Wendy's Co
Form 10-Q
August 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 1, 2018

OR
( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to _______________

Commission file number: 1-2207
THE WENDY’S COMPANY
(Exact name of registrants as specified in its charter)

Delaware	38-0471180
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Dave Thomas Blvd., Dublin, Ohio	43017
(Address of principal executive offices)	(Zip Code)

(614) 764-3100
(Registrant’s telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [x] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [x] Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [ ]
Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [x]

There were 236,991,883 shares of The Wendy’s Company common stock outstanding as of August 1, 2018.

THE WENDY’S COMPANY AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

THE WENDY’S COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands Except Par Value)

	July 1, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$194,939	$171,447
Restricted cash	30,000	32,633
Accounts and notes receivable, net	95,121	114,390
Inventories	3,283	3,156
Prepaid expenses and other current assets	22,414	20,125
Advertising funds restricted assets	87,688	62,602
Total current assets	433,445	404,353
Properties	1,226,961	1,263,059
Goodwill	741,783	743,334
Other intangible assets	1,301,463	1,321,585
Investments	52,144	56,002
Net investment in direct financing leases	228,838	229,089
Other assets	95,545	79,516
Total assets	$4,080,179	$4,096,938
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current portion of long-term debt	$31,118	$30,172
Accounts payable	21,321	22,764
Accrued expenses and other current liabilities	103,351	111,624
Advertising funds restricted liabilities	96,972	62,602
Total current liabilities	252,762	227,162
Long-term debt	2,771,660	2,724,230
Deferred income taxes	274,344	299,053
Deferred franchise fees	93,139	10,881
Other liabilities	257,735	262,409
Total liabilities	3,649,640	3,523,735
Commitments and contingencies		
Stockholders’ equity:		
Common stock, $0.10 par value; 1,500,000 shares authorized; 470,424 shares issued; 238,083 and 240,512 shares outstanding, respectively	47,042	47,042
Additional paid-in capital	2,883,167	2,885,955
Accumulated deficit	(224,120)	(163,289)
Common stock held in treasury, at cost; 232,341 and 229,912 shares, respectively	(2,219,100)	(2,150,307)
Accumulated other comprehensive loss	(56,450)	(46,198)
Total stockholders’ equity	430,539	573,203
Total liabilities and stockholders’ equity	$4,080,179	$4,096,938

See accompanying notes to condensed consolidated financial statements.

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THE WENDY’S COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands Except Per Share Amounts)

	Three Months Ended		Six Months Ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
	(Unaudited)			
Revenues:				
Sales	$167,344	$160,859	$320,993	$309,071
Franchise royalty revenue and fees	107,559	112,548	205,467	207,238
Franchise rental income	51,529	46,935	101,636	89,852
Advertising funds revenue	84,570	—	163,470	—
	411,002	320,342	791,566	606,161
Costs and expenses:				
Cost of sales	138,154	130,581	270,373	255,124
Franchise support and other costs	7,031	3,789	13,204	7,432
Franchise rental expense	24,306	21,897	47,569	40,765
Advertising funds expense	84,570	—	163,470	—
General and administrative	49,163	50,059	99,519	101,373
Depreciation and amortization	33,427	31,309	65,579	60,474
System optimization (gains) losses, net	(92)	41,050	478	39,643
Reorganization and realignment costs	3,124	17,699	5,750	17,880
Impairment of long-lived assets	1,603	253	1,809	763
Other operating income, net	(1,767)	(2,089)	(2,930)	(3,807)
	339,519	294,548	664,821	519,647
Operating profit	71,483	25,794	126,745	86,514
Interest expense, net	(30,136)	(28,935)	(60,314)	(57,910)
Loss on early extinguishment of debt	—	—	(11,475)	—
Other income, net	917	2,844	1,661	3,233
Income (loss) before income taxes	42,264	(297)	56,617	31,837
Provision for income taxes	(12,388)	(1,548)	(6,582)	(11,341)
Net income (loss)	$29,876	$(1,845)	$50,035	$20,496
Net income (loss) per share				
Basic	$.13	$(.01)	$.21	$.08
Diluted	.12	(.01)	.20	.08
Dividends per share	$.085	$.07	$.17	$.14

See accompanying notes to condensed consolidated financial statements.

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THE WENDY’S COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	Three Months Ended		Six Months Ended	
	July 1, 2018	July 2, 2017	July 1, 2018	July 2, 2017
	(Unaudited)			
Net income (loss)	$29,876	$(1,845)	$50,035	$20,496
Other comprehensive (loss) income, net:				
Foreign currency translation adjustment	(4,325)	6,065	(10,369)	8,010
Change in unrecognized pension loss:				
Unrealized gains arising during the period	—	—	156	156
Income tax provision	—	—	(39)	(60)
	—	—	117	96
Effect of cash flow hedges:				
Reclassification of losses into Net income (loss)	—	724	—	1,447
Income tax provision	—	(281)	—	(559)
	—	443	—	888
Other comprehensive (loss) income, net	(4,325)	6,508	(10,252)	8,994
Comprehensive income	$25,551	$4,663	$39,783	$29,490

See accompanying notes to condensed consolidated financial statements.

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THE WENDY’S COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Six Months Ended July 1, 2018 (Unaudited)			July 2, 2017		
Cash flows from operating activities:						
Net income	$	50,035		$	20,496	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	65,579			60,474		
Share-based compensation	9,591			11,372		
Impairment of long-lived assets	1,809			763		
Deferred income tax	(2,508		)	(2,496		)
Non-cash rental income, net	(6,239		)	(5,286		)
Net receipt of deferred vendor incentives	4,904			7,077		
System optimization losses, net	478			39,643		
Gain on sale of investments, net	—			(2,553		)
Distributions received from TimWen joint venture	5,756			5,524		
Equity in earnings in joint ventures, net	(3,648		)	(3,786		)
Long-term debt-related activities, net (see below)	15,036			6,038		
Other, net	(1,093		)	3,296		
Changes in operating assets and liabilities:						
Accounts and notes receivable, net	8,315			(9,557		)
Inventories	(150		)	(71		)
Prepaid expenses and other current assets	(891		)	(2,116		)
Advertising funds restricted assets and liabilities	6,734			(14,522		)
Accounts payable	747			(4,484		)

Accrued expenses and other current liabilities	(6,034	)	(4,051	)
Net cash provided by operating activities	148,421		105,761	
Cash flows from investing activities:				
Capital expenditures	(23,898	)	(32,117	)
Acquisitions	—		(86,788	)
Dispositions	1,814		77,980	
Proceeds from sale of investments	—		3,282	
Notes receivable, net	(538	)	(2,225	)
Payments for investments	(13	)	(375	)
Net cash used in investing activities	(22,635	)	(40,243	)
Cash flows from financing activities:				
Proceeds from long-term debt	930,809		6,359	
Repayments of long-term debt	(881,633	)	(18,262	)
Deferred financing costs	(17,340	)	(740	)
Repurchases of common stock	(84,307	)	(50,527	)
Dividends	(40,645	)	(34,447	)
Proceeds from stock option exercises	13,197		6,385	
Payments related to tax withholding for share-based compensation	(9,269	)	(2,956	)
Contingent consideration payment	(6,100	)	—	
Net cash used in financing activities	(95,288	)	(94,188	)
Net cash provided by (used in) operations before effect of exchange rate changes on cash	30,498		(28,670	)
Effect of exchange rate changes on cash	(4,401	)	3,267	
Net increase (decrease) in cash, cash equivalents and restricted cash	26,097		(25,403	)
Cash, cash equivalents and restricted cash at beginning of period	212,824		275,949	

Cash, cash equivalents and restricted cash at end of period	$	238,921	$	250,546

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THE WENDY’S COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—CONTINUED
(In Thousands)

	Six Months Ended	
	July 1, 2018	July 2, 2017
	(Unaudited)	
Detail of cash flows from operating activities:		
Long-term debt-related activities, net:		
Loss on early extinguishment of debt	$11,475	$ —
Accretion of long-term debt	625	617
Amortization of deferred financing costs	2,936	3,974
Reclassification of unrealized losses on cash flow hedges	—	1,447
	$15,036	$ 6,038
Supplemental cash flow information:		
Cash paid for:		
Interest	$70,005	$ 62,090
Income taxes, net of refunds	3,813	12,886
Supplemental non-cash investing and financing activities:		
Capital expenditures included in accounts payable	$7,463	$ 8,965
Capitalized lease obligations	1,904	238,201
Accrued debt issuance costs	332	—

	July 1, 2018	December 31, 2017
Reconciliation of cash, cash equivalents and restricted cash at end of period:		
Cash and cash equivalents	$194,939	$ 171,447
Restricted cash	30,000	32,633
Restricted cash, included in Advertising funds restricted assets	13,982	8,579
Restricted cash, included in Other assets	—	165
Total cash, cash equivalents and restricted cash	$238,921	$ 212,824

See accompanying notes to condensed consolidated financial statements.

THE WENDY’S COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands Except Per Share Amounts)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements (the “Financial Statements”) of The Wendy’s Company (“The Wendy’s Company” and, together with its subsidiaries, the “Company,” “we,” “us” or “our”) have been prepa in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and, therefore, do not include all information and footnotes required by GAAP for complete financial statements. In our opinion, the Financial Statements contain all adjustments of a normal recurring nature necessary to present fairly our financial position as of July 1, 2018, the results of our operations for the three and six months ended July 1, 2018 and July 2, 2017 and cash flows for the six months ended July 1, 2018 and July 2, 2017. The results of operations for the three and six months ended July 1, 2018 are not necessarily indicative of the results to be expected for the full 2018 fiscal year. These Financial Statements should be read in conjunction with the audited consolidated financial statements for The Wendy’s Company and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “Form 10-K”).

The principal subsidiary of the Company is Wendy’s International, LLC and its subsidiaries (“Wendy’s”). The Company manages and internally reports its business geographically. The operation and franchising of Wendy’s® restaurants in North America (defined as the United States of America (“U.S.”) and Canada) comprises virtually all of our current operations and represents a single reportable segment. The revenues and operating results of Wendy’s restaurants outside of North America are not material.

We report on a fiscal year consisting of 52 or 53 weeks ending on the Sunday closest to or on December 31. All three- and six-month periods presented herein contain 13 weeks and 26 weeks, respectively. All references to years and quarters relate to fiscal periods rather than calendar periods.

Certain reclassifications have been made to the prior year presentation to conform to the current year presentation.

The Company has reclassified certain costs associated with the Company’s franchise operations to “Franchise support and other costs,” which were previously recorded to “Other operating expense (income), net.” The costs reclassified include costs incurred to provide direct support services to our franchisees, as well as certain other direct and incremental costs for the Company’s franchise operations. Also, the Company reclassified certain restaurant operational costs from “General and administrative” to “Cost of sales.” The Company believes this new presentation will aid users in understanding its results of operations. The prior periods reflect the reclassifications of these expenses to conform to the current year presentation. There was no impact to operating profit, income (loss) before income taxes or net income (loss) as a result of these reclassifications.

The following tables illustrate the expense reclassifications made to the condensed consolidated statements of operations for the three and six months ended July 2, 2017:

Three Months Ended			
	Reclassifications		
As Previously Reported	Franchise support and other	Restaurant operational costs	As Currently Reported

		costs		
Cost of sales	$129,360	$ —	$ 1,221	$130,581
Franchise support and other costs	—	3,789	—	3,789
General and administrative	51,280	—	(1,221)	50,059
Other operating expense (income), net	1,700	(3,789)	—	(2,089)
	$182,340	$ —	$ —	$182,340

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THE WENDY’S COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands Except Per Share Amounts)

	Six Months Ended			
		Reclassifications		
	As Previously Reported	Franchise support and other costs	Restaurant operational costs	As Currently Reported
Cost of sales	$252,767	$ —	$ 2,357	$255,124
Franchise support and other costs	—	7,432	—	7,432
General and administrative	103,730	—	(2,357)	101,373
Other operating expense (income), net	3,625	(7,432)	—	(3,807)
	$360,122	$ —	$ —	$360,122

(2) New Accounting Standards

New Accounting Standards

In June 2018, the Financial Accounting Standards Board (“FASB”) issued new guidance on nonemployee share-based payment arrangements. The new guidance aligns the requirements for nonemployee share-based payments with the requirements for employee share-based payments. The Company does not expect the amendment, which is effective beginning with our 2019 fiscal year, to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued new guidance on leases, which outlines principles for the recognition, measurement, presentation and disclosure of leases applicable to both lessors and lessees. The new guidance, which is effective beginning with our 2019 fiscal year, requires lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by finance and operating leases with lease terms of more than 12 months. The guidance allows for either (1) a modified retrospective transition method under which the standard is applied at the beginning of the earliest period presented in the financial statements or (2) an alternative transition method under which the standard is applied at the adoption date and a cumulative-effect adjustment to the opening balance of retained earnings is recognized in the period of adoption. The Company is continuing to evaluate which transition method to use. We are currently implementing a new lease management system to facilitate the adoption of this guidance. As shown in Note 13, there are $1,544,785 in future minimum rental payments for operating leases that are not currently on our balance sheet; therefore, we expect this will have a material impact on our consolidated balance sheets and related disclosures. We do not expect the adoption of this guidance to have a material impact on our consolidated statements of operations and statements of cash flows.

New Accounting Standards Adopted

In May 2017, the FASB issued new guidance on the scope of modification accounting for share-based payment arrangements. The new guidance provides relief to entities that make non-substantive changes to their share-based payment arrangements. The Company adopted this amendment, prospectively, during the first quarter of 2018. The adoption of this guidance did not impact our condensed consolidated financial statements.

In January 2017, the FASB issued an amendment that clarifies the definition of a business in determining whether to account for a transaction as an asset acquisition or a business combination. The Company adopted this amendment, prospectively, during the first quarter of 2018. The adoption of this guidance did not impact our condensed consolidated financial statements.

In November 2016, the FASB issued an amendment that clarifies guidance for proper classification and presentation of restricted cash in the statement of cash flows. Accordingly, changes in restricted cash that have historically been included within operating, investing and financing activities have been eliminated, and restricted cash, including the restricted cash of the national advertising funds, is combined with cash and cash equivalents when reconciling the beginning and end of period balances for all periods presented. The Company adopted this amendment during the first quarter of 2018. The adoption of the amendment resulted in an increase in net cash used in investing activities of $18,711 during the six months ended July 2, 2017. In addition, during the six months ended July 2, 2017, net cash provided by operating activities decreased $14,822 and net cash used in financing activities decreased $1,743, primarily due to changes in restricted cash of the national advertising funds. Because of the inclusion of restricted cash in the beginning and end of period balances, our cash, cash equivalents and restricted cash as presented in the statement of cash flows increased $46,003 and $77,709 as of July 2, 2017 and January 1, 2017, respectively. This amendment did not impact the Company's condensed consolidated statements of operations and condensed consolidated balance sheets.

In August 2016, the FASB issued an amendment that provides guidance for proper classification of certain cash receipts and payments in the statement of cash flows. Upon adoption in the first quarter of 2018, the Company elected to use the nature of distribution approach for all distributions it receives from its equity method investees. The adoption of this guidance did not impact our condensed consolidated financial statements.

In March 2016, the FASB issued an amendment that provides guidance on extinguishing financial liabilities for certain prepaid stored-value products. The Company adopted this amendment during the first quarter of 2018. The adoption of this guidance did not impact our condensed consolidated financial statements.

In January 2016, the FASB issued an amendment that revises the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The Company adopted this amendment during the first quarter of 2018. The adoption of this guidance did not impact our condensed consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued amended guidance for revenue recognition. The new guidance outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of the guidance is that an entity should recognize revenue for the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. Additionally, the guidance requires improved disclosure to help users of financial statements better understand the nature, amount, timing and uncertainty of revenue that is recognized. The Company adopted the new guidance on January 1, 2018. As a result, the Company has changed its accounting policy for revenue recognition as detailed below.

The Company applied the new guidance using the modified retrospective method, whereby the cumulative effect of initially adopting the guidance was recognized as an adjustment to the opening balance of equity at January 1, 2018. Therefore, the comparative period has not been adjusted and continues to be reported under the previous revenue recognition guidance. The details of the significant changes and quantitative impact of the changes are discussed below. See Note 3 for further information regarding our revenue policies and disaggregation of our sources of revenue.

Franchise Fees

Under previous revenue recognition guidance, new build technical assistance fees and development fees were recognized as revenue when a franchised restaurant opened, as all material services and conditions related to the franchise fee had been substantially performed upon the restaurant opening. In addition, under previous guidance, technical assistance fees received in connection with sales of Company-operated restaurants to franchisees and facilitating franchisee-to-franchisee restaurant transfers (“Franchise Flips”), as well as renewal fees, were recognized as revenue when the license agreements were signed and the restaurant opened. Under the new guidance, these franchise fees are considered highly dependent upon and interrelated with the franchise right granted in the franchise agreement. As such, these franchise fees are recognized over the contractual term of the franchise agreement.

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National Advertising Funds

The Company maintains two national advertising funds (the “Advertising Funds”) established to collect and administer funds contributed for use in advertising and promotional programs for Company-operated and franchised restaurants in the U.S. and Canada. Previously, the revenue, expenses and cash flows of such Advertising Funds were not included in the Company’s condensed consolidated statements of operations and statements of cash flows because the contributions to these Advertising Funds were designated for specific purposes and the Company acted as an agent, in substance, with regard to these contributions as a result of industry-specific guidance. Under the new guidance, which superseded the previous industry-specific guidance, the revenue, expenses and cash flows of the Advertising Funds are fully consolidated into the Company’s condensed consolidated statements of operations and statements of cash flows. In addition, the Company reclassified the total stockholders’ equity of the Advertising Funds from “Advertising funds restricted liabilities” to “Accumulated deficit” upon adoption of the guidance. Upon the full consolidation of the Advertising Funds, the Company also eliminated certain amounts due to and from affiliates from “Advertising funds restricted assets” and “Advertising funds restricted liabilities.” The Company allocates a portion of its advertising funds expense to “Cost of sales” based on a percentage of sales of Company-operated restaurants. Our significant interim accounting policies include the recognition of advertising funds expense in proportion to advertising funds revenue.

Impacts on Financial Statements

The following tables summarize the impacts of adopting the revenue recognition standard on the Company’s condensed consolidated financial statements: