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BWLD - Q2 2017 Buffalo Wild Wings Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 revenues of $500m, net earnings of $8.8m and diluted EPS of $0.55. Expects 2017 GAAP EPS to be $4.00-4.50.

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Buffalo Wild Wings Second Quarter 2017 Conference Call. (Operator Instructions) I would like to remind everyone that this conference call is being recorded. I would now like to turn the call over to Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Please go ahead.

Heather L. Pribyl - *Buffalo Wild Wings, Inc. - Director of IR*

Good afternoon, and thank you for joining us as we review our second quarter 2017 results. I'm Heather Pribyl, Director of Investor Relations for Buffalo Wild Wings. Joining me today is Sally Smith, President and Chief Executive Officer; Jim Schmidt, Chief Operating Officer; and Alex Ware, Chief Financial Officer.

By now, everyone should have access to our second quarter earnings release. Copies are available on our investor website at ir.buffalowildwings.com.

Before we get started, I remind you that today's call will contain forward-looking statements, and actual results may vary materially from those discussed in forward-looking statements due to many factors, including the risks and uncertainties identified in today's earnings release, which we filed in a Form 8-K concurrent with this release and in our other filings with the Securities and Exchange Commission.

Today's commentary will discuss certain non-GAAP financials. The reconciliation between our GAAP results and non-GAAP can be found in our earnings release on our investor website.

On today's call, Sally will provide updates on the business environment and initiatives. After that, Jim will provide insights on our sales performance. Alex will cover bottom line performance and updates to the 2017 guidance.

So with that, I'll turn things over to Sally.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Thank you, Heather, and good afternoon, everyone. The second quarter was a challenging one for Buffalo Wild Wings and the casual dining industry. Same-store sales of negative 1.2% at company-owned locations and our bottom line performance were disappointing. Adjusted earnings per share were $0.66, a decline over prior year, driven by negative same-store sales, increased wing prices and a mix shift toward our value offerings.

Our traffic during the quarter outpaced the casual dining industry by 200 basis points due to continued execution on our sales initiatives. Half-Price Wing Tuesdays drove a large portion of this traffic increase. And with historically high wing costs, this lowered restaurant level margins by 140 basis points.

We're launching a new Tuesday value offering, a boneless BOGO at company-owned locations and anticipate this rollout complete by mid-September. Industrywide, it is clear that consumers are seeking value and convenience in their dining occasions. Dining at home continues to become more prevalent, and we know we must deliver an amazing experience for our fans in-restaurant and for takeout and delivery.

Delivery was in 230 company-owned locations at the end of the second quarter, up from 180 at the end of Q1, and accounted for $4.1 million of sales during the quarter. In the second quarter, takeout and delivery was 17.6% of our company-owned restaurant revenues compared to 15.7% last Q2. We estimate that third-party delivery is over 90% incremental to dine in and takeout sales.

We're expanding our delivery locations as our partners grow into additional markets. We're adding delivery ordering to our mobile app later this year, giving fans the option to order directly from our app while reducing the commissions we pay to third-party delivery providers. We are piloting beer delivery, where legal, and anticipate restaurants in Ohio and in Wisconsin to be among the first markets.

As of June 1, our Blazin' Rewards Loyalty Program is now available in all U.S. locations. Today, we have more than 2.5 million fans that are members. Blazin' Rewards is a key element in developing deeper relationships with our fans and differentiates us from our competitors. Through the program, we will provide a new kind of value to our friends and gather -- to our fans and gather the fan insight to better understand frequency, brand preferences and develop more targeted marketing programs.

Growing a loyalty program is a multiyear process, and we're in the beginning stages of this program optimization for both our fans and our operators. Although results are preliminary, increased spend from loyalty guests continues to exceed our internal goal, and our current -- and currently, the rate for loyalty attachment exceeds 20% on purchases.

Our portfolio optimization is underway as we are actively in market for the sale of 83 company-owned restaurants with the Cypress Group. Initial interest is strong, and we'll learn more about the appetite for Buffalo Wild Wings locations as bids are submitted. We have interest from both existing B-Dubs franchisees as well as multi-franchise external operators. We will update the market as appropriate as this process unfolds.

On Monday, we opened our first small-format location called B-Dubs Express in the Minneapolis market. This 2,800-square-foot location is focused on takeout and delivery, with seating for 50 and a streamlined menu. We'll learn more about the flexibility and opportunity that B-Dubs Express gives us as we seek to penetrate higher density markets where the millennial population is moving.

On the international front, we opened 2 restaurants in the quarter, including the first location in Oman. And this month, we entered Vietnam. Our international franchisees continue to work toward their goal of 20 new international openings this year.

Jim will now provide additional details on the second and third quarters.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Thank you, Sally. Our revenue in the second quarter reached $500 million, increasing 2% over the same period last year, with total systemwide sales of $953.4 million. There was a negative impact of 40 basis points from the Easter holiday shift, and there were 11 fewer NBA and NHL playoff games this year. Sales on nonevent days remain challenged, along with the industry, but we are seeing success in our sales initiatives. We believe now is the time to focus on operational excellence, which I will discuss shortly.

Our Half-Price Wing Tuesdays program has been successful in driving traffic and contributed 150 basis points to our same-store sales in the second quarter. As Sally mentioned, we're moving our Tuesday value offering in company-owned locations through a boneless BOGO offer with company rollouts through August and September. Boneless wings outsold traditional wings in 2016, demonstrating their popularity amongst our fans and a more favorable food cost than traditional wings.

Menu prices and adjustments taken during the last 12 months were 0.6%. We're evaluating our fall menu price increase and expect to adjust pricing in markets to account for wage inflation but are not anticipating a broad menu price increase.

There's never been a better time to be a football fan than this fall at Buffalo Wild Wings. We're going back to our roots and connecting our communities with our fans. We're partnering with high school teams and booster clubs, connecting with the local college alumni groups and leveraging our vendor partners to create a unique NFL viewing experience within our restaurants.

Our football experience will be supported by a multilayer marketing campaign, starting with advertising around hosting your fantasy football draft party at Buffalo Wild Wings.

One lucky fan that hosts their fantasy draft at B-Dubs and 11 of their friends will win the opportunity to hold their 2018 fantasy draft at NFL headquarters in New York City.

Our operations team is heightening our focus on operational excellence to ensure a great football experience. Our restaurant team members will work on improving the speed of service, food quality, friendliness and cleanliness to ensure every fan's visit is the best. This emphasis on service is targeted to improve guest satisfaction and our overall team member engagement.

Our featured cocktails for the fall will be variations of the Bloody Mary, including a hot Bloody Mary that is served with pretzel bites for dipping. Sauce Lab is bringing back a fan favorite, Blue Moon BBQ, and is introducing barbecue mango mashup to the lineup. We're returning to our roots with a 35th anniversary [wet] sandwich.

Last week, I announced my decision to retire from Buffalo Wild Wings as of August 14. It has been an honor to be part of the tremendous growth of Buffalo Wild Wings, expanding from a college bar to an international restaurant brand with more than 1,200 locations. I have great confidence in the future leadership of B-Dubs with a combination of emerging leaders who have grown and developed with Buffalo Wild Wings as well as exceptional talent that we've added over the years. We've built this powerful system of passionate franchisees and dedicated team members, and I look forward to cheering on Buffalo Wild Wings from the sidelines.

I'll now turn it over to Alex to cover the financials.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Thank you, Jim, and good afternoon, everyone. Obviously, Q2 was a difficult quarter. As we take steps to return to growth, we are focused on 3 key areas: one, moving our primary promotional activity off of the supply-constrained traditional wing; two, driving service excellence standards across our company restaurants to heighten guest satisfaction; and finally, delivering our cost savings targets through specific actions and an ownership mindset across the restaurants, field and home office teams.

As the year has progressed, we've seen an escalation in consumer adoption of our half-price wing offering, as total sales on promotion were at 26% in the quarter versus 24% in Q1. In addition to greater demand and elevated prices, traditional wing supply is constrained as hatch rates and capacity are down while demands for wings remains very strong. Altogether, sales mix and high wing prices put pressure on cost of sales, which rose to 32.1% of restaurant sales, a 240 basis point increase.

Traditional wings were $2.05 per pound in the second quarter or 6% higher than last year. This is a historic high for wings at this time of year.

As higher prices carry into Q3, we expect the largest variance of the year on traditional wing prices with the first 2 months -- for the first 2 months priced at $2.13 per pound, a 24% increase over the prior year, emphasizing the importance of an alternative Tuesday promotion strategy.

Under normal circumstances, we would have a meaningful level of testing and learning on this shift to boneless. Our very early learnings from 2 Tuesdays in 50 restaurants are encouraging, and we will be monitoring closely to ensure that the sales and margins achieve our intended results. Given the uncertainty, we are creating a wider-than-normal range of outcomes in our guidance for the next 6 months.

Moving down the P&L, cost of labor for the second quarter was 32.4% of restaurant sales, 40 basis points above second quarter last year, due largely to higher health care and wages, being slightly offset by hourly labor favorability as we achieved $4.2 million in savings from our fiscal fitness program in the second quarter.

Restaurant operating expenses as a percentage of restaurant sales were 15.7%, an increase of 110 basis points, resulting from a 40 basis point increase in repair and maintenance expenses, a 40 basis point increase in general liability insurance as a result of several large claims and commissions for third-party delivery of 20 basis points due to expanded rollout.

Restaurant level profit, which is calculated before depreciation, amortization and preopening expense, was $65.9 million or 13.8% of restaurant sales. This compares to restaurant level profit of 17.9% in the second quarter last year.

General and administrative expenses were $39.2 million in the second quarter compared to $29.8 million last year, inclusive of stock-based comp. The year-over-year increase is primarily attributable to higher professional fees for our proxy campaign of $4 million, $2.7 million of increased stock-based compensation expense and $900,000 in onetime severance costs related to our field realignment.

Stock-based compensation in the second quarter includes a grant of time-based RSUs for retention purposes.

We recorded an asset disposal and impairment charge in the quarter of $2.6 million, primarily related to the impairment of 2 restaurants. Excluding the impact of impairment charges, expense for asset disposals was lower as we had fewer remodels in Q2 this year. We remain on track to remodel 23 units in 2017, with 17 expected in Q3 in time for football viewing.

Other income was $5.9 million in the second quarter compared to other expense of $1 million last year, largely due to a 5.9 -- $5.7 million gain on the sale of our 45% minority interest in PizzaRev.

In summary, our net earnings in the quarter -- in the second quarter of 2017 decreased 62.9% to $8.8 million, reducing earnings per diluted share of $0.55 compared to $1.27 in the prior year. After adjusting for nonrecurring and noncash items, our net income of $10.6 million drove an adjusted EPS of $0.66 compared to $1.34 last Q2.

Now I'll highlight a few trends and provide some comments on the third quarter. In September, we anticipate the completion of the move to the Tuesday boneless BOGO at company-owned restaurants. And with this rollout, we anticipate cost of sales to fall to approximately 31.5% of restaurant revenues for Q3.

In the third quarter, we anticipate that G&A expense will be approximately $35 million, including $3 million for stock-based comp expense. And in moving to our -- on to our fiscal fitness program, we achieved approximately $5.2 million in savings in Q2. For the back half of the year, we anticipate a reduction in our expenses of approximately $7 million in Q3 and $8 million in Q4, primarily in labor. These cost savings plans help us focus on controlling what we can to help offset a challenging top line and heightened wing costs.

Now turning to our full year 2017 guidance. With continuing industry softness and uncertainty with the impact of our shifting Tuesday promotion, our same-store sales forecast for the year is now minus 1% to minus 2%. We don't anticipate making up the Q2 earnings shortfall, and our GAAP EPS is $4 to $4.50 with adjusted EPS now $4.50 to $5. As we roll the revised Tuesday offer through Q3, we anticipate Q3 EPS to be below $1. However, fourth quarter should grow nicely due to the anticipated 53rd week impact of $0.35.

At this point, we're looking forward to sharing our progress on consumer adoption of Tuesday's promotion change, as this holds great potential for reversing our recent earnings performance.

And now, back to Sally for some closing comments.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Thank you, Alex. I want to thank Jim for his leadership, passion and dedication to Buffalo Wild Wings. He started working with the company as outside counsel in 1988 and came on as general counsel in 2002. It's been a pleasure to work with him and see him develop as a leader. We wish him well and thank him for all of his contributions to the company.

And finally, I wanted to close with some commentary on my recently announced retirement. I'm proud of the overall success that Buffalo Wild Wings has achieved. I came to B-Dubs as CFO in 1994 when we had 32 restaurants, and today we are an international brand of over 1,200 restaurants and a differentiated leader in the industry. It's been a pleasure to work alongside some of the best people in the industry, and we have strong talent that is dedicated to leading the company over its next phase of growth.

As part of succession, the Board of Directors has retained an executive search firm to help identify the next CEO.

Buffalo Wild Wings is pursuing strategies to ensure customers continue to enjoy the best possible fan experience. We are dynamically managing our promotional activities in light of unusually high wing costs that will help improve our bottom line results.

I'd like to thank our team members at the restaurants, in the field and at the home office for their dedication, the success of the brand, as well as our franchisees and vendor partners.

With that, I'll now turn it back to Heather to open the line for questions.

Heather L. Pribyl - *Buffalo Wild Wings, Inc. - Director of IR*

Thank you, Sally. We will now move to the question-and-answer session of our second quarter earnings call. (Operator Instructions) Operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll go first to Jeff Farmer with Wells Fargo.

Jeffrey Daniel Farmer - *Wells Fargo Securities, LLC, Research Division - MD and Senior Restaurant Analyst*

Congratulations to you, Sally, on a very long career, a successful career. With that, first question. In response to a question on boneless wings, I think it was on the April call, management responded, "The only thing that really moves the needle on Tuesdays is the traditional wing." So assuming there is some truth to that, how much confidence can you guys really have in featuring boneless wings on Tuesdays?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Well, I think what gives us confidence in the move, 2 things. First is that we do now skew as a system to boneless over traditional. So if you look beyond promotional days, we do as a -- that is a more popular item with our customer now.

And then the second thing is, over the last 8 months, we've run a number of single-day events, our BOGO Blitz, which featured boneless wings, and it was incredibly well received by our customer. We're only 2 weeks in but so far it's -- we're pleased with what we're seeing in the markets that we have converted to the boneless promotion.

Jeffrey Daniel Farmer - *Wells Fargo Securities, LLC, Research Division - MD and Senior Restaurant Analyst*

And just as a quick follow-up, any other sort of low-hanging top line opportunities that you guys see in the near future over the next couple of quarters that you look to pursue?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

I think there's a couple of things. We talked about them a little bit in the script. We think that the continued rollout of delivery is a big opportunity for us. We will be -- as part of our IT, we'll be redesigning our website to take advantage of online ordering, as well as we will have a mobile app. And that will allow us to use a third-party integrator as we look at delivery, which should really drive down costs. And we think we've seen great results of online ordering and the growth in online ordering over this past year. And the updated website will certainly help with that. That and football. The football schedule, it's not really low-hanging fruit, but the match-ups and what the NFL has done in terms of Sunday night match-ups we believe will provide an opportunity for both in-restaurant and takeout.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

And then we also -- we are beginning to test beer takeout. We'll see how quickly we can expand that. But we do think there is an opportunity for additional beer sales with both takeout and delivery to the extent it's available.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

There's a bit of calendar favorability also at the back half -- back of the year with the Christmas shift from Sunday to Monday, would be a net benefit for us.

Operator

And we'll go next to Andrew Charles with Cowen & Company.

Andrew Michael Charles - *Cowen and Company, LLC, Research Division - VP*

Just to follow up on that first question. Sally, last quarter, when you did the shift to the boneless promotion in some of the test markets, can you help us think about what the impact was in those markets for the shift in promotion?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Okay, the shift in promotion has only happened in the last 2 weeks in 3 markets. We specifically -- the 3 we chose, 1 skewed more towards traditional wings, 1 was about equal and 1 skewed toward boneless wings. So we have 2 weeks of data. I think we really need more data than that to assess the opportunity. We do think we can come up with and develop a very compelling Thursday opportunity. We are shifting our Thursday boneless to Tuesday. And as we learn more throughout this rollout, we will make adjustments as necessary.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

We -- what we were testing in -- earlier in the quarter was the BOGO on traditional, and we learned quite a bit about the effectiveness of the BOGO programs. Jim referenced the BOGO Blitz programs. We had a few markets that we were testing the BOGO traditional. And the BOGO format really seems to resonate with the guest, and that's what drove us to then shift that back to a boneless structure for the BOGO format.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

And then we do plan -- in early September, we will start -- we will be supporting the shift to Boneless Tuesday with media, if not sooner.

Andrew Michael Charles - *Cowen and Company, LLC, Research Division - VP*

Got it. So the comments in the last call was not in reference to the go-forward test that you guys are going to be using?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Correct. That was traditional that we were testing last quarter.

Andrew Michael Charles - *Cowen and Company, LLC, Research Division - VP*

Okay. And then just a question on the margin guidance for the mid-31% COGS for next quarter. It's going to take some time. Obviously, you'll be done with the swap in promotion in mid-September. So with the mid-31% range, just curious what the -- what wing mix as a percent of your COGS you're assuming in that forecast?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, just a -- maybe as a point of reference, as we shift from the traditional to boneless, traditionals are about 31, almost 31% of our cost of sales, and boneless are about 13% of our cost of sales. So with roughly equal; slight shift to boneless. So just to give you an order of magnitude of the potential margin structure change that we would pick up with the shift to boneless. That's going to enable, as we roll that across the markets, that will enable that COGS reduction.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

And our schedule right now is a majority of our company restaurants making the shift in mid-August.

Operator

We'll go next to Will Slabaugh with Stephens.

William Everett Slabaugh - *Stephens Inc., Research Division - MD and Associate Director of Research*

I have a question about value and the Tuesday focus. So it seems like you're putting a decent amount of sales improvement in the back half on the back of the success of the Tuesday transition to include boneless. I'm curious how you're thinking about the everyday value factoring into the formula here to pull in more guests, maybe put price points on more everyday items, as opposed to what seems like a fairly heavy focus on one day and kind of how you're seeing that balance out.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

So with regard -- the sales in the back half, I think you might be talking about the cost of sales improvement. I don't know that we'll see a sales improvement in the back half as we shift to boneless Tuesday. We have a number of in-restaurant sales, I guess, everyday prices. We have certainly happy hour where we have a beer of the month. Those are items that we routinely have which offer a value. And then, of course, our Thursday. We like to think that our menu is providing value and certainly upgrading our hamburger last fall and keeping that price on track was the opportunity, I think, to drive that value. And then, of course, we've got lunch, which provides value with our FastBreak Lunch and set prices which are -- which vary from our menu.

Operator

We'll go next to David Tarantino with Baird.

David E. Tarantino - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

I just wanted to ask first a clarification question on your comps guidance for the year. And I guess the question is, are you already seeing comps sort of slower than what you reported in Q2? Or are you assuming that they will be slower in the fall as you transition the promotional strategy?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

I would say that we're not seeing slower comps than we reported. We're still seeing strong traffic. We're anticipating the comp change to be due to the shift to Tuesday boneless.

David E. Tarantino - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

Okay, that's helpful. And then my real question is about the refranchising program. And I was wondering if you could comment on the level of interest that you've seen so far and the degree of confidence that you have in completing the 80 or so units that you targeted. And then secondarily, with the recent change or additions to the board, has there been any discussion about taking that program further in terms of the mix of franchising within the system?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, we're on track doing our market discovery as we had started out doing. And at this point, we've got high level of interest. We've got staggered bids coming in against the 5 territories, effectively a bid a month coming in against those markets. We've got over 100 parties that are interested, that expressed interest. And we believe that the process will give us good visibility as to what the market appetite is and what the pricing will be. So it's a robust process.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

And at this point, we still anticipate a Phase 1 of our -- of refranchising with no changes on how we look at the market. The Phase 2, as you know, we have the -- a team going in and working on restaurant operations and with the opportunity to turn those markets around, in which case we probably wouldn't offer them for sale. But taking a look at our restaurants is just part of our ongoing process. So at this time, everything that we talked about in the first quarter on our market prioritization still holds today.

Operator

We'll go next to John Glass with Morgan Stanley.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

Could you just clarify first, I think you had a Boneless Thursday promotion already. So is that just not -- are you going to replace that with anything or are you just going from 2 promotions a week to 1 promotion, essentially just moving Boneless Thursday to Boneless Tuesday, maybe with a slightly better price?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

For right now you're correct; we do have a Boneless Thursday offering. That's going to stay in place for the moment. And then I think we're going -- we're looking at various options. We're going to take a little more time on switching the Thursday promotion. We'll see how it reacts as we make the switch to Boneless Tuesday, but we're really focused for the moment on driving that switch on Tuesday. And that's going to be our -- we're going to be laser focused on that for the next few months.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

And how important is Boneless Thursday in your total sales mix?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

It's not -- it does not contribute to the same extent that the current Wing Tuesday promotion does.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

Okay. And then stepping back and looking at the -- at least the data I have shows the industry didn't really soften sequentially from the first to the second quarter. Maybe I'm -- maybe you have different data. But the industry hasn't really changed. It sounds like your promotional activity was similar first to second quarter, and you've been successful, in fact, just with Wing Tuesday, even though it's hurt margins. Now you pointed out there was an Easter shift and maybe fewer games, but is there anything else that you see in your business that's driving that sequential softness in your sales? What else would it be, I guess, if the industry really hasn't gotten worse?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

The -- I don't know that we're seeing anything change dramatically quarter-to-quarter right now. I mean, you've got some shifts. Easter shifted in the second quarter. And then we did have...

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Easter is a negative for us, unlike other concepts, where it's a positive.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

And then we did lose playoff games, which didn't help year-over-year. But no, I think we -- all of our focused efforts to drive sales, all of our initiatives are being successful. That day-to-day traffic has not recovered to the extent that we want to see it, but it is not getting worse than it was earlier this year.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes. I would just add the -- our traffic continues to outpace the category. And we have the pressure of the mix shift on our same-store sales into the half-off Tuesday program. So that's been a...

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

What was the traffic this quarter? I'm sorry if I missed that and you said it.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

We're about 200 basis points favorable to the category.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

What would you say it is in absolute numbers since there's a lot of ways to look at the category? What was your traffic in the second quarter?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

We were between 0.5 and negative 1 on traffic.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

You were between plus 5 and minus 0.1?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

0.5, minus 0.5 to minus 1.

Operator

We'll go next to Karen Holthouse with Goldman Sachs.

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

Just one quick housekeeping, or 2 quick housekeeping questions. What was price in the quarter, and then wings as a percent of revenue, and wings as a percent of COGS?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Price was 0.6%; wings as a percent of sales, 23%; and wings as a percent of COGS, 30.7%.

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

All right. You said 37%?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

30.7%. Sorry.

Karen Holthouse - *Goldman Sachs Group Inc., Research Division - VP*

30.7%, okay. So my sort of back of the envelope math would then say the sort of breaking out wing pressure on cost of sales, which looks like it was about 150 basis points year-over-year, about 50 basis points of that inflation, but there would have been some benefit from underlying price, which would say the promotion is costing you like 1.5% of margin to get 140 bps of traffic. Is that the right way of thinking about it? I'm just trying to understand, if you just took it away overnight, even if it hurt comps, would it actually be profit accretive?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

It's a pretty good envelope you're working with there, Karen.

Operator

We'll go next to Dennis Geiger with UBS.

Dennis Geiger - *UBS Investment Bank, Research Division - Director and Equity Research Analyst of Restaurants*

You've previously briefly highlighted sales opportunities that you've identified through work with an outside consultant. Is there anything more that you can highlight there specific to those initiatives, anything that you're seeing in those tests, if they've started yet, and perhaps when we should think about the broader rollout of when that might occur?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

They're in test right now, some of those initiatives. We don't yet have results back. But our anticipation is, if they go well, we would start to roll those next year in Q1.

Dennis Geiger - *UBS Investment Bank, Research Division - Director and Equity Research Analyst of Restaurants*

Okay. And can you just remind us, I think it was 3 or 4 of them, just briefly what they were and what they entailed, if that's possible?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Yes, very quickly. The first one was kind of a game time menu that would be different in the way it approaches a menu for game time. And so it would allow a person to make an order at one time and then you would have food coming throughout a game. It was a way to improve margins and also the fan experience during the game.

I think the one we're really excited about, we call it Realtime Rewards, and on that one it would look at kind of surprise and delight during a game, such as if you get a game-winning home run, then there might be a special on an appetizer at the store, something like that. And that's I know in test right now in market. And we're really excited about the potential for that because it really helps to improve the experience during the game time.

And then the third one that we're working on is what we call Beer Bank. And the idea there is that you could prepurchase beer. It's kind of like a beer gift card that you could then redeem on subsequent visits.

Those were the 3 primary ones that we are working on, and they're in various stage of test right now, with the thought that, based on results, we'll be rolling them after the first of the year.

Operator

We'll go next to Jeffrey Bernstein with Barclays.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Sally, with your upcoming retirement, and congratulations on that front, I'm just wondering whether you can provide any color on the board's thoughts, whether it's in the initial meetings or just qualitatively, how the board is thinking about their top priorities going forward. I ask that just because we are kind of in a changing of the guards here, and you guys had recently given some color on unit openings longer term and cost-saving initiatives and restaurant margins, leverage. I'm just wondering, have you had any discussions as a board in terms of whether any of those guidance measures stick or whether we're really open to totally new guidance in future months or quarters?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

So with regard to my succession, the board has a smaller committee of the board to work with the recruiting firm. I know they've interviewed all board members as well as select members of management on what attributes they'd like to have in the next CEO. And that's as far as I know at this point. I believe the recruiting firm is out identifying and possibly talking with candidates.

With regard to the other part of your question, I think that's just the normal course of business that any business should always be looking at as to do we need a change in strategy, is the company -- what growth opportunities does the company have. And that will be an ongoing discussion or part of the discussion that we have with our board at our upcoming quarterly meeting.

Jeffrey Andrew Bernstein - *Barclays PLC, Research Division - Director and Senior Research Analyst*

Got it. And just specifically in terms of the cost-saving target that you guys put out, I know you mentioned something specific about cost savings in the third and fourth quarter, but should we still be assuming, I think you had said roughly $25 million in saves, or I think it was north of 100 basis points? Is that a target that comes sometime soon and we shouldn't expect any change to that? I know that was a big driver of potentially accelerated earnings growth for next year.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Right. We are still tracking to the $40 million to $50 million over the next 1.5 years, and we achieved $5 million of that in Q2. We are looking to capture $7 million in Q3 and $8 million in Q4. So we are tracking against that overall goal.

Operator

We'll go next to Andrew Strelzik with BMO Capital Markets.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

I actually have 2 questions on underlying wing prices. The first, if I just hold the current wing prices steady for the rest of the year, it looks like you'd be at about 10% inflation adjusting for the collar. So what gives you the confidence to maintain that 8% to 10% level? Are you expecting that wing prices have already made their seasonal move and so you don't see it again? That would be number one.

And number two, can you just help us understand the mechanics of the wing price collar? I guess where I'm coming from is, if that needs to be renegotiated next year, what's the risk that I guess you start kind of in the hole from an inflationary perspective when that goes into effect, given where wing prices are right now?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

As it relates to the seasonality, obviously this year has been very unusual, and we have not seen the let-down. Our understanding is that there's not much frozen capacity in the marketplace, which we believe is going to maintain. Even if there's a bit of excess supply that comes onto the market, that that is going to be absorbed and going into -- put into frozen supply. So we believe that pricing is going to stay at these levels, perhaps moderating a little bit as we get towards the end of the year. We'll have a bit more capacity coming online. So we're hopeful that some of that pressure will come off. And frankly, our shift to the boneless BOGO will probably aid that shift.

I'm sorry. And the second part of your question was?

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

The mechanics of the wing price collar. When do you need to renegotiate that? And given where wing prices are currently, is there a risk that, that gets renegotiated towards where the current spot price is and that creates risk going forward?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, we would expect that the market will -- we are a large purchaser of wings. And as we shift our promotional activities, we think it could give more flexibility around 2018 and how we think about setting those contracts for next year. So it's early yet to make any calls on what impact that might have.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

And if I could sneak one more question, and I know you mentioned the promotional shift at the company locations. Are the franchisees going to follow, or what's the plan just to keep the continuity across the system?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Yes, the plan is to shift the whole system over time. We haven't set specific timing yet, but our expectation would be that we'll have the entire system shift and we just haven't -- we're working through the details of the timing.

Operator

We'll go next to Jason West with Credit Suisse.

Jason Taylor West - *Crédit Suisse AG, Research Division - Senior Analyst*

Could you guys provide the boneless sales mix in the quarter as well? I believe you usually give that number.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Boneless was 21% of sales, Jason.

Jason Taylor West - *Crédit Suisse AG, Research Division - Senior Analyst*

Okay. Got it. And I guess just on this question about the franchisees and the margins, the decline in the margins this quarter was a little more severe than I think most people thought. And, I don't know, do you feel like the franchisees are seeing similar trends right now, just given the wing environment? Have they maybe avoided some of this if they weren't doing the Wing Tuesdays? And if margins are going to be digging out of this hole here, does that, do you think, change some of the appetite out there to take on more stores?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

I'll first start with the margin. Our franchisees are seeing the same kind of margin pressures as they are -- have -- they're still on Half-price Wing Tuesdays. And we have shifted some of that to the boneless -- or to a BOGO Wing Tuesday in a few select markets. They certainly want to see what the guest reaction is at company stores, and that's why we want to be thoughtful on the rollout as we learn more. Though certainly that's the case in almost any initiative we have. The more information we have, the more likely it is or the faster the franchisees adopt.

The second part of your question is how does that impact the possibility of -- on the sale of franchise locations. Those margins are reflected certainly in our company restaurants, on the stores that are out there. That hasn't seemed to be an issue with the interest expressed by both inside and outside the market. It's -- we used to say fluctuating wing prices is something we always had worked with, and I would expect that we still will. This is just an incredibly unusual high we have as part of our strategy work, doing some menu optimization as well as food optimization. What can we do from a menu and offering standpoint to take that pressure off of traditional wings. That's a little bit longer term. And so we're moving to the boneless wings in the short term to alleviate that cost pressure, and franchisees are watching it.

Operator

We'll go next to Brett Levy with Deutsche Bank.

Brett Saul Levy - *Deutsche Bank AG, Research Division - VP*

I know you started to give us a little bit of color on what you were learning from to-go from loyalty from delivery. Can you give us a little bit more detail in terms of what are the -- what does the average customer look like, their frequency, how are they using you? Are they using you for multiple avenues in-store? Are the rewards players going with delivery in-store, to-go, things of that nature?

And just if you could -- just following back on John's question about the competitive landscape, how much of the shortfall do you think is internal execution issues and how much is just what's going on with the competitive landscape?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Okay. So let's see. The first part has more color on the loyalty. It's still early and -- but we do have a lot of data. As we've analyzed some of the initial passes, we do find that, that guest uses us multiple times during the course of a week. So they may -- or over the course of the month. They are both a takeout customer and an in-restaurant eater. I don't think -- we haven't been able to capture if that person is a delivery customer at this point, as it's third-party delivery, and so there isn't a vehicle to get their loyalty number in the system, although they can -- I believe they can go online and enter their receipt. That will be one of the pieces of our website and our mobile app, that allows awarding loyalty points for delivery.

And it is -- we do know that the Tuesday value customer does come back at other times. That is one of the reasons why our franchisees, as they think about Tuesday sales and not moving immediately to Boneless Tuesday, the half-price wings has driven traffic. They like seeing the traffic in their restaurants. We like seeing the traffic in our restaurants. And they feel that it's driven traffic other days of the week as well.

So still early on loyalty, but the information that we are getting is the attachment and average check tends to be higher than those that aren't part of loyalty.

And then you had a second part of the question and I -- if you could repeat that.

Brett Saul Levy - *Deutsche Bank AG, Research Division - VP*

Sure. I was just curious, with respect to the competitive landscape, how much of the shortfall that you're seeing on your sales do you think is internal and how much of it is external? What are you seeing from your more direct competitors and your closest geographic competitors?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Well, if they're public, we have that information. And certainly you have the same information we have. I think the industry is challenged out there. There is an overcapacity. And I think -- and not just casual dining but the entire restaurant landscape. I do think you've seen a shift to delivery -- well, there's carryout and delivery. And we're finally seeing perhaps a little closing of the gap between restaurant prices and grocery stores. That certainly helps on the restaurant side.

Internal execution, the goals that we set for our FastBreak Lunch are exceeding what we expected at the beginning of the year. So that's been -- I think we've executed that very well. Certainly our Blitz days have been executed well. Our carryout again exceeding our expectations that we set at the beginning of the year. But we also thought that the industry would not be -- we use kind of the industry average as our baseline when we set our promotions.

Our focus on beer has trended slightly less than we expected when we put that in at the beginning of the year. And so we've got a number of initiatives that we're working on for beer as well.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

And then, as we did mention, in the back half of the year with football, we always challenge ourselves to get better. And so we are going to be refreshing our focus on service in our restaurant with that focus on making sure we're delivering quality food in a timely manner with friendly service, and we're keeping our restaurants as clean as possible. So we have a -- that is, loyalty was our big focus for the first half of the year, and we did a great job of driving loyalty. The focus in the back end -- back half of the year is going to be around operational execution in our restaurants.

Brett Saul Levy - *Deutsche Bank AG, Research Division - VP*

Thank you. Sally, Jim, best wishes.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Thank you.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Thank you.

Operator

We'll go next to Matt DiFrisco with Guggenheim Securities.

Matthew James DiFrisco - *Guggenheim Securities, LLC, Research Division - Director and Senior Equity Analyst*

I just had a clarification. I wanted to hear about the 11 days of the playoffs that were missed this year. Obviously 2 of them, having the NBA just not even happening in the finals. Those are big games. I wonder if you could quantify how much that impacted your same-store sales?

And then I had a question about some new food items and menu. I'm curious. A lot of investors and a lot of consumers obviously have been somewhat critical about the food that you offer and that there's been a lack of improvement on it when a lot of other brands, even lower brands than yours, have done a lot to address better, higher quality food at the same relative food cost. Just curious, what's in the pipeline and what have you done or what can you do going forward to address maybe elevating your food experience, which just seems to have been stagnant recently?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

Well, the -- our customers love our wings. I mean, I think that's clear from all of the activity we have, from the strength of our promotions around wings. So both our traditional boneless wings are an item that we know our customers love. It's one of the most sought-after items on takeout and delivery, right behind pizza. So I think we have just incredibly attractive core menu items with both our boneless and traditional wings, complemented by our sauces, which I rank them up there with anybody's. So I think our core items are very strong.

That said, we're always looking to improve quality. We came out -- we really came out and we redid our burger last fall and it's been very, very well received. And we're looking to do even more in that category this fall.

We're also going to be looking at some menu optimization work over the next year, opportunity to maybe pull back on our menu and also decide how do we look at the rest of our menu and where are there opportunities to improve quality. That's something we're always seeking to do.

So I would anticipate you will see some menu changes in the next year. But for us, that core product, the wings is really what drives our success.

Matthew James DiFrisco - *Guggenheim Securities, LLC, Research Division - Director and Senior Equity Analyst*

And then what about the playoff games? Can you quantify how much that might have had an impact on the quarter?

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

I don't know the exact impact right now. We're trying to look it up right now, Matt.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

It's hard to quantify because the days of the week don't necessarily align year-over-year.

Matthew James DiFrisco - *Guggenheim Securities, LLC, Research Division - Director and Senior Equity Analyst*

Okay. I'm just thinking 2 NBA playoff games not occurring in the finals would have been somewhat meaningful. Maybe even out of a 90-day period that's pretty heavy, when there's no other sports going on during that period.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Yes, absolutely. It is.

James M. Schmidt - *Buffalo Wild Wings, Inc. - COO*

They were big days a year ago.

Matthew James DiFrisco - *Guggenheim Securities, LLC, Research Division - Director and Senior Equity Analyst*

Okay. If you can quantify it sometime or off-line, I'll come back to you.

Operator

We'll go next to Peter Saleh with BTIG.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

I just wanted to come back to the refranchising. Can you just -- given the level of interest that you're seeing on the refranchising side, do you expect to provide any royalty abatement or royalty reduction to get the deals closed on these 83 units?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

We've got a few markets that have some challenges, and we're just doing a very short-term pro forma on what those -- what that impact might be. But this is -- generally speaking, no. We're looking to maintain the full value. And if there is any kind of reduction, it's a very short term and there's a clear calendar of what that abatement might look like.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

Very helpful. And then on the delivery side, could you give us a sense of how the economics are on -- really on the margins? Is a delivery order similar to an in-store purchase? Is the margin lower than that? Clearly it's got to be not as good of a margin as a carryout order. But just any sort of magnitude would be helpful.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, there are a couple of factors that play into that. We've got -- because delivery, we don't have any promotional pricing on delivery, so the Half-off Tuesday program is -- you don't get that discount with delivery. So if we sort of strip that out and look at sort of non-Tuesday, the non-Tuesday margins, the delivery margins are better than dine-in -- or excuse me, the food cost really is what we're talking about here. Food costs are slightly higher than dine-in but they are lower than takeout. And that suggests that the delivery order is a broader purchase. It's got more sides. They'll have beverages associated with that. We referenced the beer delivery that we'll be starting as well to boost the margins for both takeout and delivery. But the delivery margins, it's a broader menu, a broader offering that people are buying, versus takeout tends to be a bit more focused just on the entrées that they're taking out.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

Okay. And last question for me on...

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

I'm sorry. And I would just add also the commission for delivery cost does not show up in our restaurant level margin. That commission is below the line -- or excuse me, it's in our operating expenses. It's not in our -- in revenue. But we talked about the mobile order. That will enable us to be able to take control of those economics and not be solely focused with our delivery providers on -- with their commission rates.

Peter Mokhlis Saleh - *BTIG, LLC, Research Division - MD and Senior Restaurant Analyst*

Great. And then just last question for me on the labor line. Can you talk a little bit about the team captain initiative? Has that -- is that in the process of, I guess, dialing back or reallocating those hours? I would have thought your labor line would have delevered a little bit more, given you had a negative 1.2% comp?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, labor was -- we had good labor performance in the quarter. That would be the bright spot. And the GECs, I think that's what you're referring to, our Guest Experience Captain program, we wound down that program. We had it in about 10% of our stores, and we wound that down by the end of Q2. So we've now reallocated those activities back to front-of-house staff across the company stores.

Operator

And we'll go next to Nick Setyan with Wedbush Securities.

Nerses Setyan - *Wedbush Securities Inc., Research Division - SVP of Equity Research and Equity Analyst*

In terms of the system as a whole, what would you say the bottom 20th percentile unit level margins are and what the top 20th percentile of the unit level margins are right now?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Well, it runs the gamut, Nick. We've got some that -- where the margins are underwater. We've got some where they're in excess of 30%. And so it's a pretty wide spread. I don't think we've broken out sort of what that spread looks like, but we run a wide range.

As we considered the markets that we put into Phase 1 of our portfolio optimization, certainly the margin structure played into that decision, where we thought others could manage those restaurants more effectively than we.

Nerses Setyan - *Wedbush Securities Inc., Research Division - SVP of Equity Research and Equity Analyst*

Got it. In terms of -- just a couple of clarifications. On the other operating costs, you mentioned part of the deleverage is obviously third-party delivery commissions. Would you be able to quantify exactly how much that deleverage was driven by the third-party commissions?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

It was 20 basis points of OpEx in the quarter.

Nerses Setyan - *Wedbush Securities Inc., Research Division - SVP of Equity Research and Equity Analyst*

20 basis points.

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

That's a structural change as we extend -- as we extend delivery, and then we will be moderating that as we take control of our delivery traffic through our mobile order.

Nerses Setyan - *Wedbush Securities Inc., Research Division - SVP of Equity Research and Equity Analyst*

And then just a final clarification. In terms of the comp guidance for the rest of the year, is that colored by the July trends? Or is that purely theoretical, that once you do the switch over to the boneless from the bone-in promotion on Tuesdays, it should drive a lower comp? Or is that something that's already happening starting here in July?

Alexander H. Ware - *Buffalo Wild Wings, Inc. - CFO, EVP and Treasurer*

Yes, no, it's -- we've got -- we've been working hard on our modeling. We don't have market experience. So the -- I noted in my remarks just the wider range. At this point in the year you'd think we'd be narrowing the range, but we actually widened it out just based on the uncertainty of what the consumer adoption will be for this program and what the mix shift is that we'll see. So we wanted to make sure that we adequately capture that. This program, the traditional wing Tuesday program has been in place for 30 years. And so it's one that, particularly on the franchise side, they're very focused on holding on to that program. And it's one that we're going to be working hard to make that migration. So that's the -- that was why the downdraft to the Q2 -- or excuse me, the balance of year.

Nerses Setyan - *Wedbush Securities Inc., Research Division - SVP of Equity Research and Equity Analyst*

So it's not because July was already kind of there; it's more because you just wanted to be conservative around what could potentially take place?

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Correct.

Operator

And that does conclude today's question-and-answer session. At this time, I would like to turn the conference back over to management for any additional or closing remarks.

Sally J. Smith - *Buffalo Wild Wings, Inc. - CEO & President*

Okay. Well, I want to thank everyone for listening and the questions asked. We have work cut out for us. But I do want to thank our team members out there in the restaurants and, as I said, our franchisees and our vendors. It's been a difficult environment. I think we've got the right things in place, and everyone's working hard to improve that bottom line performance. And we'll be back to you with our third quarter conference call at the end of October. So thank you, everyone.

Operator

Again, that does conclude today's presentation. We thank you for your participation.