

# Meritage Hospitality Group Inc.

## Quarterly Report

**For Quarterly Period Ended April 3, 2016**

The following information provides updates to the Annual Report for Fiscal Year Ended January 3, 2016. 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 January 3, 2016 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:

3310 Eagle Park Drive NE, Suite 205

Grand Rapids, MI 49525

Telephone: 616.776.2600

Facsimile: 616.776.2776

Web: [www.meritagehospitality.com](http://www.meritagehospitality.com)

**Item 2     Shares outstanding.**

<u>Common Shares</u>	<u>4/3/16</u>	<u>1/3/16</u>	<u>12/28/14</u>
Authorized:	30,000,000 shares	30,000,000 shares	30,000,000 shares
Outstanding:	5,706,173 shares	5,651,242 shares	5,607,523 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. 360 holders	approx. 360 holders	approx. 383 holders
Number of record holders:	approx. 95 holders	approx. 95 holders	approx. 100 holders
 <u>Preferred A</u>			
Authorized:	200,000 shares	200,000 shares	200,000 shares
Outstanding:	29,520 shares	29,520 shares	29,520 shares
Freely Tradable (public float):	29,520 shares	29,520 shares	29,520 shares
Number of record holders:	2 holders	2 holders	2 holders
 <u>Preferred B</u>			
Authorized:	1,350,000 shares	1,350,000 shares	1,350,000 shares
Outstanding:	856,000 shares	856,000 shares	746,000 shares
Freely Tradable (public float):	300,000 shares	300,000 shares	300,000 shares
Number of record holders:	41 holders	39 holders	38 holders

### Item 3 Interim financial statements.

See the unaudited consolidated financial report for the quarter ended April 3, 2016 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.

#### Overview

The Company reported revenues of \$54.1 million for the three months ended April 3, 2016 compared to revenues of \$46.5 million for the three months ended March 29, 2015, an increase of 16.4%. The increase in revenues was primarily the result of a full quarter of sales from the 24 Wendy's restaurants acquired throughout 2015. Additionally, total Company "same store sales" increased by 4.6% for all restaurants in the three months ended April 3, 2016.

The Company continues to evaluate acquisition opportunities in the Wendy's and casual dining restaurant segments. Since 2009, the Company has acquired 109 Wendy's restaurants through 14 separate transactions.

#### Results of Operations

Meritage operates in the quick-service and casual dining restaurant industries. The Company has experienced significant growth through its acquisition efforts and the launch of its own independent concepts, Twisted Rooster, Crooked Goose and Freighters Eatery & Taproom. At April 3, 2016, the Company operated 159 Wendy's quick-service restaurants under franchise agreements with The Wendy's Company and five casual dining restaurants. Of the Wendy's restaurants, 46 are located in Michigan, 49 in Florida, 36 in Georgia, two in North Carolina, one in South Carolina, 10 in Virginia, and 15 in Ohio. All five casual dining restaurants are located in Michigan.

A schedule of Company restaurants follows:

	<u>Wendy's</u>	<u>Casual Dining</u>	<u>Total Restaurants</u>
Restaurants as of December 28, 2014	137	5	142
Acquired restaurants	24	-	24
Newly opened restaurants	2	-	2
Closed restaurants	-2	-	-2
Restaurants as of January 3, 2016	161	5	166
Newly opened restaurants	1	-	1
Closed restaurants	-3	-	-3
Restaurants as of April 3, 2016	159	5	164

Results of operations are summarized below.

	Three Months Ended			
	(000's)			
	<u>4/3/2016</u>		<u>3/29/2015</u>	
Food and Beverage Revenue	\$54,053	100.0%	\$46,453	100.0%
Costs and Expenses				
Cost of food and beverages	14,239	27.5%	12,751	27.4%
Labor and related expenses	16,290	30.1%	13,773	29.6%
Advertising expenses	2,240	4.1%	1,908	4.1%
Other operating expenses	14,063	26.0%	12,510	26.9%
Total Operating Costs	<u>46,831</u>	<u>88.1%</u>	<u>40,942</u>	<u>88.1%</u>
General & administrative expense	2,863	5.3%	2,447	5.3%
Preopening and acquisition expenses	416	0.8%	214	0.5%
Closing and disposition expenses	998	1.8%	5	0.0%
Depreciation and amortization	1,330	2.5%	1,064	2.3%
Total Costs and Expenses	<u>52,438</u>	<u>97.0%</u>	<u>44,672</u>	<u>96.2%</u>
Income from Operations	<u>1,615</u>	<u>3.0%</u>	<u>1,781</u>	<u>3.8%</u>
Other Expense (Income)				
Interest expense	684	1.3%	554	1.2%
Other expense (income)	148	0.3%	(351)	-0.8%
Total Other Expense	<u>832</u>	<u>1.5%</u>	<u>204</u>	<u>0.4%</u>
Income Before Income Taxes	<u>783</u>	<u>1.4%</u>	<u>1,578</u>	<u>3.4%</u>
Income Tax Expense	<u>242</u>	<u>0.4%</u>	<u>501</u>	<u>1.1%</u>
Net Income	<u><u>541</u></u>	<u><u>1.0%</u></u>	<u><u>1,077</u></u>	<u><u>2.3%</u></u>

### Food and Beverage Revenue

For the three months ended April 3, 2016, revenues increased 16.4%, to \$54.1 million from \$46.5 million in the three months ended March 29, 2015.

The Company's Wendy's restaurants reported sales of \$50.9 million in the three months ended April 3, 2016, an increase of 18.5% over the prior year's first quarter sales. The most significant contributing factor to the increase was a full quarter of sales from the 24 Wendy's restaurants acquired throughout 2015. The Company's Wendy's restaurants experienced a "same store sales" (i.e., food and beverage revenue for stores in full operation on a per period basis for both fiscal years) increase of 5.8% over the prior year's first quarter sales.

The Company's casual dining restaurants reported sales of \$3.1 million in the three months ended April 3, 2016, a "same stores sales" decrease of 9.8% from the prior year, reflecting an overall national downward trend in the casual dining segment for the first quarter, as well as increased competitive intrusion.

### Cost of Food and Beverages

The cost of food and beverages as a percent of revenues for the three months ended April 3, 2016 remained consistent when compared to the prior year.

**Labor and Related Expenses**

Labor and related expenses increased to 30.1% of revenues for the three months ended April 3, 2016 from 29.6% of revenues in the same period of the prior year. The increase in labor is primarily attributed to the overall increase in minimum wage, combined with additional labor required for the nation-wide Wendy's value meal promotion, "Four-for-Four", which offered four items for four dollars.

**Other Operating Expenses**

Other operating expenses decreased to 26.0% of revenues for the three months ended April 3, 2016 from 26.9% of revenues in the same period of the prior year. The decrease is partially related to increased sales in 2016, resulting in a dilutive impact of fixed costs as a percentage of sales. In addition, overall utilities expense was reduced during 2016 from improved weather conditions when compared to 2015.

**General and Administrative Expenses**

General and administrative expenses remained consistent as a percent of revenues when compared to the prior year.

**Preopening and Acquisition Expenses**

Preopening and acquisition expenses include costs associated with the opening of a newly built Wendy's restaurant, as well as costs related to numerous reimagining efforts.

**Closing and Disposition Expenses**

Included in closing and disposition expenses are actual and estimated costs related to the closure of under-performing restaurants. We expect these to be an ongoing expense from continuing efforts to improve our overall restaurant portfolio.

**Interest Expense**

The increase in the amount of interest expense was primarily due to financings associated with the acquisition of 24 Wendy's restaurants in 2015.

**Other Expense**

Other income in the prior year was primarily related to a gain on a real estate transaction completed in the first quarter of 2015. There were no transactions of this nature in the current year.

## Income Tax Expense

Income tax expense is summarized below.

	Three Months Ended (000's)	
	4/3/2016	3/29/2015
Federal income tax expense	285	303
State and local income tax expense	155	132
Change in deferred tax asset	(198)	66
Income tax expense	242	501

## 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 April 3, 2016, the Company was in compliance with all of these covenants.

## Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements as of April 3, 2016.

**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.

May 12, 2016

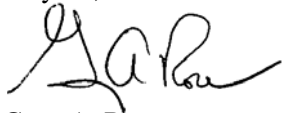


Robert E. Schermer, Jr.  
Chief Executive Officer

I, Gary A. Rose, 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.

May 12, 2016



Gary A. Rose  
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; 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 Michigan, Florida, Georgia, North and South Carolina, Virginia and Ohio, 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 into Florida, the Company could be adversely affected by tropical storms or hurricanes. 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. and Subsidiaries**

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**Consolidated Financial Report  
April 3, 2016 and March 29, 2015**

**Consolidated Financials Statements**

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# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Balance Sheet (unaudited)

	April 3, 2016	January 3, 2016
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 5,165,318	\$ 6,587,845
Receivables	269,005	428,196
Inventories	1,305,504	1,401,707
Prepaid expenses and other current assets	2,626,238	2,515,490
Total Current Assets	9,366,065	10,933,238
<b>Property and Equipment - Net</b>	51,779,296	49,072,061
<b>Goodwill</b>	38,016,614	38,016,614
<b>Intangible Assets</b>	1,346,933	1,383,076
<b>Deferred Income Taxes</b>	2,529,843	2,332,186
<b>Other Assets</b>		
Notes receivable	548,215	548,215
Long-term investments	5,261,724	5,261,724
Deposits and other assets	2,911,628	1,975,441
Total Assets	<b>\$ 111,760,318</b>	<b>\$ 109,522,555</b>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Trade accounts payable	\$ 6,436,491	\$ 10,027,501
Revolving line of credit	7,859,600	6,792,864
Current portion of long-term debt	7,528,223	6,586,265
Accrued liabilities	8,468,117	9,512,562
Total Current Liabilities	30,292,431	32,919,192
<b>Unearned Vendor Allowances</b>	2,598,117	565,906
<b>Accrued Rent</b>	2,751,237	2,664,792
<b>Deferred Compensation</b>	2,791,232	1,780,525
<b>Long-term Debt - Net of current portion</b>	42,632,656	41,224,622
<b>Deferred Gain - Sale and leaseback transactions</b>	9,616,598	9,834,161
<b>Equity</b>	21,078,047	20,533,357
Total Liabilities and Equity	<b>\$ 111,760,318</b>	<b>\$ 109,522,555</b>

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Statement of Operations (unaudited)

	Three Months Ended	
	April 3, 2016	March 29, 2015
<b>Food and Beverage Revenue</b>	\$ 54,052,687	\$ 46,453,127
<b>Costs and Expenses</b>		
Cost of food and beverages	14,238,703	12,751,048
Labor and related expenses	16,289,636	13,772,626
Advertising expenses	2,240,066	1,908,401
Other operating expenses	14,062,895	12,510,198
Total Operating Expenses	46,831,300	40,942,273
General and administrative expenses	2,862,569	2,446,505
Preopening and acquisition expenses	416,324	213,907
Closing and disposition expenses	997,812	4,858
Depreciation and amortization	1,329,605	1,064,267
Total Costs and Expenses	52,437,610	44,671,810
<b>Income from Operations</b>	1,615,077	1,781,317
<b>Other Expense (Income)</b>		
Interest expense	684,054	554,117
Other expense (income)	147,764	(350,607)
Total Other Expense	831,818	203,510
<b>Income Before Income Taxes</b>	783,259	1,577,807
<b>Income Tax Expense</b>	241,948	500,829
<b>Net Income</b>	<b>\$ 541,311</b>	<b>\$ 1,076,978</b>

See notes to consolidated financial statements

## Meritage Hospitality Group Inc. and Subsidiaries

### Consolidated Statement of Equity (unaudited)

	Series A Convertible Preferred Stock	Series B Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
<b>Balance - December 28, 2014</b>	\$ 295	\$ 7,460	\$ 56,075	\$ 17,371,126	\$ (4,403,304)	\$ 13,031,652
Net income					7,026,294	7,026,294
Issuance of 110,000 shares of preferred stock		1,100		1,098,900		1,100,000
Issuance of 43,720 shares of common stock			437	51,522		51,959
Common stock dividends				(337,781)		(337,781)
Preferred stock dividends				(657,564)		(657,564)
Stock option expense				318,797		318,797
<b>Balance - January 3, 2016</b>	<u>\$ 295</u>	<u>\$ 8,560</u>	<u>\$ 56,512</u>	<u>\$ 17,845,000</u>	<u>\$ 2,622,990</u>	<u>\$ 20,533,357</u>
Net income					541,311	541,311
Issuance of 54,931 shares of common stock			549	71,303		71,852
Preferred stock dividends				(177,842)		(177,842)
Stock option expense				109,369		109,369
<b>Balance - April 3, 2016</b>	<u>\$ 295</u>	<u>\$ 8,560</u>	<u>\$ 57,061</u>	<u>\$ 17,847,830</u>	<u>\$ 3,164,301</u>	<u>\$ 21,078,047</u>

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Statement of Cash Flows (unaudited)

	Three Months Ended	
	April 3, 2016	March 29, 2015
<b>Cash Flows from Operating Activities</b>		
Net Income	\$ 541,311	\$ 1,076,978
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,329,605	1,064,267
Deferred income taxes	(197,657)	65,566
Amortization of deferred gain from sale and leaseback transactions	(217,563)	(227,668)
Compensation paid by issuance of common stock	8,977	9,005
Loss on disposal of fixed assets	324,391	3,785
Stock option expense	109,369	63,653
Changes in operating assets and liabilities which provided (used) cash:		
Receivables	159,191	(13,032)
Inventories	96,203	133,169
Prepaid expenses and other current assets	(110,748)	198,677
Deposits and other assets	(938,747)	(66,622)
Accounts payable	(3,591,010)	(211,642)
Accrued liabilities	(1,044,447)	(348,063)
Other long-term liabilities	1,010,707	92,772
Accrued rent	86,445	60,031
Unearned vendor allowances	2,032,211	(254,460)
Net cash (used in) provided by operating activities	(401,762)	1,646,416
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(4,306,573)	(1,685,192)
Change in long-term investments	-	(64,224)
Acquisitions, net	-	(6,134,351)
Net cash used in investing activities	(4,306,573)	(7,883,767)

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Statement of Cash Flows (unaudited) Continued

	Three Months Ended	
	April 3, 2016	March 29, 2015
<b>Cash Flows from Financing Activities</b>		
Proceeds from long-term debt	4,363,426	5,000,000
Proceeds from revolving lines of credit - net	1,066,736	603,253
Proceeds from sale leaseback transactions	-	6,303,342
Principal payments on long-term debt	(1,941,371)	(1,064,424)
Principal payments on capital lease	(72,062)	(49,623)
Payments on debt related to sale leaseback transactions	-	(5,398,365)
Payments on financing costs	(15,954)	(31,663)
Proceeds from sale of common stock	62,875	-
Preferred stock dividends paid	(177,842)	(155,842)
Net cash provided by financing activities	3,285,808	5,206,678
<b>Net Decrease in Cash</b>	(1,422,527)	(1,030,673)
<b>Cash - Beginning of year</b>	6,587,845	5,200,901
<b>Cash - End of year</b>	<u>\$ 5,165,318</u>	<u>\$ 4,170,228</u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid for:		
Interest	\$ 723,891	\$ 556,266
Income taxes	\$ 65,274	\$ 36,000
Significant non-cash investing and financing transactions:		
Deferred gain on sale leaseback transactions	\$ -	\$ 689,719

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

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## Notes to Consolidated Financial Statements (unaudited)

### Note 1 - Consolidation

The consolidated financial statements include the accounts of Meritage Hospitality Group Inc., all of its wholly owned subsidiaries, and its 98.5% owned subsidiary, RDG-MHG, LLC., ("RDG"). RDG is a 15% partner in TRG-Meritage Bahamas, LLC., ("TRG"). All intercompany transactions and balances have been eliminated in consolidation.

### Note 2 - Stockholders' Equity

The Company has 5,000,000 authorized shares of \$0.01 par value per share preferred stock. 200,000 shares are designated as Series A convertible cumulative preferred stock, with 29,520 shares issued and outstanding as of April 3, 2016 and January 3, 2016. 1,350,000 shares are designated as Series B convertible cumulative preferred stock, with 856,000 shares issued and outstanding as of April 3, 2016 and January 3, 2016.

The Company has 30,000,000 authorized shares of \$0.01 par value per share common stock, with 5,706,173 and 5,651,242 shares issued and outstanding as of April 3, 2016 and January 3, 2016, respectively.

### Note 3 - 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 reimagine a portion of the Wendy's restaurants acquired during 2015 and 2014 by December 31, 2021. As of April 3, 2016, the Company has remaining estimated capital improvements of \$7,882,000 toward these efforts.