

Meritage Hospitality Group Inc.
Quarterly Report

For Quarterly Period Ended October 3, 2021

The following information provides an update to the Annual Report for Fiscal Year Ended January 3, 2021. Accordingly, this report does not contain all the information required of an issuer for its annual disclosure obligations and should therefore be reviewed in conjunction with the Annual Report for Fiscal Year Ended January 3, 2021 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.

<u>Common Shares</u>	<u>10/03/21</u>	<u>01/03/21</u>	<u>12/29/19</u>
Authorized:	30,000,000 shares	30,000,000 shares	30,000,000 shares
Outstanding:	6,716,436 shares	6,643,681 shares	6,348,259 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. 689 holders	approx. 698 holders	approx. 740 holders
Number of record holders:	approx. 60 holders	approx. 68 holders	approx. 73 holders
<u>Preferred B</u>			
Authorized:	1,350,000 shares	1,350,000 shares	1,350,000 shares
Outstanding:	805,900 shares	809,067 shares	809,067 shares
Freely Tradable (public float):	300,000 shares	300,000 shares	300,000 shares
Number of record holders:	25 holders	45 holders	44 holders
<u>Preferred C</u>			
Authorized:	200,000 shares	200,000 shares	1,500,000 shares
Outstanding:	160,360 shares	160,360 shares	160,360 shares
Number of record holders:	7 holders	7 holders	7 holders
<u>Preferred D</u>			
Authorized:	600,000 shares	600,000 shares	600,000 shares
Outstanding:	310,293 shares	310,293 shares	310,293 shares
Number of record holders:	24 holders	24 holders	24 holders

<u>Preferred E</u>	<u>07/04/21</u>	<u>01/03/21</u>	<u>12/29/19</u>
Authorized:	800,000 shares	800,000 shares	800,000 shares
Outstanding:	341,510 shares	341,510 shares	238,766 shares
Number of record holders:	14 holders	14 holders	10 holders

Item 3 Interim financial statements.

See the unaudited consolidated financial report for the quarter ended October 3, 2021 attached at the end of this report. The unaudited consolidated financial statements include the following reports:

- (1) balance sheets;
- (2) statements of operations and comprehensive income;
- (3) statements of equity;
- (4) statements of cash flows; and
- (5) notes to consolidated financial statements.

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

Overview

Meritage operates in the quick-service and casual dining restaurant industries. The Company has experienced significant growth through acquisitions, newly built locations, reimagining campaigns, and investment in independent concept restaurants. The Company has committed significant capital resources to the Wendy's brand initiatives, including a commitment to build 50 new restaurants by November 30, 2025 under a development agreement with Wendy's, as well as the launch of a new Wendy's breakfast menu in March 2020. As of the date of this report, the Company has completed approximately 20 of the new restaurant commitments and since 2009, has acquired 264 Wendy's restaurants through 26 separate transactions making it the largest franchisee in the Wendy's system. As part of its long-term growth strategy, the Company continues to evaluate acquisition opportunities in the Wendy's system, as well as other growth opportunities in the restaurant industry.

In connection with the Company's continued growth initiatives, the Company entered into an Area Development Agreement effective August 18, 2021, with its newest franchisor, Taco John's. Subject to certain terms and conditions, the Company committed to build 50 new Taco John's restaurants by March 31, 2026, with options to develop an additional 150 restaurants thereafter. The Company estimates it will invest approximately \$100 million in the initial 50 store roll-out and anticipates it will be eligible to receive significant economic incentives subject to fulfilling its development schedule under the Area Development Agreement.

As of October 3, 2021, the Company operated 337 Wendy's quick-service restaurants under franchise agreements with The Wendy's Company and eight independent restaurants operating under four concepts. Of the Wendy's quick-service restaurants, nine are operating in Arkansas, 32 in Connecticut, 55 in Florida, 48 in Georgia, 12 in Indiana, 13 in Massachusetts, 55 in Michigan, seven in Mississippi, three in Missouri, two in North Carolina, 15 in Ohio, 28 in Oklahoma, one in South Carolina, 32 in Tennessee, 12 in Texas and 13 in Virginia. All eight independent concept restaurants are located in Michigan.

A schedule of Company restaurants is as follows:

	Wendy's	Independent Concepts	Total Restaurants
Restaurants as of December 29, 2019	331	6	337
Acquired restaurants	-	-	-
Newly opened restaurants	8	1	9
Closed restaurants	(6)	-	(6)
Restaurants as of January 3, 2021	333	7	340
Acquired restaurants	-	-	-
Newly opened restaurants	8	1	9
Closed restaurants	(4)	-	(4)
Restaurants as of October 3, 2021	337	8	345

Recent Developments Related to COVID-19

In January 2020, the World Health Organization (“WHO”) announced a global health emergency resulting from a new strain of coronavirus (COVID-19). As the virus spread globally, the COVID-19 outbreak was classified as a pandemic in March 2020.

As a result of associated governmental actions, the Company was mandated to close dine-in services for all its restaurants in mid-March 2020. In accordance with governmental orders, the Company began to re-open some of its dining rooms in mid-June 2020. As of the date of this report and as permitted by local executive orders, all of the Company’s Wendy’s dining rooms and independent concept restaurants have re-opened. While the Company is optimistic the disruption from the COVID-19 pandemic will continue to lessen, there remains a level of uncertainty around the duration and severity of future disruption. As a result, the Company is not able to fully estimate the complete impact of the pandemic on its results of operations, financial condition, or liquidity.

Throughout fiscal year 2020 and the peak of the pandemic, the Company focused on swiftly reacting and adjusting to the continuously evolving environment caused by COVID-19, enabling the Company to produce a healthy financial performance. While future financial performance remains difficult to predict, the Company believes that based on its historical ability to promptly respond to unanticipated developments, as well as its overall financial and operational structure, it is appropriately positioned to address potential risks and future impact brought on by the COVID-19 pandemic. However, no assurance can be made in this regard.

See *Forward-Looking Statements* for further discussion of the COVID-19 pandemic on the Company’s business.

Results of Operations

Results of operations are summarized as follows:

	Three Months Ended (in thousands)				Nine Months Ended (in thousands)			
	10/03/21		09/27/20		10/03/21		09/27/20	
Food and Beverage Revenue	\$ 147,513	100.0%	\$ 136,640	100.0%	\$ 428,623	100.0%	\$ 376,181	100.0%
Expenses								
Food and beverage	39,706	26.9%	36,423	26.7%	111,001	25.9%	98,497	26.2%
Labor and related	49,023	33.2%	39,099	28.6%	134,543	31.4%	110,279	29.3%
Occupancy	19,879	13.5%	18,451	13.5%	56,958	13.3%	51,328	13.6%
Advertising	5,652	3.8%	4,778	3.5%	16,567	3.9%	13,025	3.5%
Franchise fees	5,539	3.8%	5,154	3.8%	16,236	3.8%	14,191	3.8%
Other operating	13,904	9.4%	11,224	8.2%	37,805	8.8%	30,695	8.2%
Total Operating Expenses	133,703	90.6%	115,129	84.3%	373,110	87.0%	318,015	84.5%
General and administrative	6,762	4.6%	7,696	5.6%	24,273	5.7%	18,143	4.8%
Preopening, acquisition and closing	1,057	0.7%	997	0.7%	2,525	0.6%	7,232	1.9%
Depreciation and amortization	4,175	2.8%	4,660	3.4%	12,068	2.8%	14,136	3.8%
Total Expenses	145,697	98.8%	128,482	94.0%	411,976	96.1%	357,526	95.0%
Income from Operations	1,816	1.2%	8,158	6.0%	16,647	3.9%	18,655	5.0%
Other (Income) Expense								
Interest	1,516	1.0%	2,063	1.5%	5,036	1.2%	8,805	2.3%
Other	(2,285)	(1.5%)	333	0.2%	(8,086)	(1.9%)	731	0.2%
Total Other (Income) Expense	(769)	(0.5%)	2,396	1.7%	(3,050)	(0.7%)	9,536	2.5%
Income Before Income Taxes	2,585	1.7%	5,762	4.3%	19,697	4.6%	9,119	2.5%
Income Tax Expense	170	0.1%	1,167	0.9%	4,464	1.0%	2,134	0.6%
Consolidated Net Income	<u>\$ 2,415</u>	<u>1.6%</u>	<u>\$ 4,595</u>	<u>3.4%</u>	<u>\$ 15,233</u>	<u>3.6%</u>	<u>\$ 6,985</u>	<u>1.9%</u>
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest I	14	0.0%	95	0.1%	536	0.1%	100	0.0%
Consolidated Comprehensive Net Income								
Attributable to Controlling Interest	<u>\$ 2,401</u>	<u>1.6%</u>	<u>\$ 4,500</u>	<u>3.3%</u>	<u>\$ 14,697</u>	<u>3.5%</u>	<u>\$ 6,885</u>	<u>1.9%</u>

Food and Beverage Revenue

The Company reported revenue of \$147.5 and \$428.6 million for the three and nine months ended October 3, 2021, representing an increase of 8.0% and 13.9% over prior year's sales of \$136.6 and \$376.2 million for the three and nine months ended September 27, 2020, respectively. 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, without adjusting for any impact resulting from the COVID-19 pandemic) increased by 5.6% and 11.7% for three and nine months ended October 3, 2021, when compared to the same periods in the prior year. Increases are primarily due to reduced sales revenue in the first half of 2020 resulting from closed dine-in services as mandated due to the COVID-19 pandemic, as well as strategic price increases deployed throughout the year.

The Company's Wendy's restaurants reported sales of \$144.5 and \$421.7 million for the three and nine months ended October 3, 2021, representing an increase of 7.5% and 13.6% over prior year's sales of \$134.5 and \$371.2 million for the three and nine months ended September 27, 2020, respectively. The Company's Wendy's restaurants experienced a "same store sales" increase of 5.1% and 11.3% for the three and nine months ended October 3, 2021, when compared to the same periods in the prior year. Increases are primarily the result of incremental sales provided from the launch of Wendy's Breakfast menu in March 2020, as well as reduced sales in 2020 resulting from the COVID-19 pandemic.

The Company's independent concept restaurants reported sales of \$3.0 and \$6.9 million for the three and nine months ended October 3, 2021, representing an increase of 38.9% and 40.3% from prior year sales of \$2.1 and \$5.0 million for the three and nine months ended September 27, 2020, respectively. Independent concept restaurants experienced a "same store sales" increase of 38.0% and 47.7% for the three and nine months ended September 27, 2021, when compared to the same periods in the prior year. These increases reflect the impact of both closed and limited operations in 2020 due to state and local ordinances implemented in response to the COVID-19 pandemic.

Cost of Food and Beverage

The cost of food and beverage increased to 26.9% of revenue for the three months ended October 3, 2021, from 26.7% of revenue for the three months ended September 27, 2020. The increase primarily represents a significant increase in commodity costs exclusive to the third quarter of 2021. Such increases were partially offset by a 19.2% decline in the average cost of beef for the three months ended October 3, 2021, when compared to the same period in the prior year.

For the nine months ended October 3, 2021, the cost of food and beverage decreased to 25.9% of revenue from 26.2% of revenue for the nine months ended September 27, 2020. The decrease is primarily the result of a 15.8% decline in the average cost of beef for the nine months ended October 3, 2021, as well as favorable commodity costs in the first quarter of 2021. Such decline was offset by the impact of increased commodity costs realized in the third quarter of 2021.

In addition to the impact of forementioned commodity costs, the Company has responded to evolving market conditions by deploying strategic price increases over the last 12 months.

Labor and Related Expenses

Labor and related expenses increased to 33.2% and 31.4% of revenue for the three and nine months ended October 3, 2021 from 28.6% and 29.3% of revenue for the three and nine months ended September 27, 2020, respectively. The significant increase in overall labor costs primarily reflect the impact of increased hourly wage rates caused by reduced available staff and increased market wage competition.

Occupancy Expenses

Occupancy expenses as a percent of revenue remained consistent at 13.5% of revenue for the three months ended October 3, 2021 when compared to the same period in the prior year. Occupancy expenses decreased to 13.3% of revenue for the nine months ended October 3, 2021 from 13.6% of revenue for the nine months ended September 27, 2020, respectively. The decrease represents the dilutive impact of fixed costs from increased sales over the prior year, slightly offset by increased repair and maintenance costs.

Other Operating Expenses

Other operating expenses increased to 9.4% and 8.8% of revenue for the three and nine months ended October 3, 2021, from 8.2% of revenue for the three and nine months ended September 27, 2020. The increase represents the rising cost of certain supplies as well as increased technology service fees assessed by the Company's Wendy's Franchisor.

General and Administrative Expenses

General and administrative expenses decreased to 4.6% of revenue for the three months ended October 3, 2021, from 5.6% of revenue for the three months ended September 27, 2020. General and administrative expenses increased to 5.7% of revenue for the nine months ended October 3, 2021, from 4.8% of revenue for the same period in the prior year. The associated quarterly variances as a percent of revenue are primarily due to the fluctuation in incentive compensation accruals which are based on financial performance.

Preopening, Acquisition and Closing Expenses

Preopening and acquisition expenses generally represent costs associated with opening new locations, concepts, or product lines in addition to numerous reimagining efforts and acquisitions.

Closing expenses generally 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.

Preopening, acquisition and closing expenses in 2020 included one-time costs related to preparing for the launch of Wendy's Breakfast, as well as non-recurring costs related to the COVID-19 pandemic which include, but are not limited to, safety supplies, legal and bank fees, business interruption income replacement and other expenses. Such costs were offset by a reduction in expenses due to construction during the COVID-19 pandemic.

Depreciation and Amortization

The decrease in the amount of depreciation and amortization expense was primarily due to reduced real estate construction throughout 2020 due to the COVID-19 pandemic.

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Interest Expense

The decrease in the amount of interest expense is primarily due to a decline in the effective interest rate on variable debt over the prior year, as well as favorable interest rates obtained in the Company's recent refinancing effective August 5, 2021. Further associated with the decline is the amount of interest expense due to the change in fair value of the Company's interest rate swap agreements which were recognized as interest expense through the second quarter of 2021. Effective with the recent refinancing, the Company implemented a change in accounting principle to recognize the change in fair value of its swap agreements through other comprehensive income, a component of equity.

Interest expense is summarized as follows:

	Three Months Ended (in thousands)		Nine Months Ended (in thousands)	
	10/03/21	09/27/20	10/03/21	09/27/20
Interest expense - swap	\$ (145)	\$ (493)	\$ (1,035)	\$ 867
Interest expense	1,661	2,556	6,071	7,938
Total interest expense	<u>\$ 1,516</u>	<u>\$ 2,063</u>	<u>\$ 5,036</u>	<u>\$ 8,805</u>

Other (Income) Expense

Other (Income) Expense generally represents gains on real estate transactions completed throughout the year, which are partially offset by stock option expense. The increase in income is primarily due to the quantity and profitability of sale and leaseback transactions for the nine months ended October 3, 2021, when compared to sale and leaseback transactions for the same period in the prior year.

Income Tax Expense

Income tax expense is summarized as follows:

	Three Months Ended (in thousands)		Nine Months Ended (in thousands)	
	10/03/21	09/27/20	10/03/21	09/27/20
Federal income tax expense	\$ (557)	\$ 94	\$ 802	\$ 1,168
State and local income tax expense	(152)	203	941	869
Change in deferred income taxes	879	870	2,721	97
Total Income tax expense	<u>\$ 170</u>	<u>\$ 1,167</u>	<u>\$ 4,464</u>	<u>\$ 2,134</u>

Financial Condition

Management monitors short and long-term cash needs and believes that with its ongoing operations and access to cash, the Company has sufficient capital and liquidity to meet its ongoing obligations. Loan covenants of the Company's various loan agreements include requirements for the maintenance of certain financial ratios. As of October 3, 2021, the Company was in compliance with these covenants.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements not disclosed elsewhere within the consolidated financial statements as of October 3, 2021.

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 condition. 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.

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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.

November 9, 2021



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.

November 9, 2021



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,” “would,” and similar expressions (including the negative versions), 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 actions 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 preferences, 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 or other food safety issues; promotions and price discounting by competitors; severe weather; changes in travel patterns; road construction; demographic trends; failure to manage social media trends; the cost of food, labor and energy; supply chain interruptions; 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; risks associated with leasing real property; 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, including cyber security and information technology security; credit card fraud; Meritage’s ability to consummate acquisitions or, if consummated, to successfully integrate acquired businesses into Meritage’s operations; Meritage’s execution of growth initiatives; and the recurring need for restaurant 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, other labor and employment matters, and the operation of its restaurants. Meritage is also subject to risks and uncertainties related to disruptions to or reductions in business operations, liquidity, prospects or supply chains due to pandemics, epidemics, widespread health emergencies, or outbreaks of infectious diseases such as the coronavirus disease COVID-19, its potential variants and developments related to these types of events. 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
October 3, 2021 and September 27, 2020**

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

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Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Balance Sheets		
(in thousands)		
	(unaudited) October 3, 2021	January 3, 2021
Assets		
Current Assets		
Cash	\$ 53,796	\$ 32,319
Receivables	1,650	1,733
Inventories	4,018	3,616
Prepaid expenses and other current assets	7,621	8,515
Total Current Assets	67,085	46,183
Property and Equipment - Net	133,651	118,323
Goodwill	174,243	174,243
Intangible Assets	5,165	5,039
Operating Lease Right-of-Use Assets - Net	359,814	337,575
Other Assets		
Long-term investments	1,786	1,786
Deposits and other assets	6,990	6,777
Total Assets	\$ 748,734	\$ 689,926
Liabilities and Equity		
Current Liabilities		
Trade accounts payable	\$ 14,326	\$ 16,928
Lines of credit	18,187	10,040
Current portion of long-term debt	13,201	19,996
Current portion of operating lease obligations payable	23,253	22,024
Accrued liabilities	26,819	25,695
Total Current Liabilities	95,786	94,683
Unearned Vendor Allowances	3,893	2,872
Operating Lease Obligations Payable	342,080	320,876
Other Long-term Liabilities	16,623	14,553
Long-term Debt - Net of current portion	168,684	148,862
Deferred Income Taxes	12,382	9,661
Equity	109,286	98,419
Total Liabilities and Equity	\$ 748,734	\$ 689,926

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Operations and Comprehensive Income (in thousands, except per share data)

	Three Months Ended (unaudited)	
	October 3, 2021	September 27, 2020
Food and Beverage Revenue	\$ 147,513	\$ 136,640
Expenses		
Food and beverage	39,706	36,423
Labor and related	49,023	39,099
Occupancy	19,879	18,451
Advertising	5,652	4,778
Franchise fees	5,539	5,154
Other operating	13,904	11,224
Total Operating Expenses	133,703	115,129
General and administrative	6,762	7,696
Preopening, acquisition and closing	1,057	997
Depreciation and amortization	4,175	4,660
Total Expenses	145,697	128,482
Income from Operations	1,816	8,158
Other (Income) Expense		
Interest	1,516	2,063
Other	(2,285)	333
Total Other (Income) Expense	(769)	2,396
Income Before Income Taxes	2,585	5,762
Income Tax Expense	170	1,167
Consolidated Net Income	\$ 2,415	\$ 4,595
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	14	95
Consolidated Comprehensive Net Income Attributable to Controlling Interest	\$ 2,401	\$ 4,500
Other Comprehensive Income		
Change in interest rate swap valuation	220	-
Consolidated Comprehensive Net Income	\$ 2,621	\$ 4,500
Earnings per share		
Basic	\$ 0.28	\$ 0.62
Diluted	\$ 0.24	\$ 0.48
Basic Weighted Average Shares Outstanding	6,725	6,456
Diluted Weighted Average Shares Outstanding	8,899	9,447

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Operations and Comprehensive Income (in thousands, except per share data)

	Nine Months Ended (unaudited)	
	October 3, 2021	September 27, 2020
Food and Beverage Revenue	\$ 428,623	\$ 376,181
Expenses		
Food and beverage	111,001	98,497
Labor and related	134,543	110,279
Occupancy	56,958	51,328
Advertising	16,567	13,025
Franchise fees	16,236	14,191
Other operating	37,805	30,695
Total Operating Expenses	373,110	318,015
General and administrative	24,273	18,143
Preopening, acquisition and closing	2,525	7,232
Depreciation and amortization	12,068	14,136
Total Expenses	411,976	357,526
Income from Operations	16,647	18,655
Other (Income) Expense		
Interest	5,036	8,805
Other	(8,086)	731
Total Other (Income) Expense	(3,050)	9,536
Income Before Income Taxes	19,697	9,119
Income Tax Expense	4,464	2,134
Consolidated Net Income	\$ 15,233	\$ 6,985
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	536	100
Consolidated Comprehensive Net Income Attributable to Controlling Interest	\$ 14,697	\$ 6,885
Other Comprehensive Income		
Change in interest rate swap valuation	220	-
Consolidated Comprehensive Net Income	\$ 14,917	\$ 6,885
Earnings per share		
Basic	\$ 1.96	\$ 0.84
Diluted	\$ 1.53	\$ 0.69
Basic Weighted Average Shares Outstanding	6,708	6,439
Diluted Weighted Average Shares Outstanding	9,629	8,756

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Equity (in thousands)

	Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interest	Total
Balance - December 29, 2019	<u>\$ 13</u>	<u>\$ 64</u>	<u>\$ 33,652</u>	<u>\$ -</u>	<u>\$ 47,120</u>	<u>\$ 2,229</u>	<u>\$ 83,078</u>
Net income	-	-	-	-	14,910	845	15,755
Issuance of common stock	-	3	121	-	-	-	124
Issuance of preferred stock	1	-	2,399	-	-	-	2,400
Repurchase of common stock	-	-	(183)	-	-	-	(183)
Common stock dividends	-	-	-	-	(907)	-	(907)
Preferred stock dividends, net	-	-	-	-	(1,634)	-	(1,634)
Company-owned stock	-	-	(1,271)	-	-	-	(1,271)
Stock option expense	-	-	1,515	-	-	-	1,515
Distributions	-	-	-	-	-	(458)	(458)
Balance - January 3, 2021	<u>\$ 14</u>	<u>\$ 67</u>	<u>\$ 36,233</u>	<u>\$ -</u>	<u>\$ 59,489</u>	<u>\$ 2,616</u>	<u>\$ 98,419</u>
Net income	-	-	-	-	14,697	536	15,233
Issuance of common stock	-	1	132	-	-	-	133
Repurchase of common stock	-	-	(622)	-	-	-	(622)
Repurchase of preferred stock	-	-	(107)	-	-	-	(107)
Common stock dividends	-	-	-	-	(1,610)	-	(1,610)
Preferred stock dividends, net	-	-	-	-	(1,242)	-	(1,242)
Interest rate swap	-	-	-	222	-	-	222
Company-owned stock	-	-	(2,053)	-	-	-	(2,053)
Stock option expense	-	-	932	-	-	-	932
Distributions	-	-	-	-	-	(19)	(19)
Balance - October 3, 2021 (unaudited)	<u>\$ 14</u>	<u>\$ 68</u>	<u>\$ 34,515</u>	<u>\$ 222</u>	<u>\$ 71,334</u>	<u>\$ 3,133</u>	<u>\$ 109,286</u>

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Cash Flows (in thousands)

	Nine Months Ended (unaudited)	
	October 3, 2021	September 27, 2020
Cash Flows from Operating Activities		
Net Income	\$ 15,233	\$ 6,985
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	12,068	14,136
Amortization of financing costs	417	464
Deferred income taxes	2,721	469
Loss on disposal of fixed assets	2,729	2,226
Gain on sale leaseback transactions	(8,121)	(666)
Change in fair market value of swap	(1,035)	867
Change in company-owned stock	(2,053)	(319)
Stock option expense	932	1,182
Changes in assets and liabilities which provided (used) cash:		
Receivables	83	(101)
Inventories	(402)	15
Prepaid expenses and other current assets	894	318
Deposits and other assets	(1,018)	(481)
Accounts payable	(2,602)	(8,841)
Accrued liabilities	1,318	8,543
Unearned vendor allowances	1,021	2,657
Other long-term liabilities	3,327	944
Net cash provided by operating activities	25,512	28,398
Cash Flows from Investing Activities		
Purchase of property and equipment	(63,216)	(22,445)
Purchase of intangible assets	(312)	(914)
Proceeds from sale of asset	842	900
Net cash used in investing activities	(62,686)	(22,459)

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Cash Flows (in thousands)

Nine Months Ended (unaudited)	
October 3, 2021	September 27, 2020
Cash Flows from Financing Activities	
Proceeds from long-term debt	181,800
Principal payments on long-term debt	(166,083)
Proceeds from lines of credit	67,146
Payments on lines of credit	(27,647)
Proceeds from sale leaseback transactions	41,363
Payments on lines of credit related to sale and leaseback transactions	(31,352)
Principal payments on finance leases	-
Payments on financing costs	(3,109)
Payments on repurchase of stock	(729)
Proceeds from sale of common stock	133
Proceeds from issuance of preferred stock, net	-
Common stock dividends paid	(1,610)
Preferred stock dividends paid, net	(1,242)
Distributions to Variable Interest Entity members	(19)
Net cash provided by financing activities	58,651
Net Increase in Cash	21,477
Cash - Beginning of period	32,319
Cash - End of period	\$ 53,796

Supplemental Disclosure of Cash Flow Information

Cash paid for:		
Interest	\$ 6,454	\$ 8,061
Income taxes	\$ 2,451	\$ 269
Significant non-cash investing and financing activities:		
Preferred stock dividends accrued but not paid	\$ -	\$ 414

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited)

(in thousands, except share data)

Note 1 – Consolidation

The consolidated financial statements include the accounts of Meritage Hospitality Group Inc., ("MHGI") 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 a primary beneficiary.

Restaurant Holdings is reported as a noncontrolling interest in the accompanying consolidated financial statements. All intercompany transactions and balances between the Company, its subsidiaries and Restaurant Holdings have been eliminated in consolidation.

As the Company generates revenue through the sale of restaurant food and beverage, it aggregates results into sales from Wendy's restaurants and independent concept restaurants. Included in the consolidated statements of operations for the three and nine months ended October 3, 2021 and September 27, 2020 are the following results:

	Three Months Ended		Nine Months Ended	
	10/03/21	09/27/20	10/03/21	09/27/20
Wendy's restaurants	\$ 144,541	\$ 134,500	\$ 421,673	\$ 371,229
Independent concept restaurants	2,972	2,140	6,950	4,952
Total Revenue	<u>\$ 147,513</u>	<u>\$ 136,640</u>	<u>\$ 428,623</u>	<u>\$ 376,181</u>

Note 2 - Leases

The Company has operating lease agreements for unowned restaurants, the corporate office, and certain equipment. Land and building leases used in operations have remaining lease terms ranging from one to 20 years, some of which include options to renew for up to 50 years.

On the consolidated balance sheets, operating leases are included in operating lease right-of-use ("ROU") assets, operating lease obligations payable, and current portion of operating lease obligations payable. Finance leases are included in property and equipment, long-term debt, and current portion of long-term debt.

Operating lease ROU assets and operating lease liabilities are recognized based on the present value of future minimum lease payments over the lease term upon commencement date. The Company's lease terms may include options to extend or terminate the lease. The present value of future minimum lease payments includes these options only when it is reasonably certain such options will be exercised.

The Company's leases do not provide an implicit rate. In determining present value of future minimum lease payments, the Company utilized an incremental borrowing rate congruent with its primary lending agreement. The weighted average effective discount rate as of October 3, 2021 was 4.6%.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited)

(in thousands, except share data)

Base rent expense includes non-lease components such as taxes, insurance, and maintenance when required under the lease agreements and is classified as occupancy expense in the consolidated statements of operations. As a result of adopting ASC 842, the Company elected the practical expedient to not separate non-lease components from the lease components to which they relate. For certain equipment leases, the Company applies a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Rent expense from operating leases was recognized as follows:

	Three Months Ended		Nine Months Ended	
	10/03/21	09/27/20	10/03/21	09/27/20
Operating lease costs:				
Fixed base lease expense - real estate	\$ 9,687	\$ 9,295	\$ 28,732	\$ 27,475
Fixed base lease expense - equipment	408	372	1,170	1,025
Variable lease expense/(concessions)	240	207	672	479
Total	<u>\$ 10,335</u>	<u>\$ 9,874</u>	<u>\$ 30,574</u>	<u>\$ 28,979</u>

Supplemental cash flow information related to operating leases was as follows:

	Three Months Ended		Nine Months Ended	
	10/03/21	09/27/20	10/03/21	09/27/20
Cash paid for amounts included in the measurement of lease liabilities	\$ 9,853	\$ 9,761	\$ 28,988	\$ 25,641
Right-of-use assets obtained in exchange for lease obligations	\$ 22,523	\$ 9,812	\$ 24,444	\$ 22,256

The weighted-average remaining lease term for operating leases as of both October 3, 2021 and September 27, 2020 was approximately 15 years.

The future payments due under operating leases as of October 3, 2021 are as follows:

2021	\$ 9,770
2022	39,131
2023	38,755
2024	38,425
2025	37,225
Thereafter	<u>336,612</u>
Total	\$ 499,918
Less present value discount	<u>(134,585)</u>
Lease liability recognized	<u>\$ 365,333</u>

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited)

(in thousands, except share data)

Note 3 – Sale and Leasebacks

For the nine months ended October 3, 2021, the Company completed 18 sale and leaseback transactions. Through these transactions, the Company netted proceeds of \$41,363, and with such proceeds paid down indebtedness of \$31,352. The Company recorded net gains of \$8,121 related to these sale and leaseback transactions in other income on the consolidated statement of operations.

For the nine months ended September 27, 2020, the Company completed 13 sale and leaseback transactions. Through these transactions, the Company netted proceeds of \$27,418, and with such proceeds paid down indebtedness of \$27,200. The Company recorded net gains of \$666 related to these sale and leaseback transactions in other income on the consolidated statement of operations.

Note 4 – Information About Variable Interest Entity

Restaurant Holdings facilitates real estate transactions where the Company has potential economic benefits in future sale and leaseback transactions. This variable interest entity ("VIE") is owned by related parties and not directly by the Company.

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 upside to the Company. Restaurant Holdings, upon acquisition of real estate, leases such real estate to the Company and utilizes rent revenue to pay the interest expense on its bank debt. The Company's senior credit facility requires the Company to finance acquisitions of real estate with a minimum of 25% of the purchase price in equity which the Company believes is dilutive to its long-term real estate strategy.

Restaurant Holdings leverages a revolving credit facility with a bank other than the Company's senior lender that allows for borrowings up to \$30,000 secured by its interest in the real estate and personal guarantees of owners. As of October 3, 2021 and January 3, 2021, Restaurant Holdings had bank debt obligations totaling \$9,589 and \$12,137, respectively.

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Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited)

(in thousands, except share data)

Included in the consolidated balance sheets as of October 3, 2021 and January 3, 2021 are the following amounts related to Restaurant Holdings, before eliminating entries:

	10/03/21	01/03/21
Assets:		
Current assets	\$ 3,396	\$ 4,951
Property and Equipment - net	5,381	7,811
Investment in MHGI preferred stock	5,000	5,000
Other assets	-	420
Total Assets	<u>\$ 13,777</u>	<u>\$ 18,182</u>
Liabilities:		
Current liabilities	\$ 63	\$ 2,811
Current portion of long-term debt	400	400
Revolving line of credit	5,289	7,537
Long-term debt	<u>3,897</u>	<u>4,195</u>
Total Liabilities	9,649	14,943
Equity - Noncontrolling interest	<u>4,128</u>	<u>3,239</u>
Total Liabilities and Equity	<u>\$ 13,777</u>	<u>\$ 18,182</u>

Note 5 - Commitments and Contingencies

As part of the Company's ongoing franchise relationship with The Wendy's Company, the Company entered into agreements which contain certain reimagining and development requirements. Through these agreements, the Company committed to reimage 100% of its portfolio by December 31, 2024 and to develop 50 new restaurants by November 30, 2025. Pursuant to these agreements, the Company is entitled to receive significant economic incentives which include royalty and national marketing fee relief. As of the date of this report, the Company has reimaged approximately 64% of its portfolio with 36% remaining, and has completed approximately 20 of the new restaurant commitments. The Company estimates that it will invest approximately \$127,000 in the remaining reimagining and development of its Wendy's restaurant portfolio.

The Company additionally is required to complete certain agreed upon improvements to facilities. As of October 3, 2021, these capital improvements have remaining estimated costs of approximately \$713.

Effective August 2021, the Company entered into an Area Development Agreement with its newest franchisor, Taco John's. Subject to certain terms and conditions, the Company committed to build 50 new Taco John's restaurants by March 31, 2026 with options to develop an additional 150 restaurants thereafter. The Company estimates it will invest approximately \$100,000 in the initial 50 store roll-out and is entitled to receive significant economic incentives subject to fulfilling its development schedule.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited) (in thousands, except share data)

Note 6 - Long-Term Debt

Effective August 5, 2021, the Company refinanced its existing debt to a \$302,800 credit facility with a maturity date of April 2027. The new credit facility includes \$181,800 million in long-term debt, \$15,000 in revolving short-term debt, and \$106,000 of available credit lines.

Note 7 - Equity

The Company has 5,000,000 authorized shares of \$0.01 par value, convertible preferred stock. As of October 3, 2021 and January 3, 2021, preferred stock was designated as follows net of consolidation:

	10/03/21	01/03/21
Preferred B:		
Authorized:	1,350,000	1,350,000
Outstanding:	805,900	809,067
Preferred C:		
Authorized:	200,000	200,000
Outstanding:	160,360	160,360
Preferred D:		
Authorized:	600,000	600,000
Outstanding:	310,293	310,293
Preferred E, net:		
Authorized:	800,000	800,000
Outstanding:	128,744	128,744

The Company's preferred stock ranks senior to the Company's common stock with respect to payment of dividends and distributions upon liquidation or dissolution.

The Company has 30,000,000 authorized shares of \$0.01 par value common stock, with 6,716,436 and 6,643,681 shares issued and outstanding as of October 3, 2021 and January 3, 2021, respectively. The common shares of the Company are quoted on the OTC Markets under the symbol "MHGU."

Note 8 – Recent Developments Related to COVID-19

In January 2020, the World Health Organization ("WHO") announced a global health emergency resulting from a new strain of coronavirus. Based on the rapid increase in global exposure, the COVID-19 outbreak was classified as a pandemic in March 2020.

As a result of governmental actions taken to curtail the spread of the coronavirus, the Company was mandated to close dine-in services for all its restaurants in mid-March 2020. In accordance with state and local executive orders, the Company began to phase in the re-opening of its dining rooms beginning in mid-June 2020. As of the date of this report, all of the Company's Wendy's dining rooms and independent concept restaurants have re-opened.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Notes to Consolidated Financial Statements (unaudited) (in thousands, except share data)

The Company continues to monitor the impact of COVID-19 on its financial condition, liquidity, operations, workforce, suppliers, and industry. Given the ongoing evolution of the pandemic and varied governmental responses, the Company is not able to fully estimate the complete impact or duration of the pandemic on its results of operations, financial condition, or liquidity.

Note 9 – Reclassification

Certain 2020 immaterial amounts have been reclassified to conform to the 2021 presentation.