assurances that a combination of cost management and price increases can accommodate all of the costs associated with compliance.

Litigation from customers, franchisees, employees and others could harm our reputation and impact operating results.

Our legal and regulatory environment exposes us to complex compliance and litigation risk. Claims of illness or injury relating to food content, food quality or food handling are common in the QSR industry, as are intellectual property claims (including often aggressive or opportunistic attempts to enforce patents used in information technology systems). In addition, class action lawsuits have been filed, and may continue to be filed, against various QSRs alleging, among other things, that QSRs have failed to disclose the health risks associated with foods we serve and that QSR marketing practices have encouraged obesity and other health issues. There are also litigation and compliance risks and costs associated with privacy, consumer data protection and similar laws, particularly as they apply to children, as well as laws related to the collection and use of consumer, employee and franchisee data. We additionally may be subject to employee, franchisee and other claims in the future based on, among other things, discrimination, harassment, wrongful termination and wage, rest break and meal break issues, including those relating to overtime compensation. Litigation, as well as regulatory and legal changes, involving our relationship with our franchisees and the legal distinction between our franchisees and us for employment law purposes, if determined adversely, could increase costs, negatively impact the business prospects of our franchisees and subject us to incremental liability for their actions. In addition to decreasing our sales and profitability and diverting management resources, adverse publicity or a substantial judgment against us could negatively impact our reputation, hindering the ability to attract and retain qualified franchisees and grow the business.

We may not be able to adequately protect our intellectual property, which could decrease the value of our brand and products.

The success of our business depends on the continued ability to use existing trademarks, service marks and other components of our brand in order to increase brand awareness and further develop branded products. All of the steps we have taken to protect our intellectual property may not be adequate.

Our reputation and business could be materially harmed as a result of security breaches.

Security breaches involving our systems or those of our franchisees or third-party providers may occur, such as unauthorized access, denial of service, computer viruses and other disruptive problems caused by hackers and other bad actors. In fact, as further described below, in 2017 the Company discovered that payment card numbers were acquired without authorization as part of a malware attack experienced at certain Sonic Drive-In locations. Our technology systems contain personal, financial and other information that is entrusted to us by our customers and employees as well as financial, proprietary and other confidential information related to our business. While we take precautions to avoid security breaches, an actual or alleged security breach could result in system disruptions, shutdowns, theft or unauthorized disclosure of confidential information. The occurrence of any of these incidents, or the reporting of such incidents whether accurate or not, could result in adverse publicity, loss of consumer confidence, increased costs, reduced sales and profits and criminal penalties or civil liabilities.

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We have incurred and in the future may incur costs resulting from breaches of security of confidential consumer information related to our electronic processing of credit and debit card transactions.

A significant portion of our restaurant sales are by credit or debit cards. As previously announced, in 2017 the Company discovered that payment card numbers were acquired without authorization as part of a malware attack experienced at certain Sonic Drive-In locations. The Company was named as a defendant in nine purported class action complaints related to the breach. The cases were consolidated in the Northern District of Ohio (the "Litigation"). The plaintiffs in the Litigation assert various claims related to the Company's alleged failure to safeguard customer credit card information and seek monetary damages, injunctive and declaratory relief and attorneys' fees and costs. The Company believes it has meritorious defenses to the Litigation and intends to vigorously oppose the claims asserted by the plaintiffs. On October 10, 2018, the parties to the Litigation filed a joint motion seeking preliminary approval of a class settlement. Based on the terms of class settlement, which is subject to final court approval, we do not believe any payments made in connection with the class settlement or the Litigation more generally would be in excess of our cyber liability insurance coverage. The Company has since been named as a defendant in one additional purported class action complaint filed on October 16, 2018, in the United States District Court for the Eastern District of Arkansas. We cannot provide assurance that we will not become subject to other inquiries or claims relating to the payment card breach. We may be subject to losses associated with claims and anticipated claims by payment card companies for non-ordinary course operating expenses, card issuer losses and card replacement costs, as well as fines and penalties issued by payment card companies in connection with the payment card breach. We may also be subject to fines and penalties imposed by state and/or federal regulators relating to or arising out of the payment card breach. It is possible that losses associated with the payment card breach, including losses associated with the Litigation, could have a material adverse effect on our results of operations in future periods.

We may in the future become subject to additional claims for purportedly fraudulent transactions arising out of the actual or alleged theft of credit or debit card information, and we may also be subject to further lawsuits or other proceedings relating to these types of incidents. Any such claim or proceeding arising from the payment card breach could cause us to incur significant unplanned expenses, which could have an adverse impact on our financial condition and results of operations. Further, adverse publicity resulting from these allegations may have a material adverse effect on us and our restaurants.

Unreliable or inefficient drive-in technology, lack of support for drive-in technology and failure to successfully implement technology initiatives could adversely impact operating results.

We rely on proprietary and commercially available technologies at our drive-ins, including point-of-sale, digital point-of-purchase and payment card systems. We rely on this technology not only to efficiently operate our drive-ins but also to drive sales growth and margin improvement. Our strategic technology initiatives may not be timely or effectively implemented or adequately resourced. Certain technology networks and systems may also be unreliable or inefficient, and our technology vendors may limit or terminate product support and maintenance or be unwilling or unable to provide products and services needed to execute our technology initiatives. Additionally, replacement parts and support and maintenance skills may become scarce, cost prohibitive or non-existent. Any such risks could disrupt drive-in operations, render us unable to achieve desired strategic results and impact sales and profitability.

Ownership and leasing of significant amounts of real estate exposes us to possible liabilities and losses.

We own or lease the land and building for all Company Drive-Ins. Accordingly, we are subject to all of the risks associated with owning and leasing real estate. In particular, the value of our assets could decrease and our costs could increase because of changes in the investment climate for real estate, demographic trends and supply or demand for the use of our drive-ins, which may result from competition from similar restaurants in the area, as well as liability for environmental conditions. We generally cannot cancel the leases, so if an existing or future Sonic Drive-In is not profitable, and we decide to close it, we may nonetheless be committed to perform our obligations under the applicable lease including, among other things, paying rent for the balance of the lease term. In addition, as each of the leases expires, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close drive-ins in desirable locations.

Catastrophic events may disrupt our business.

Unforeseen events, or the prospect of such events, including war, terrorism and other domestic or international conflicts, public health issues, including health epidemics or pandemics, and natural disasters such as hurricanes, earthquakes or other adverse weather and climate conditions, whether occurring in the United States or abroad, could disrupt our operations, disrupt the operations of franchisees, suppliers or customers or result in political or economic instability. These events could reduce demand for our products or make it difficult or impossible to receive products from suppliers.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Of the 179 Company Drive-Ins operating as of August 31, 2018, we operated 83 of them on property leased from third parties and 96 of them on property we own. The leases expire on dates ranging from 2019 to 2037, with the majority of the third-party leases providing for renewal options. All third-party leases provide for specified monthly rental payments and/or rentals based on sales volume. Most third-party leases require Sonic to maintain the property and pay the cost of insurance and taxes.

We also own and lease 162 properties and sublease 48 properties to franchisees and other parties. These leases with franchisees and other parties expire on dates ranging from 2018 to 2037, with the majority of the leases providing for renewal options. The majority of the leases and subleases for Franchise Drive-Ins provide for percentage rent based on sales volume, with a minimum base rent. These leases generally require the franchisee to maintain the property and pay the costs of insurance and taxes. Virtually all of our owned properties are pledged as collateral under the terms of our securitized financing facility, as described under “Liquidity and Sources of Capital” in Part II, Item 7.

Our corporate headquarters is located in Oklahoma City. We have an existing lease to occupy approximately 100,433 square feet. This lease expires in November 2023 and has two five-year renewal options. Sonic believes its properties are suitable for the purposes for which they are being used.

Item 3. Legal Proceedings

The Company was named as a defendant in nine purported class action complaints related to a 2017 payment card breach at certain Sonic Drive-Ins. The cases were consolidated in the Northern District of Ohio (the “Litigation”). The plaintiffs in the Litigation assert various claims related to the Company’s alleged failure to safeguard customer credit card information and seek monetary damages, injunctive and declaratory relief and attorneys’ fees and costs. The Company believes it has meritorious defenses to the Litigation and intends to vigorously oppose the claims asserted by the plaintiffs. On October 10, 2018, the parties to the Litigation filed a joint motion seeking preliminary approval of a class settlement. Based on the terms of the class settlement, which is subject to final court approval, we do not believe any payments made in connection with the class settlement or the Litigation more generally would be in excess of our cyber liability insurance coverage. The Company has since been named as a defendant in one additional purported class action complaint filed on October 16, 2018, in the United States District Court for the Eastern District of Arkansas. We cannot provide assurance that we will not become subject to other inquiries or claims relating to the payment card breach in the future. Although we maintain cyber liability insurance, it is possible the ultimate amount paid by us relating to the payment card breach may be in excess of our cyber liability insurance coverage applicable to claims of this nature. We are unable to estimate the amount of any such excess.

The Company is involved in various other legal proceedings and has certain unresolved claims pending. Based on the information currently available, management believes that all such other claims currently pending are either covered by insurance or would not have a material adverse effect on the Company’s business or financial condition.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 4A. Executive Officers of the Company

Identification of Executive Officers

The following table identifies the executive officers of the Company:

Name	Age	Position	Executive Officer Since
Clifford Hudson	63	Chairman of the Board of Directors and Chief Executive Officer	1985
Claudia S. San Pedro	49	President	2007
John H. Budd III	51	Executive Vice President and Chief Strategy and Business Development Officer	2013
Jose A. Dueñas	46	Executive Vice President and Chief Brand Officer	2017
Christina D. Vaughan	43	President of Sonic Restaurants, Inc.	2017
Paige S. Bass	49	Senior Vice President, General Counsel and Assistant Corporate Secretary	2007
E. Edward Saroch	61	Senior Vice President of Franchise Relations	2017
Corey R. Horsch	40	Vice President, Chief Financial Officer and Treasurer	2015
Lori Abou Habib	38	Vice President and Chief Marketing Officer	2017
Michelle E. Britten	51	Vice President and Chief Accounting Officer	2012
Carolyn C. Cummins	60	Vice President of Compliance and Corporate Secretary	2004

Business Experience

The following sets forth the business experience of the executive officers of the Company for at least the past five years:

Clifford Hudson has served as the Company's Chairman of the Board since January 2000 and Chief Executive Officer since April 1995. He also served as President from April 1995 to January 2000, reassumed that position from November 2004 until May 2008, April 2013 to January 2016 and again March 2017 to February 2018. He has served in various other offices with the Company since 1984. Mr. Hudson has served as a Director of the Company since 1993.

Claudia S. San Pedro has served as the Company's President since February 2018. She served as Executive Vice President and Chief Financial Officer from August 2015 to February 2018 and served as Senior Vice President and Chief Financial Officer from April 2015 until August 2015. Ms. San Pedro served as Vice President of Investor Relations and Communications of the Company from January 2013 until April 2015 and was its Vice President of Investor Relations from July 2010 until January 2013. She served as Vice President of Investor Relations and Brand Strategies from October 2009 until July 2010. Ms. San Pedro has also served as Treasurer of the Company from January 2007 until October 2015. She served as the Director of the Oklahoma Office of State Finance from June 2005 through November 2006. From July 2003 to May 2005, Ms. San Pedro served as the Budget Division Director for the Oklahoma Office of State Finance.

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John H. Budd III has served as Executive Vice President and Chief Strategy and Business Development Officer of the Company since January 2018. He served as Executive Vice President and Chief Development and Strategy Officer from January 2016 to January 2018, and as Senior Vice President and Chief Development and Strategy Officer from August 2013 until January 2016. Mr. Budd served in several progressive positions for Boston Consulting Group from 1997 until joining Sonic in August 2013. His most recent position with Boston Consulting Group was Partner and Managing Director.

Jose A. Dueñas has served as Executive Vice President and Chief Brand Officer since August 2017. Mr. Dueñas served as Executive Vice President and Chief Marketing Officer for Olive Garden, Darden Restaurants, Inc., from November 2014 to August 2017, and was its Senior Vice President of Brand Marketing from June 2012 to October 2014. Mr. Dueñas served in several progressive positions with Kellogg Company from September 1995 to May 2012, the most recent of which was Vice President and General Manager of the toaster pastries business.

Christina D. Vaughan has served as President of Sonic Restaurants, Inc. since January 2017. She served as Vice President of Market Strategies for the Company from November 2012 until July 2015, and Vice President of Franchise Operations for the Company from August 2015 to December 2016. Ms. Vaughan held various positions of increasing responsibility from the time she first joined the Company as a field marketing representative in September 2002 until November 2012.

Paige S. Bass has served as Senior Vice President and General Counsel of the Company since October 2014 and served as Vice President and General Counsel of the Company from January 2007 until October 2014. She has also served as Assistant Corporate Secretary since October 2008. Ms. Bass joined the Company as Associate General Counsel in 2004. Prior to joining the Company, Ms. Bass was employed as an associate with the law firm of Crowe & Dunlevy in Oklahoma City, Oklahoma.

E. Edward Saroch has served as Senior Vice President of Franchise Relations since January 2013 and was Senior Vice President of Field Services - West Region from November 2011 until January 2013. Mr. Saroch was the Senior Vice President of East Markets from September 2010 until November 2011. Mr. Saroch joined the Company in October 1995.

Corey R. Horsch has served as Vice President, Chief Financial Officer and Treasurer of the Company since February 2018. He served as Vice President of Investor Relations and Treasurer of the Company from October 2015 to February 2018. Mr. Horsch served as a Portfolio Manager with Surveyor Capital from May 2011 until September 2015. He served as a Senior Research Analyst with Luther King Capital Management from June 2006 until April 2011. Prior to June 2006, Mr. Horsch worked for almost six years with Credit Suisse in various positions of increasing responsibility, the most recent of which was Vice President, Senior U.S. Equity Research Analyst.

Lori I. Abou Habib has served as Vice President and Chief Marketing Officer since August 2017 and served as a Vice President in marketing roles for the Company from January 2016 until August 2017. She held various marketing roles of increasing responsibility from 2007 when she joined Sonic until she became Vice President of Local Relationship Marketing in January 2016.

Michelle E. Britten has served as Vice President and Chief Accounting Officer since January 2016 and as Vice President and Controller of the Company from November 2012 until January 2016. She served as Senior Director of Corporate Accounting from April 2009 until November 2012 and as Senior Director of SEC Reporting from January 2007 until April 2009. Ms. Britten joined the Company in 2005 as its Director of SEC Reporting.

Carolyn C. Cummins has served as the Company's Corporate Secretary since January 2007 and as the Company's Vice President of Compliance since April 2004. Ms. Cummins joined the Company as Assistant General Counsel in 1999.

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PART II

Item 5. Market for the Company’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividends

The Company’s common stock trades on NASDAQ under the symbol “SONC.” In August 2014, the Company initiated a quarterly cash dividend program with respect to shares of our common stock. A quarterly cash dividend has been paid in each subsequent quarter. The following table sets forth the high and low sales price for the Company’s common stock as reported on NASDAQ and the dividends declared and paid during the period indicated.

	Sales Price				Dividends Declared and Paid	
	Fiscal year ended August 31, 2018		Fiscal year ended August 31, 2017		Fiscal year ended August 31,	
	High	Low	High	Low	2018	2017
First Quarter	$27.00	$22.11	$28.87	$21.12	$0.16	$0.14
Second Quarter	29.62	23.22	28.60	24.57	0.16	0.14
Third Quarter	27.52	23.51	29.44	22.50	0.16	0.14
Fourth Quarter	37.44	24.29	30.05	22.66	0.16	0.14

Subsequent to the end of fiscal year 2018, the Company and Inspire Brands, Inc. ("Inspire") entered into a definitive merger agreement under which Inspire will acquire Sonic. The agreement remains subject to shareholder approval, and the Company is not permitted to pay a dividend prior to the closing of the acquisition. For more information regarding the agreement, see note 16 - Subsequent events, included in Part II, Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

Stockholders

As of October 12, 2018, the Company had 497 record holders of its common stock.

Issuer Purchases of Equity Securities

Shares repurchased during the fourth quarter of fiscal year 2018 are as follows (in thousands, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value that May Yet Be Purchased Under the Program (1)
June 1, 2018 through June 30, 2018	318	$ 31.43	318	$ 380,914
July 1, 2018 through July 31, 2018	268	35.76	268	371,325

August 1, 2018 through August 31, 2018	304	34.49	304	360,822
Total	890		890	

(1) In August 2017, the Board of Directors extended the share repurchase program, authorizing the purchase of up to \$160 million of the Company’s outstanding shares of common stock through August 31, 2018. In June 2018, the Board of Directors authorized a \$500.0 million share repurchase program through August 31, 2021, replacing the Company's previous fiscal year 2018 authorization.

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Item 6. Selected Financial Data

The following table sets forth selected financial data regarding the Company's financial condition and operating results. One should read the following information in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" below in Part II, Item 7, and the Company's Consolidated Financial Statements included elsewhere in this report.
Selected Financial Data
(In thousands, except per share data)

	Fiscal year ended August 31,				
	2018	2017	2016	2015	2014
Income Statement Data:					
Company Drive-In sales	$240,722	$296,101	$425,795	$436,031	$405,363
Franchise Drive-Ins:					
Franchise royalties and fees	172,443	170,527	170,319	161,342	138,416
Lease revenue	7,804	7,436	7,459	5,583	4,291
Other	2,621	3,203	2,747	3,133	4,279
Total revenues	423,590	477,267	606,320	606,089	552,349
Cost of Company Drive-In sales	203,177	249,911	356,820	363,938	342,109
Selling, general and administrative	80,077	78,687	82,089	79,336	69,415
Depreciation and amortization	38,355	39,248	44,418	45,892	42,210
Provision for impairment of long-lived assets	664	1,140	232	1,440	114
Other operating (income) expense, net	(5,086)	(14,994)	(4,691)	(945)	(176