

NATHANS FAMOUS INC
Form 10-Q
November 02, 2018

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended **September 23, 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 No. 001-35962

NATHAN'S FAMOUS, INC.

(Exact name of registrant as specified in its charter)

Delaware 11-3166443
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

One Jericho Plaza, Second Floor – Wing A, Jericho, New York 11753

(Address of principal executive offices)

(Zip Code)

(516) 338-8500

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(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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, every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐
Non-accelerated filer ☐
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 Exchange Act). Yes ☐ No ☒

At November 2, 2018, an aggregate of 4,191,569 shares of the registrant's common stock, par value of \$.01, were outstanding.

NATHAN'S FAMOUS, INC. AND SUBSIDIARIES

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Nathan's Famous, Inc. and Subsidiaries**CONSOLIDATED BALANCE SHEETS**

September 23, 2018 and March 25, 2018

(in thousands, except share and per share amounts)

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements.**

	September 23, 2018 (Unaudited)	March 25, 2018
ASSETS		
CURRENT ASSETS		
Cash	\$ 66,154	\$57,339
Accounts and other receivables, net (Note F)	10,720	10,502
Inventories	552	384
Prepaid expenses and other current assets (Note G)	523	2,873
Assets held for sale (Note H)	593	610
Total current assets	78,542	71,708
Property and equipment, net of accumulated depreciation of \$8,295 and \$8,264, respectively	5,202	6,642
Goodwill	95	95
Intangible asset	1,353	1,353
Deferred income taxes	406	-
Long term contractual accounts receivable	440	-
Other assets	343	293
Total assets	\$ 86,381	\$80,091
LIABILITIES AND STOCKHOLDERS' (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable	\$ 4,654	\$6,565
Accrued expenses and other current liabilities (Note I)	11,040	11,248

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Deferred franchise fees	559	193
Total current liabilities	16,253	18,006
Long-term debt, net of unamortized debt issuance costs of \$4,896 and \$5,242, respectively (Note O)	145,104	144,758
Other liabilities (Note I)	1,303	1,355
Deferred franchise fees	3,044	238
Deferred income taxes	-	302
Total liabilities	165,704	164,659
COMMITMENTS AND CONTINGENCIES (Note P)		
STOCKHOLDERS' (DEFICIT)		
Common stock, \$.01 par value; 30,000,000 shares authorized; 9,318,942 and 9,311,922 shares issued; and 4,191,569 and 4,184,549 shares outstanding at September 23, 2018 and March 25, 2018, respectively	93	93
Additional paid-in capital	60,887	60,823
(Accumulated deficit)	(63,000)) (68,181)
Stockholders' (deficit) before treasury stock	(2,020)) (7,265)
Treasury stock, at cost, 5,127,373 shares at September 23, 2018 and March 25, 2018	(77,303)) (77,303)
Total stockholders' (deficit)	(79,323)) (84,568)
Total liabilities and stockholders' (deficit)	\$ 86,381	\$80,091

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries**CONSOLIDATED STATEMENTS OF EARNINGS**

Thirteen and Twenty-six weeks ended September 23, 2018 and September 24, 2017

(in thousands, except share and per share amounts)

(Unaudited)

	Thirteen weeks ended September 23,		Twenty-six weeks ended September 23,	
	September 2018	September 24, 2017	September 2018	September 24, 2017
REVENUES				
Sales	\$21,573	\$24,392	\$42,044	\$46,622
License royalties	5,746	5,764	13,844	13,165
Franchise fees and royalties	1,239	1,315	2,343	2,487
Advertising fund revenue (Note B)	772	-	1,267	-
Total revenues	29,330	31,471	59,498	62,274
COSTS AND EXPENSES				
Cost of sales	15,160	17,906	30,606	35,316
Restaurant operating expenses	1,141	1,105	2,051	2,009
Depreciation and amortization	339	367	684	735
General and administrative expenses	3,438	3,359	7,323	7,030
Advertising fund expense (Note B)	772	-	1,267	-
Total costs and expenses	20,850	22,737	41,931	45,090
Income from operations	8,480	8,734	17,567	17,184
Interest expense	(2,651)	(3,663)	(5,301)	(7,326)
Interest income	115	35	176	70
Other income, net	519	21	540	42
Income before provision for income taxes	6,463	5,127	12,982	9,970
Provision for income taxes	1,979	2,007	3,703	3,928
Net income	\$4,484	\$3,120	\$9,279	\$6,042

PER SHARE INFORMATION

Weighted average shares used in computing income per share:

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Basic	4,188,000	4,179,000	4,187,000	4,178,000
Diluted	4,231,000	4,212,000	4,229,000	4,213,000
Income per share:				
Basic	\$1.07	\$.75	\$2.22	\$1.45
Diluted	\$1.06	\$.74	\$2.19	\$1.43
Dividends declared per share				
	\$.25	\$-	\$.50	\$-

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries**CONSOLIDATED STATEMENT OF STOCKHOLDERS' (DEFICIT)**

Twenty-six weeks ended September 23, 2018

(in thousands, except share amounts)

(Unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock, at Cost Shares	Amount	Total Stockholders' (Deficit)
Balance, March 25, 2018	9,311,922	\$ 93	\$ 60,823	\$ (68,181)	5,127,373	\$(77,303)	\$(84,568)
Cumulative effect of the adoption of ASC 606	-	-	-	(2,004)	-	-	(2,004)
Shares issued in connection with share-based compensation plans	7,020	-	134	-	-	-	134
Withholding tax on net share settlement of share-based compensation plans	-	-	(174)	-	-	-	(174)
Dividends on common stock	-	-	-	(2,094)	-	-	(2,094)
Share-based compensation	-	-	104	-	-	-	104
Net income	-	-	-	9,279	-	-	9,279
Balance, September 23, 2018	9,318,942	\$ 93	\$ 60,887	\$ (63,000)	5,127,373	\$(77,303)	\$(79,323)

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Twenty-six weeks ended September 23, 2018 and September 24, 2017

(in thousands)

(Unaudited)

	September 23, 2018	September 24, 2017
Cash flows from operating activities:		
Net income	\$ 9,279	\$ 6,042
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	684	735
Gain on sale of property and equipment	(323)	-
Amortization of debt issuance costs	346	599
Share-based compensation expense	104	199
Income tax benefit on stock option exercises	46	194
Provision for doubtful accounts	92	57
Deferred income taxes	23	40
Changes in operating assets and liabilities:		
Accounts and other receivables, net	(310)	(2,636)
Inventories	(168)	(25)
Prepaid expenses and other current assets	2,350	620
Long term contractual accounts receivable	(440)	-
Other assets	(50)	5
Accounts payable, accrued expenses and other current liabilities	(2,015)	(431)
Deferred franchise fees - current	366	102
Deferred franchise fees – long term	71	-
Other liabilities	(52)	(100)
Net cash provided by operating activities	10,003	5,401
Cash flows from investing activities:		
Proceeds from disposal of property and equipment	1,330	-
Purchase of property and equipment	(234)	(357)
Net cash provided by (used in) investing activities	1,096	(357)

Cash flows from financing activities:		
Proceeds from exercise of stock options	134	-
Dividends paid to stockholders	(2,244)	(125)
Payments of withholding tax on net share settlement of share-based compensation plans	(174)	(157)
Net cash (used in) financing activities	(2,284)	(282)
Net increase in cash	8,815	4,762
Cash, beginning of period	57,339	56,915
Cash, end of period	\$ 66,154	\$ 61,677
Cash paid during the period for:		
Interest	\$ 4,968	\$ 6,750
Income taxes paid	\$ 1,319	\$ 3,400

The accompanying notes are an integral part of these consolidated financial statements.

NATHAN'S FAMOUS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 23, 2018

(Unaudited)

NOTE A - BASIS OF PRESENTATION

The accompanying consolidated financial statements of Nathan's Famous, Inc. and subsidiaries (collectively "Nathan's," the "Company," "we," "us" or "our") as of and for the thirteen and twenty-six week periods ended September 23, 2018 and September 24, 2017 have been prepared in accordance with accounting principles generally accepted in the United States of America. The unaudited financial statements include all adjustments (consisting of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of financial condition, results of operations and cash flows for the periods presented. However, our results of operations are seasonal in nature, and the results of any interim period are not necessarily indicative of results for any other interim period or the full fiscal year.

Certain information and footnote disclosures normally included in financial statements in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to the requirements of the Securities and Exchange Commission. We have reclassified certain prior period items in the Consolidated Balance Sheet as of March 25, 2018 and the Statement of Earnings for the thirteen and twenty-six week periods ended September 24, 2017 to be comparable with the classifications as of and for the thirteen and twenty-six week periods ended September 23, 2018. These reclassifications had no effect on previously reported total assets, total liabilities, stockholders' deficit or net income. Management believes that the disclosures included in the accompanying consolidated interim financial statements and footnotes are adequate to make the information not misleading, but should be read in conjunction with the consolidated financial statements and notes thereto included in Nathan's Annual Report on Form 10-K for the fiscal year ended March 25, 2018.

A summary of the Company's significant accounting policies is identified in Note B of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended March 25, 2018.

Effective March 26, 2018, the Company adopted Accounting Standards Codification 606, "Revenue Recognition – Revenue from Contracts with Customers" ("ASC 606"). There have been no other significant changes to the Company's significant accounting policies subsequent to March 25, 2018.

NOTE B – ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

Revenue recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance codified in ASC 606 which amends the guidance in former ASC 605, “Revenue Recognition.” The core principle of the standard is to recognize revenue when control of the promised goods or services is transferred to customers in an amount that reflects the consideration expected to be received for those goods or services. The standard also requires additional disclosures around the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

This adoption of the new standard did not impact the Company’s recognition of sales from Company-operated restaurants as those sales are recognized on a cash basis at the time of the underlying sale and are presented net of sales tax. The standard also did not impact the recognition of sales from its Branded Product Program or its recognition of royalty income earned from its franchised restaurants or retail licenses, which are based on a percent of sales and recognized at the time the underlying sales occur.

The details of the significant changes in revenue recognition and quantitative impact of the changes are discussed below.

Franchise fees and international development fees

Under previous revenue recognition guidance, franchise fees were recognized as income when substantially all services to be performed by Nathan’s and conditions relating to the sale of the franchise had been performed or satisfied, which generally occurred when the franchised restaurant commenced operations.

Under previous revenue recognition guidance, international development fees were recognized as income, net of direct expenses, upon the opening of the first restaurant within the territory.

Under the new guidance, the standard requires that the transaction price received from customers be allocated to each separate and distinct performance obligation. The transaction price attributable to each separate and distinct performance obligation is then recognized as the performance obligations are satisfied. The services that we provide related to upfront fees we receive from franchisees do not contain separate and distinct performance obligations from the franchise right and as of March 26, 2018, initial restaurant franchise fees, renewal fees, transfer fees, and international development fees shall be recognized over the term of the respective agreement.

National advertising fund

The Company maintains a national advertising fund (the “Advertising Fund”) established to collect and administer funds contributed for use in advertising and promotional programs for Company-operated and franchised restaurants. Previously, the revenue, expenses and cash flows of the Advertising Fund were reported on the Company’s Consolidated Balance Sheets and not included in the Company’s Consolidated Statements of Earnings and Statements of Cash Flows because the contributions to the Advertising Fund were designated for specific purposes and the Company acted as an agent, in substance, with regard to these contributions as a result of industry-specific guidance.

Under the new guidance, which supersedes the previous industry-specific guidance, the revenue, expenses and cash flows of the Advertising Fund are fully consolidated into the Company’s Consolidated Statements of Earnings and Statements of Cash Flows.

While this treatment will impact the gross amount of reported advertising fund revenue and related expenses, the impact is expected to be an offsetting increase to both revenue and expense with no impact to income from operations or net income because the Company attempts to manage the Advertising Fund to breakeven over the course of the fiscal year. However, any surplus or deficit in the Advertising Fund will impact income from operations and net income.

The Company applied the new guidance using the modified retrospective method, whereby the cumulative effect of initially adopting the guidance was recognized as an adjustment to the opening balance of accumulated deficit at March 26, 2018 in the amount of \$2,004,000, net of tax. Therefore, the results of operations from the comparative period have not been adjusted and continue to be reported under the previous revenue recognition guidance.

Impacts on Consolidated Financial Statements

The following tables summarize the impact of adopting ASC 606 on the Company’s condensed consolidated financial statements as of and for the thirteen and twenty-six weeks ended September 23, 2018 (in thousands):

	Adjustments	
	Balance	Balances
As	FranchisSheet	Without

	Reported	Fees	Reclassifications	Adoption
<u>Condensed Consolidated Balance Sheet</u>				
<i>September 23, 2018</i>				
Deferred income taxes	406	(731)	325	-
Total assets	86,381	(731)	325	85,975
Accrued expenses and other current liabilities	11,040	(112)	-	10,928
Deferred franchise fees	559	(378)	14	195
Total current liabilities	16,253	(490)	14	15,777
Deferred income taxes	-	-	325	325
Deferred franchise fees	3,044	(2,219)	(14) 811
Total liabilities	165,704	(2,709)	325	163,320
(Accumulated deficit)	(63,000)	1,978	-	(61,022)
Stockholders' (deficit) before treasury stock	(2,020)	1,978	-	(42)
Total stockholders' (deficit)	(79,323)	1,978	-	(77,345)
Total liabilities and stockholders' (deficit)	86,381	(731)	325	85,975

	Adjustments			Balances
	Balance			
	As	Franchise	Advertising	Without
	Reported	Fees	Reclassifications	Adoption
<u>Condensed Consolidated Statement of Earnings</u>				
<i>Thirteen weeks ended September 23, 2018</i>				
Franchise fees and royalties	1,239	(66)	-	1,173
Advertising fund revenue	772	-	(772)	-
Total revenues	29,330	(66)	(772)	28,492
General and administrative expenses	3,438	(2)	-	3,436
Advertising fund expense	772	-	(772)	-
Total costs and expenses	20,850	(2)	(772)	20,076
Income from operations	8,480	(64)	-	8,416
Income before provision for income taxes	6,463	(64)	-	6,399
Provision for income taxes	1,979	(20)	-	1,959
Net income	4,484	(44)	-	4,440

Condensed Consolidated Statement of Earnings***Twenty-six weeks ended September 23, 2018***

Franchise fees and royalties	2,343	(138)	-	2,205
Advertising fund revenue	1,267	-	(1,267)	-
Total revenues	59,498	(138)	(1,267)	58,093
General and administrative expenses	7,323	(98)	-	7,225
Advertising fund expense	1,267	-	(1,267)	-
Total costs and expenses	41,931	(98)	(1,267)	40,566
Income from operations	17,567	(40)	-	17,527
Income before provision for income taxes	12,982	(40)	-	12,942
Provision for income taxes	3,703	(14)	-	3,689
Net income	9,279	(26)	-	9,253

	Adjustments			Balances
	As	Franchise	Advertising	Without
	Reported	Fees	Fund	Adoption
<u>Condensed Consolidated Statement of Cash Flows</u>				
<i>Twenty-six weeks ended September 23, 2018</i>				
Cash flows from operating activities:				
Net income	9,279	(26)	-	9,253
Changes in operating assets and liabilities:				
Accounts payable, accrued expenses and other current liabilities	(2,015)	(112)	-	(2,127)
Deferred franchise fees	437	138	-	575
Net cash provided by operating activities	10,003	-	-	10,003
Net cash provided by investing activities	1,096	-	-	1,096

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Net cash (used in) financing activities	(2,284)	-	-	(2,284)
Net increase in cash	8,815	-	-	8,815

Contract balances

The following table provides information about receivables and contract liabilities (Deferred franchise fees) from contracts with customers (in thousands):

	September 23, 2018
Receivables (a)	\$ 480
Deferred franchise fees (b)	\$ 3,183

(a) Receivables of \$40 and \$440 are included in Accounts and other receivables, net and Long term contractual accounts receivable, respectively.

(b) Deferred franchise fees of \$364 and \$2,819 are included in Deferred franchise fees – current and long term, respectively.

Significant changes in Deferred franchise fees are as follows (in thousands):

	Twenty-six Weeks Ended September 23, 2018
Deferred franchise fees at beginning of period (a)	\$ 3,139
Additions to deferred revenue	706
Revenue recognized during the period	(242)
Deferred franchise fees at end of period	\$ 3,603

(a) Includes the cumulative effect of adopting ASC 606 of \$2,735.

Anticipated Future Recognition of Deferred Franchise Fees

The following table reflects the estimated franchise fees to be recognized in the future related to performance obligations that are unsatisfied at the end of the period (in thousands):

	Estimate for fiscal year
2019 (a)	\$ 163
2020	337
2021	329
2022	318
2023	282
Thereafter	2,174
Total	\$ 3,603

(a) Represents franchise fees expected to be recognized for the remainder of the 2019 fiscal year, which includes international development fees expected to be recognized over the duration of one year or less. Amount does not include \$242 of franchise fee revenue recognized for the twenty-six weeks ended September 23, 2018.

We have applied the optional exemption, as provided for under ASC 606, which allows us not to disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

NOTE C – NEW ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

In February 2016, the FASB issued new guidance on leases, which outlines principles for the recognition, measurement, presentation and disclosure of leases applicable to both lessors and lessees. The new standard is effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods. The standard is required to take effect in Nathan's first quarter (June 2019) of our fiscal year ending March 29, 2020. The new guidance requires lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by finance and operating leases with lease terms of more than 12 months. The guidance requires either a modified retrospective transition approach with application in all comparative periods presented, or an alternative transition method, which permits a company to use its effective date as the date of initial application without restating comparative period financial statements. The new guidance also provides several practical expedients and policies that companies may elect under either transition method. We currently expect to apply the alternative transition method and elect the package of practical expedients under which we will not reassess the classification of our existing leases, reevaluate whether any expired or existing contracts are or contain leases or reassess initial direct costs under the new guidance. We do not expect to elect the practical expedient that permits a reassessment of lease terms for existing leases and are continuing to evaluate other practical expedients and elections specified in the new guidance. As of September 23, 2018, there were \$10,492,000 in future minimum rental payments for operating leases that are not currently recorded on our balance sheet; therefore, we expect this new guidance will have a material impact on our consolidated balance sheets and related disclosures. We do not expect the adoption of this guidance to have a material impact on our consolidated statements of earnings and statement of cash flows.

In January 2017, the FASB issued an update to the accounting guidance to simplify the testing for goodwill impairment. The update removes the requirement to determine the implied fair value of goodwill to measure the amount of impairment loss, if any, under the second step of the current goodwill impairment test. A company will perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment charge will be recognized for the amount by which the reporting unit's carrying amount exceeds its fair value, not to exceed the carrying amount of the goodwill. The guidance is effective prospectively for public business entities for annual reporting periods beginning after December 15, 2019. This standard is required to take effect in Nathan's first quarter (June 2020) of our fiscal year ending March 28, 2021. Nathan's does not expect the adoption of this new guidance to have a material impact on its results of operations or financial position.

The Company does not believe that any other recently issued, but not yet effective accounting standards, when adopted, will have a material effect on the accompanying consolidated financial statements.

NOTE D – INCOME PER SHARE

Basic income per common share is calculated by dividing income by the weighted-average number of common shares outstanding and excludes any dilutive effect of stock options. Diluted income per common share gives effect to all potentially dilutive common shares that were outstanding during the period. Dilutive common shares used in the computation of diluted income per common share result from the assumed exercise of stock options and warrants, as determined using the treasury stock method.

The following chart provides a reconciliation of information used in calculating the per-share amounts for the thirteen and twenty-six week periods ended September 23, 2018 and September 24, 2017, respectively.

Thirteen weeks

	Net Income		Number of Shares		Net Income Per Share	
	2018	2017	2018	2017	2018	2017
	(in thousands)		(in thousands)			
<u>Basic EPS</u>						
Basic calculation	\$4,484	\$3,120	4,188	4,179	\$1.07	\$0.75
Effect of dilutive employee stock options	-	-	43	33	(0.01)	(0.01)
<u>Diluted EPS</u>						
Diluted calculation	\$4,484	\$3,120	4,231	4,212	\$1.06	\$0.74

Twenty-six weeks

	Net Income		Number of Shares		Net Income Per Share	
	2018	2017	2018	2017	2018	2017
	(in thousands)		(in thousands)			
<u>Basic EPS</u>						
Basic calculation	\$9,279	\$6,042	4,187	4,178	\$2.22	\$1.45
Effect of dilutive employee stock options	-	-	42	35	(0.03)	(0.02)
<u>Diluted EPS</u>						
Diluted calculation	\$9,279	\$6,042	4,229	4,213	\$2.19	\$1.43

There were no options to purchase shares of common stock for the thirteen and twenty-six week periods ended September 23, 2018 and September 24, 2017 excluded from the computation of diluted earnings per share.

NOTE E – FAIR VALUE MEASUREMENTS

Nathan's follows a three-level fair value hierarchy that prioritizes the inputs to measure fair value. This hierarchy requires entities to maximize the use of "observable inputs" and minimize the use of "unobservable inputs." The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels are defined as follows:

Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for an identical asset or liability in an active market

Level 2 - inputs to the valuation methodology include quoted prices for a similar asset or liability in an active market or model-derived valuations in which all significant inputs are observable for substantially the full term of the asset or liability

Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement of the asset or liability

The Company's long-term debt had a face value of \$150,000,000 as of September 23, 2018 and a fair value of \$150,375,000 as of September 23, 2018. The Company estimates the fair value of its long-term debt based upon review of observable pricing in secondary markets as of the last trading day of the fiscal period, which we classify as Level 2.

The carrying amounts of cash, accounts receivable and accounts payable approximate fair value due to the short-term maturity of the instruments.

Certain non-financial assets and liabilities are measured at fair value on a non-recurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances, such as when evidence of impairment exists. At September 23, 2018, no fair value adjustment or material fair value measurements were required for non-financial assets or liabilities.

NOTE F – ACCOUNTS AND OTHER RECEIVABLES, NET

Accounts and other receivables, net, consist of the following (in thousands):

	September 23, 2018	March 25, 2018
Branded product sales	\$ 7,760	\$7,604
Franchise and license royalties	2,099	2,767
Other	1,489	599
	11,348	10,970
Less: allowance for doubtful accounts	628	468
Accounts and other receivables, net	\$ 10,720	\$10,502

Accounts receivable are due within 30 days and are stated at amounts due from franchisees, retail licensees and Branded Product Program customers, net of an allowance for doubtful accounts. Accounts that are outstanding longer than the contractual payment terms are generally considered past due. The Company does not recognize franchise and license royalties that are not deemed to be realizable.

The Company individually reviews each past due account and determines its allowance for doubtful accounts by considering a number of factors, including the length of time accounts receivable are past due, the Company's previous loss history, the customer's current and expected future ability to pay its obligation to the Company, the condition of the general economy and the industry as a whole. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings. After the Company has used reasonable collection efforts, it writes off accounts receivable through a charge to the allowance for doubtful accounts.

Changes in the Company's allowance for doubtful accounts for the twenty-six week period ended September 23, 2018 and the fiscal year ended March 25, 2018 are as follows (in thousands):

	September 23, 2018	March 25, 2018
Beginning balance	\$ 468	\$ 457
Reclassification to conform with ASC 606	77	-
Bad debt expense	92	34
Accounts written off	(9)	(23)
Ending balance	\$ 628	\$ 468

NOTE G – PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following (in thousands):

	September 23, 2018	March 25, 2018
Income taxes	\$ -	\$ 1,624
Insurance	110	266
Other	413	983
Total prepaid expenses and other current assets	\$ 523	\$ 2,873

NOTE H – ASSETS HELD FOR SALE

Prior to the end of fiscal 2018, we entered into an agreement to sell a Company-owned restaurant located in Bay Ridge, Brooklyn, NY for \$12,250,000. At September 23, 2018, we had received a \$2,201,000 non-refundable deposit toward the sale of this restaurant which was included in accrued expenses and other current liabilities in the accompanying Consolidated Balance Sheet. The sale was expected to close during the second quarter of fiscal 2019.

Effective July 15, 2018, we amended the Agreement of Sale to extend the closing date until October 2018 and received an additional down-payment of \$1,000,000 and a \$175,000 fee to extend the closing date by three months. Property and equipment of \$593,000 and \$610,000 related to this sale has been classified as Assets held for sale in our Consolidated Balance Sheets at September 23, 2018 and March 25, 2018, respectively. The sale was completed on October 23, 2018.

On August 9, 2018, the Company completed the sale of its regional office building located in Fort Lauderdale, Florida for proceeds of \$1,330,000 and recorded a gain of \$323,000, which represented the excess of the proceeds, less costs to sell, over the carrying value on that date. The gain was recorded in Other income, net in the Company's Consolidated Statement of Earnings during the thirteen weeks ended September 23, 2018.

NOTE I – ACCRUED EXPENSES, OTHER CURRENT LIABILITIES AND OTHER LIABILITIES

Accrued expenses and other current liabilities consist of the following (in thousands):

	September 23, 2018	March 25, 2018
Payroll and other benefits	\$ 1,960	\$2,733
Accrued rebates	1,255	1,541
Rent and occupancy costs	213	200
Deferred revenue	209	780
Construction costs	58	68
Interest	3,934	3,948
Professional fees	84	157
Sales, use and other taxes	941	80
Dividend payable	-	150
Deposit payable	2,201	1,201
Other	185	390
Total accrued expenses and other current liabilities	\$ 11,040	\$11,248

Other liabilities consist of the following (in thousands):

	September 23, 2018	March 25, 2018
Reserve for uncertain tax positions	\$ 467	\$467
Deferred rental liability	625	677
Other	211	211
Total other liabilities	\$ 1,303	\$1,355

NOTE J – REVENUES

The Company's disaggregated revenues for the thirteen and twenty-six weeks ended September 23, 2018 and September 24, 2017 are as follows (in thousands):

	Thirteen weeks ended September 23, 2018		Twenty-six weeks ended September 23, 2018	
	September 24, 2017 (1)		September 24, 2017 (1)	
Branded Products	\$15,410	\$ 18,130	\$31,855	\$ 36,067
Company-operated restaurants	6,163	6,262	10,189	10,555
Total sales	21,573	24,392	42,044	46,622
License royalties	5,746	5,764	13,844	13,165
Royalties	1,104	1,218	2,101	2,330
Franchise fees	135	97	242	157
Total franchise fees and royalties	1,239	1,315	2,343	2,487
Advertising fund revenue	772	-	1,267	-
Total revenues	\$29,330	\$ 31,471	\$59,498	\$ 62,274

(1) As disclosed in Note B, prior period amounts have not been adjusted under the modified retrospective method of adoption of ASC 606.

The following table disaggregates revenues by primary geographical market (in thousands):

	Thirteen weeks ended September 23, 2018		Twenty-six weeks ended September 24, 2018	
	2017		2017	
United States	\$28,620	\$ 29,779	\$57,476	\$ 58,643
International	710	1,692	2,022	3,631
Total revenues	\$29,330	\$ 31,471	\$59,498	\$ 62,274

NOTE K – INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act, (the “Tax Act”) was enacted which among other provisions, permanently reduces the top corporate tax rate from 35 percent to a flat 21 percent beginning January 1, 2018 and eliminates the corporate Alternative Minimum Tax. The Tax Act limits the deduction of business interest, net of interest income, to 30 percent of the adjusted taxable income of the taxpayer in any taxable year. Any amount disallowed under the limitation is treated as business interest paid or accrued in the following year. Disallowed interest will have an indefinite carryforward. The Tax Act also repeals the performance-based exception to the \$1.0 million deduction limitation on executive compensation and modifies the definition of “covered employees”. Additionally, the Tax Act intended to allow businesses to immediately expense the full cost of new equipment. However, the law as written does not currently permit restaurant companies to take advantage of the laws’ intention.

The income tax provisions for the twenty-six week periods ended September 23, 2018 and September 24, 2017 reflect effective tax rates of 28.5% and 39.4%, respectively. The majority of the decline in the Company’s tax rate is due to the reduction in our Federal income tax rate from 34% to 21% pursuant to the Tax Act. Nathan’s effective tax rates for the twenty-six week periods ended September 23, 2018 and September 24, 2017 were reduced by 0.4% and 1.9%, respectively, as a result of the tax benefits associated with stock compensation. For the twenty-six week periods ended September 23, 2018 and September 24, 2017, excess tax benefits of \$46,000 and \$194,000, respectively, were reflected in the Consolidated Statements of Earnings as a reduction in determining the provision for income taxes.

The amount of unrecognized tax benefits at September 23, 2018 was \$250,000, all of which would impact Nathan’s effective tax rate, if recognized. As of September 23, 2018, Nathan’s had \$238,000 of accrued interest and penalties in connection with unrecognized tax benefits.

In January 2018, Nathan's received notification from the State of Virginia that it was seeking to review Nathan's tax returns for the period April 2014 through March 2017. The review has been completed; Nathan's has accepted the findings and settled the matter in the second quarter fiscal 2019. The effects of the review have been factored into the Company's effective tax rate for fiscal 2019.

Nathan's estimates that its annual tax rate for the fiscal year ending March 31, 2019 will be in the range of approximately 27.0% to 30.0% excluding the impact of any discrete items recorded and excess tax benefit associated with stock compensation. The final annual tax rate is subject to many variables, including the ultimate determination of revenue and income tax by state, among other factors, and therefore cannot be determined until the end of the fiscal year; therefore, the actual tax rate could differ from our current estimates. In addition, the ultimate benefit of the Tax Act on Nathan's is unclear as the lower annual tax rate could be outweighed by deduction limitations and other provisions included in further guidance and regulations.

NOTE L – SEGMENT INFORMATION

Nathan's considers itself to be a brand marketer of the Nathan's Famous signature products to the foodservice industry pursuant to its various business structures. Nathan's sells its products directly to consumers through its restaurant operations segment consisting of Company-operated and franchised restaurants, to distributors that resell our products to the foodservice industry through the Branded Product Program ("BPP") and by third party manufacturers pursuant to license agreements that sell our products to club stores and grocery stores nationwide. The Company's Chief Executive Officer has been identified as the Chief Operating Decision Maker ("CODM") who evaluates performance and allocates resources for the Branded Product Program, Product Licensing and Restaurant Operations segments based upon a number of factors, the primary profit measure being income from operations. Certain administrative expenses are not allocated to the segments and are reported within Corporate.

Branded Product Program – This segment derives revenue principally from the sale of hot dog products either directly to foodservice operators or to various foodservice distributors who resell the products to foodservice operators.

Product licensing – This segment derives revenue, primarily in the form of royalties, from licensing a broad variety of Nathan's Famous branded products, including our hotdogs, sausage and corned beef products, frozen French fries and additional products through retail grocery channels and club stores throughout the United States.

Restaurant operations – This segment derives revenue from sale of our products at Company-owned restaurants and earns fees and royalties from its franchised restaurants.

Revenues from operating segments are from transactions with unaffiliated third parties and do not include any intersegment revenues.

Income from operations attributable to Corporate consists principally of administrative expenses not allocated to the operating segments such as executive management, finance, information technology, legal, insurance, corporate office costs, corporate incentive compensation and compliance costs.

Interest expense, interest income and other income, net are managed centrally at the corporate level, and, accordingly, such items are not presented by segment since they are excluded from the measure of profitability reviewed by the CODM.

Operating segment information is as follows (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	Sept. 23, 2018	Sept. 24, 2017	Sept. 23, 2018	Sept. 24, 2017
Revenues				
Branded Product Program	\$15,410	\$18,130	\$31,855	\$36,067
Product licensing	5,746	5,764	13,844	13,165
Restaurant operations	7,402	7,577	12,532	13,042
Corporate (1)	772	-	1,267	-
Total revenues	\$29,330	\$31,471	\$59,498	\$62,274
Income from operations				
Branded Product Program	\$2,730	\$2,692	\$5,261	\$4,964
Product licensing	5,700	5,719	13,753	13,075
Restaurant operations	2,095	2,335	2,845	3,230
Corporate	(2,045)	(2,012)	(4,292)	(4,085)
Income from operations	\$8,480	\$8,734	\$17,567	\$17,184
Interest expense	(2,651)	(3,663)	(5,301)	(7,326)
Interest income	115	35	176	70
Other income, net	519	21	540	42

Income before provision for income taxes **\$6,463** \$5,127 **\$12,982** \$9,970

(1) Represents advertising fund revenue

NOTE M– SHARE-BASED COMPENSATION

Total share-based compensation during the thirteen-week periods ended September 23, 2018 and September 24, 2017 was \$23,000 and \$100,000, respectively. Total share-based compensation during the twenty-six week periods ended September 23, 2018 and September 24, 2017 was \$104,000 and \$199,000, respectively. Total share-based compensation is included in general and administrative expenses in our accompanying Consolidated Statements of Earnings. As of September 23, 2018, there was \$342,000 of unamortized compensation expense related to share-based incentive awards. We expect to recognize this expense over approximately thirty-six months, which represents the weighted average remaining requisite service periods for such awards.

The Company recognizes compensation cost for unvested stock-based incentive awards on a straight-line basis over the requisite service period. Compensation cost charged to expense under all stock-based incentive awards is as follows (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	Sept. 23, 2018	Sept. 24, 2017	Sept. 23, 2018	Sept. 24, 2017
Stock options	\$22	\$38	\$60	\$76
Restricted stock	1	62	44	123
Total compensation cost	\$23	\$100	\$104	\$199

Stock options outstanding:

During the fiscal year ended March 29, 2015, the Company granted options to purchase 50,000 shares at an exercise price of \$53.89 per share, all of which expire five years from the date of grant. All such stock options vest ratably over a four-year period which commenced August 6, 2015 and contained anti-dilution rights that were structured to equalize the award's fair value before and after the modification.

In connection with the Company's special cash dividend, paid on January 4, 2018, to stockholders of record as of December 22, 2017, the Company performed an analysis, pursuant to the anti-dilution provisions of the 2010 Stock Incentive Plan, as amended (the "2010 Plan"), and issued replacement options to purchase 68,498 shares at an exercise price of \$33.438 for the unvested stock options outstanding as of the record date of December 22, 2017, canceling 64,384 shares at an exercise price of \$35.58 per share. Nathan's performed its evaluation based on the closing price of its common stock on December 20, 2017, the day before the stock went ex-dividend, of \$83.20 per share, or \$78.20 per share excluding the dividend of \$5.00 per share. No other terms or conditions of the outstanding options were modified.

In connection with the Company's special cash dividend, paid on March 27, 2015, to stockholders of record as of March 20, 2015, the Company performed an analysis, pursuant to the anti-dilution provisions of the 2010 Plan, and issued replacement options to purchase 75,745 shares at an exercise price of \$35.58 for the unvested stock options outstanding as of March 29, 2015, canceling 50,000 shares at an exercise price of \$53.89. Nathan's performed its evaluation based on the closing price of its common stock on March 27, 2015 of \$73.56 per share, or \$48.56 per share excluding the dividend of \$25.00 per share. No other terms or conditions of the outstanding options were modified.

During the twenty-six week period ended September 23, 2018, the Company granted options to purchase 10,000 shares at an exercise price of \$89.90 per share, all of which expire five years from the date of grant. All such stock options vest ratably over a three year period commencing September 12, 2018.

The weighted-average option fair values, as determined using the Black-Scholes option valuation model, and the assumptions used to estimate these values for stock options granted during the thirteen weeks and twenty-six weeks ended September 23, 2018, are as follows:

Weighted-average option fair values	\$25.6314	
Expected life (years)	4.5	
Interest rate	2.87	%
Volatility	32.57	%
Dividend yield	1.11	%

The expected dividend yield is based on historical and projected dividend yields. The Company expects volatility based primarily on historical monthly price changes of the Company's stock equal to the expected life of the option. The risk free interest rate is based on the U.S. Treasury yield in effect at the time of the grant. The expected option term is the number of years the Company estimates the options will be outstanding prior to exercise based on expected employment termination behavior.

Transactions with respect to stock options for the twenty-six weeks ended September 23, 2018 are as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Options outstanding at March 25, 2018 fiscal year (A)	68,498	\$ 33.438	1.36	\$ 2,648
Granted	10,000	89.900	4.97	-
Exercised	(4,030)	33.438	-	224
Options outstanding at September 23, 2018	74,468	\$ 41.020	1.42	\$ 3,430
Options exercisable at September 23, 2018	64,468	\$ 33.438	0.87	\$ 3,430

A- Represents outstanding options after giving effect to the replacement options issued in connection with the Company's 2015 and 2017 special dividends.

Restricted stock:

Transactions with respect to restricted stock for the twenty-six weeks ended September 23, 2018 are as follows:

		Weighted- Average Grant-date
	Shares	Fair value Per share
Unvested restricted stock at March 25, 2018	5,000	\$ 49.80
Granted	1,000	89.90
Vested	(5,000)	(49.80)
Unvested restricted stock at September 23, 2018	1,000	\$ 89.90

During the twenty-six week period ended September 23, 2018, the Company granted 1,000 shares of restricted stock at a fair value of \$89.90 per share representing the closing price on the date of the grant, which will be fully vested three years from the date of grant. The restrictions on the shares lapse ratably over a three-year period on the annual anniversary of the date of grant. The compensation expense related to this restricted stock award is expected to be \$89,900 and will be recognized, commencing on the grant date, over three years.

NOTE N– STOCKHOLDERS' EQUITY

1. *Dividends*

On May 31, 2018, Nathan's Board of Directors authorized the commencement of a regular dividend of \$1.00 per share per annum, payable at the rate of \$0.25 per quarter. The initial \$0.25 per share dividend was declared on June 8, 2018 and paid on June 22, 2018 to stockholders of record at the close of business on June 18, 2018. Effective August 3, 2018, the Board declared its quarterly cash dividend of \$0.25 per share which was paid on September 21, 2018 to stockholders of record at the close of business on September 10, 2018. Through September 23, 2018, we have paid \$2,094,000 of regular dividends.

Effective November 2, 2018, the Board of Directors declared its quarterly cash dividend of \$0.25 per share payable on December 14, 2018 to stockholders of record at the close of business on December 3, 2018. Our ability to pay future

dividends is limited by the terms of the Indenture, dated November 1, 2017, between the Company, certain of its wholly-owned subsidiaries, as guarantors and U.S. Bank National Association, as trustee and collateral trustee (the “Indenture”). In addition, the declaration and payment of any cash dividends in the future are subject to final determination of the Board and will be dependent upon our earnings and financial requirements.

On November 1, 2017, the Company’s Board of Directors declared a special cash dividend of \$5.00 per share payable to stockholders of record as of December 22, 2017 of which approximately \$20,923,000 was paid on January 4, 2018 to the stockholders. The Company also accrued \$25,000 for the expected dividends payable on unvested restricted shares pursuant to the terms of the restricted stock agreement. As unvested restricted stock vests, the declared dividend is paid. The Company paid this \$25,000 during the thirteen weeks ended June 24, 2018.

On March 10, 2015, the Company’s Board of Directors declared a special cash dividend of \$25.00 per share payable to stockholders of record as of March 20, 2015 of which approximately \$115,100,000 was paid on March 27, 2015 to the stockholders. The Company accrued \$1,000,000 for the expected dividends payable on unvested shares pursuant to the terms of the restricted stock agreements. As unvested restricted stock vests, the declared dividend is paid. As of March 25, 2018 we had paid \$875,000 of the accrued dividend and the remaining \$125,000 was paid during the thirteen weeks ended June 24, 2018.

2. Common Stock Purchase Rights

On June 5, 2013, Nathan’s adopted a stockholder rights plan (the “2013 Rights Plan”) under which all stockholders of record as of June 17, 2013 received rights to purchase shares of common stock (the “2013 Rights”).

The 2013 Rights were distributed as a dividend. Initially, the 2013 Rights will attach to, and trade with, the Company’s common stock. Subject to the terms, conditions and limitations of the 2013 Rights Plan, the 2013 Rights will become exercisable if (among other things) a person or group acquires 15% or more of the Company’s common stock. Upon such an event and payment of the purchase price of \$100.00 (the “2013 Right Purchase Price”), each 2013 Right (except those held by the acquiring person or group) will entitle the holder to acquire one share of the Company’s common stock (or the economic equivalent thereof) or, if the then-current market price is less than the then current 2013 Right Purchase Price, a number of shares of the Company’s common stock which at the time of the transaction has a market value equal to the then current 2013 Right Purchase Price at a purchase price per share equal to the then current market price of the Company’s Common Stock.

On June 14, 2018, the Company and American Stock Transfer and Trust Company, LLC, the Rights Agent, amended the 2013 Rights Plan. The Amendment postponed the expiration date to September 30, 2018, at which time it terminated.

At September 23, 2018, the Company had reserved 5,165,171 shares of common stock for issuance upon exercise of the 2013 Rights. On September 30, 2018, the Rights Plan terminated.

3. Stock Repurchase Programs

During the period from October 2001 through September 23, 2018, Nathan's purchased 5,127,373 shares of common stock at a cost of approximately \$77,303,000 pursuant to various stock repurchase plans previously authorized by the Board of Directors. During the twenty-six week period ended September 23, 2018, we did not repurchase any shares of common stock.

In 2016, the Company's Board of Directors authorized increases to the sixth stock repurchase plan for the purchase of up to 1,200,000 shares of its common stock on behalf of the Company. As of September 23, 2018, Nathan's had repurchased 939,742 shares at a cost of \$29,641,000 under the sixth stock repurchase plan. At September 23, 2018, there were 260,258 shares remaining to be repurchased pursuant to the sixth stock repurchase plan. The plan does not have a set expiration date. Purchases under the Company's stock repurchase program may be made from time to time, depending on market conditions, in open market or privately-negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the repurchases.

NOTE O – LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	September 23, 2018	March 25, 2018
6.625% Senior Secured Notes due 2025	\$ 150,000	\$ 150,000
Less: unamortized debt issuance costs	(4,896)	(5,242)
Long-term debt, net	\$ 145,104	\$ 144,758

On November 1, 2017, the Company issued \$150,000,000 of 6.625% Senior Secured Notes due 2025 (the "2025 Notes") in a private offering in accordance with Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"). The 2025 Notes were issued pursuant to the Indenture. The Company used the net proceeds of the 2025 Notes offering to satisfy and discharge the Indenture relating to the 10.000% Senior Secured Notes due 2020 and

redeem the 2020 Notes (the "Redemption"), paid a portion of a special \$5.00 per share cash dividend to Nathan's stockholders of record, with the remaining net proceeds for general corporate purposes, including working capital. The Company also funded the majority of the special dividend of \$5.00 per share through its existing cash. The Redemption occurred on November 16, 2017.

The 2025 Notes bear interest at 6.625% per annum, payable semi-annually on May 1st and November 1st of each year. The Company made its required semi-annual interest payments of \$4,968,750 on May 1, 2018 and November 1, 2018.

The 2025 Notes have no scheduled principal amortization payments prior to its final maturity on November 1, 2025.

The terms and conditions of the 2025 Notes are as follows:

There are no financial maintenance covenants associated with the 2025 Notes. As of September 23, 2018, Nathan's was in compliance with all covenants associated with the 2025 Notes.

The Indenture contains certain covenants limiting the Company's ability and the ability of its restricted subsidiaries (as defined in the Indenture) to, subject to certain exceptions and qualifications: (i) incur additional indebtedness; (ii) pay dividends or make other distributions on, redeem or repurchase, capital stock; (iii) make investments or other restricted payments; (iv) create or incur certain liens; (v) incur restrictions on the payment of dividends or other distributions from its restricted subsidiaries; (vi) enter into certain transactions with affiliates; (vii) sell assets; or (viii) effect a consolidation or merger. Certain Restricted Payments which may be made or indebtedness incurred by Nathan's or its Restricted Subsidiaries may require compliance with the following financial ratios:

Fixed Charge Coverage Ratio: the ratio of the Consolidated Cash Flow to the Fixed Charges for the relevant period, currently set at 2.0 to 1.0 in the Indenture. The Fixed Charge Coverage Ratio applies to determining whether additional Restricted Payments may be made, certain additional debt may be incurred and acquisitions may be made.

Priority Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Priority Lien to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate; currently set at 0.40 to 1.00 in the Indenture.

Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Lien on any property of Nathan's or any Guarantor to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate. The Secured Leverage Ratio under the Indenture is 3.75 to 1.00 and applies if Nathan's wants to incur additional debt on the same terms as the 2025

Notes.

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The Indenture also contains customary events of default, including, among other things, failure to pay interest, failure to comply with agreements related to the indenture, failure to pay at maturity or acceleration of other indebtedness, failure to pay certain judgments, and certain events of insolvency or bankruptcy. Generally, if any event of default occurs, the Trustee or the holders of at least 25% in principal amount of the 2025 Notes may declare the 2025 Notes due and payable by providing notice to the Company. In case of default arising from certain events of bankruptcy or insolvency, the 2025 Notes will become immediately due and payable.

The 2025 Notes are general senior secured obligations, are fully and unconditionally guaranteed by substantially all of the Company's wholly-owned subsidiaries and rank *pari passu* in right of payment with all of the Company's existing and future indebtedness that is not subordinated, are senior in right of payment to any of the Company's existing and future subordinated indebtedness, are structurally subordinated to any existing and future indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the 2025 Notes, and are effectively junior to all existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes.

Pursuant to the terms of a collateral trust agreement, the liens securing the 2025 Notes and the guarantees will be contractually subordinated to the liens securing any future credit facility.

The 2025 Notes and the guarantees are the Company and the guarantors' senior secured obligations and will rank:

senior in right of payment to all of the Company and the guarantors' future subordinated indebtedness;

effectively senior to all unsecured senior indebtedness to the extent of the value of the collateral securing the 2025 Notes and the guarantees;

pari passu with all of the Company and the guarantors' other senior indebtedness;

effectively junior to any future credit facility to the extent of the value of the collateral securing any future credit facility and the 2025 Notes and the guarantees and certain other assets;

effectively junior to any of the Company and the guarantors' existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes and the guarantees to the extent of the value of any such assets; and

structurally subordinated to the indebtedness of any of the Company's current and future subsidiaries that do not guarantee the 2025 Notes.

The Company may redeem the 2025 Notes in whole or in part prior to November 1, 2020, at a redemption price of 100% of the principal amount of the 2025 Notes redeemed plus the Applicable Premium, plus accrued and unpaid interest. An Applicable Premium is the greater of 1% of the principal amount of the 2025 Notes; or the excess of the

present value at such redemption date of (i) the redemption price of the 2025 Notes at November 1, 2020 plus (ii) all required interest payments due on the 2025 Notes through November 1, 2020 (excluding accrued but unpaid interest to the redemption date), computed using a discount rate equal to the Treasury Rate as of such redemption date plus 50 basis points; over the then outstanding principal amount of the 2025 Notes.

Prior to November 1, 2020, if using the net cash proceeds of certain equity offerings, the Company has the option to redeem up to 35% of the aggregate principal amount of the 2025 Notes at a redemption price equal to 106.625% of the principal amount of the 2025 Notes redeemed, plus accrued and unpaid interest and any additional interest.

On or after November 1, 2020, the Company may redeem some or all of the 2025 Notes at a decreasing premium over time, plus accrued and unpaid interest as follows:

<u>YEAR</u>	<u>PERCENTAGE</u>	
On or after November 1, 2020 and prior to November 1, 2021	103.313	%
On or after November 1, 2021 and prior to November 1, 2022	101.656	%
On or after November 1, 2022	100.000	%

In certain circumstances involving a change of control, the Company will be required to make an offer to repurchase all or, at the holder's option, any part, of each holder's 2025 Notes pursuant to the offer described below (the "Change of Control Offer"). In the Change of Control Offer, the Company will be required to offer payment in cash equal to 101% of the aggregate principal amount of 2025 Notes repurchased plus accrued and unpaid interest, to the date of purchase.

If the Company sells certain assets and does not use the net proceeds as required, the Company will be required to use such net proceeds to repurchase the 2025 Notes at 100% of the principal amount thereof, plus accrued and unpaid interest and additional interest penalty, if any, to the date of repurchase.

The 2025 Notes may be traded between qualified institutional buyers pursuant to Rule 144A of the Securities Act. We have recorded the 2025 Notes at cost.

NOTE P – COMMITMENTS AND CONTINGENCIES

1. Commitments

On February 27, 2017, a wholly-owned subsidiary of the Company executed a Guaranty of Lease (the “Brooklyn Guaranty”) in connection with its re-franchising of a restaurant located in Brooklyn, New York. The Company is obligated to make payments under the Brooklyn Guaranty in the event of a default by the tenant/franchisee. The Brooklyn Guaranty has an initial term of 10 years and one 5-year option and is limited to 24 months of rent for the first three years of the term. Nathan’s has recorded a liability of \$204,000 as a component of Other liabilities on the accompanying Consolidated Balance Sheets, in connection with the Brooklyn Guaranty which does not include potential percentage rent, real estate tax increases, attorney’s fees and other costs as these amounts are not reasonably determinable at this time. Nathan’s has received a personal guaranty from the franchisee for all obligations under the Brooklyn Guaranty. For the remainder of the term, the Brooklyn Guaranty is limited to 12 months of rent plus reasonable costs of collection and attorney’s fees.

2. Contingencies

The Company and its subsidiaries are from time to time involved in ordinary and routine litigation. Management presently believes that the ultimate outcome of these proceedings, individually or in the aggregate, will not have a material adverse effect on the Company’s financial position, cash flows or results of operations. Nevertheless, litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling could include money damages and, in such event, could result in a material adverse impact on the Company’s results of operations for the period in which the ruling occurs.

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

Forward-Looking Statements

Statements in this Form 10-Q quarterly report may be “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. These risks and uncertainties, many of which are not within our control, include but are not limited to: the status of our licensing and supply agreements, including our licensing revenue and overall profitability being substantially dependent on our agreement with John Morrell & Co., economic, weather (including the effects on the supply of cattle and the impact of weather on sales at our restaurants, particularly during Summer months), and changes in the price of beef trimmings; our ability to pass on the cost of any price increases in beef and beef trimmings, or labor costs; legislative, business conditions or tariffs; the collectibility of receivables; changes in consumer tastes; the impact of our debt service and repayment obligations under the 2025 Notes; the impact of the Tax Cuts and Jobs Act (“Tax Act”); the continued viability of Coney Island as a destination location for visitors; the ability to continue to attract franchisees; the impact of the new minimum wage legislation in New York State or other changes in labor laws, including court decisions which could render a franchisor as a “joint employee” or the impact of our new union contracts; our ability to attract competent restaurant and managerial personnel; the enforceability of international franchising agreements and the future effects of any food borne illness; such as bovine spongiform encephalopathy, BSE or e-coli; as well as those risks discussed from time to time in this Form 10-Q and our Form 10-K annual report for the year ended March 25, 2018, and in other documents we file with the Securities and Exchange Commission. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in the forward-looking statements. We generally identify forward-looking statements with the words “believe,” “intend,” “plan,” “expect,” “anticipate,” “estimate,” “will,” “should” and similar expressions. Any forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-Q.

Introduction

As used in this Report, the terms “we”, “us”, “our”, “Nathan’s” or the “Company” mean Nathan’s Famous, Inc. and its subsidiaries (unless the context indicates a different meaning).

We are engaged primarily in the marketing of the “Nathan’s Famous” brand and the sale of products bearing the “Nathan’s Famous” trademarks through several different channels of distribution. Historically, our business has been the operation and franchising of quick-service restaurants featuring Nathan’s World Famous Beef Hot Dogs, crinkle-cut French-fried potatoes, and a variety of other menu offerings. Our Company-owned and franchised units operate under the name “Nathan’s Famous,” the name first used at our original Coney Island restaurant opened in 1916. Nathan’s product licensing program sells packaged hot dogs and other meat products to retail customers through supermarkets or grocery-type retailers for off-site consumption. Our Branded Product Program enables foodservice retailers and others to sell some of Nathan’s proprietary products outside of the realm of a traditional franchise relationship. In conjunction with this program, purchasers of Nathan’s products are granted a limited use of the Nathan’s Famous trademark with respect to the sale of the purchased products, including Nathan’s World Famous Beef Hot Dogs, certain other proprietary food items and paper goods. Our Branded Menu Program is a limited franchise program, under which foodservice operators may sell a greater variety of Nathan’s Famous menu items than under the Branded Product Program.

Our revenues are generated primarily from selling products under Nathan’s Branded Product Program, operating Company-owned restaurants, licensing agreements for the sale of Nathan’s products within supermarkets and club stores, the sale of Nathan’s products directly to other foodservice operators and the manufacture of certain proprietary spices by third parties and franchising the Nathan’s restaurant concept (including the Branded Menu Program). See Note B of these Consolidated Financial Statements for information related to the Company’s adoption of ASC 606 effective March 26, 2018.

At September 23, 2018, our restaurant system consisted of 265 Nathan’s franchised units, including 121 Branded Menu units, and five Company-owned units (including one seasonal unit), one of which was sold subsequent to September 23, 2018, located in 22 states, and 12 foreign countries. At September 24, 2017, our restaurant system consisted of 281 Nathan’s franchised units, including 125 Branded Menu units, and five Company-owned units (including one seasonal unit), located in 19 states, and 12 foreign countries.

In addition to plans for expansion through our Branded Product Program, licensing and franchising, Nathan’s continues to seek to co-brand within its restaurant system. Nathan’s is also the owner of the Arthur Treacher’s brand. Currently there are also seven locations operating under our Arthur Treacher’s Branded Menu Program agreement.

As described in our Annual Report on Form 10-K for the year ended March 25, 2018, our future results could be materially impacted by many developments including our dependence on John Morrell & Co. as our principal supplier and the dependence of our licensing revenue and overall profitability on our agreement with John Morrell & Co. In addition, our future operating results could be impacted by supply constraints on beef or by increased costs of beef compared to earlier periods in addition to the potential impact that the recently imposed tariff’s may have on the business.

On November 1, 2017, the Company issued \$150,000,000 of 6.625% Senior Secured Notes due 2025 (the “2025 Notes”) and used the majority of the proceeds of this offering to redeem the 2020 Notes (the “Redemption”), paid a portion of the special \$5.00 cash dividend and used any remaining proceeds for general corporate purposes, including working capital. Our future results could also be impacted by our obligations under the 2025 Notes. As a result of the issuance of the 2025 Notes, Nathan’s expects to incur interest expense of \$9,937,500 per annum, reducing its cash interest expense by \$3,562,500 per annum as compared to our annual interest requirements under the 2020 Notes. Nathan’s expects to incur annual amortization of debt issuance costs of approximately \$691,000 through November 1, 2025. The impact of interest expense resulting from the refinancing on net income has been reflected in our results for the thirteen and twenty-six week periods ended September 23, 2018 and September 24, 2017.

As described below, we are also including information relating to EBITDA and Adjusted EBITDA in the Form 10-Q quarterly report.

Critical Accounting Policies and Estimates

As discussed in our Form 10-K for the fiscal year ended March 25, 2018, the discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently, actual results could differ from those estimates. Our most critical accounting policies and estimates relate to revenue recognition; impairment of goodwill and other intangible assets; impairment of long-lived assets; share-based compensation and income taxes (including uncertain tax positions). As discussed in Note B, the Company adopted ASC 606, “Revenue Recognition – Revenue from Contracts with Customers.” There have been no other significant changes to the Company’s accounting policies subsequent to March 25, 2018.

Adoption of New Accounting Pronouncements

Please refer to Note B of the preceding consolidated financial statements for our discussion of the Adoption of the New Accounting Pronouncement.

New Accounting Pronouncements Not Yet Adopted

Please refer to Note C of the preceding consolidated financial statements for our discussion of New Accounting Pronouncements Not Yet Adopted.

EBITDA and Adjusted EBITDA

The Company believes that EBITDA and Adjusted EBITDA are useful to investors to assist in assessing and understanding the Company's operating performance and underlying trends in the Company's business because EBITDA and Adjusted EBITDA are (i) among the measures used by management in evaluating performance and (ii) are frequently used by securities analysts, investors and other interested parties as a common performance measure.

Reconciliation of GAAP and Non-GAAP Measures

The following is provided to supplement certain Non-GAAP financial measures.

In addition to disclosing results that are determined in accordance with Generally Accepted Accounting Principles in the United States of America ("US GAAP"), the Company has provided EBITDA which excludes (i) interest expense; (ii) provision for income taxes and (iii) depreciation and amortization expense. The Company has also provided Adjusted EBITDA excluding stock-based compensation that the Company believes will impact the comparability of its results of operations.

EBITDA and Adjusted EBITDA are not recognized terms under US GAAP and should not be viewed as alternatives to net income or other measures of financial performance or liquidity in conformity with US GAAP. Additionally, our definitions of EBITDA and Adjusted EBITDA may differ from other companies. Analysis of results and outlook on a non-US GAAP basis should be used as a complement to, and in conjunction with, data presented in accordance with US GAAP.

The following is a reconciliation of Net income to Adjusted EBITDA (in thousands):

	Thirteen weeks ended September 23, 2018 (unaudited)		Twenty-six weeks ended September 24, 2017 (unaudited)	
Net income	\$4,484	\$ 3,120	\$9,279	\$ 6,042
Interest expense	2,651	3,663	5,301	7,326
Provision for income taxes	1,979	2,007	3,703	3,928
Depreciation and amortization	339	367	684	735
EBITDA	9,453	9,157	18,967	18,031
Stock-based compensation	23	100	104	199
Adjusted EBITDA	\$9,476	\$ 9,257	\$19,071	\$ 18,230

Results of Operations

Thirteen weeks ended September 23, 2018 compared to thirteen weeks ended September 24, 2017

Revenues

Total sales decreased by 11.6% to \$21,573,000 for the thirteen weeks ended September 23, 2018 (“second quarter fiscal 2019”) as compared to \$24,392,000 for the thirteen weeks ended September 24, 2017 (“second quarter fiscal 2018”). Foodservice sales from the Branded Product Program decreased by 15.0% to \$15,410,000 for the second quarter fiscal 2019 as compared to sales of \$18,130,000 in the second quarter fiscal 2018. Our average selling prices decreased by approximately 9.2% as a result of our pricing strategy, which is more closely correlated to the cost of beef which decreased by approximately 11.5%, during the second quarter fiscal 2019 as compared to the second quarter fiscal 2018. During the second quarter fiscal 2019, the volume of business decreased by approximately 8.6%. During the fiscal 2018 period, we added a new distributor to our distribution network that increased our sales during implementation of the new distributor. In addition to the additional business realized, this distributor temporarily provided distribution to a number of significant contract accounts, further increasing their fiscal 2018 purchases. During fiscal 2019, distribution reverted to our traditional methodology, which reduced their inventory purchases from us. We estimate that excluding the effects of the re-distributors’ purchases in both years, we estimate that customer shipments, decreased by approximately 2.3% during the second quarter fiscal 2019. Total Company-owned restaurant sales were \$6,163,000 during the second quarter fiscal 2019 compared to \$6,262,000 during the second

quarter fiscal 2018 due to lower sales at our Coney Island Boardwalk location principally due to the unfavorable weather conditions during the summer months.

License royalties were \$5,746,000 in the second quarter fiscal 2019 as compared to \$5,764,000 in the second quarter fiscal 2018. Total royalties earned on sales of hot dogs from our license agreement with John Morrell & Co. at retail were \$5,257,000 for the second quarter fiscal 2019 as compared to \$5,288,000 in the second quarter fiscal 2018. The decrease is due to a 3.7% decrease in volume during the second quarter fiscal 2019 as compared to the second quarter fiscal 2018, in addition to a decrease in average selling prices of approximately 1.7%, on which our royalties are calculated. We also earned \$98,000 from John Morrell & Co. from new products, other than hot dogs, during the second quarter fiscal 2019. Beginning in fiscal 2019, we agreed to reduce the royalty rate earned on the foodservice business with John Morrell & Co., on sales of hot dogs to Sam's Club, in an attempt to secure additional business. As a result of these actions, we secured additional business which increased royalties by \$120,000 as compared to the second quarter fiscal 2018. Royalties earned from all other licensing agreements for the manufacture and sale of Nathan's products increased by \$13,000 during the second quarter fiscal 2019 as compared to the second quarter fiscal 2018.

Franchise fees and royalties were \$1,239,000 in the second quarter fiscal 2019 as compared to \$1,315,000 in the second quarter fiscal 2018. Total royalties were \$1,104,000 in the second quarter fiscal 2019 as compared to \$1,218,000 in the second quarter fiscal 2018. Royalties earned under the Branded Menu program were \$253,000 in the second quarter fiscal 2019 as compared to \$313,000 in the second quarter fiscal 2018. Royalties earned under the Branded Menu Program are not based upon a percentage of restaurant sales but are based upon product purchases. Traditional franchise royalties were \$841,000 in the second quarter fiscal 2019 as compared to \$895,000 in the second quarter fiscal 2018. Franchise restaurant sales decreased to \$18,559,000 in the second quarter fiscal 2019 as compared to \$20,295,000 in the second quarter fiscal 2018 primarily due to the impact of units closed in the previous fiscal year in addition to a 2.6% decline in comparable domestic sales. Comparable domestic franchise sales (consisting of 93 Nathan's outlets, excluding sales under the Branded Menu Program) were \$15,478,000 in the second quarter fiscal 2019 as compared to \$15,895,000 in the second quarter fiscal 2018.

At the beginning of the fiscal 2019 period we adopted ASC 606. Footnote B in the accompanying Consolidated Financial Statements provides a full explanation of this new accounting standard. Beginning in fiscal 2019, the most significant component of this new standard will affect the timing that Nathan's will recognize franchise fees. Franchise fee income will now be recorded into income on a prorated basis over the term of the franchise agreement as compared to previously recording the full franchise fee into income upon the opening of a new restaurant.

At September 23, 2018, 265 domestic and international franchised or Branded Menu Program franchise outlets were operating compared to 281 domestic and international franchised or Branded Menu Program franchise outlets at September 24, 2017. Total franchise fee income, including cancellations, was \$135,000 in the second quarter fiscal 2019 compared to \$97,000 in the second quarter fiscal 2018. Domestic franchise fee income was \$39,000 in the second quarter fiscal 2019 compared to \$76,000 in the second quarter fiscal 2018. International franchise fee income was \$34,000 in the second quarter fiscal 2019 compared to \$11,000 during the second quarter fiscal 2018. During the second quarter fiscal 2019, total franchise fees would have been \$69,000 under the previous revenue recognition guidance. During the second quarter fiscal 2019, five new franchised outlets opened, including three new Branded Menu Program outlets. During the second quarter fiscal 2018, 17 new franchised outlets opened, including eight new Branded Menu Program outlets.

Advertising fund revenue, after eliminating Company contributions, was \$772,000 during the second quarter fiscal 2019 period. Pursuant to the adoption of ASC 606, income and expenses of the Advertising Fund are required to be included as components of the Company's Statements of Earnings and Cash Flows. Nathan's manages its Advertising Fund with the expectation that inflows and outflows will be offsetting and has also recorded a separate Advertising fund expense. Prior to the adoption of ASC 606, the activities of the Advertising Fund were reported within the Consolidated Balance Sheet.

Costs and Expenses

Overall, our cost of sales decreased by 15.3% to \$15,160,000 in the second quarter fiscal 2019 as compared to \$17,906,000 in the second quarter fiscal 2018. Our gross profit (representing the difference between sales and cost of sales) decreased to \$6,413,000 or 29.7% of sales during the second quarter fiscal 2019 as compared to \$6,486,000 or 26.6% of sales during the fiscal 2018 period. The margin improvement was primarily due to the lower cost of beef in the Branded Product Program and in the Company-operated restaurants partly offset due to the higher labor costs at the Company-owned restaurants due to the annual increases in the New York minimum wages and other labor regulations.

Cost of sales in the Branded Product Program decreased by approximately \$2,832,000 during the second quarter fiscal 2019 period as compared to the second quarter fiscal 2018 period, primarily due to the 11.5% decrease in the average cost per pound of our hot dogs and the 8.6% decrease in the volume of product sold discussed above. We did not make any purchase commitments of beef during the fiscal 2019 and 2018 periods. If the cost of beef and beef trimmings increases and we are unable to pass on these higher costs through price increases or otherwise reduce any increase in our costs through the use of purchase commitments, our margins will be adversely impacted.

With respect to Company-owned restaurants, our cost of sales during the second quarter fiscal 2019 was \$3,131,000 or 50.8% of restaurant sales, as compared to \$3,045,000 or 48.6% of restaurant sales in the second quarter fiscal 2018 primarily due to the impact of higher labor costs principally associated with the effects of the New York State

minimum wage increase. Lower beef costs were offset by higher seafood and other food costs during the second quarter fiscal 2019. We expect that our labor costs going forward will continue to be impacted by the multi-year new increase in minimum wage requirements in New York State, other labor regulations and any increase in food costs from higher commodity costs.

Restaurant operating expenses were \$1,141,000 in the second quarter fiscal 2019 as compared to \$1,105,000 in the second quarter fiscal 2018. The increase in restaurant operating costs results primarily from higher home delivery costs, insurance and maintenance.

Depreciation and amortization was \$339,000 in the second quarter fiscal 2019 as compared to \$367,000 in the second quarter fiscal 2018.

General and administrative expenses increased by \$79,000 or 2.4% to \$3,438,000 in the second quarter fiscal 2019 as compared to \$3,359,000 in the second quarter fiscal 2018. The increase in general and administrative expenses was primarily attributable to higher compensation and marketing costs, partly offset by lower professional fees and lower occupancy costs after selling the Florida office.

Advertising fund expense was \$772,000 during the second quarter fiscal 2019. Pursuant to the adoption of ASC 606, revenue and expenses of the Advertising Fund are required to be included as components of the Company's Statements of Earnings and Cash Flows. Nathan's manages its Advertising Fund with the expectation that inflows and outflows will be offsetting. Prior to the adoption of ASC 606, the activities of the Advertising Fund were reported within the Consolidated Balance Sheet.

Other Items

Interest expense of \$2,651,000 in the second quarter fiscal 2019 represented accrued interest of \$2,478,000 on the 2025 Notes at 6.625% per annum and amortization of debt issuance costs of \$173,000. Interest expense of \$3,663,000 in the second quarter fiscal 2018 represented accrued interest of \$3,364,000 on the 2020 Notes and amortization of debt issuance costs of \$299,000.

Interest income was \$115,000 for the second quarter fiscal 2019 as compared to \$35,000 in the second quarter fiscal 2018.

Other income primarily relates to a gain on the sale of our Florida office of \$323,000, a fee of \$175,000 to extend the closing date of the sale of our restaurant located in Bay Ridge, Brooklyn, NY by three months and sublease income from a franchised restaurant which was \$21,000 in each of the second quarter fiscal 2019 and second quarter fiscal 2018.

Provision for Income Taxes

On December 22, 2017, the Tax Act was enacted which among other provisions, permanently reduces the top corporate tax rate from 35 percent to a flat 21 percent beginning January 1, 2018 and eliminates the corporate Alternative Minimum Tax. The Tax Act limits the deduction of business interest, net of interest income, to 30 percent of the adjusted taxable income of the taxpayer in any taxable year. Any amount disallowed under the limitation is treated as business interest paid or accrued in the following year. Disallowed interest will have an indefinite carryforward. The Tax Act also repeals the performance-based exception to the \$1.0 million deduction limitation on executive compensation and modifies the definition of “covered employees”. Additionally, the Tax Act intended to allow businesses to immediately expense the full cost of new equipment. However, the law as written does not currently permit restaurant companies to take advantage of the laws’ intention.

The income tax provision for the thirteen week periods ended September 23, 2018 and September 24, 2017 reflect effective tax rates of 30.6% and 39.1%, respectively. The majority of the decline in the Company’s tax rate is due to the reduction in our Federal income tax rate from 34% to 21% pursuant to the Tax Act. Nathan’s effective tax rate for the thirteen week period ended September 24, 2017 was reduced by 2.3%, respectively, as a result of the tax benefits associated with stock compensation. Nathan’s effective tax rate without this adjustment would have been 41.4% for the second quarter fiscal 2018. As described under Note K to the Consolidated Financial Statements, Nathan’s estimates that its annual tax rate for the fiscal year ending March 31, 2019 will be in the range of approximately 27.0% to 30.0% excluding the impact of the excess tax benefits associated with stock compensation and the potential impact of any reduction to the Company’s unrecognized tax benefits.

The amount of unrecognized tax benefits at September 23, 2018 was \$250,000, all of which would impact Nathan’s effective tax rate, if recognized. As of September 23, 2018, Nathan’s had \$238,000 of accrued interest and penalties in connection with unrecognized tax benefits.

In January 2018, Nathan’s received notification from the State of Virginia that it was seeking to review Nathan’s tax returns for the period April 2014 through March 2017. The review has been completed; Nathan’s has accepted the

findings and settled the matter in the second quarter fiscal 2019. The effects of the review have been factored into the Company's effective tax rate for fiscal 2019.

Nathan's estimates that its annual tax rate for the fiscal year ending March 31, 2019 will be in the range of approximately 27.0% to 30.0% excluding the impact of any discrete items recorded and excess tax benefit associated with stock compensation. The final annual tax rate is subject to many variables, including the ultimate determination of revenue and income tax by state, among other factors, and therefore cannot be determined until the end of the fiscal year; therefore, the actual tax rate could differ from our current estimates. In addition, the ultimate benefit of the Tax Act on Nathan's is unclear as the lower annual tax rate could be outweighed by deduction limitations and other provisions included in further guidance and regulations.

Results of Operations

Twenty-six weeks ended September 23, 2018 compared to twenty-six weeks ended September 24, 2017

Revenues

Total sales decreased by 9.8% to \$42,044,000 for the twenty-six weeks ended September 23, 2018 ("fiscal 2019 period") as compared to \$46,622,000 for the twenty-six weeks ended September 24, 2017 ("fiscal 2018 period"). Foodservice sales from the Branded Product Program decreased by 11.7% to \$31,855,000 for the fiscal 2019 period as compared to sales of \$36,067,000 in the fiscal 2018 period. Our average selling prices decreased by approximately 7.2% as a result of our pricing strategy, which is more closely correlated to the cost of beef which decreased by approximately 10.0%, during the fiscal 2019 period as compared to the fiscal 2018 period. During the fiscal 2019 period, the volume of business decreased by approximately 6.3%. During the fiscal 2018 period, we added a new distributor to our distribution network that increased our sales during implementation of the new distributor. In addition to the additional business realized, this distributor temporarily provided distribution to a number of significant contract accounts, further increasing their fiscal 2018 purchases. During fiscal 2019, distribution reverted to our traditional methodology, which reduced their inventory purchases from us. We estimate that excluding the effects of the re-distributors' purchases in both years, we estimate that customer shipments, increased by approximately 2.8% during the fiscal 2019 period. Total Company-owned restaurant sales were \$10,189,000 during the fiscal 2019 period compared to \$10,555,000 during the fiscal 2018 period due to lower sales at our Coney Island locations principally during April 2018 and during the summer of 2018 when the weather was exceptionally unfavorable in the Northeastern United States.

License royalties were \$13,844,000 in the fiscal 2019 period as compared to \$13,165,000 in the fiscal 2018 period. Total royalties earned on sales of hot dogs from our license agreement with John Morrell & Co. at retail increased 5.1% to \$12,795,000 for the 2019 fiscal period as compared to \$12,173,000 in the fiscal 2018 period. The increase is due to a 3.4% increase in volume during the fiscal 2019 period as compared to the fiscal 2018 period, in addition to an increase in average selling prices of approximately 1.6%, on which our royalties are calculated. Beginning in fiscal 2019, we agreed to reduce the royalty rate earned on the foodservice business with John Morrell & Co., substantially on sales of hot dogs to Sam's Club, in an attempt to secure additional business. Overall, we earned reduced royalties of \$23,000 as compared to the fiscal 2018 period. We also earned \$98,000 from John Morrell & Co. from new products, other than hotdogs, during the fiscal 2019 period. Royalties earned from all other licensing agreements for the manufacture and sale of Nathan's products increased by \$57,000 during the fiscal 2019 period as compared to the fiscal 2018 period.

Franchise fees and royalties were \$2,343,000 in the fiscal 2019 period as compared to \$2,487,000 in the fiscal 2018 period. Total royalties were \$2,101,000 in the fiscal 2019 period as compared to \$2,330,000 in the fiscal 2018 period. Royalties earned under the Branded Menu program were \$465,000 in the fiscal 2019 period as compared to \$586,000 in the fiscal 2018 period. Royalties earned under the Branded Menu Program are not based upon a percentage of restaurant sales but are based upon product purchases. Traditional franchise royalties were \$1,619,000 in the fiscal 2019 period as compared to \$1,716,000 in the fiscal 2018 period. Franchise restaurant sales decreased to \$35,932,000 in the fiscal 2019 period as compared to \$39,141,000 in the fiscal 2018 period primarily due to the impact of units closed in the previous fiscal year and a 0.6% decrease in comparable domestic sales. Comparable domestic franchise sales (consisting of 89 Nathan's outlets, excluding sales under the Branded Menu Program) were \$29,674,000 in the fiscal 2019 period as compared to \$29,854,000 in the fiscal 2018 period.

At the beginning of the fiscal 2019 period we adopted ASC 606. Footnote B in the accompanying Consolidated Financial Statements provides a full explanation of this new accounting standard. Beginning in fiscal 2019, the most significant component of this new standard will affect the timing that Nathan's will recognize franchise fees. Franchise fee income will now be recorded into income on a prorated basis over the term of the franchise agreement as compared to previously recording the full franchise fee into income upon the opening of a new restaurant.

At September 23, 2018, 265 domestic and international franchised or Branded Menu Program franchise outlets were operating compared to 281 domestic and international franchised or Branded Menu Program franchise outlets at September 24, 2017. Total franchise fee income, including cancellations, was \$242,000 in the fiscal 2019 period compared to \$157,000 in the fiscal 2018 period. Domestic franchise fee income was \$79,000 in the fiscal 2019 period compared to \$107,000 in the fiscal 2018 period. International franchise fee income was \$121,000 in the fiscal 2019 period compared to \$40,000 during the fiscal 2018 period. Cancellation fees, were \$42,000 in the fiscal 2019 period compared to \$10,000 during the fiscal 2018 period. During the fiscal 2019 period, total franchise fees would have been \$104,000, under the previous revenue recognition guidance. During the fiscal 2019 period, nine new franchised outlets opened including two international locations and four new Branded Menu Program outlets opened. During the fiscal 2018 period, 27 new franchised outlets opened including nine international locations and 15 new Branded Menu Program outlets opened.

Advertising fund revenue, after eliminating Company contributions, was \$1,267,000 during the fiscal 2019 period. Pursuant to the adoption of ASC 606, income and expenses of the Advertising Fund are required to be included as components of the Company's Statements of Earnings and Cash Flows. Nathan's manages its Advertising Fund with the expectation that inflows and outflows will be offsetting and has also recorded a separate Advertising fund expense. Prior to the adoption of ASC 606, the activities of the Advertising Fund were reported within the Consolidated Balance Sheet.

Costs and Expenses

Overall, our cost of sales decreased by 13.3% to \$30,606,000 in the fiscal 2019 period as compared to \$35,316,000 in the fiscal 2018 period. Our gross profit (representing the difference between sales and cost of sales) increased to \$11,438,000 or 27.2% of sales during the fiscal 2019 period as compared to \$11,306,000 or 24.3% of sales during the fiscal 2018 period. The margin improvement was primarily due to the lower cost of beef in the Branded Product Program and in the Company-operated restaurants partly offset due to the higher labor costs at the Company-owned restaurants due to the annual increases in the New York minimum wages and other labor regulations.

Cost of sales in the Branded Product Program decreased by approximately \$4,630,000 during the fiscal 2019 period as compared to the fiscal 2018 period, primarily due to the 10.0% decrease in the average cost per pound of our hot dogs and the 6.3% decrease in the volume of product sold discussed above. We did not make any purchase commitments of beef during the fiscal 2019 and 2018 periods. If the cost of beef and beef trimmings increases and we are unable to pass on these higher costs through price increases or otherwise reduce any increase in our costs through the use of purchase commitments, our margins will be adversely impacted.

With respect to Company-owned restaurants, our cost of sales during the fiscal 2019 period was \$5,435,000 or 53.3% of restaurant sales, as compared to \$5,515,000 or 52.3% of restaurant sales in the fiscal 2018 period primarily due to the impact of higher labor costs principally associated with the effects of the New York State minimum wage increase. Lower beef costs were offset by higher seafood and other food costs during the second quarter fiscal 2019. We expect that our labor costs going forward will continue to be impacted by the multi-year new increase in minimum wage requirements in New York State, other labor regulations and any increase in food costs from higher commodity costs.

Restaurant operating expenses were \$2,051,000 in the fiscal 2019 period as compared to \$2,009,000 in the fiscal 2018 period. The increase in restaurant operating costs results primarily from higher home delivery costs, occupancy costs, insurance and maintenance.

Depreciation and amortization was \$684,000 in the fiscal 2019 period as compared to \$735,000 in the fiscal 2018 period as a result of lower capital spending.

General and administrative expenses increased by \$293,000 or 4.2% to \$7,323,000 in the fiscal 2019 period as compared to \$7,030,000 in the fiscal 2018 period. The increase in general and administrative expenses was primarily attributable to higher marketing expenses and professional fees. We incurred professional fees of approximately \$38,000 to implement ASC 606 and we were also required to expense approximately \$98,000 of legal fees as a result of the adoption of ASC 606, which would have previously been offset against franchise fee revenue. We also incurred higher legal fees in connection with the sale of two Company-owned properties.

Advertising fund expense was \$1,267,000 during the fiscal 2019 period. Pursuant to the adoption of ASC 606, revenue and expenses of the Advertising Fund are required to be included as components of the Company's Statements of Earnings and Cash Flows. Nathan's manages its Advertising Fund with the expectation that inflows and outflows will be offsetting. Prior to the adoption of ASC 606, the activities of the Advertising Fund were reported within the Consolidated Balance Sheet.

Other Items

Interest expense of \$5,301,000 in the fiscal 2019 period represented accrued interest of \$4,955,000 on the 2025 Notes at 6.625% per annum and amortization of debt issuance costs of \$346,000. Interest expense of \$7,326,000 in the fiscal 2018 period represented accrued interest of \$6,727,000 on the 2020 Notes and amortization of debt issuance costs of \$599,000.

Interest income was \$176,000 for the fiscal 2019 period as compared to \$70,000 in the fiscal 2018 period.

Other income primarily relates to a gain on the sale of our Florida office of \$323,000, a fee of \$175,000 to extend the closing date of the sale of our restaurant located in Bay Ridge, Brooklyn, NY by three months and sublease income from a franchised restaurant which was \$42,000 in each of the fiscal 2019 and fiscal 2018 periods.

Provision for Income Taxes

On December 22, 2017, the Tax Act was enacted which among other provisions, permanently reduces the top corporate tax rate from 35 percent to a flat 21 percent beginning January 1, 2018 and eliminates the corporate Alternative Minimum Tax. The Tax Act limits the deduction of business interest, net of interest income, to 30 percent of the adjusted taxable income of the taxpayer in any taxable year. Any amount disallowed under the limitation is treated as business interest paid or accrued in the following year. Disallowed interest will have an indefinite carryforward. The Tax Act also repeals the performance-based exception to the \$1.0 million deduction limitation on executive compensation and modifies the definition of “covered employees”. Additionally, the Tax Act intended to allow businesses to immediately expense the full cost of new equipment. However, the law as written does not currently permit restaurant companies to take advantage of the laws’ intention.

The income tax provisions for the twenty-six week periods ended September 23, 2018 and September 24, 2017 reflect effective tax rates of 28.5% and 39.4%, respectively. The majority of the decline in the Company’s tax rate is due to the reduction in our Federal income tax rate from 34% to 21% pursuant to the Tax Act. Nathan’s effective tax rates for the twenty-six week periods ended September 23, 2018 and September 24, 2017 were reduced by 0.4% and 1.9%, respectively, as a result of the tax benefits associated with stock compensation. For the twenty-six week periods ended September 23, 2018 and September 24, 2017, excess tax benefits of \$46,000 and \$194,000, respectively, were reflected in the Consolidated Statements of Earnings as a reduction in determining the provision for income taxes. As described under Note K to the Consolidated Financial Statements, Nathan’s estimates that its annual tax rate for the fiscal year ending March 31, 2019 will be in the range of approximately 27.0% to 30.0% excluding the impact of the excess tax benefits associated with stock compensation and the potential impact of any reduction to the Company’s unrecognized tax benefits.

The amount of unrecognized tax benefits at September 23, 2018 was \$250,000, all of which would impact Nathan’s effective tax rate, if recognized. As of September 23, 2018, Nathan’s had \$238,000 of accrued interest and penalties in connection with unrecognized tax benefits.

In January 2018, Nathan's received notification from the State of Virginia that it was seeking to review Nathan's tax returns for the period April 2014 through March 2017. The review has been completed; Nathan's has accepted the findings and settled the matter in the second quarter fiscal 2019. The effects of the review have been factored into the Company's effective tax rate for fiscal 2019.

Nathan's estimates that its annual tax rate for the fiscal year ending March 31, 2019 will be in the range of approximately 27.0% to 30.0% excluding the impact of any discrete items recorded and excess tax benefit associated with stock compensation. The final annual tax rate is subject to many variables, including the ultimate determination of revenue and income tax by state, among other factors, and therefore cannot be determined until the end of the fiscal year; therefore, the actual tax rate could differ from our current estimates. In addition, the ultimate benefit of the Tax Act on Nathan's is unclear as the lower annual tax rate could be outweighed by deduction limitations and other provisions included in further guidance and regulations.

Off-Balance Sheet Arrangements

Nathan's did not have any open purchase commitments for hot dogs outstanding as of September 23, 2018. Nathan's may enter into purchase commitments in the future as favorable market conditions become available.

Liquidity and Capital Resources

Cash at September 23, 2018 aggregated \$66,154,000, increasing by \$8,815,000 during the fiscal 2019 period as compared to cash of \$57,339,000 at March 25, 2018. Net working capital increased to \$62,289,000 from \$53,702,000 at March 25, 2018. On November 1, 2018, we paid our second semi-annual interest payment of \$4,968,750 for fiscal 2019. We expect to pay our third quarter dividend on December 14, 2018.

In November 2017, the Company refinanced its then-outstanding 2020 Notes totaling \$135.0 million at 10.000% per annum by issuing \$150.0 million 2025 Notes at 6.625% per annum. Please refer to Note O – Long Term Debt in the accompanying Consolidated Financial Statements, for the effects of the Company's refinancing from the preceding consolidated financial statements.

The 2025 Notes bear interest at 6.625% per annum, payable semi-annually on May 1st and November 1st of each year, beginning on May 1, 2018. Semi-annual interest payments are \$4,968,750. During the twenty-six week period ended September 23, 2018, we paid interest of \$4,968,750 on May 1, 2018 for the 2025 Notes. On November 1, 2018, we paid our second semi-annual interest payment of \$4,968,750. The 2025 Notes have no scheduled principal

amortization payments prior to its final maturity on November 1, 2025.

The Indenture for the 2025 Notes contains certain covenants limiting the Company's ability and the ability of its restricted subsidiaries (as defined in the Indenture) to, subject to certain exceptions and qualifications: (i) incur additional indebtedness; (ii) pay dividends or make other distributions on, redeem or repurchase, capital stock; (iii) make investments or other restricted payments; (iv) create or incur certain liens; (v) incur restrictions on the payment of dividends or other distributions from its restricted subsidiaries; (vi) enter into certain transactions with affiliates; (vii) sell assets; or (viii) effect a consolidation or merger.

The Indenture for the 2025 Notes also contains customary events of default, including, among other things, failure to pay interest, failure to comply with agreements related to the Indenture, failure to pay at maturity or acceleration of other indebtedness, failure to pay certain judgments, and certain events of insolvency or bankruptcy. Generally, if any event of default occurs, the Trustee or the holders of at least 25% in principal amount of the 2025 Notes may declare the 2025 Notes due and payable by providing notice to the Company. In case of default arising from certain events of bankruptcy or insolvency, the 2025 Notes will become immediately due and payable.

As of September 23, 2018, Nathan's was in compliance with all covenants associated with the 2025 Notes.

The 2025 Notes are general senior secured obligations, are fully and unconditionally guaranteed by substantially all of the Company's wholly-owned subsidiaries and rank *pari passu* in right of payment with all of the Company's existing and future indebtedness that is not subordinated, are senior in right of payment to any of the Company's existing and future subordinated indebtedness, are structurally subordinated to any existing and future indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the 2025 Notes, and are effectively junior to all existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes. Pursuant to the terms of a collateral trust agreement, the liens securing the 2025 Notes and the guarantees will be contractually subordinated to the liens securing any future credit facility.

The 2025 Notes and the guarantees will be the Company and the guarantors' senior secured obligations and will rank:

senior in right of payment to all of the Company and the guarantors' future subordinated indebtedness;

effectively senior to all unsecured senior indebtedness to the extent of the value of the collateral securing the 2025 Notes and the guarantees;

pari passu with all of the Company and the guarantors' other senior indebtedness;

effectively junior to any future credit facility to the extent of the value of the collateral securing any future credit facility and the 2025 Notes and the guarantees and certain other assets;

effectively junior to any of the Company and the guarantors' existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes and the guarantees to the extent of the value of any such assets; and

structurally subordinated to the indebtedness of any of the Company's current and future subsidiaries that do not guarantee the 2025 Notes.

Cash provided by operations of \$10,003,000 in the fiscal 2019 period is primarily attributable to net income of \$9,279,000 in addition to other non-cash operating items of \$972,000, offset by changes in other operating assets and liabilities of \$248,000. Non-cash operating activities consist principally of \$684,000 depreciation and amortization, \$346,000 amortization of debt issuance costs and share-based compensation of \$104,000. Non-cash operating items also include \$46,000 of excess income tax benefits from stock-based compensation arrangements as a result of the accounting for certain aspects of its share-based payments to employees, all of which were partially offset by the gain on the sale of our Florida office of \$323,000. In the fiscal 2019 period, accounts and other receivables increased by \$310,000 compared to the fiscal 2018 period due primarily to increased seasonal advances to the Advertising Fund of \$858,000 and higher receivables from Branded Product Program sales of \$156,000, offset by lower license royalties of \$668,000. In the fiscal 2019 period, prepaid expenses and other current assets decreased by \$2,350,000 due principally to the reduction of prepaid income taxes of \$1,624,000 which were deposited in fiscal 2018, prior to the successful debt refinancing that have been applied to current year earnings. The decrease in accounts payable, accrued expenses and other current liabilities of \$2,015,000 is primarily due the reduction in accounts payable of \$1,911,000 due principally to seasonal fluctuations, a reduction of accrued payroll and other benefits of \$773,000 due primarily to the payment of prior year incentive compensation, and reductions in deferred revenue of \$571,000 and accrued rebates of \$286,000 partly offset by the receipt of an additional deposit of \$1,000,000 toward the sale of our restaurant located in Bay Ridge, Brooklyn, NY and higher taxes payable of \$861,000.

Cash provided by investing activities was \$1,096,000 in the fiscal 2019 period primarily represents proceeds received from the sale of our regional Florida office of \$1,330,000 which was partially offset by capital expenditures incurred for our Branded Product Program and select restaurant improvements of \$234,000. On October 23, 2018, we completed the sale of a company-owned restaurant in Bay Ridge, NY and received \$9,245,000, net of previously received deposits and expenses.

Cash used in financing activities of \$2,284,000 in the fiscal 2019 period relates primarily to the payments of the Company's regular \$0.25 per share cash dividend of \$2,094,000. The Company also paid \$174,000 for withholding taxes on the net share vesting of employee restricted stock and dividends of \$150,000 relating to the previously declared special cash dividend in connection with the vesting of 5,000 shares of the Company's restricted stock. The Company also received \$134,000 of proceeds from the exercise of stock options.

During the period from October 2001 through September 23, 2018, Nathan's purchased 5,127,373 shares of its common stock at a cost of approximately \$77,303,000 pursuant to its stock repurchase plans previously authorized by the Board of Directors. Since March 26, 2007, we have repurchased 3,236,273 shares at a total cost of approximately \$70,145,000, reducing the number of shares then-outstanding by 53.8%.

In 2016, the Company's Board of Directors authorized increases to the sixth stock repurchase plan for the purchase of up to 1,200,000 shares of its common stock on behalf of the Company. As of September 23, 2018, Nathan's has repurchased 939,742 shares at a cost of \$29,641,000 under the sixth stock repurchase plan. At September 23, 2018, there were 260,258 shares remaining to be repurchased pursuant to the sixth stock repurchase plan. The plan does not have a set expiration date. Purchases under the Company's stock repurchase program may be made from time to time, depending on market conditions, in open market or privately-negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the repurchases.

Management believes that available cash, and cash generated from operations should provide sufficient capital to finance our operations, satisfy our debt service requirements and stock repurchases for at least the next 12 months.

As discussed above, we had cash at September 23, 2018 aggregating \$66,154,000. Our Board routinely monitors and assesses its cash position and our current and potential capital requirements. In November 2017, we refinanced \$135,000,000 10.000% Notes due 2020 with \$150,000,000 6.625% Notes due 2025 and, our Board of Directors announced the payment of a \$5.00 per share special dividend to the shareholders of record as of the close of business on December 22, 2017. On May 31, 2018, Nathans' Board of Directors authorized the commencement of a regular dividend of \$1.00 per share per annum, payable at the rate of \$0.25 per share per quarter. Through September 23, 2018, we have declared and paid two quarterly dividend distributions totaling \$2,094,000.

Effective November 2, 2018, the Board declared its third quarterly cash dividend of \$0.25 per share which is payable on December 14, 2018 to stockholders of record as of the close of business on December 3, 2018. Our ability to pay future dividends is limited by the terms of the Indenture with US Bank National Association, as trustee and collateral trustee. In addition, the payment of any cash dividends in the future are subject to final determination of the Board and will be dependent upon our earnings and financial requirements. We may also return capital to our stockholders through stock repurchases, subject to any restrictions in the Indenture, although there is no assurance that the Company will make any repurchases under its existing stock-repurchase plan.

We expect that in the future we will make investments in certain existing restaurants, support the growth of the Branded Product and Branded Menu Programs, service the outstanding debt and continue our stock repurchase programs, funding those investments from our operating cash flow. We may also incur capital and other expenditures or engage in investing activities in connection with opportunistic situations that may arise on a case-by-case basis. In the fiscal year ending March 31, 2019, we will be required to make interest payments of \$9,937,500, all of which have been made as of November 1, 2018.

At September 23, 2018, we sublet one property to a franchisee that we lease from a third party. We remain contingently liable for all costs associated with this property including: rent, property taxes and insurance. We may incur future cash payments with respect to such property, consisting primarily of future lease payments, including costs and expenses associated with terminating such lease.

The following schedule represents Nathan's cash contractual obligations and commitments by maturity as of September 23, 2018 (in thousands):

Cash Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long term debt (a)	\$150,000	\$-	\$-	\$-	\$150,000
Employment Agreements	5,975	1,500	2,125	1,750	600
Operating Leases	10,492	1,668	2,282	2,201	4,341

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Gross Cash Contractual Obligations	166,467	3,168	4,407	3,951	154,941
Sublease Income	1,744	266	490	383	605
Net Cash Contractual Obligations	\$164,723	\$2,902	\$3,917	\$3,568	\$154,336

a) Represents the 2025 Notes.

b) At September 23, 2018, the Company had unrecognized tax benefits of \$250,000.

On February 27, 2017, a wholly-owned subsidiary of the Company executed a Guaranty of Lease (the “Brooklyn Guaranty”) in connection with its re-franchising of a restaurant located in Brooklyn, New York. The Company is obligated to make payments under the Brooklyn Guaranty in the event of a default by the tenant/franchisee. The Brooklyn Guaranty has an initial term of 10 years and one 5-year option and is limited to 24 months of rent for the first three years of the term. Nathan’s has recorded a liability of \$204,015 in connection with the Brooklyn Guaranty which does not include potential percentage rent, real estate tax increases, attorney’s fees and other costs as these amounts are not reasonably determinable at this time. Nathan’s has received a personal guaranty from the franchisee for all obligations under the Brooklyn Guaranty. For the remainder of the term, the Brooklyn Guaranty is limited to 12 months of rent plus reasonable costs of collection and attorney’s fees.

Inflationary Impact

We do not believe that general inflation has materially impacted earnings since 2006. However, we have experienced significant volatility in our costs for our hot dogs and certain food products, distribution costs and utilities. From 2011 through 2014, we experienced unprecedented increases in the cost of beef. Beginning March 2015, the beef markets stabilized through June 2015 before subsequently declining by approximately 30%. As a result of the decline through March 2016, the market price of hot dogs during the fiscal year ended March 27, 2016 was approximately 7.1% lower than the fiscal year ended March 29, 2015. During the fiscal 2017 period, beef prices remained favorable, and as such, our market price for hot dogs was 17.1% lower than during the fiscal 2016 period. Despite the favorable pricing of fiscal 2017, prices began escalating in January 2017 and continued increasing through June 2017 before beginning to slightly decline until July which is when the costs stabilized through March 2018 at approximately 10% higher than the same period of the fiscal 2017 period. Since April 2018 our commodity cost for hot dogs had been stable before beginning to decline in September 2018. As such, our market price for hot dogs during our fiscal 2019 period was approximately 10.0% lower than the fiscal 2018 period.

We are unable to predict the future cost of our hot dogs and expect to experience price volatility for our beef products during fiscal 2019. To the extent that beef prices increase as compared to earlier periods, it could impact our results of operations. In the past, we entered into purchase commitments for a portion of our hot dogs to reduce the impact of increasing market prices. Our most recent purchase commitment was completed for approximately 2,600,000 pounds of hot dogs at approximately \$2.01 per pound which we purchased between February and May 2016. We may attempt to enter into similar purchase arrangements for hot dogs and other products in the future. Additionally, we expect to continue experiencing volatility in oil and gas prices on our distribution costs for our food products and utility costs in the Company-owned restaurants and volatile insurance costs resulting from the uncertainty of the insurance markets.

New York State enacted legislation increasing the minimum hourly wage for fast food workers of restaurant chains with 30 or more locations nationwide. The increase will be phased in differently between New York City and the rest of New York State. Effective December 31, 2017, the minimum wage increased to \$13.50 and \$11.75 in New York City and outside of New York City, respectively.

In New York City, the hourly rate of pay will increase to \$15.00 on Dec. 31, 2018.

The minimum hourly rate of pay for the remainder of New York State will increase to \$12.75 on Dec. 31, 2018; \$13.75 on Dec. 31, 2019; \$14.50 on Dec. 31, 2020; and \$15.00 on July 1, 2021.

All of Nathan's Company-operated restaurants are within New York State, three of which operate within New York City that have been affected by this new legislation.

The Company is further studying the impact on the Company's operations and is developing strategies and tactics, including pricing and potential operating efficiencies, to minimize the effects of these increases and future increases. We have recently increased certain selling prices to pass on recent cost of sales increases. However, if we are unable to fully offset these and future increases through pricing and operating efficiencies, our margins and profits will be negatively affected.

Effective April 1, 2014, the City of New York, passed legislation requiring employers to offer paid sick leave to all employees, including part-time employees, who work more than 80 hours for the employer. Nathan's operates three restaurants that have been affected by this new legislation.

Effective November 27, 2017, the City of New York Fair Work Legislation package of bills took effect that the city estimates will cover some 65,000 fast food workers by giving them more predictable work schedules. A key

component of the package is a requirement that fast food restaurants schedule their workers at least two weeks in advance or pay employees between \$10 to \$75 per change, depending on the situation. Due to Nathan's dependency on weather conditions at our two beach locations during the summer, we are unable to determine the potential impact on our results of operations, which could be material. We have estimated that the daily penalty could amount to as much as \$10,000 per day during the height of the summer season for these two restaurants.

Continued increases in labor, food and other operating expenses, including health care, could adversely affect our operations and those of the restaurant industry and we might have to further reconsider our pricing strategy as a means to offset reduced operating margins.

We believe that these increases in the minimum wage and other labor regulations could have a significant financial impact on our financial results and the results of our franchisees that operate in New York State. Our business could be negatively impacted if the decrease in margins for our franchisees results in the potential loss of new franchisees or the closing of a significant number of franchised restaurants.

The Company's business, financial condition, operating results and cash flows can be impacted by a number of factors, including but not limited to those set forth above in "Management's Discussion and Analysis of Financial Condition and Results of Operations," any one of which could cause our actual results to vary materially from recent results or from our anticipated future results. For a discussion identifying additional risk factors and important factors that could cause actual results to differ materially from those anticipated, also see the discussions in "Forward-Looking Statements" and "Notes to Consolidated Financial Statements" in this Form 10-Q and "Risk Factors" in our Form 10-K for our fiscal year ended March 25, 2018.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Cash

We have historically invested our cash in money market funds or short-term, fixed rate, highly rated and highly liquid instruments which are generally reinvested when they mature. Although these existing investments are not considered at risk with respect to changes in interest rates or markets for these instruments, our rate of return on short-term investments could be affected at the time of reinvestment as a result of intervening events. As of September 23, 2018, Nathan's cash aggregated \$66,154,000. Earnings on this cash would increase or decrease by approximately \$165,000 per annum for each 0.25% change in interest rates.

Borrowings

At September 23, 2018, we had \$150,000,000 of 2025 Notes outstanding which are due in November 2025. Interest expense on these borrowings would increase or decrease by approximately \$375,000 per annum for each 0.25% change in interest rates. We currently do not anticipate entering into interest rate swaps or other financial instruments to hedge our borrowings.

Commodity Costs

We do not believe that general inflation has materially impacted earnings since 2006. However, we have experienced significant volatility in our costs for our hot dogs and certain food products, distribution costs and utilities. From 2011 through 2014, we experienced unprecedented increases in the cost of beef. Beginning March 2015, the beef markets stabilized through June 2015 before subsequently declining by approximately 30%. As a result of the decline through March 2016, the market price of hot dogs during the fiscal year ended March 27, 2016 was approximately 7.1% lower than the fiscal year ended March 29, 2015. During the fiscal 2017 period, beef prices remained favorable, and as such, our market price for hot dogs was 17.1% lower than during the fiscal 2016 period. Despite the favorable pricing of fiscal 2017, prices began escalating in January 2017 and continued increasing through June 2017 before beginning to slightly decline until July which is when the costs stabilized through March 2018 at approximately 10% higher than the same period of the fiscal 2017 period. Since April 2018 our commodity cost for hot dogs has been stable before beginning to decline in September 2018. As such, our market price for hot dogs during our fiscal 2019 period was approximately 10.0% lower than the fiscal 2018 period.

We are unable to predict the future cost of our hot dogs and expect to experience price volatility for our beef products during fiscal 2019. To the extent that beef prices increase as compared to earlier periods, it could impact our results of operations. In the past, we entered into purchase commitments for a portion of our hot dogs to reduce the impact of increasing market prices. Our most recent purchase commitment was completed for approximately 2,600,000 pounds of hot dogs at approximately \$2.01 per pound which we purchased between February and May 2016. We may attempt to enter into similar purchase arrangements for hot dogs and other products in the future. Additionally, we expect to continue experiencing volatility in oil and gas prices on our distribution costs for our food products and utility costs in the Company-owned restaurants and volatile insurance costs resulting from the uncertainty of the insurance markets.

With the exception of purchase commitments, we have not attempted to hedge against fluctuations in the prices of the commodities we purchase using future, forward, option or other instruments. As a result, we expect that the majority of our future commodity purchases will be subject to market changes in the prices of such commodities. We have attempted to enter sales agreements with our customers that are correlated to our cost of beef, thus reducing our market volatility, or have passed through permanent increases in our commodity prices to our customers that are not on formula pricing, thereby reducing the impact of long-term increases on our financial results. A short-term increase or decrease of 10.0% in the cost of our food and paper products for the twenty-six weeks ended September 23, 2018 would have increased or decreased our cost of sales by approximately \$2,699,000.

Foreign Currencies

Foreign franchisees generally conduct business with us and make payments in United States dollars, reducing the risks inherent with changes in the values of foreign currencies. As a result, we have not purchased future contracts, options or other instruments to hedge against changes in values of foreign currencies and we do not believe fluctuations in the value of foreign currencies would have a material impact on our financial results.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as required by Exchange Act Rule 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

There were no changes in our internal controls over financial reporting that occurred during the quarter ended September 23, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and our Chief Executive Officer and Chief Financial Officer have concluded that such controls and procedures are effective at the reasonable assurance level.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in the Annual Report on Form 10-K for the fiscal year ended March 25, 2018, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Nathan's. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

As described under Note N – Stockholder’s Equity to the Company’s Consolidated Financial Statements, the Company’s 2013 Rights Plan terminated on September 30, 2018.

Effective November 2, 2018, the Board declared its quarterly cash dividend of \$0.25 per share which is payable on December 14, 2018 to shareholders of record as of the close of business on December 3, 2018.

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Item 6. Exhibits.

- 3.1 Certificate of Incorporation. (Incorporated by reference to Exhibit 3.1 to Registration Statement on Form S-1 No. 33- 56976.)
- 3.2 Amendment to the Certificate of Incorporation, filed December 15, 1992. (Incorporated by reference to Exhibit 3.2 to Registration Statement on Form S-1 No. 33-56976.)
- 3.3 By-Laws, as amended. (Incorporated by reference to Exhibit 3.1 to Form 8-K dated November 1, 2006.)
- 4.1 Specimen Stock Certificate. (Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-1 No. 33-56976.)
- 4.2 Indenture, dated as of November 1, 2017, by and among Nathan's Famous, Inc., certain of its wholly owned subsidiaries, as guarantors, and U.S. Bank National Association, a National Banking Association, as trustee and collateral trustee (including the form of Note) (Incorporated by reference to Exhibit 4.1 to the Company's Current Report filed on Form 8-K dated November 1, 2017.)
- 10.1 Amendment to Agreement of Sale between Nathan's Famous Operating Corp. and 660 86 LLC dated July 15, 2018 (Incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q for the quarter ended June 24, 2018.)
- 31.1 *Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 *Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 *Certification by Eric Gatoff, CEO, Nathan's Famous, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 *Certification by Ronald G. DeVos, CFO, Nathan's Famous, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.1 *The following materials from the Nathan's Famous, Inc., Quarterly Report on Form 10-Q for the quarter ended September 23, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Earnings, (iii) the Consolidated Statement of Stockholders' (Deficit), (iv) the Consolidated Statements of Cash Flows and (v) related notes.

*Filed herewith.

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.

NATHAN'S FAMOUS, INC.

Date: November 2, 2018

By: /s/ Eric Gatoff
Eric Gatoff
Chief Executive Officer
(Principal Executive Officer)

Date: November 2, 2018

By: /s/ Ronald G. DeVos
Ronald G. DeVos
Vice President - Finance
and Chief Financial Officer
(Principal Financial and Accounting
Officer)

Exhibit Index.

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