Meritage Hospitality Group Inc.
Quarterly Report

For Quarterly Period Ended July 1, 2018

The following information provides updates to the Annual Report for Fiscal Year Ended December 31, 2017. Accordingly, this report does not contain all the information required of an issuer for its initial disclosure obligations, and should therefore be reviewed in conjunction with the Annual Report for Fiscal Year Ended December 31, 2017 and any interim reports or updates provided since the fiscal year-end report.

Item 1 Exact name of the issuer and the address of its principal executive offices.

Name of the Company or Issuer:
Meritage Hospitality Group Inc. (the "Company" or "Meritage").

Address of Principal Office:
45 Ottawa Ave SW, Suite 600
Grand Rapids, MI 49503
Telephone: 616.776.2600
Facsimile: 616.776.2776
Web: www.meritagehospitality.com

Item 2 Shares outstanding.

Common Shares	07/01/18	12/31/17	01/01/17
Authorized:	30,000,000 shares	30,000,000 shares	30,000,000 shares
Outstanding:	6,221,656 shares	6,152,816 shares	5,979,371 shares
Freely Tradable (public float):	approx. 3,000,000 shs.	approx. 3,000,000 shs.	approx. 3,000,000 shs.
Number of beneficial holders owning at least 100 shares:	approx. 719 holders	approx. 676 holders	approx. 491 holders
Number of record holders:	approx. 78 holders	approx. 85 holders	approx. 91 holders
Preferred A			
Authorized:	0 shares	0 shares	200,000 shares
Outstanding:	0 shares	0 shares	29,520 shares
Freely Tradable (public float):	0 shares	0 shares	29,520 shares
Number of record holders:	0 holders	0 holders	2 holders
Preferred B			
Authorized:	1,350,000 shares	1,350,000 shares	1,350,000 shares
Outstanding:	816,667 shares	818,967 shares	852,850 shares
Freely Tradable (public float):	300,000 shares	300,000 shares	300,000 shares
Number of record holders:	39 holders	40 holders	37 holders
Preferred C			
Authorized:	1,500,000 shares	1,500,000 shares	0 shares
Outstanding:	170,360 shares	170,360 shares	0 shares
Number of record holders:	7 holders	7 holders	0 holders

<u>Preferred D</u>			
Authorized:	600,000 shares	600,000 shares	0 shares
Outstanding:	310,293 shares	0 shares	0 shares
Number of record holders:	24 holders	0 holders	0 holders

Item 3 Interim financial statements.

See the unaudited consolidated financial report for the quarter ended July 1, 2018 attached at the end of this report. The unaudited consolidated financial statements include the following reports:

(1) balance sheet;
(2) statement of operations;
(3) statement of equity;
(4) statement of cash flows; and
(5) notes to consolidated financial statements.

Item 4 Management's discussion and analysis or plan of operation.

<u>Overview</u>

The Company reported revenues of $116.9 million and $216.6 million for the three and six months ended July 1, 2018 compared to revenues of $78.7 and $140.7 million for the three and six months ended July 2, 2017, an increase of 48.5% and 53.9%, respectively. The increase in revenues was primarily the result of additional revenues from the 71 Wendy's restaurants acquired in 2017, the 56 Wendy's restaurants acquired in 2018, and to a lesser extent, additional increased revenue from the opening of the Company's newest casual dining restaurant, Stan Diego Baja Taco Kitchen.

The Company continues to evaluate acquisition opportunities in the Wendy's and casual dining restaurant segments. Since 2009, the Company has acquired 254 Wendy's restaurants through 24 separate transactions.

As a result of the Company's 2017 common stock price performance, the Company was recently recognized as one of the Best 50 Companies on the OTCQX.

<u>Results of Operations</u>

Meritage operates in the quick-service and casual dining restaurant industries. The Company has experienced significant growth through its acquisition efforts, reimage campaigns, and investment in casual dining segments. The Company's newest independent concept, Stan Diego Baja Taco Kitchen, opened in the second quarter of 2018 as a reimage and rebranding of the Company's previous concept, Crooked Goose. At July 1, 2018, the Company operated 305 Wendy's quick-service restaurants under franchise agreements with The Wendy's Company and six casual dining restaurants. Of the Wendy's quick-service restaurants, 9 are located in Arkansas, 27 in Connecticut, 51 in Florida, 38 in Georgia, 12 in Indiana, 12 in Massachusetts, 55 in Michigan, seven in Mississippi, three in Missouri, two in North Carolina, 15 in Ohio, 21 in Oklahoma, one in South Carolina, 35 in Tennessee, five in Texas and 12 in Virginia. All six casual dining restaurants are located in Michigan.

A schedule of Company restaurants follows:

	Wendy's	Casual Dining	Total Restaurants
Restaurants as of January 1, 2017	175	6	181
Acquired restaurants	71	-	71
Newly opened restaurants	8	-	8
Closed restaurants	-5	-	-5
Restaurants as of December 31, 2017	249	6	255
Acquired restaurants	56	-	56
Newly opened restaurants	2	-	2
Closed restaurants	-2	-	-2
Restaurants as of July 1, 2018	305	6	311

Results of operations are summarized below.

	Three Months Ended (000's)				Six Months Ended (000's)			
	7/1/2018		7/2/2017		7/1/2018		7/2/2017	
Food and Beverage Revenue	$ 116,910	100%	$ 78,715	100%	$ 216,615	100%	$ 140,731	100%
Costs and Expenses								
Cost of food and beverages	31,206	26.7	21,150	26.9	58,403	27.0	37,214	26.4
Labor and related expenses	32,705	28.0	22,286	28.3	62,302	28.8	40,380	28.7
Advertising expenses	4,977	4.3	3,335	4.2	9,202	4.2	5,954	4.2
Other operating expenses	28,982	24.8	19,233	24.4	54,831	25.3	35,086	24.9
Total Operating Expenses	97,870	83.7	66,003	83.9	184,738	85.3	118,634	84.3
General and administrative expenses	6,476	5.5	4,408	5.6	11,024	5.1	7,999	5.7
Preopening and acquisition expenses	595	0.5	845	1.1	1,852	0.9	1,358	1.0
Closing and disposition expenses	41	0.0	14	0.0	119	0.1	104	0.1
Depreciation and amortization	3,013	2.6	2,029	2.6	5,773	2.7	3,808	2.7
Total Costs and Expenses	107,995	92.4	73,300	93.1	203,507	93.9	131,903	93.7
Income from Operations	8,915	7.6	5,416	6.9	13,109	6.1	8,828	6.3
Other Expense (Income)								
Interest expense	877	0.8	1,514	1.9	3,374	1.6	2,170	1.5
Other expense (income)	212	0.2	(978)	(1.2)	534	0.2	(924)	(0.7)
Total Other Expense	1,090	0.9	535	0.7	3,908	1.8	1,246	0.9
Income Before Income Taxes	7,825	6.7	4,881	6.2	9,201	4.2	7,582	5.4
Income Tax Expense Expense	2,178	1.9	1,892	2.4	2,141	1.0	2,726	1.9
Consolidated Net Income	5,647	4.8	2,989	3.8	7,060	3.3	4,855	3.4
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	8	0.0	16	0	77	0.0	13	0
Consolidated Net Income Attributable to Controlling Interest	$ 5,639	4.8%	$ 2,973	3.8%	$ 6,983	3.2%	$ 4,843	3.4%

Food and Beverage Revenue

In the three months ended July 1, 2018, revenues increased 48.5% to $116.9 million from $78.7 million in the three months ended July 2, 2017. In the six months ended July 1, 2018, revenues increased 53.9% to $216.6 million from $140.7 million in the six months ended July 2, 2017. Total Company "same store sales" (i.e., food and beverage revenue for stores in full operation on a per period basis for both fiscal years) decreased by 0.6% and 0.7%, respectively for the three and six months ended July 1, 2018.

The Company's Wendy's restaurants reported sales of $113.4 million and $210.3 million in the three and six months ended July 1, 2018, representing increases of 51.4% and 57.6%, respectively over the same periods in the prior year. The most significant contributing factor to the increase was additional sales from the 71 Wendy's restaurants acquired throughout 2017, as well as the 56 Wendy's restaurants acquired in the first quarter of 2018. The Company's Wendy's restaurants experienced a "same store sales" increase of 0.1% in the second quarter of 2018, and remained neutral for the first half of 2018. The quarterly increase is the result of strategic market level price increases deployed that mitigated the impact of Wendy's value promotions, such as the "$1 Double Stack", "50 Cent Frosty", and "Buffalo Ranch Crispy Chicken".

The Company's casual dining restaurants reported sales of $3.5 million and $6.3 million in the three and six months ended July 1, 2018, representing decreases of 8.9% and 13.9% over the same periods in the prior year. The Company's casual dining restaurants experienced "same store sales" decreases of 14.3% and 12.9% for the three and six months ended July 1, 2018, respectively. The decline in sales is primarily due to an overall national downward trend in the casual dining segment resulting from an increase in industry offerings and related consumer preferences toward locally concentrated establishments. To mitigate the downward market trend, the Company recently reimaged and rebranded the Crooked Goose location to a new concept, Stan Diego Baja Taco Kitchen in an effort toward realigning menu offerings to meet customer evolving needs and tastes.

C**ost of Food and Beverages**

Cost of food and beverage has been impacted by increased commodity costs, market level pricing, and shifts in product mix as a result of Wendy's value promotions. Food and beverage as a percent of revenues was 26.7% and 27.0% in the three and six months ended July 1, 2018, compared to 26.9% and 26.4% for the same periods in the prior year. The quarterly decrease in cost of food and beverage of 0.2% is primarily the result of strategic price increases deployed that mitigated the impact of the aforementioned Wendy's value promotions. This decrease is offset by a 3.8% increase in average beef costs for the three months ended July 1, 2018. The year-to-date increase is primarily the result of a 6.2% increase in average beef costs for the six months ended July 1, 2018 when compared to the same period in the prior year.

Labor and Related Expenses

Labor and related expenses decreased 0.3% to 28.0% from 28.3% for the three months ended July 1, 2018. The quarterly decrease is primarily attributed to increased pricing and an enhanced focus over the management of hourly labor. Labor and related expenses for the six months ended July 1, 2018 remained consistent when compared to the same period in the prior year.

Other Operating Expenses

Other operating expenses increased as a percentage of revenues to 24.8% and 25.3%, respectively for the three and six months ended July 1, 2018 from 24.4% and 24.9%, respectively in the three and six months ended July 2, 2017. The increase in other operating expenses is partially the result of increased property taxes. The property tax increase is related to both increased building and property values due to reimaging efforts, as well as above average building and property values within the new markets most recently entered. Additionally, the increase is partially related to elevated electricity usage as a result of higher than average temperatures across all markets during the second quarter.

General and Administrative Expenses

General and administrative expenses remained consistent for the three months ended July 1, 2018, when compared to the same period in the prior year. General and administrative expenses for the six months ended July 1, 2018 decreased to 5.1% from 5.7% in the six months ended July 1, 2017. The decrease as a percent of revenues is due to the decline in incentive compensation accruals, which are calculated as a percentage of earnings from operations.

Preopening and Acquisition Expenses

Preopening and acquisition expenses represent costs associated with acquisitions as well as numerous reimaging efforts.

Closing and Disposition Expenses

Closing and disposition expenses represent actual and estimated costs related to the closure of under-performing restaurants. Closing and disposition expenses are expected to be an ongoing cost due to continuing efforts to improve the Company's overall restaurant portfolio.

Interest Expense

Total interest cost incurred in the three and six months ended July 1, 2018 increased due to financings associated with the Company's most recent acquisitions, as well as numerous reimaging efforts. The Company's senior lender requires the Company to swap a minimum of 50% of its term debt. In addition to existing swap agreements totaling $70 million as of December 31, 2017, the company entered into a new $50 million swap agreement associated with recent acquisition financing during the first quarter of 2018. The Company measures interest rate swaps at fair value, and assesses their value based on their mark-to-market value. Accordingly, during the second quarter, the Company recorded an increase in fair value of $1.6 million, causing a decrease in quarterly interest expense.

Income Tax Expense

The decrease in federal income tax for the three and six months ended July 1, 2018 is primarily due to the newly enacted federal tax rates.

Income tax expense is summarized below.

	Three Months Ended (000's)		Six Months Ended (000's)	
	7/1/2018	7/2/2017	7/1/2018	7/2/2017
Federal income tax expense	$ 60	$ 481	$ 531	$ 929
State and local income tax expense	397	480	921	714
Change in deferred tax asset	1,722	931	689	1,083
Income tax expense	$ 2,178	$ 1,892	$ 2,141	$ 2,726

Financial Condition
Management monitors short and long-term cash needs and believes at this time, that with its ongoing operations and current cash balances, the Company has sufficient capital to meet its ongoing obligations. Loan covenants of the Company's various loan agreements include requirements for the maintenance of certain financial ratios. At July 1, 2018, the Company was in compliance with all of these covenants.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as of July 1, 2018.

Item 5 Legal proceedings.

The Company is involved in various routine legal proceedings that are incidental to its business. All of these proceedings arose in the ordinary course of the Company's business and, in the opinion of the Company, any potential liability of the Company with respect to these legal proceedings will not, in the aggregate, be material to the Company's consolidated financial statements. The Company maintains various types of insurance standard to the industry that, subject to deductibles, will insure over many claims and legal proceedings brought against the Company.

Item 6 Defaults upon senior securities.

None.

Item 7 Other information.

None.

Item 8 Exhibits.

None.

Item 9 Certifications.

I, Robert E. Schermer, Jr., Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Meritage Hospitality Group Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

August 9, 2018

Robert E. Schermer, Jr.
Chief Executive Officer

I, Tracey A. Smith, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Meritage Hospitality Group Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

August 9, 2018

Tracey A. Smith
Chief Financial Officer

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report that are not historical facts constitute forward-looking statements. These may be identified by words such as "estimates," "anticipates," "hopes," "projects," "plans," "expects," "believes," "should," and similar expressions, and by the context in which they are used. Such statements are based only upon current expectations of the Company. Any forward-looking statement speaks only as of the date made. Reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to differ materially from those expressed or implied. Meritage undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which they are made.

Statements concerning expected financial performance, business strategies and action which Meritage intends to pursue to achieve its strategic objectives, constitute forward-looking information. Implementation of these strategies and achievement of such financial performance are subject to numerous conditions, uncertainties and risk factors, which could cause actual performance to differ materially from the forward-looking statements. These include, without limitation: competition; changes in the national or local economy; changes in consumer tastes and eating habits; concerns about the nutritional quality of our restaurant menu items; concerns about consumption of beef or other menu items due to diseases; promotions and price discounting by competitors; severe weather; changes in travel patterns; road construction; demographic trends; the cost of food, labor and energy; the availability and cost of suitable restaurant sites; the ability to finance expansion; interest rates; insurance costs; the availability of adequate managers and hourly-paid employees; directives issued by the franchisor regarding operations and menu pricing; the general reputation of Meritage's and its franchisors' restaurants; the relationship between Meritage and its franchisors; legal claims; security; Meritage's ability to consummate acquisitions or, if consummated, to successfully integrate acquired businesses into Meritage's operations; credit card fraud; and the recurring need for renovation and capital improvements. Meritage is also subject to extensive government regulations relating to, among other things, zoning, public health, sanitation, alcoholic beverage control, environment, food preparation, minimum and overtime wages and tips, employment of minors, citizenship requirements, working conditions, and the operation of its restaurants. Because Meritage's operations are concentrated in certain areas of Arkansas, Connecticut, Florida, Georgia, Indiana, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas and Virginia, significant economic changes in these states, or in the local economies where our restaurants are located, could adversely affect our operations. Additionally, with Meritage's expansion, the Company could be adversely affected by tropical storms, hurricanes, or tornadoes. The Company's news releases and public reports are not intended to constitute an offer to sell or a solicitation of an offer to buy any securities of the Company or otherwise engage in a transaction with the Company.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Financial Report
July 1, 2018 and July 2, 2017

Contents

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Balance Sheet (unaudited)

	July 1, 2018	December 31, 2017
Assets		
Current Assets		
Cash	$ 17,086,897	$ 12,917,352
Receivables	711,231	935,123
Inventories	2,971,435	2,638,675
Prepaid expenses and other current assets	5,839,114	2,544,802
Total Current Assets	26,608,677	19,035,952
Property and Equipment - Net	120,583,123	111,633,411
Goodwill	163,350,263	91,743,204
Intangible Assets	3,451,942	1,915,064
Deferred Income Taxes	-	311,436
Other Assets		
Notes receivable	248,215	548,215
Long-term investments	5,751,851	5,751,851
Deposits and other assets	4,410,733	4,352,552
Total Assets	**$ 324,404,804**	**$ 235,291,685**
Liabilities and Equity		
Current Liabilities		
Trade accounts payable	$ 12,831,115	$ 17,691,499
Lines of credit	37,701,898	35,451,756
Current portion of long-term debt	15,484,063	10,199,550
Accrued liabilities	15,575,461	13,609,124
Total Current Liabilities	81,592,537	76,951,929
Unearned Vendor Allowances	6,125,092	1,636,248
Accrued Rent	3,685,443	3,377,073
Other long-term Liabilities	4,134,547	4,739,426
Long-term Debt - Net of current portion	159,873,633	97,452,984
Deferred Income Taxes	377,726	-
Deferred Gain - Sale and leaseback transactions	16,136,712	12,665,482
Equity	52,479,114	38,468,543
Total Liabilities and Equity	**$ 324,404,804**	**$ 235,291,685**

See notes to consolidated financial statements

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statement of Operations (unaudited)

	Three Months Ended	
	July 1, 2018	July 2, 2017
Food and Beverage Revenue	$ 116,910,202	$ 78,715,356
Costs and Expenses		
Cost of food and beverages	31,206,169	21,149,618
Labor and related expenses	32,705,334	22,285,595
Advertising expenses	4,976,834	3,335,461
Other operating expenses	28,982,013	19,232,693
Total Operating Expenses	97,870,350	66,003,367
General and administrative expenses	6,475,920	4,407,954
Preopening and acquisition expenses	595,201	845,382
Closing and disposition expenses	40,947	14,116
Depreciation and amortization	3,012,955	2,028,856
Total Costs and Expenses	107,995,373	73,299,675
Income from Operations	8,914,829	5,415,681
Other Expense (Income)		
Interest expense	877,443	1,513,517
Other expense (income)	212,218	(978,448)
Total Other Expense	1,089,661	535,069
Income Before Income Taxes	7,825,168	4,880,612
Income Tax Expense	2,178,169	1,891,612
Consolidated Net Income	**$ 5,646,999**	**$ 2,989,000**
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	7,655	15,573
Consolidated Net Income Attributable to Controlling Interest	**$ 5,639,344**	**$ 2,973,427**

See notes to consolidated financial statements

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statement of Operations (unaudited)

	Six Months Ended	
	July 1, 2018	July 2, 2017
Food and Beverage Revenue	$ 216,615,385	$ 140,730,642
Costs and Expenses		
Cost of food and beverages	58,402,849	37,213,965
Labor and related expenses	62,301,900	40,380,213
Advertising expenses	9,202,164	5,953,728
Other operating expenses	54,831,318	35,086,275
Total Operating Expenses	184,738,231	118,634,181
General and administrative expenses	11,023,733	7,999,082
Preopening and acquisition expenses	1,852,323	1,357,692
Closing and disposition expenses	119,101	104,192
Depreciation and amortization	5,773,208	3,807,557
Total Costs and Expenses	203,506,596	131,902,704
Income from Operations	13,108,789	8,827,938
Other Expense (Income)		
Interest expense	3,374,084	2,169,938
Other expense (income)	533,952	(923,545)
Total Other Expense	3,908,036	1,246,393
Income Before Income Taxes	9,200,753	7,581,545
Income Tax Expense	2,140,839	2,726,413
Consolidated Net Income	**$ 7,059,914**	**$ 4,855,132**
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	76,642	12,597
Consolidated Net Income Attributable to Controlling Interest	**$ 6,983,272**	**$ 4,842,535**

See notes to consolidated financial statements

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statement of Equity (unaudited)

	Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Noncontrolling Interest	Total
Balance - January 1, 2017	$ 8,823	$ 59,794	$ 16,984,822	$ 9,072,968	$ -	$ 26,126,407
Net income				8,961,336	76,835	9,038,171
Issuance of 70,448 shares of common stock		704	72,985			73,689
Issuance of 170,360 shares of preferred stock	1,704		3,952,245			3,953,949
Preferred stock conversion	(634)	1,030	(431)			(35)
Common stock dividends			(609,024)			(609,024)
Preferred stock dividends			(896,052)			(896,052)
Company owned stock			(380,575)			(380,575)
Stock option expense			1,015,340			1,015,340
Contributed Capital					555,555	555,555
Distributions					(408,882)	(408,882)
Balance - December 31, 2017	$ 9,893	$ 61,528	$ 20,139,309	$ 18,034,304	$ 223,508	$ 38,468,543
Net income				6,983,272	76,642	7,059,914
Issuance of 64,714 shares of common stock		647	87,933			88,580
Issuance of 310,293 shares of preferred stock	3,103		7,282,654			7,285,757
Preferred stock conversion	(23)	41	(44)			(26)
Common stock dividends			(247,493)			(247,493)
Preferred stock dividends			(682,017)			(682,017)
Company owned stock			(272,823)			(272,823)
Stock option expense			784,881			784,881
Distributions					(6,202)	(6,202)
Balance - July 1, 2018	$ 12,973	$ 62,216	$ 27,092,400	$ 25,017,576	$ 293,948	$ 52,479,114

See notes to consolidated financial statements

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statement of Cash Flows (unaudited)

	Six Months Ended	
	July 1, 2018	July 2, 2017
Cash Flows from Operating Activities		
Net Income	$ 7,059,914	$ 4,855,132
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	5,773,208	3,807,557
Amortization of financing costs	247,308	115,743
Deferred income taxes	689,162	1,083,385
Amortization of deferred gain from sale and leaseback transactions	(558,372)	(438,176)
Recognition of deferred gain on sale and leaseback transactions	(20,226)	-
Change in fair market value of swap	(1,624,366)	111,592
Compensation paid by issuance of common stock	37,830	35,955
Gain on company owned stock	(272,823)	(252,106)
Loss on disposal of fixed assets	79,921	650,884
Stock option expense	784,881	366,233
Changes in operating assets and liabilities which provided (used) cash:		
Receivables	223,892	(401,028)
Inventories	53,197	38,128
Prepaid expenses and other current assets	(3,294,312)	(2,334,855)
Deposits and other assets	(764,599)	(861,805)
Accounts payable	(4,909,718)	1,472,734
Accrued liabilities	1,526,725	3,269,991
Other long-term liabilities	1,019,487	1,113,649
Accrued rent	308,370	135,188
Unearned vendor allowances	4,316,646	3,229,500
Net cash provided by operating activities	10,676,125	15,997,701
Cash Flows from Investing Activities		
Purchase of property and equipment	(33,248,690)	(39,235,540)
Purchase of intangible assets	(1,615,567)	(783,000)
Change in long-term investments	-	(55,390)
Capital contribution into variable interest entity	-	500,000
Proceeds from sale of assets	700,564	
Acquisitions, net	(85,027,979)	(47,139,681)
Net cash used in investing activities	(119,191,672)	(86,713,611)

See notes to consolidated financial statements

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statement of Cash Flows (unaudited) Continued

	Six Months Ended July 1, 2018	Six Months Ended July 2, 2017
Cash Flows from Financing Activities		
Proceeds from long-term debt	112,148,704	44,190,000
Proceeds from lines of credit - net	32,097,557	35,381,835
Proceeds from sale leaseback transactions	36,276,326	7,972,581
Proceeds from note receivable	300,000	-
Principal payments on long-term debt	(43,570,777)	(2,831,904)
Principal payments on capital leases	(200,532)	(163,906)
Payments on line of credit related to sale leaseback transactions	(29,847,414)	(5,356,854)
Payments of financing costs	(919,541)	(394,945)
Payments on preferred stock conversion	(26)	-
Proceeds from sale of common stock	50,750	-
Proceeds from issuance of preferred stock	7,285,757	3,953,949
Distributions from variable interest entity	(6,202)	-
Common stock dividends paid	(247,493)	(272,461)
Preferred stock dividends paid	(682,017)	(440,696)
Net cash provided from financing activities	112,685,092	82,037,599
Net Increase in Cash	4,169,545	11,321,689
Cash - Beginning of year	12,917,352	9,835,808
Cash - End of period	$ 17,086,897	$ 21,157,497
Supplemental Disclosure of Cash Flow Information		
Cash paid for:		
Interest	$ 3,212,444	$ 1,863,792
Income taxes	$ 432,673	$ 1,024,432
Significant non-cash investing and financing transactions:		
Deferred gain on sale leaseback transactions	$ 4,049,829	$ 1,230,034

See notes to consolidated financial statements

Note 1 - Consolidation

The consolidated financial statements include the accounts of Meritage Hospitality Group Inc., all of its wholly owned subsidiaries, its 98.5% owned subsidiary, RDG-MHG, LLC., ("RDG") a 15% partner in TRG-Meritage Bahamas, LLC., ("TRG") and its variable interest entity (VIE), Restaurant Holdings, LLC ("Restaurant Holdings"), for which the Company is the primary beneficiary.

Restaurant Holdings and the attributable equity is reported as a noncontrolling interest in the accompanying consolidated financial statements. For the purpose of consolidation, the effects of eliminations of revenue and expense due to intercompany transactions between the Company and Restaurant Holdings are attributed to the Company. All intercompany transactions and balances have been eliminated in consolidation.

Restaurant Holdings is treated as a partnership for federal income tax purposes. Consequently, federal income taxes are not payable or provided for by Restaurant Holdings. Restaurant Holdings' members are taxed individually on their pro-rata ownership share of the VIE's earnings. Restaurant Holdings' net income or loss is allocated among the members in accordance with Restaurant Holdings' operating agreement.

Note 2 - Stockholders' Equity

The Company has 5,000,000 authorized shares of $0.01 par value per share preferred stock. 1,350,000 shares are designated as Series B convertible cumulative preferred stock, with 816,667 shares issued and outstanding as of July 1, 2018 and 818,967 shares issued and outstanding as of December 31, 2017. 1,500,000 shares are designated as Series C convertible cumulative preferred stock, with 170,360 shares issued and outstanding as of July 1, 2018 and December 31, 2017. 600,000 shares are designated as Series D convertible cumulative preferred stock, with 310,293 shares issued and outstanding as of July 1, 2018, and zero shares issued and outstanding as of December 31, 2017.

The Company raised approximately $7,285,757, net of fees, from issuing 310,293 shares of Series D cumulative convertible preferred stock in February 2018.

The Company has 30,000,000 authorized shares of $0.01 par value per share common stock, with 6,221,656 and 6,152,816 shares issued and outstanding as of July 1, 2018 and December 31, 2017, respectively.

Note 3 - Acquisitions

The Company acquired 56 Wendy’s restaurants through four transactions in 2018. All restaurants acquired included the business and equipment. The Company acquired certain properties and leased the remaining. The Company entered into new lease agreements for certain newly acquired locations with the restaurants' building owners and franchise agreements for all locations with the Company's franchisor, The Wendy’s Company. The acquisitions were financed with approximately $78,954,000 of new debt, $5,614,000 of cash raised through equity and $460,000 of cash paid. The transactions resulted in the recording of approximately $71,607,000 of goodwill, $9,284,000 of land and building, $4,412,000 of equipment and leasehold improvements, $386,000 of inventory and $661,000 of liabilities.

Approximately $41,143,000 of revenue was recognized during the six months ended July 1, 2018 from the acquired locations. In accordance with Accounting Standards Codification 805-10-50-2, the Company deemed it impracticable to disclose sufficient and materially accurate proforma revenue and net income related to the acquisitions, as the determination of proforma adjustments requires assumptions about the sellers intent that cannot be independently substantiated, and also requires significant estimates for which it is impossible to distinguish objectively information about those estimates.

Note 4 - Sale Leasebacks

The Company completed 17 sale and leaseback transactions during the six months ended July 1, 2018. The Company netted proceeds of approximately $36,143,000, and with such proceeds paid down indebtedness of $29,847,000, and deposited $6,296,000 into the Company's treasury. The Company recorded deferred gains of approximately $4,049,000. The gains are being amortized over the 20-year lease terms and recorded as a reduction of base rent expense.

Note 5 - Commitments and Contingencies

As part of the Company's ongoing franchise relationship with The Wendy's Company, the Company is required to complete certain agreed upon improvements to facilities as well as reimage a portion of the Wendy's restaurants acquired during 2015 and 2014 by December 31, 2021. As of July 1, 2018, the Company has remaining estimated capital improvements of $6,250,000 toward these efforts.

Note 6 - Information About Variable Interest Entity

Restaurant Holdings LLC was formed to facilitate real estate transactions where the Company has potential monetary upside in future sale and leaseback transactions. This VIE is owned by related parties and not directly by the Company. Restaurant Holdings is considered to be a variable interest entity because its assets are leased to the Company and these leases with the Company are the primary source of revenue to service its obligations. Restaurant Holdings leverages a credit facility with a bank other than the Company's senior lender, secured by its interest in the real estate and has availability of borrowings up to $35,000,000. As of July 1, 2018, Restaurant Holdings had bank debt obligations totaling $22,679,000.

The economic structure of the Company's senior credit facility requires 25% equity for real estate transactions, which the Company believes is dilutive to its long-term growth strategy. The purpose of Restaurant Holdings is to provide a source of capital to fund the purchase of restaurant real estate, and when sold, provide potential monetary upside to the Company. Restaurant Holdings, upon acquisition of real estate, will lease such real estate to the Company and use rent revenue to pay the interest expense on its bank debt.

In connection with its acquisitions, Restaurant Holdings contractually committed to purchase the real estate of 11 properties in May 2019 with a purchase price of $17,667,000, subject to negotiation of final terms and conditions.

Included in the consolidated balance sheet as of July 1, 2018 and December 31, 2017 are the following amounts related to Holdings, before consolidated eliminating entries.

	July 1, 2018	December 31, 2017
Assets:		
Current assets	$ 620,337	$ 1,168,374
Property and Equipment - net	24,509,258	20,261,416
Total Assets	$ 25,129,595	$ 21,429,790
Liabilities:		
Current liabilities	$ 2,156,671	$ 3,331,856
Revolving line of credit	22,678,976	17,874,426
Total Liabilities	24,835,647	21,206,282
Equity - Noncontrolling interest	293,948	223,508
Total Liabilities and Equity	$ 25,129,595	$ 21,429,790

Note 7 - New Accounting Principles

As of January 1, 2018 the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, "Revenue from Contracts with Customers (Topic 606)", which superseded the current revenue recognition requirements in Topic 605, Revenue Recognition. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition the ASU also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgements and assets recognized from costs incurred to obtain or fulfill a contract. The adoption of this new standard did not have a significant impact on the timing or method of revenue recognized from restaurant sales as food and beverage revenues are recognized upon delivery. Revenues derived from the sale of gift cards are processed through the Company's franchise agreement with its franchisor, the Wendy's Company, and casual dining gift card revenue is not significant.

The guidance also requires additional disclosure to help users of financial statements better understand the nature, amount, timing and uncertainty of revenue that is recognized. As the Company generates revenue through the sale of restaurant food and beverages it aggregates results into sales from Wendy's restaurants and casual dining. Included in the consolidated income statement for the six month period ending July 1, 2018 and July 2, 2017 are the following results aggregated by segment:

	2018	2017
Wendy's restaurants	$ 210,312,022	$133,415,085
Casual dining restaurants	6,303,363	7,315,557
Total revenue	$ 216,615,385	$140,730,642