Operator: Greetings and welcome to Diversified Restaurant Holdings Second Quarter 2019 Financial Results Conference Call. At this time, all participants are in a listen-only mode. [Operator Instructions] Please note, this conference is being recorded.

It is now my pleasure to turn the conference over to your host, Craig Mychajluk. Thank you, you may begin.

Craig Mychajluk: Thank you, and good morning, everyone. We appreciate your time today and your interest in Diversified Restaurant Holdings. Joining me on the call is Michael Ansley, our Executive Chairman and Interim CEO; and Toni Werner, our Interim Chief Financial Officer. You should have a copy of the financial results that were released after markets closed yesterday, and if not, you can access it at our website diversifiedrestaurantholdings.com. There's also a slide presentation posted on our website that we will refer to during today's call.

If you would, please refer to slide 2. As you are aware, we may make some forward-looking statements on this call during the formal discussion, as well as during the Q&A. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what is stated on today's call.

These risks and uncertainties and other factors are provided in the earnings release, as well as with other documents filed by the Company with the Securities and Exchange Commission. These documents can be found on the Company's website or at www.sec.gov.

During today's call, we will discuss non-GAAP measures, which we believe will be useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with GAAP. Reconciliations of non-GAAP to comparable GAAP measures are provided in the tables accompanying the earnings release.

So, with that, let me turn it over to Michael to begin. Michael?

Michael Ansley: Thank you, Craig, and good morning, everyone. As many of you are aware, we announced in early July restructuring and management changes. As a result, Toni and I assumed our current interim roles as CEO and CFO. From this restructuring we have realized significant cost savings, which we will talk to more in a moment. I can confidently say, that we have not missed a beat internally from the back office to the restaurant level.

We remain focused on our strategic priorities to restructure our debt, grow sales, and leverage our infrastructure. I'm especially pleased with the great effort of all of our associates. We have an incredibly talented and dedicated group that spans 64 locations in five states. They continue to work hard every day and I'm thankful for their support. We are also energized by the changes being implemented by Inspire, and while most are at the early stage, we are seeing a strengthening of the brand and are certainly excited for the things to come.

During the recent quarter, the successful execution of the delivery channel continued to drive our top line, while we also benefited from a number of favorable sports events in our core markets. Most notably, the St. Louis Blues' run through the playoffs to the Stanley Cup win and two additional NBA playoff games.

This is our third consecutive quarter of same store sales growth, increasing 5.8%, despite the negative impact from Easter shift. Importantly, our average check and traffic were both up in the quarter. That was the first time we have achieved that milestone in over four years since the first quarter of 2015.

We still faced headwinds around chicken wing prices, labor costs and delivery fees in the quarter, though the impacts from delivery fees are abating. We have been working to improve the margins in the delivery channel and have seen great improvements as shown on slide 11. We increased pricing to help offset fees in June and have meaningfully driven down third party fees with new negotiated rates. In fact, going forward, our contribution margin from this channel should be on par with dine-in. We believe delivery is an important channel with significant upside and expect delivery sales will continue to experience strong growth in 2019.

Chicken wing prices on the other hand continued to climb in the second quarter approaching peak levels from 2017, and, while they have since come down a little, we do expect prices to be elevated throughout the remainder of 2019. To help offset this headwind, we implemented a 100-basis point combined price increase on traditional and boneless wings on June 1, so, we will see the full impact of that in our third quarter results.

We also continued to optimize our operations and overhead in order to better leverage our sales growth and improve earnings going forward. Those include cost saving initiatives around IT, local marketing spend, and the personnel restructuring already mentioned. In total, we expect to reduce annual costs by approximately $2.0 million. As previously disclosed and discussed, we are working with our advisors both for the evaluation of strategic alternatives for the business and to restructure our debt.

Our advisors include the ongoing engagement of Duff & Phelps and the recent engagement of Stephens regarding our debt. While this process is underway, we are unable to comment further until the Board has approved a definitive course of action. We have confidence that we can address these issues in a manner that is in the best interest of all stakeholders.

Our July sales results have been encouraging, and while trends cooled some from the second quarter given the sports impacts we are still positive.

We were also contending with the typical slower summer period and significantly reduced national media coverage as our franchisor has geared up to leverage fall football and new product launches.

With that said, the fall advertising push and brand relaunch initiatives have kicked off this month. Following the successful launch of the All-American Cheeseburger in March, new chicken products were introduced in August. We now offer two new hand-breaded chicken sandwiches and hand-breaded chicken tenders.

On-tap, we are targeting a November launch of our new higher quality boneless wings that will consist of less breading. You can check out slide 20 for some pictures. Each new item is truly a step change in quality and product offering and we believe will drive additional traffic.

You will see an increased national advertising presence this fall with expanded emphasis on social media as we highlight our new products and value proposition around football.

There will be some new promotions like the three fantasy draft day bundles that are depicted on slide 21. We also relaunched and will reemphasize the BOGO Wing Tuesday promotion. Some of the ads in support of that promo are also highlighted on that slide. While there may be some cost and margin considerations in the short term, there is a lot of history and success with the BOGO Wing Tuesday promotion and it is good to see us getting back to our roots.

Overall, we are excited for what all of this means for DRH, especially when layering on the successes we're having with delivery, loyalty attachment, and operational effectiveness. By continuing to focus on delivering quality and value to our customers, we believe we are positioning DRH for long-term success.

With that, I will turn it over to Toni for details about our financials.

Toni Werner: Thank you, Michael, and good morning everyone. Sales in the second quarter totaled $38.9 million, an increase of $1.9 million or 5%, despite one fewer restaurant. Same-store sales increased 5.8% with average check up 3.1%, and traffic up 2.6%. We implemented a menu price increase on June 1, so, we only saw one month of benefit from that in our numbers. There was an unfavorable calendar shift in the quarter as Easter, a holiday in which our restaurants are closed fell within this year's second quarter versus the first quarter in 2018.

As was discussed last quarter, we estimate this impact was approximately 1 point to same-store sales from this shift. As Michael mentioned, delivery was a significant contributor to our sales growth this quarter as it added $2.6 million from 58 locations. There were also the favorable sporting events, which added about $1 million. For additional details on our sales, please see slides 6, 7, and 8 for average check and traffic trends, and the second quarter and year-to-date sales bridge.

Adjusted EBITDA for the quarter was $3.9 million, or 9.9% of sales, up 10 basis points from last year's period, and restaurant level EBITDA was $5.7 million with a margin of 14.6%. Year-to-date, adjusted EBITDA and restaurant level EBITDA margins were 10.5%, and 15.2% respectively. Higher sales and lower G&A expenses helped to offset increased wing costs, labor costs, and delivery expenses.

Slides 9 and 10 show the quarter and year-to-date EBITDA bridges calling out these items and slide 12 presents a breakout of our historical quarterly restaurant level margins. Cost of sales for the quarter was 80 basis points higher than last year as traditional wing prices continued to increase driving food and beverage costs to 29.3% of sales, a level that is reminiscent to the heights we saw back in 2017.

Traditional wings as a percentage of total cost of sales also increased to 25.8%, which reflects a product mix shift toward more traditional wings and lower costs for boneless wings and other commodities. See slide 15 for cost of sales trends. As Michael mentioned, we did take an off-cycle price increase on wings to help combat the pressure, though given the timing, that impact will be more fully felt in the third quarter.

If you want to take a look at the detail behind wing prices, see slide 24. While we have seen a slight decline in wing prices that are typically given in the summer months, we are still running at a level higher than last year. All indications are that will continue to the end of 2019. Compensation costs increased 10 basis points to 27.6% of sales, primarily due to higher average wages as a result of the tight labor market. We have seen less pressure on average wages and do not foresee any significant jumps from here. However, similar to the first quarter, we do expect to see some additional labor costs around the launch of new products and other initiatives. We present a year-over-year labor bridge on slides 16 and 17.

Michael spoke to the cost saving initiatives that have been implemented and you can really see the impacts on the following two expense lines. Other operating costs as a percentage of sales were 20.9% or 60 basis points lower due to the ongoing focus of lessening the impact of third-party delivery fees and IT cost saving initiatives.

Our G&A costs as a percentage of sales were down 100 basis points to 4.9% of sales due to lower corporate overhead and other efficiency initiatives. For the full-year of 2019, we are targeting G&A expenses below 5% of sales, excluding non-recurring items. We generated $5.2 million in cash from operations this year, which was up 16%, and we ended the quarter with cash and cash equivalents of $3.3 million.

We do not expect to build any new restaurants or complete any major remodels this year. As a result we expect capital expenditures to approximate $2.0 million in 2019. So far, we are on track with these projections having spent $1.2 million year-to-date. The focus has been on minor facility upgrades and general maintenance-type investments and included approximately $0.2 million for the new plate ware rollout in March.

Our franchisor is still developing and evaluating potential new building design standards and testing a variety of remodel options. They are aiming to finalize plans before the end of 2020. This will be a staged process, so we do not expect to be reinvesting into our locations with the new format until sometime in 2021. We continued to pay down our debt, which declined nearly $6 million since 2018 year-end.

As a reminder, our debt amortization is approximately $1 million per month and the maturity date is June 2020. Given the maturity and onerous demands on our free cash flow, we are working to refinance the debt further supporting our ability to invest in the business to drive improved financial performance.

With that, Operator, we can now open the line for questions.

Operator: Thank you. [Operator Instructions] Our first question comes from John Sturges with Oppenheimer. Please proceed with your question.

John Sturges: Thank you. Nice quarter. Congratulations. Nice recovery last couple of months. I was curious about the Easter shift from first to second quarter. Was that primarily responsible for the traffic dip you are showing?

Michael Ansley: There was some impact from that, but it was rather minor. We can get back to you on that.

John Sturges: That's okay. I'm just looking for general trends. It was a nice average check rise, but I see there was some loyalty dip in one measure that was the loyalty attachment. I guess you had, what's called the guest loyalty was higher. Is there a shift in the type of customer you are serving? I am just curious if you are seeing some kind of a migration to your new product line?

Michael Ansley: No. we haven't seen that. We have one region that's underperforming in the loyalty attachment, which is our home market in Detroit, but we're still working on getting that improved. We've seen the loyalty numbers and all of the other markets are actually exceeding that. They are getting closer to 30%. Again, we're addressing that particular market, but we haven't seen a shift in our clientele.

John Sturges: Okay. Because I thought the new offerings might have changed the market share so that you might be more attractive. Either way, it is still a good quarter. Thank you.

Operator: [Operator Instructions] Our next question comes from Craig Rabinowitz with Newbridge. Please proceed with your question.

Craig Rabinowitz: Good morning, gentlemen. There was an article in Barron's not too long ago, about a company that took, I believe a 5% stake in the Company, and was interested in possibly working on helping the Company restructure at favorable terms. I believe that was the way the article read. I was wondering if there has been progress made with them and if you said where that stands?

Michael Ansley: As we've said, we're working on a number of different initiatives. We are very cognizant of where we are as far as our deadlines for debt. We have a number of advisors working with us on strategic alternatives and the debt refinancing and at this point we can't talk any further about that until we have a definitive course of direction from our Board.

Craig Rabinowitz: Is there a timeframe involved where your board meets and would make some type of determination?

Michael Ansley: As we've said, it's very fluid right now. So, I can't really pin down a particular date, but we are cognizant of the deadline, and we take our fiduciary responsibility very seriously. As soon as we have a resolution everybody will be first to know.

Craig Rabinowitz: Okay. Thank you very much.

Operator: We have reached the end of the question-and-answer session. At this time, I like to turn the call back over to management for closing comments.

Michael Ansley: Thanks for joining us on today's call and your interest in Diversified Restaurant Holdings. We look forward to talking to you again after our third quarter results, but please feel free to reach out to us at any time between now and then. Thank you for participating and have a great day.

Operator: This concludes today's conference. You may disconnect your lines at this time. And we thank you for your participation.