

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **September 29, 2019**.

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 No. 001-35962

NATHAN'S FAMOUS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

11-3166443

(I.R.S. Employer Identification No.)

One Jericho Plaza, Second Floor – Wing A, Jericho, New York 11753

(Address and Zip Code of principal executive offices)

(516) 338-8500

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$.01 per share	NATH	The NASDAQ Global Market

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes 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	_____	Accelerated filer	<input checked="" type="checkbox"/> _____
Non-accelerated filer	_____		
Smaller reporting company	<input checked="" type="checkbox"/> _____	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

At November 8, 2019, an aggregate of 4,227,029 shares of the registrant's common stock, par value of \$.01, were outstanding.

NATHAN'S FAMOUS, INC. AND SUBSIDIARIES

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Nathan's Famous, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS
September 29, 2019 and March 31, 2019
(in thousands, except share and per share amounts)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

	September 29, 2019 (Unaudited)	March 31, 2019
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (Note F)	\$ 79,471	\$ 75,446
Accounts and other receivables, net (Note H)	12,170	10,173
Inventories	615	535
Prepaid expenses and other current assets (Note I)	595	1,007
Total current assets	<u>92,851</u>	<u>87,161</u>
Property and equipment, net of accumulated depreciation of \$9,221 and \$8,611, respectively	4,450	4,889
Operating lease assets (Note P)	7,520	-
Goodwill	95	95
Intangible asset, net	1,325	1,353
Deferred income taxes	359	343
Other assets	460	465
Total assets	<u>\$ 107,060</u>	<u>\$ 94,306</u>
LIABILITIES AND STOCKHOLDERS' (DEFICIT)		
CURRENT LIABILITIES		
Current portion of operating lease liabilities (Note P)	\$ 1,009	\$ -
Accounts payable	4,914	5,222
Accrued expenses and other current liabilities (Note J)	7,749	9,384
Deferred franchise fees	301	318
Total current liabilities	<u>13,973</u>	<u>14,924</u>
Long-term debt, net of unamortized debt issuance costs of \$4,205 and \$4,551, respectively (Note O)	145,795	145,449
Long-term operating lease liabilities (Note P)	7,251	-
Other liabilities (Note J)	773	1,390
Deferred franchise fees	2,215	2,687
Total liabilities	<u>170,007</u>	<u>164,450</u>
COMMITMENTS AND CONTINGENCIES (Note Q)		
STOCKHOLDERS' (DEFICIT)		
Common stock, \$.01 par value; 30,000,000 shares authorized; 9,368,792 and 9,336,338 shares issued; and 4,227,029 and 4,194,575 shares outstanding at September 29, 2019 and March 31, 2019, respectively	94	93
Additional paid-in capital	62,072	60,945
(Accumulated deficit)	(46,810)	(52,879)
Stockholders' equity before treasury stock	<u>15,356</u>	<u>8,159</u>
Treasury stock, at cost, 5,141,763 shares at September 29, 2019 and March 31, 2019	(78,303)	(78,303)
Total stockholders' (deficit)	<u>(62,947)</u>	<u>(70,144)</u>
Total liabilities and stockholders' (deficit)	<u>\$ 107,060</u>	<u>\$ 94,306</u>

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS

Thirteen and Twenty-six weeks ended September 29, 2019 and September 23, 2018

(in thousands, except share and per share amounts)

(Unaudited)

	Thirteen weeks ended		Twenty-six weeks ended	
	September 29, 2019	September 23, 2018	September 29, 2019	September 23, 2018
REVENUES				
Sales	\$ 22,106	\$ 21,573	\$ 42,343	\$ 42,044
License royalties	5,425	5,746	14,147	13,844
Franchise fees and royalties	1,498	1,239	2,575	2,343
Advertising fund revenue	697	772	1,179	1,267
Total revenues	<u>29,726</u>	<u>29,330</u>	<u>60,244</u>	<u>59,498</u>
COSTS AND EXPENSES				
Cost of sales	16,289	15,160	31,711	30,606
Restaurant operating expenses	1,108	1,141	2,027	2,051
Depreciation and amortization	337	339	647	684
General and administrative expenses	3,559	3,438	7,496	7,323
Advertising fund expense	1,067	772	1,549	1,267
Total costs and expenses	<u>22,360</u>	<u>20,850</u>	<u>43,430</u>	<u>41,931</u>
Income from operations	7,366	8,480	16,814	17,567
Gain (loss) on disposal of property and equipment	(2)	323	(2)	323
Interest expense	(2,651)	(2,651)	(5,301)	(5,301)
Interest income	370	115	736	176
Other income, net	20	196	41	217
Income before provision for income taxes	5,103	6,463	12,288	12,982
Provision for income taxes	1,445	1,979	3,261	3,703
Net income	<u>\$ 3,658</u>	<u>\$ 4,484</u>	<u>\$ 9,027</u>	<u>\$ 9,279</u>
PER SHARE INFORMATION				
Weighted average shares used in computing income per share:				
Basic	4,227,000	4,188,000	4,216,000	4,187,000
Diluted	4,227,000	4,231,000	4,216,000	4,229,000
Income per share:				
Basic	\$.87	\$ 1.07	\$ 2.14	\$ 2.22
Diluted	\$.87	\$ 1.06	\$ 2.14	\$ 2.19
Dividends declared per share	\$.35	\$.25	\$.70	\$.50

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT)

Thirteen weeks ended September 29, 2019 and September 23, 2018

(in thousands, except share amounts)

(Unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock, at Cost Shares	Amount	Total Stockholders' (Deficit)
Balance, June 30, 2019	9,368,572	\$ 94	\$ 62,050	\$ (48,989)	5,141,763	\$ (78,303)	\$ (65,148)
Shares issued in connection with share-based compensation plans	220	-	-	-	-	-	-
Withholding tax on net share settlement of share-based compensation plans	-	-	(8)	-	-	-	(8)
Dividends on common stock	-	-	-	(1,479)	-	-	(1,479)
Share-based compensation	-	-	30	-	-	-	30
Net income	-	-	-	3,658	-	-	3,658
Balance, September 29, 2019	9,368,792	\$ 94	\$ 62,072	\$ (46,810)	5,141,763	\$ (78,303)	\$ (62,947)
	Common Shares	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock, at Cost Shares	Amount	Total Stockholders' (Deficit)
Balance, June 24, 2018	9,314,912	\$ 93	\$ 60,730	\$ (66,437)	5,127,373	\$ (77,303)	\$ (82,917)
Shares issued in connection with share-based compensation plans	4,030	-	134	-	-	-	134
Dividends on common stock	-	-	-	(1,047)	-	-	(1,047)
Share-based compensation	-	-	23	-	-	-	23
Net income	-	-	-	4,484	-	-	4,484
Balance, September 23, 2018	9,318,942	\$ 93	\$ 60,887	\$ (63,000)	5,127,373	\$ (77,303)	\$ (79,323)

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT)

Twenty-six weeks ended September 29, 2019 and September 23, 2018

(in thousands, except share amounts)

(Unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock, at Cost Shares	Amount	Total Stockholders' (Deficit)
Balance, March 31, 2019	9,336,338	\$ 93	\$ 60,945	\$ (52,879)	5,141,763	\$ (78,303)	\$ (70,144)
Shares issued in connection with share-based compensation plans	32,454	1	1,077	-	-	-	1,078
Withholding tax on net share settlement of share-based compensation plans	-	-	(8)	-	-	-	(8)
Dividends on common stock	-	-	-	(2,958)	-	-	(2,958)
Share-based compensation	-	-	58	-	-	-	58
Net income	-	-	-	9,027	-	-	9,027
Balance, September 29, 2019	9,368,792	\$ 94	\$ 62,072	\$ (46,810)	5,141,763	\$ (78,303)	\$ (62,947)

	Common Shares	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock, at Cost Shares	Amount	Total Stockholders' (Deficit)
Balance, March 25, 2018	9,311,922	\$ 93	\$ 60,823	\$ (68,181)	5,127,373	\$ (77,303)	\$ (84,568)
Cumulative effect of the adoption of ASC 606	-	-	-	(2,004)	-	-	(2,004)
Shares issued in connection with share-based compensation plans	7,020	-	134	-	-	-	134
Withholding tax on net share settlement of share-based compensation plans	-	-	(174)	-	-	-	(174)
Dividends on common stock	-	-	-	(2,094)	-	-	(2,094)
Share-based compensation	-	-	104	-	-	-	104
Net income	-	-	-	9,279	-	-	9,279
Balance, September 23, 2018	9,318,942	\$ 93	\$ 60,887	\$ (63,000)	5,127,373	\$ (77,303)	\$ (79,323)

The accompanying notes are an integral part of these consolidated financial statements.

Nathan's Famous, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

Twenty-six weeks ended September 29, 2019 and September 23, 2018

(in thousands)

(Unaudited)

	September 29, 2019	September 23, 2018
Cash flows from operating activities:		
Net income	\$ 9,027	\$ 9,279
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	647	684
(Gain) loss on disposal of property and equipment	2	(323)
Amortization of debt issuance costs	346	346
Share-based compensation expense	58	104
Income tax benefit on stock option exercises	228	46
Provision for doubtful accounts	23	92
Deferred income taxes	(16)	23
Changes in operating assets and liabilities:		
Accounts and other receivables, net	(2,020)	(310)
Inventories	(80)	(168)
Prepaid expenses and other current assets	412	2,350
Other assets	5	(50)
Accounts payable, accrued expenses and other current liabilities	(2,171)	(2,015)
Deferred franchise fees	(489)	(3)
Other liabilities	123	(52)
Net cash provided by operating activities	6,095	10,003
Cash flows from investing activities:		
Proceeds from disposal of property and equipment	-	1,330
Purchase of property and equipment	(182)	(234)
Net cash (used in) provided by investing activities	(182)	1,096
Cash flows from financing activities:		
Dividends paid to stockholders	(2,958)	(2,244)
Proceeds from exercise of stock options	1,078	134
Payments of withholding tax on net share settlement of share-based compensation plans	(8)	(174)
Net cash (used in) financing activities	(1,888)	(2,284)
Net increase in cash and cash equivalents	4,025	8,815
Cash and cash equivalents, beginning of period	75,446	57,339
Cash and cash equivalents, end of period	<u>\$ 79,471</u>	<u>\$ 66,154</u>
Cash paid during the period for:		
Interest	<u>\$ 4,969</u>	<u>\$ 4,968</u>
Income taxes paid	<u>\$ 2,955</u>	<u>\$ 1,319</u>
Noncash financing activity:		
Dividends declared per share	<u>\$.70</u>	<u>\$.50</u>

The accompanying notes are an integral part of these consolidated financial statements.

NATHAN'S FAMOUS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 29, 2019

(Unaudited)

NOTE A - BASIS OF PRESENTATION

The accompanying consolidated financial statements of Nathan's Famous, Inc. and subsidiaries (collectively "Nathan's," the "Company," "we," "us" or "our") as of and for the thirteen and twenty-six week periods ended September 29, 2019 and September 23, 2018 have been prepared in accordance with accounting principles generally accepted in the United States of America. The unaudited financial statements include all adjustments (consisting of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of financial condition, results of operations and cash flows for the periods presented. However, our results of operations are seasonal in nature, and the results of any interim period are not necessarily indicative of results for any other interim period or the full fiscal year.

Certain information and footnote disclosures normally included in financial statements in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to the requirements of the Securities and Exchange Commission.

We have reclassified certain prior period items in the Consolidated Statement of Earnings for the thirteen and twenty-six week periods ended September 23, 2018 to conform with the classifications for the thirteen and twenty-six week periods ended September 29, 2019. We have reclassified certain prior period items in the Consolidated Statement of Cash Flows in the twenty-six week period ended September 23, 2018 to conform with the classifications for the fiscal year ended March 31, 2019. These reclassifications had no effect on previously reported net income or cash flows. Management believes that the disclosures included in the accompanying consolidated interim financial statements and footnotes are adequate to make the information not misleading, but should be read in conjunction with the consolidated financial statements and notes thereto included in Nathan's Annual Report on Form 10-K for the fiscal year ended March 31, 2019.

A summary of the Company's significant accounting policies is identified in Note B of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2019.

NOTE B – ADOPTION OF NEW ACCOUNTING STANDARDS

Leases

In February 2016, the Financial Accounting Standards Board ("FASB") issued new guidance on leases, Topic 842, which outlines principles for the recognition, measurement, presentation and disclosure of leases applicable to both lessors and lessees. The new guidance requires lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by finance and operating leases. The Company adopted the new guidance during the first quarter of fiscal 2020 using the effective date of April 1, 2019 as the date of initial application; therefore, the comparative period has not been adjusted and continues to be reported under the previous lease guidance.

The new standard provides for a number of practical expedients upon adoption. The Company elected the package of practical expedients, which permits the Company not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. For those leases that fall under the definition of a short-term lease, the Company elected the short-term lease recognition exemption. Under this practical expedient, for those leases that qualify, we did not recognize right-of-use ("ROU") assets or liabilities. The Company also elected the practical expedient for lessees to account for lease components and non-lease components as a single lease component for all underlying classes of assets. The Company did not elect the use-of-hindsight practical expedient.

As a result of adopting this new guidance on the first day of fiscal year 2020, substantially all of the Company's operating lease commitments were subject to the new guidance and were recognized as operating lease assets and liabilities, initially measured as the present value of future lease payments for the remaining lease term discounted using the Company's incremental borrowing rate based on the remaining lease term as of the adoption date. The Company recognized operating lease assets and liabilities of \$7,804,000 and \$8,533,000, respectively, as of the first day of fiscal year 2020. The difference between the assets and liabilities is attributable to the reclassification of certain existing lease-related assets and liabilities as an adjustment to the right-of-use assets.

The effects of the changes made to the Company's consolidated balance sheet as of April 1, 2019 for the adoption of the new lease guidance were as follows (in thousands):

	Balance at March 31, 2019	Adjustments due to adoption of the new lease guidance	Reclassifications	Balance at April 1, 2019
Other Assets				
Operating lease assets	-	7,804	-	7,804
Other assets	465	-	31	496
Current Liabilities				
Current portion of operating lease liabilities	-	1,162	-	1,162
Long Term Liabilities				
Long-term operating lease liabilities	-	7,371	-	7,371
Other liabilities	1,390	(729)	31	692

The adoption of the new guidance is non-cash in nature and had no impact on net cash flows from operating, investing, or financing activities.

See Note P for additional information regarding our lease arrangements and the Company's updated lease accounting policies.

NOTE C – NEW ACCOUNTING STANDARDS NOT YET ADOPTED

In June 2016, the FASB issued new guidance on the measurement of credit losses, which significantly changes the impairment model for most financial instruments. Current guidance requires the recognition of credit losses based on an incurred loss impairment methodology that reflects losses once the losses are probable. Under the new standard, the Company will be required to use a current expected credit loss model (“CECL”) that will immediately recognize an estimate of credit losses that are expected to occur over the life of the financial instruments that are in the scope of this update, including trade receivables. The CECL model uses a broader range of reasonable and supportable information in the development of credit loss estimates. This guidance is effective for public business entities for annual reporting periods beginning after December 15, 2019. This standard is required to take effect in Nathan’s first quarter (June 2020) of our fiscal year ending March 28, 2021. The Company is currently evaluating the impact that the adoption of this guidance will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued an update to the accounting guidance to simplify the testing for goodwill impairment. The update removes the requirement to determine the implied fair value of goodwill to measure the amount of impairment loss, if any, under the second step of the current goodwill impairment test. A company will perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment charge will be recognized for the amount by which the reporting unit’s carrying amount exceeds its fair value, not to exceed the carrying amount of the goodwill. The guidance is effective prospectively for public business entities for annual reporting periods beginning after December 15, 2019. This standard is required to take effect in Nathan’s first quarter (June 2020) of our fiscal year ending March 28, 2021. Nathan’s does not expect the adoption of this new guidance to have a material impact on its results of operations or financial position.

The Company does not believe that any other recently issued, but not yet effective accounting standards, when adopted, will have a material effect on the accompanying consolidated financial statements.

NOTE D – REVENUES

The Company’s disaggregated revenues for the thirteen and twenty-six weeks ended September 29, 2019 and September 23, 2018 are as follows (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	September 29, 2019	September 23, 2018	September 29, 2019	September 23, 2018
Branded Products	\$ 16,182	\$ 15,410	\$ 32,295	\$ 31,855
Company-operated restaurants	5,924	6,163	10,048	10,189
Total sales	<u>22,106</u>	<u>21,573</u>	<u>42,343</u>	<u>42,044</u>
License royalties	5,425	5,746	14,147	13,844
Franchise royalties	1,047	1,104	2,027	2,101
Franchise fees	451	135	548	242
Total franchise fees and royalties	<u>1,498</u>	<u>1,239</u>	<u>2,575</u>	<u>2,343</u>
Advertising fund revenue	697	772	1,179	1,267
Total revenues	<u>\$ 29,726</u>	<u>\$ 29,330</u>	<u>\$ 60,244</u>	<u>\$ 59,498</u>

The following table disaggregates revenues by primary geographical market (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	September 29, 2019	September 23, 2018	September 29, 2019	September 23, 2018
United States	\$ 28,235	\$ 28,620	\$ 57,622	\$ 57,476
International	1,491	710	2,622	2,022
Total revenues	<u>\$ 29,726</u>	<u>\$ 29,330</u>	<u>\$ 60,244</u>	<u>\$ 59,498</u>

Contract balances

The following table provides information about contract liabilities (Deferred franchise fees) from contracts with customers (in thousands):

	September 29, 2019	March 31, 2019
Deferred franchise fees (a)	<u>\$ 2,516</u>	<u>\$ 3,005</u>

(a) Deferred franchise fees of \$301 and \$2,215 as of September 29, 2019 and \$318 and \$2,687 as of March 31, 2019 are included in Deferred franchise fees – current and long term, respectively.

Significant changes in Deferred franchise fees are as follows (in thousands):

	Twenty-six weeks ended	
	September 29, 2019	September 23, 2018
Deferred franchise fees at beginning of period	3,005	3,139 (a)
Revenue recognized during the period	(548)	(242)
New deferrals due to cash received and other	59	706
Deferred franchise fees at end of period	<u>\$ 2,516</u>	<u>\$ 3,603</u>

(a) Includes the cumulative effect of adopting Topic 606 of \$2,735.

Anticipated Future Recognition of Deferred Franchise Fees

The following table reflects the estimated franchise fees to be recognized in the future related to performance obligations that are unsatisfied at the end of the period (in thousands):

	Estimate for fiscal year
2020 (a)	\$ 152
2021	296
2022	286
2023	249
2024	233
Thereafter	1,300
Total	<u>\$ 2,516</u>

(a) Represents franchise fees expected to be recognized for the remainder of the 2020 fiscal year, which includes international development fees expected to be recognized over the duration of one year or less. Amount does not include \$548 of franchise fee revenue recognized for the twenty-six weeks ended September 29, 2019.

We have applied the optional exemption, as provided for under Topic 606, which allows us not to disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

NOTE E – INCOME PER SHARE

Basic income per common share is calculated by dividing income by the weighted-average number of common shares outstanding and excludes any dilutive effect of stock options. Diluted income per common share gives effect to all potentially dilutive common shares that were outstanding during the period. Dilutive common shares used in the computation of diluted income per common share result from the assumed exercise of stock options and warrants, as determined using the treasury stock method.

The following chart provides a reconciliation of information used in calculating the per-share amounts for the thirteen and twenty-six week periods ended September 29, 2019 and September 23, 2018, respectively.

Thirteen weeks

	Net Income		Number of Shares		Net Income Per Share	
	2019	2018	2019	2018	2019	2018
	(in thousands)		(in thousands)			
Basic EPS						
Basic calculation	\$ 3,658	\$ 4,484	4,227	4,188	\$ 0.87	\$ 1.07
Effect of dilutive employee stock options	-	-	-	43	-	(0.01)
Diluted EPS						
Diluted calculation	<u>\$ 3,658</u>	<u>\$ 4,484</u>	<u>4,227</u>	<u>4,231</u>	<u>\$ 0.87</u>	<u>\$ 1.06</u>

Twenty-six weeks

	Net Income		Number of Shares		Net Income Per Share	
	2019	2018	2019	2018	2019	2018
	(in thousands)		(in thousands)			
Basic EPS						
Basic calculation	\$ 9,027	\$ 9,279	4,216	4,187	\$ 2.14	\$ 2.22
Effect of dilutive employee stock options	-	-	-	42	-	(0.03)
Diluted EPS						
Diluted calculation	<u>\$ 9,027</u>	<u>\$ 9,279</u>	<u>4,216</u>	<u>4,229</u>	<u>\$ 2.14</u>	<u>\$ 2.19</u>

Options to purchase 10,000 shares of common stock in the thirteen and twenty-six week periods ended September 29, 2019 were not included in the computation of diluted EPS because the exercise price exceeded the average market price of common shares during the period.



NOTE F – CASH AND CASH EQUIVALENTS

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents at September 29, 2019 and March 31, 2019 were \$20,000,000. Substantially all of the Company’s cash and cash equivalents are in excess of government insurance.

NOTE G – FAIR VALUE MEASUREMENTS

Nathan’s follows a three-level fair value hierarchy that prioritizes the inputs to measure fair value. This hierarchy requires entities to maximize the use of “observable inputs” and minimize the use of “unobservable inputs.” The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels are defined as follows:

- Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for an identical asset or liability in an active market
- Level 2 - inputs to the valuation methodology include quoted prices for a similar asset or liability in an active market or model-derived valuations in which all significant inputs are observable for substantially the full term of the asset or liability
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement of the asset or liability

The face value and fair value of long-term debt as of September 29, 2019 and March 31, 2019 were as follows (in thousands):

	September 29, 2019		March 31, 2019	
	Face value	Fair value	Face Value	Fair value
Long-term debt	\$ 150,000	\$ 149,250	\$ 150,000	\$ 145,688

The Company estimates the fair value of its long-term debt based upon review of observable pricing in secondary markets as of the last trading day of the fiscal period. Accordingly, the Company classifies its long-term debt as Level 2.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of the instruments.

Certain non-financial assets and liabilities are measured at fair value on a non-recurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances, such as when evidence of impairment exists. At September 29, 2019, no fair value adjustment or material fair value measurements were required for non-financial assets or liabilities.

NOTE H – ACCOUNTS AND OTHER RECEIVABLES, NET

Accounts and other receivables, net, consist of the following (in thousands):

	September 29, 2019	March 31, 2019
Branded product sales	\$ 8,724	\$ 7,432
Franchise and license royalties	2,552	2,661
Other	1,502	665
	<u>12,778</u>	<u>10,758</u>
Less: allowance for doubtful accounts	608	585
Accounts and other receivables, net	<u>\$ 12,170</u>	<u>\$ 10,173</u>

Accounts receivable are due within 30 days and are stated at amounts due from franchisees, retail licensees and Branded Product Program customers, net of an allowance for doubtful accounts. Accounts that are outstanding longer than the contractual payment terms are generally considered past due. The Company does not recognize franchise and license royalties that are not deemed to be realizable.

The Company individually reviews each past due account and determines its allowance for doubtful accounts by considering a number of factors, including the length of time accounts receivable are past due, the Company's previous loss history, the customer's current and expected future ability to pay its obligation to the Company, the condition of the general economy and the industry as a whole. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings. After the Company has used reasonable collection efforts, it writes off accounts receivable through a charge to the allowance for doubtful accounts.

Changes in the Company's allowance for doubtful accounts for the twenty-six week period ended September 29, 2019 and the fiscal year ended March 31, 2019 are as follows (in thousands):

	September 29, 2019	March 31, 2019
Beginning balance	\$ 585	\$ 468
Reclassification to conform with Topic 606	-	77
Bad debt expense	23	100
Accounts written off	-	(60)
Ending balance	<u>\$ 608</u>	<u>\$ 585</u>

NOTE I – PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following (in thousands):

	September 29, 2019	March 31, 2019
Income taxes	\$ -	\$ 106
Insurance	94	244
Other	501	657
Total prepaid expenses and other current assets	<u>\$ 595</u>	<u>\$ 1,007</u>

NOTE J – ACCRUED EXPENSES, OTHER CURRENT LIABILITIES AND OTHER LIABILITIES

Accrued expenses and other current liabilities consist of the following (in thousands):

	September 29, 2019	March 31, 2019
Payroll and other benefits	\$ 1,972	\$ 3,150
Accrued rebates	654	770
Rent and occupancy costs	117	113
Deferred revenue	256	807
Construction costs	58	58
Interest	4,098	4,111
Professional fees	106	146
Sales, use and other taxes	104	27
Corporate income taxes	176	-
Other	208	202
Total accrued expenses and other current liabilities	<u>\$ 7,749</u>	<u>\$ 9,384</u>

Other liabilities consist of the following (in thousands):

	September 29, 2019	March 31, 2019
Reserve for uncertain tax positions	\$ 537	\$ 496
Deferred rental liability	-	670
Other	236	224
Total other liabilities	<u>\$ 773</u>	<u>\$ 1,390</u>

NOTE K – INCOME TAXES

The income tax provisions for the twenty-six periods ended September 29, 2019 and September 23, 2018 reflect effective tax rates of 26.5% and 28.5%, respectively.

Nathan's effective tax rates for the twenty-six week periods ended September 29, 2019 and September 23, 2018 were reduced by 1.9% and 0.4%, respectively, as a result of the tax benefits associated with stock compensation. For the twenty-six week periods ended September 29, 2019 and September 23, 2018, excess tax benefits of \$228,000 and \$46,000, respectively, were reflected in the Consolidated Statements of Earnings as a reduction in determining the provision for income taxes. Nathan's effective tax rates without these adjustments would have been 28.4% for the fiscal 2020 period and 28.9% for the fiscal 2019 period.

The amount of unrecognized tax benefits at September 29, 2019 was \$280,000 all of which would impact Nathan's effective tax rate, if recognized. As of September 29, 2019, Nathan's had \$267,000 of accrued interest and penalties in connection with unrecognized tax benefits.

NOTE L – SEGMENT INFORMATION

Nathan's considers itself to be a brand marketer of the Nathan's Famous signature products to the foodservice industry pursuant to its various business structures. Nathan's sells its products directly to consumers through its restaurant operations segment consisting of Company-operated and franchised restaurants, to distributors that resell our products to the foodservice industry through the Branded Product Program ("BPP") and by third party manufacturers pursuant to license agreements that sell our products to club stores and grocery stores nationwide. The Company's Chief Executive Officer has been identified as the Chief Operating Decision Maker ("CODM") who evaluates performance and allocates resources for the Branded Product Program, Product Licensing and Restaurant Operations segments based upon a number of factors, the primary profit measure being income from operations. Certain administrative expenses are not allocated to the segments and are reported within the Corporate segment.

Branded Product Program – This segment derives revenue principally from the sale of hot dog products either directly to foodservice operators or to various foodservice distributors who resell the products to foodservice operators.

Product licensing – This segment derives revenue, primarily in the form of royalties, from licensing a broad variety of Nathan's Famous branded products, including our hotdogs, sausage and corned beef products, frozen French fries and additional products through retail grocery channels and club stores throughout the United States.

Restaurant operations – This segment derives revenue from sale of our products at Company-owned restaurants and earns fees and royalties from its franchised restaurants.

Revenues from operating segments are from transactions with unaffiliated third parties and do not include any intersegment revenues.

Income from operations attributable to Corporate consists principally of administrative expenses not allocated to the operating segments such as executive management, finance, information technology, legal, insurance, corporate office costs, corporate incentive compensation, compliance costs and the operating results of the advertising fund.

Interest expense, interest income, gain (loss) on disposal of property and equipment, and other income, net, are managed centrally at the corporate level, and, accordingly, such items are not presented by segment since they are excluded from the measure of profitability reviewed by the CODM.

Operating segment information is as follows (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	<u>Sept. 29, 2019</u>	<u>Sept. 23, 2018</u>	<u>Sept. 29, 2019</u>	<u>Sept. 23, 2018</u>
Revenues				
Branded Product Program	\$ 16,182	\$ 15,410	\$ 32,295	\$ 31,855
Product licensing	5,425	5,746	14,147	13,844
Restaurant operations	7,422	7,402	12,623	12,532
Corporate (1)	697	772	1,179	1,267
Total revenues	<u>\$ 29,726</u>	<u>\$ 29,330</u>	<u>\$ 60,244</u>	<u>\$ 59,498</u>
Income from operations				
Branded Product Program	\$ 2,124	\$ 2,730	\$ 4,327	\$ 5,261
Product licensing	5,380	5,700	14,056	13,753
Restaurant operations	2,103	2,095	2,853	2,845
Corporate	(2,241)	(2,045)	(4,422)	(4,292)
Income from operations	<u>\$ 7,366</u>	<u>\$ 8,480</u>	<u>\$ 16,814</u>	<u>\$ 17,567</u>
Gain (loss) on disposal of property and equipment	(2)	323	(2)	323
Interest expense	(2,651)	(2,651)	(5,301)	(5,301)
Interest income	370	115	736	176
Other income, net	20	196	41	217
Income before provision for income taxes	<u>\$ 5,103</u>	<u>\$ 6,463</u>	<u>\$ 12,288</u>	<u>\$ 12,982</u>

(1) Represents advertising fund revenue



NOTE M– SHARE-BASED COMPENSATION

Total share-based compensation during the thirteen-week periods ended September 29, 2019 and September 23, 2018 was \$30,000 and \$23,000, respectively. Total share-based compensation during the twenty-six week periods ended September 29, 2019 and September 23, 2018 was \$58,000 and \$104,000, respectively. Total share-based compensation is included in general and administrative expenses in our accompanying Consolidated Statements of Earnings. As of September 29, 2019, there was \$226,000 of unamortized compensation expense related to share-based incentive awards. We expect to recognize this expense over approximately twenty-three months, which represents the weighted average remaining requisite service periods for such awards.

The Company recognizes compensation cost for unvested stock-based incentive awards on a straight-line basis over the requisite service period. Compensation cost charged to expense under all stock-based incentive awards is as follows (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	Sept. 29, 2019	Sept. 23, 2018	Sept. 29, 2019	Sept. 23, 2018
Stock options	\$ 22	\$ 22	\$ 43	\$ 60
Restricted stock	8	1	15	44
Total compensation cost	\$ 30	\$ 23	\$ 58	\$ 104

Stock options:

There were no new share-based awards granted during the twenty-six week period September 29, 2019.

During the fiscal year March 31, 2019, the Company granted options to purchase 10,000 shares at an exercise price of \$89.90 per share, all of which expire five years from the date of grant. All such stock options vest ratably over a three-year period commencing September 12, 2019.

Transactions with respect to stock options for the twenty-six weeks ended September 29, 2019 are as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Options outstanding at March 31, 2019 fiscal year (A)	42,234	\$ 46.807	1.32	\$ 1,127
Granted	-	-	-	-
Exercised	(32,234)	\$ 33.438	-	1,134
Options outstanding at September 29, 2019	10,000	\$ 89.90	3.95	-
Options exercisable at September 29, 2019	3,333	\$ 89.90	3.95	-

A- Represents outstanding options after giving effect to the replacement options issued in connection with the Company's special dividend to shareholders of record on December 22, 2017.

Restricted stock:

Transactions with respect to restricted stock for the twenty-six weeks ended September 29, 2019 are as follows:

	Shares	Weighted-Average Grant-date Fair value Per share
Unvested restricted stock at March 31, 2019	1,000	\$ 89.90
Granted	-	-
Vested	(333)	\$ 89.90
Unvested restricted stock at September 29, 2019	667	\$ 89.90

NOTE N– STOCKHOLDERS' EQUITY

1. Dividends

Effective June 14, 2019, the Board declared its first quarterly cash dividend of \$0.35 per share for fiscal year 2020, aggregating \$1,479,000, which was paid on June 28, 2019 to stockholders of record as of the close of business on June 24, 2019.

Effective August 9, 2019 the Board declared its second quarterly cash dividend of \$0.35 per share, aggregating \$1,479,000, which was paid on September 6, 2019 to stockholders of record as of the close of business on August 26, 2019.

Effective November 8, 2019 the Board declared its third quarterly cash dividend of \$0.35 per share payable on December 6, 2019 to stockholders of record as of the close of business on November 25, 2019.

Our ability to pay future dividends is limited by the terms of the Indenture with U.S. Bank National Association, as trustee and collateral trustee (see Note O). In addition to the terms of the Indenture, the declaration and payment of any cash dividends in the future are subject to final determination of

the Board and will be dependent upon our earnings and financial requirements.

2. Stock Incentive Plans

On September 13, 2012, the Company amended the Nathan's Famous, Inc. 2010 Stock Incentive Plan (the "2010 Plan") increasing the number of shares available for issuance by 250,000 shares. Shares to be issued under the 2010 Plan may be made available from authorized but unissued stock, common stock held by the Company in its treasury, or common stock purchased by the Company on the open market or otherwise. The number of shares issuable and the grant, purchase or exercise price of outstanding awards are subject to adjustment in the amount that the Company's Compensation Committee considers appropriate upon the occurrence of certain events, including stock dividends, stock splits, mergers, consolidations, reorganizations, recapitalizations, or other capital adjustments. In the event that the Company issues restricted stock awards pursuant to the 2010 Plan, each share of restricted stock would reduce the amount of available shares for issuance by either 3.2 shares for each share of restricted stock granted or 1 share for each share of restricted stock granted.

On September 18, 2019, the Company's shareholders approved the Nathan's Famous, Inc. 2019 Stock Incentive Plan (the "2019 Plan"). The 2019 Plan will be effective as of July 1, 2020 (the "Effective Date"). Following the Effective Date, (i) no additional stock awards shall be granted under the 2010 Plan and (ii) all outstanding stock awards previously granted under the 2010 Plan shall remain subject to the terms of the 2010 Plan. All awards granted on or after the Effective Date of the 2019 Plan shall be subject to the terms of the 2019 Plan.

Once effective, we will be able to issue up to: (a) 369,584 shares of common stock under the 2019 Plan which includes: (i) shares that have been authorized but not issued pursuant to the 2010 Plan as of July 1, 2020 up to a maximum of an additional 208,584 shares and (ii) any shares subject to any outstanding options or restricted stock grants under any plan of the Company that were outstanding as of July 1, 2020 and that subsequently expire unexercised, or are otherwise forfeited, up to a maximum of an additional 11,000 shares. As of September 29, 2019, there were up to 208,584 shares available to be issued for future option grants or up to 184,808 shares of restricted stock that may be granted under the 2010 Plan.

3. Stock Repurchase Programs

During the period from October 2001 through September 29, 2019, Nathan's purchased 5,141,763 shares of common stock at a cost of approximately \$78,303,000 pursuant to various stock repurchase plans previously authorized by the Board of Directors. During the twenty-six week period ended September 29, 2019, we did not repurchase any shares of common stock.

In 2016, the Company's Board of Directors authorized increases to the sixth stock repurchase plan for the purchase of up to 1,200,000 shares of its common stock on behalf of the Company. As of September 29, 2019, Nathan's had repurchased 954,132 shares at a cost of \$30,641,000 under the sixth stock repurchase plan. At September 29, 2019, there were 245,868 shares remaining to be repurchased pursuant to the sixth stock repurchase plan. The plan does not have a set expiration date. Purchases under the Company's stock repurchase program may be made from time to time, depending on market conditions, in open market or privately-negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the repurchases.

NOTE O – LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	<u>September 29, 2019</u>	<u>March 31, 2019</u>
6.625% Senior Secured Notes due 2025	\$ 150,000	\$ 150,000
Less: unamortized debt issuance costs	(4,205)	(4,551)
Long-term debt, net	<u>\$ 145,795</u>	<u>\$ 145,449</u>

On November 1, 2017, the Company issued \$150,000,000 of 6.625% Senior Secured Notes due 2025 (the "2025 Notes") in a private offering in accordance with Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"). The 2025 Notes were issued pursuant to an indenture dated as of November 1, 2017 by and among the Company, certain of its wholly-owned subsidiaries and U.S. Bank National Association (the "Indenture"). The Company used the net proceeds of the 2025 Notes offering to satisfy and discharge the Indenture relating to the \$135,000,000 of 10.000% Senior Secured Notes due 2020 and redeem such notes (the "Redemption"), paid a portion of a special \$5.00 per share cash dividend to Nathan's stockholders of record, with the remaining net proceeds for general corporate purposes, including working capital. The Company also funded the majority of the special dividend of \$5.00 per share through its existing cash. The Redemption occurred on November 16, 2017.

The 2025 Notes bear interest at 6.625% per annum, payable semi-annually on May 1st and November 1st of each year. The Company made its required semi-annual interest payments of \$4,968,750 on May 1, 2019 and November 1, 2019.

The 2025 Notes have no scheduled principal amortization payments prior to its final maturity on November 1, 2025.

A summary of certain terms and conditions of the 2025 Notes is as follows (terms not defined shall have the meanings set forth in the Indenture):

There are no financial maintenance covenants associated with the 2025 Notes. As of September 29, 2019, Nathan's was in compliance with all covenants associated with the 2025 Notes.

The Indenture contains certain covenants limiting the Company's ability and the ability of its restricted subsidiaries (as defined in the Indenture) to, subject to certain exceptions and qualifications: (i) incur additional indebtedness; (ii) pay dividends or make other distributions on, redeem or repurchase, capital stock; (iii) make investments or other restricted payments; (iv) create or incur certain liens; (v) incur restrictions on the payment of dividends or other distributions from its restricted subsidiaries; (vi) enter into certain transactions with affiliates; (vii) sell assets; or (viii) effect a consolidation or merger. Certain Restricted Payments which may be made or indebtedness incurred by Nathan's or its Restricted Subsidiaries may require compliance with the following financial ratios:

Fixed Charge Coverage Ratio: the ratio of the Consolidated Cash Flow to the Fixed Charges for the relevant period, currently set at 2.0 to 1.0 in the Indenture. The Fixed Charge Coverage Ratio applies to determining whether additional Restricted Payments may be made, certain additional debt may be incurred and acquisitions may be made.

Priority Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Priority Lien to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate; currently set at 0.40 to 1.00 in the Indenture.

Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Lien on any property of Nathan's or any Guarantor to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate. The Secured Leverage Ratio under the Indenture is 3.75 to 1.00 and applies if Nathan's wants to incur additional debt on the same terms as the 2025 Notes.

The Indenture also contains customary events of default, including, among other things, failure to pay interest, failure to comply with agreements related to the Indenture, failure to pay at maturity or acceleration of other indebtedness, failure to pay certain judgments, and certain events of insolvency or bankruptcy. Generally, if any event of default occurs, the Trustee or the holders of at least 25% in principal amount of the 2025 Notes may declare the 2025 Notes due and payable by providing notice to the Company. In case of default arising from certain events of bankruptcy or insolvency, the 2025 Notes will become immediately due and payable.

The 2025 Notes are general senior secured obligations, are fully and unconditionally guaranteed by substantially all of the Company's wholly-owned subsidiaries and rank *pari passu* in right of payment with all of the Company's existing and future indebtedness that is not subordinated, are senior in right of payment to any of the Company's existing and future subordinated indebtedness, are structurally subordinated to any existing and future indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the 2025 Notes, and are effectively junior to all existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes.

Pursuant to the terms of a collateral trust agreement, the liens securing the 2025 Notes and the guarantees will be contractually subordinated to the liens securing any future credit facility.

The 2025 Notes and the guarantees are the Company and the guarantors' senior secured obligations and will rank:

- senior in right of payment to all of the Company and the guarantors' future subordinated indebtedness;
- effectively senior to all unsecured senior indebtedness to the extent of the value of the collateral securing the 2025 Notes and the guarantees;
- *pari passu* with all of the Company and the guarantors' other senior indebtedness;
- effectively junior to any future credit facility to the extent of the value of the collateral securing any future credit facility and the 2025 Notes and the guarantees and certain other assets;
- effectively junior to any of the Company and the guarantors' existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes and the guarantees to the extent of the value of any such assets; and
- structurally subordinated to the indebtedness of any of the Company's current and future subsidiaries that do not guarantee the 2025 Notes.

The Company may redeem the 2025 Notes in whole or in part prior to November 1, 2020, at a redemption price of 100% of the principal amount of the 2025 Notes redeemed plus the Applicable Premium, plus accrued and unpaid interest. An Applicable Premium is the greater of 1% of the principal amount of the 2025 Notes; or the excess of the present value at such redemption date of (i) the redemption price of the 2025 Notes at November 1, 2020 plus (ii) all required interest payments due on the 2025 Notes through November 1, 2020 (excluding accrued but unpaid interest to the redemption date), computed using a discount rate equal to the Treasury Rate as of such redemption date plus 50 basis points; over the then outstanding principal amount of the 2025 Notes.

Prior to November 1, 2020, if using the net cash proceeds of certain equity offerings, the Company has the option to redeem up to 35% of the aggregate principal amount of the 2025 Notes at a redemption price equal to 106.625% of the principal amount of the 2025 Notes redeemed, plus accrued and unpaid interest and any additional interest.

On or after November 1, 2020, the Company may redeem some or all of the 2025 Notes at a decreasing premium over time, plus accrued and unpaid interest as follows:

YEAR	PERCENTAGE
On or after November 1, 2020 and prior to November 1, 2021	103.313%
On or after November 1, 2021 and prior to November 1, 2022	101.656%
On or after November 1, 2022	100.000%

In certain circumstances involving a change of control, the Company will be required to make an offer to repurchase all or, at the holder's option, any part, of each holder's 2025 Notes pursuant to the offer described below (the "Change of Control Offer"). In the Change of Control Offer, the Company will be required to offer payment in cash equal to 101% of the aggregate principal amount of 2025 Notes repurchased plus accrued and unpaid interest, to the date of purchase.

If the Company sells certain assets and does not use the net proceeds as required, the Company will be required to use such net proceeds to repurchase the 2025 Notes at 100% of the principal amount thereof, plus accrued and unpaid interest and additional interest penalty, if any, to the date of repurchase.

The 2025 Notes may be traded between qualified institutional buyers pursuant to Rule 144A of the Securities Act. We have recorded the 2025 Notes at cost.

NOTE P – LEASES

The Company is party as lessee to various leases for its Company-operated restaurants and lessee/sublessor to one franchised location property, including land and buildings, as well as leases for its corporate office and certain office equipment.

Determination of Whether a Contract Contains a Lease

We determine if an arrangement is a lease at inception or modification of a contract, and classify each lease as either an operating or finance lease at commencement. The Company only reassesses lease classification subsequent to commencement upon a change to the expected lease term or the contract being modified. Operating leases represent the Company's right to use an underlying asset as lessee for the lease term, and lease obligations represent the Company's obligation to make lease payments arising from the lease.

A contract contains a lease if the contract conveys the right to control the use of the identified property, plant or equipment for a period of time in exchange for consideration. At commencement, contracts containing a lease are further evaluated for classification as an operating lease or finance lease where the Company is a lessee, or as an operating, sales-type or direct financing lease where the Company is a lessor, based on their terms.

ROU Model and Determination of Lease Term

The Company uses the ROU model to account for leases where the Company is the lessee, which requires an entity to recognize a lease liability and ROU asset on the lease commencement date. A lease liability is measured equal to the present value of the remaining lease payments over the lease term and is discounted using the incremental borrowing rate, as the rate implicit in the Company's leases is not readily determinable. The incremental borrowing rate is the rate of interest that the Company would have to pay to borrow, on a collateralized basis over a similar term, an amount equal to the lease payments in a similar economic environment. Lease payments include payments made before the commencement date and any residual value guarantees, if applicable. The initial ROU asset consists of the initial measurement of the lease liability, adjusted for any payments made before the commencement date, initial direct costs and lease incentives earned. When determining the lease term, as both lessee and lessor, the Company includes option periods when it is reasonably certain that those options will be exercised.

Operating leases

For operating leases, minimum lease payments or receipts, including minimum scheduled rent increases, are recognized as rent expense where the Company is a lessee, or income where the Company is a lessor, as applicable, on a straight-line basis (“Straight-Line Rent”) over the applicable lease terms. There is a period under certain lease agreements referred to as a rent holiday (“Rent Holiday”) that generally begins on the possession date and ends on the rent commencement date. During a Rent Holiday, no cash rent payments are typically due under the terms of the lease; however, rent expense is recorded for that period on a straight-line basis. The excess of the Straight-Line Rent over the minimum rents paid is included in the ROU asset where the Company is a lessee. The excess of the Straight-Line Rent over the minimum rents received is recorded as a deferred lease asset and is included in “Other Assets” where the Company is a lessor. The Company recorded \$31,000 in Other Assets at September 29, 2019. Certain leases contain provisions, referred to as contingent rent (“Contingent Rent”), that require additional rental payments based upon restaurant sales volume. Contingent Rent is recognized each period as the liability is incurred or the asset is earned.

Lease cost for operating leases is recognized on a straight-line basis and includes the amortization of the ROU asset and interest expense relating to the operating lease liability. Variable lease cost for operating leases include Contingent Rent and payments for executory costs such as real estate taxes, insurance and common area maintenance, which are excluded from the measurement of the lease liability. Short-term lease cost for operating leases includes rental expense for leases with a term of less than 12 months. Leases with an initial expected term of 12 months or less are not recorded in the Consolidated Balance Sheets and the related lease expense is recognized on a straight-line basis over the lease term. Lease costs are recorded in the Consolidated Statements of Earnings based on the nature of the underlying lease as follows: (1) rental expense related to leases for Company-operated restaurants is recorded to “Restaurant Operating Expenses,” (2) rental expense for leased properties that are subsequently subleased to franchisees is recorded to “Other income, net” and (3) rental expense related to leases for corporate offices and equipment is recorded to “General and administrative expenses.”

Rental income for operating leases on properties subleased to franchisees is recorded to “Other income, net.”

Significant Assumptions and Judgement

Management makes certain estimates and assumptions regarding each new lease and sublease agreement, renewal and amendment, including, but not limited to, property values, market rents, property lives, discount rates and probable term, all of which can impact (1) the classification and accounting for a lease or sublease as operating or finance, (2) the Rent Holiday and escalations in payment that are taken into consideration when calculating Straight-Line Rent, (3) the term over which leasehold improvements for each restaurant are amortized and (4) the values and lives of adjustments to the initial ROU asset where the Company is the lessee, or favorable and unfavorable leases where the Company is the lessor. The amount of depreciation and amortization, interest and rent expense and income would vary if different estimates and assumptions were used.

Company as lessee

The components of the net lease cost for the thirteen and twenty-six week periods ended September 29, 2019 were as follows (in thousands):

	Thirteen weeks ended September 29, 2019	Twenty-six weeks ended September 29, 2019
Statement of Earnings		
Operating lease cost	\$ 278	\$ 560
Short term lease cost	4	10
Variable lease cost	537	960
Less: Sublease income, net	(20)	(41)
Total net lease cost (a)	<u>\$ 799</u>	<u>\$ 1,489</u>

- (a) The thirteen and twenty-six week periods ended September 29, 2019 include \$669, net and \$1,209, net recorded to “Restaurant Operating Expenses” for leases for Company-operated restaurants, \$150 and \$321 recorded to “General and administrative expenses” for leases for corporate offices and equipment and \$20 and \$41 recorded to “Other income, net” for leased properties that are leased to franchisees:

Cash paid for amounts included in the measurement of lease liabilities were as follows (in thousands):

	Thirteen weeks ended September 29, 2019	Twenty-six weeks ended September 29, 2019
Operating cash flows from operating leases	<u>\$ 131</u>	<u>\$ 291</u>

The weighted average remaining lease term and weighted-average discount rate for operating leases as of September 29, 2019 were as follows:

Weighted average remaining lease term (years):	
Operating leases	9.0
Weighted average discount rate:	
Operating leases	9.079%

Future lease commitments to be paid and received by the Company as of September 29, 2019 were as follows (in thousands):

	Payments Operating Leases	Receipts Subleases	Net Leases
Fiscal year:			
2020 (a)	\$ 494	\$ 77	\$ 417
2021	1,256	270	986
2022	1,510	272	1,238
2023	1,523	168	1,355
2024	1,453	169	1,284
Thereafter	5,868	521	5,347
Total lease commitments	\$ 12,104	\$ 1,477	\$ 10,627
Less: Amount representing interest	3,844		
Present value of lease liabilities (b)	<u>\$ 8,260</u>		

(a) Represents the remainder of fiscal year 2020 which excludes the twenty-six weeks ended September 29, 2019.

(b) The present value of minimum operating lease payments of \$1,009 and \$7,251 are included in “Current portion of operating lease liabilities” and “Long-term operating lease liabilities,” respectively.

Future lease commitments to be paid and received by the Company as of March 31, 2019 were as follows (in thousands):

	Payments Operating Leases	Receipts Subleases	Net Leases
Fiscal year:			
2020	\$ 1,162	\$ 273	\$ 889
2021	1,249	270	979
2022	1,503	272	1,231
2023	1,520	168	1,352
2024	1,453	169	1,284
Thereafter	5,868	521	5,347
Total lease commitments	<u>\$ 12,755</u>	<u>\$ 1,673</u>	<u>\$ 11,082</u>

Company as lessor

The components of lease income for the thirteen week and twenty-six week periods ended September 29, 2019 were as follows (in thousands):

	Thirteen weeks ended September 29, 2019	Twenty-six weeks ended September 29, 2019
Operating lease income, net	<u>\$ 20</u>	<u>\$ 41</u>

NOTE Q – COMMITMENTS AND CONTINGENCIES

1. Commitments

On February 27, 2017, a wholly-owned subsidiary of the Company executed a Guaranty of Lease (the “Brooklyn Guaranty”) in connection with its re-franchising of a restaurant located in Brooklyn, New York. The Company is obligated to make payments under the Brooklyn Guaranty in the event of a default by the tenant/franchisee. The Brooklyn Guaranty has an initial term of 10 years and one 5-year option and is limited to 24 months of rent for the first three years of the term. Nathan’s has recorded a liability of \$217,000 in connection with the Brooklyn Guaranty which does not include potential percentage rent, real estate tax increases, attorney’s fees and other costs as these amounts are not reasonably determinable at this time. Nathan’s has received a personal guaranty from the franchisee for all obligations under the Brooklyn Guaranty. For the remainder of the term, the Brooklyn Guaranty is limited to 12 months of rent plus reasonable costs of collection and attorney’s fees.

2. Contingencies

The Company and its subsidiaries are from time to time involved in ordinary and routine litigation. Management presently believes that the ultimate outcome of these proceedings, individually or in the aggregate, will not have a material adverse effect on the Company’s financial position, cash flows or results of operations. Nevertheless, litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling could include money damages and, in such event, could result in a material adverse impact on the Company’s results of operations for the period in which the ruling occurs.



Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

This Form 10-Q contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1933, as amended, that involve risks and uncertainties. You can identify forward-looking statements because they contain words such as “believes”, “expects”, “projects”, “may”, “would”, “should”, “seeks”, “intends”, “plans”, “estimates”, “anticipates” or similar expressions that relate to our strategy, plans or intentions. All statements we make relating to our estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and financial results or to our expectations regarding future industry trends are forward-looking statements. In addition, we, through our senior management, from time to time make forward-looking public statements concerning our expected future operations and performance and other developments. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may change at any time, and, therefore, our actual results may differ materially from those that we expected. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and, of course, it is impossible for us to anticipate all factors that could affect our actual results. All forward-looking statements contained in this Form 10-Q are based upon information available to us on the date of this Form 10-Q.

Statements in this Form 10-Q quarterly report may be “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. These risks and uncertainties, many of which are not within our control, include but are not limited to: economic, weather (including the affects on the supply of cattle and the impact of weather on sales at our restaurants, particularly during Summer months), and change in the price of beef trimmings; our ability to pass on the cost of any price increases in beef and beef trimmings, or labor costs; legislative, business conditions or tariffs; the collectibility of receivables; changes in consumer tastes; the status of our licensing and supply agreements, including our licensing revenue and overall profitability being substantially dependent on our agreement with John Morrell & Co., the impact of our debt service and repayment obligations under the 2025 Notes; the impact of the Tax Cuts and Jobs Act (“the Tax Act”); the continued viability of Coney Island as a destination location for visitors; the ability to continue to attract franchisees; the impact of the new minimum wage legislation in New York State or other changes in labor laws, including court decisions which could render a franchisor as a “joint employee” or the impact of our new union contracts; our ability to attract competent restaurant and managerial personnel; the enforceability of international franchising agreements and the future effects of any food borne illness; such as bovine spongiform encephalopathy, BSE or e-coli; as well as those risks discussed from time to time in this Form 10-Q and our Form 10-K annual report for the year ended March 31, 2019, and in other documents we file with the Securities and Exchange Commission. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in the forward-looking statements. We generally identify forward-looking statements with the words “believe,” “intend,” “plan,” “expect,” “anticipate,” “estimate,” “will,” “should” and similar expressions. Any forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-Q.

Introduction

As used in this Report, the terms “we”, “us”, “our”, “Nathan’s” or the “Company” mean Nathan’s Famous, Inc. and its subsidiaries (unless the context indicates a different meaning).

We are engaged primarily in the marketing of the “Nathan’s Famous” brand and the sale of products bearing the “Nathan’s Famous” trademarks through several different channels of distribution. Historically, our business has been the operation and franchising of quick-service restaurants featuring Nathan’s World Famous Beef Hot Dogs, crinkle-cut French-fried potatoes, and a variety of other menu offerings. Our Company-owned and franchised units operate under the name “Nathan’s Famous,” the name first used at our original Coney Island restaurant opened in 1916. Nathan’s product licensing program sells packaged hot dogs and other meat products to retail customers through supermarkets or grocery-type retailers for off-site consumption. Our Branded Product Program enables foodservice retailers and others to sell some of Nathan’s proprietary products outside of the realm of a traditional franchise relationship. In conjunction with this program, purchasers of Nathan’s products are granted a limited use of the Nathan’s Famous trademark with respect to the sale of the purchased products, including Nathan’s World Famous Beef Hot Dogs, certain other proprietary food items and paper goods. Our Branded Menu Program is a limited franchise program, under which foodservice operators may sell a greater variety of Nathan’s Famous menu items than under the Branded Product Program.

Our revenues are generated primarily from selling products under Nathan's Branded Product Program, operating Company-owned restaurants, licensing agreements for the sale of Nathan's products within supermarkets and club stores, the sale of Nathan's products directly to other foodservice operators and the manufacture of certain proprietary spices by third parties and franchising the Nathan's restaurant concept (including the Branded Menu Program).

At September 29, 2019, our restaurant system consisted of 241 Nathan's franchised units, including 111 Branded Menu units, and four Company-owned units (including one seasonal unit), located in 22 states, and 12 foreign countries. At September 23, 2018, our restaurant system consisted of 265 Nathan's franchised units, including 121 Branded Menu units, and five Company-owned units (including one seasonal unit), located in 22 states, and 12 foreign countries. Nathan's is also the owner of the Arthur Treacher's brand and continued to seek to co-brand within its restaurant system. Currently, there are also six locations operating under our Arthur Treacher's Branded Menu Program agreements.

Over the past several years, our strategic emphasis has been to increase the number of distribution points for our products across all of our business platforms, including our Licensing Program for distribution of Nathan's Famous branded consumer packaged goods, our Branded Products Program for distribution of Nathan's Famous branded bulk products to the foodservice industry, and our namesake restaurant system comprised of both Company-owned and franchised units. The primary drivers of our recent growth have been our Licensing and Branded Product Programs, which are now the largest contributors to the Company's profits.

While we remain committed to these parts of our business, we have now begun implementing plans to reinvigorate our restaurant system and have hired a new Senior Vice President of Restaurants to spearhead this initiative. The operating plan we have adopted in this regard is focused on surrounding our core items, hot dogs and French fries, with much higher quality other menu items developed to deliver best-in-class customer experience and greater customer frequency. Menu development activities will be combined with concept positioning efforts, operational improvements and more effective digital and social marketing campaigns. The goal is to improve the performance of the existing restaurant system and to grow it through franchising efforts. In order to support these activities, we expect to incur approximately \$800,000 to \$900,000 of incremental expenses, including \$370,000 projected to be incurred by the Advertising Fund. Additionally, while we do not expect to significantly increase the number of company-owned operations, we do expect to opportunistically and strategically invest in a small number of new units as showcase locations for prospective franchisees and master developers as we seek to grow our franchise system.

As described in our Annual Report on Form 10-K for the year ended March 31, 2019, our future results could be materially impacted by many developments including our dependence on John Morrell & Co. as our principal supplier and the dependence of our licensing revenue and overall profitability on our agreement with John Morrell & Co. In addition, our future operating results could be impacted by supply constraints on beef or by increased costs of beef compared to earlier periods in addition to the potential impact that any future tariffs may have on the business.

On November 1, 2017, the Company issued \$150,000,000 of 6.625% Senior Secured Notes due 2025 (the "2025 Notes") and used the majority of the proceeds of this offering to redeem (the "Redemption") the Company's 10.000% Senior Secured Notes due 2020 (the "2020 Notes"), paid a portion of the special \$5.00 cash dividend and used any remaining proceeds for general corporate purposes, including working capital. Our future results could also be impacted by our obligations under the 2025 Notes. As a result of the issuance of the 2025 Notes, Nathan's incurs interest expense of \$9,937,500 per annum, which reduced our cash interest expense by \$3,562,500 per annum as compared to our annual interest requirements under the 2020 Notes. Nathan's expects to incur annual amortization of debt issuance costs of approximately \$691,000 through November 1, 2025.

As described below, we are also including information relating to EBITDA and Adjusted EBITDA, which are non-GAAP financial measures, in the Form 10-Q quarterly report. See "Reconciliation of GAAP and Non-GAAP Measures."

Critical Accounting Policies and Estimates

As discussed in our Form 10-K for the fiscal year ended March 31, 2019, the discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently, actual results could differ from those estimates. Our most critical accounting policies and estimates relate to revenue recognition; leases; impairment of goodwill and other intangible assets; impairment of long-lived assets; share-based compensation and income taxes (including uncertain tax positions). As discussed in Note B, the Company adopted Topic 842, "Leases" effective April 1, 2019. There have been no other significant changes to the Company's accounting policies subsequent to March 31, 2019.

Adoption of New Accounting Standards

Please refer to Note B of the preceding consolidated financial statements for our discussion of the Adoption of the New Accounting Standard.

New Accounting Standards Not Yet Adopted

Please refer to Note C of the preceding consolidated financial statements for our discussion of New Accounting Standards Not Yet Adopted.

EBITDA and Adjusted EBITDA

The Company believes that EBITDA and Adjusted EBITDA, which are non-GAAP financial measures, are useful to investors to assist in assessing and understanding the Company's operating performance and underlying trends in the Company's business because EBITDA and Adjusted EBITDA are (i) among the measures used by management in evaluating performance and (ii) are frequently used by securities analysts, investors and other interested parties as a common performance measure.

Reconciliation of GAAP and Non-GAAP Measures

The following is provided to supplement certain Non-GAAP financial measures.

In addition to disclosing results that are determined in accordance with Generally Accepted Accounting Principles in the United States of America ("US GAAP"), the Company has provided EBITDA, a non-GAAP financial measure, which is defined as net income excluding (i) interest expense; (ii) provision for income taxes and (iii) depreciation and amortization expense. The Company has also provided Adjusted EBITDA, a non-GAAP financial measure, which is defined as EBITDA, excluding share-based compensation and the (gain) loss on disposal of property and equipment that the Company believes will impact the comparability of its results of operations.

EBITDA and Adjusted EBITDA are not recognized terms under US GAAP and should not be viewed as alternatives to net income or other measures of financial performance or liquidity in conformity with US GAAP. Additionally, our definitions of EBITDA and Adjusted EBITDA may differ from other companies. Analysis of results and outlook on a non-US GAAP basis should be used as a complement to, and in conjunction with, data presented in accordance with US GAAP.

The following is a reconciliation of net income to EBITDA and Adjusted EBITDA (in thousands):

	Thirteen weeks ended		Twenty-six weeks ended	
	September 29, 2019	September 23, 2018	September 29, 2019	September 23, 2018
	(unaudited)		(unaudited)	
Net income	\$ 3,658	\$ 4,484	\$ 9,027	\$ 9,279
Interest expense	2,651	2,651	5,301	5,301
Provision for income taxes	1,445	1,979	3,261	3,703
Depreciation and amortization	337	339	647	684
EBITDA	<u>8,091</u>	<u>9,453</u>	<u>18,236</u>	<u>18,967</u>
Share-based compensation	30	23	58	104
(Gain) loss on disposal of property and equipment (A)	2	(323)	2	(323)
Adjusted EBITDA	<u>\$ 8,123</u>	<u>\$ 9,153</u>	<u>\$ 18,296</u>	<u>\$ 18,748</u>

(A) We have reclassified (Gain) loss on disposal of property and equipment in the thirteen and twenty-six week periods ended September 23, 2018 to conform with the March 31, 2019 classifications.

Results of Operations

Thirteen weeks ended September 29, 2019 compared to thirteen weeks ended September 23, 2018

Revenues

Total sales increased by 2.5% to \$22,106,000 for the thirteen weeks ended September 29, 2019 ("second quarter fiscal 2020") as compared to \$21,573,000 for the thirteen weeks ended September 23, 2018 ("second quarter fiscal 2019"). Foodservice sales from the Branded Product Program increased by 5.0% to \$16,182,000 for the second quarter fiscal 2020 as compared to sales of \$15,410,000 in the second quarter fiscal 2019. During the second quarter fiscal 2020, the volume of business increased by approximately 5.4%. Our average selling prices decreased by approximately 0.5%.

During the fiscal 2018 period, we added a new distributor to our distribution network that increased our sales during implementation of the new distributor. In addition to the additional business realized, beginning in the third quarter fiscal 2018, this distributor temporarily provided distribution to a number of significant contract accounts, further increasing their fiscal 2018 purchases. During the first quarter of fiscal 2019, the temporary distribution to our significant contract accounts began reverting back to our traditional methodology, although not fully completed until the second quarter of fiscal 2019. Excluding the effects of the re-distributors' purchases in both years, we estimate that customer shipments increased by approximately 1.6% during the second quarter fiscal 2020. We do not expect any further impact to the comparability of our quarterly results in the future from this temporary situation.

Total Company-owned restaurant sales decreased by 3.9% to \$5,924,000 during the second quarter fiscal 2020 compared to \$6,163,000 during the second quarter fiscal 2019. Comparable Company-owned restaurant sales, excluding sales from the restaurant that was sold last year, increased by approximately \$127,000 or 2.2% as compared to the comparable period last year.

License royalties were \$5,425,000 in the second quarter fiscal 2020 as compared to \$5,746,000 in the second quarter fiscal 2019. Total royalties earned on sales of hot dogs from our license agreement with John Morrell & Co. at retail and foodservice, substantially from sales of hot dogs to Sam's Club and WalMart, decreased 6.1% to \$4,935,000 for the second quarter fiscal 2020 as compared to \$5,257,000 in the second quarter fiscal 2019. The decrease is primarily due to a decline in average net selling price of 5.7% which was partly offset by a 3.3% increase in retail volume during the second quarter fiscal 2020 period as compared to the second quarter fiscal 2019. Additionally, the foodservice business earned lower royalties of \$116,000 as compared to the second quarter fiscal 2019 due to a shift in the Sam's Club business. Royalties earned from all other licensing agreements for the manufacture and sale of Nathan's products increased by \$1,000 during the second quarter fiscal 2020 period as compared to the second quarter fiscal 2019.

Franchise fees and royalties were \$1,498,000 in the second quarter fiscal 2020 as compared to \$1,239,000 in the second quarter fiscal 2019. Total royalties were \$1,047,000 in the second quarter fiscal 2020 as compared to \$1,104,000 in the second quarter fiscal 2019. Royalties earned under the Branded Menu program were \$220,000 in the second quarter fiscal 2020 as compared to \$263,000 in the second quarter fiscal 2019. Royalties earned under the Branded Menu Program are not based upon a percentage of restaurant sales but are based upon product purchases. Traditional franchise royalties were \$827,000 in the second quarter fiscal 2020 as compared to \$841,000 in the second quarter fiscal 2019. Franchise restaurant sales decreased to \$18,323,000 in the second quarter fiscal 2020 as compared to \$18,559,000 in the second quarter fiscal 2019 primarily due to a 1.7% increase in comparable domestic sales which was more than offset by the impact of units closed in the previous year, net of units opened in the current year. Comparable domestic franchise sales (consisting of 88 Nathan's outlets, excluding sales under the Branded Menu Program) were \$14,800,000 in the second quarter fiscal 2020 as compared to \$14,546,000 in the second quarter fiscal 2019.

At September 29, 2019, 241 franchised outlets, including domestic, international and Branded Menu Program outlets were operating compared to 265 domestic and international franchised or Branded Menu Program franchise outlets at September 23, 2018. Total franchise fee income was \$451,000 in the second quarter fiscal 2020 compared to \$135,000 in the second quarter fiscal 2019. Domestic franchise fee income was \$35,000 in the second quarter fiscal 2020 compared to \$39,000 in the second quarter fiscal 2019. International franchise fee income was \$41,000 in the second quarter fiscal 2020 compared to \$34,000 during the second quarter fiscal 2019. We recognized \$375,000 of forfeited fees in the second quarter fiscal 2020 primarily from the termination of our Master Franchise Agreement for Russia and Kyrgyzstan as compared to forfeited fees of \$62,000 in the second quarter fiscal 2019. During the second quarter fiscal 2020, nine new franchised outlets opened, including four new Branded Menu Program outlets. During the second quarter fiscal 2019, five new franchised outlets opened, including three new Branded Menu Program outlets.

Advertising fund revenue, after eliminating Company contributions, was \$697,000 during the second quarter fiscal 2020 and \$772,000 during the second quarter fiscal 2019 period.

Costs and Expenses

Overall, our cost of sales increased by \$1,129,000 to \$16,289,000 in the second quarter fiscal 2020 as compared to \$15,160,000 in the second quarter fiscal 2019. Our gross profit (representing the difference between sales and cost of sales) decreased to \$5,817,000 or 26.3% of sales during the second quarter fiscal 2020 as compared to \$6,413,000 or 29.7% of sales during the fiscal 2019 period. The reduction in margin was primarily due to the higher cost of beef in the Branded Product Program which was partly offset by the higher margin at the comparable four Company-operated restaurants due principally to the effects of higher sales.

Cost of sales in the Branded Product Program increased by approximately \$1,319,000 during the second quarter fiscal 2020 as compared to the second quarter fiscal 2019, primarily due to the 5.6% increase in the average cost per pound of our hot dogs and the 5.4% increase in the volume of product sold as discussed above. We did not make any purchase commitments for beef during the fiscal 2020 and 2019 periods. If the cost of beef and beef trimmings increases and we are unable to pass on these higher costs through price increases or otherwise reduce any increase in our costs through the use of purchase commitments, our margins will be adversely impacted.

With respect to Company-owned restaurants, our cost of sales during the second quarter fiscal 2020 was \$2,941,000 or 49.6% of restaurant sales, as compared to \$3,131,000 or 50.8% of restaurant sales in the second quarter fiscal 2019. Excluding the restaurant that was sold, cost of sales were 49.6% of restaurant sales in each of the second quarters of fiscal 2020 and fiscal 2019. Lower food and paper costs, despite higher beef costs, offset higher labor and associated costs. Higher wages, principally associated with the effects of the New York State minimum wage increase, were partly offset by the impact of higher sales at the comparable four Company-owned restaurants. We expect that our future labor costs at our restaurants outside of New York City will continue to be impacted by the remaining multi-year increase in minimum wage requirements in New York State, as well as other new labor regulations and any increase in commodity costs.

Restaurant operating expenses were \$1,108,000 in the second quarter fiscal 2020 as compared to \$1,141,000 in the second quarter fiscal 2019. Excluding \$88,000 of restaurant operating expenses from the fiscal 2019 period for the restaurant that was sold, we incurred higher occupancy costs of \$25,000, primarily percentage rent on higher sales and property taxes, higher insurance costs of \$17,000 and other expenses of \$12,000.

Depreciation and amortization was \$337,000 in the second quarter fiscal 2020 as compared to \$339,000 in the second quarter fiscal 2019 as a result of lower capital spending and reduced depreciation and amortization attributable to the restaurant that was sold of \$8,000 which were partly offset by amortization of the Arthur Treachers' intellectual property.

General and administrative expenses increased by \$121,000 or 3.5% to \$3,559,000 in the second quarter fiscal 2020 as compared to \$3,438,000 in the second quarter fiscal 2019. The increase in general and administrative expenses was primarily attributable to higher compensation expenses of \$75,000, occupancy costs of \$17,000 and professional fees of \$14,000.

Advertising fund expense, after eliminating Company contributions, was \$1,067,000 during the second quarter fiscal 2020, as compared to \$772,000 in the second quarter fiscal 2019. Nathan's has determined that the Advertising Funds' normal seasonal deficit is not expected to be fully recovered during the remainder of the fiscal year and has reflected the projected deficit in its second quarter fiscal 2020 results of operations.

Other Items

Interest expense of \$2,651,000 in the second quarter fiscal 2020 and second quarter fiscal 2019 represented accrued interest of \$2,478,000 on the 2025 Notes at 6.625% per annum and amortization of debt issuance costs of \$173,000.

Interest income was \$370,000 for the second quarter fiscal 2020 as compared to \$115,000 in the second quarter fiscal 2019.

Gain (loss) on disposal of property and equipment related to asset retirements incurred due to the replacement of certain kitchen equipment. During the second quarter fiscal 2019 we recognized a gain on the sale of our Florida office of \$323,000.

Other income, primarily relates to a sublease of a franchised restaurant, was \$20,000 in the second quarter fiscal 2020. Other income in the second quarter fiscal 2019 of \$196,000 included a fee of \$175,000 to extend the closing date of the sale of our restaurant located in Bay Ridge, Brooklyn, NY and sublease income of a franchised restaurant, of \$21,000.

Provision for Income Taxes

The income tax provision for the thirteen-week periods ended September 29, 2019 and September 23, 2018 reflect effective tax rates of 28.3% and 30.6%, respectively. In January 2018, Nathan's received notification from the State of Virginia that it was seeking to review Nathan's tax returns for the period April 2014 through March 2017. The review was completed and the matter settled in the second quarter of fiscal 2019. The effects of the review were factored into the Company's effective tax rate for fiscal 2019.

The amount of unrecognized tax benefits at September 29, 2019 was \$280,000 all of which would impact Nathan's effective tax rate, if recognized. As of September 29 2019, Nathan's had \$267,000 of accrued interest and penalties in connection with unrecognized tax benefits.

Nathan's estimates that its unrecognized tax benefit excluding accrued interest and penalties could be further reduced by up to \$11,000 during the fiscal year ending March 29, 2020.

Results of Operations

Twenty-six weeks ended September 29, 2019 compared to twenty-six weeks ended September 23, 2018

Revenues

Total sales increased by \$299,000 to \$42,343,000 for the twenty-six weeks ended September 29, 2019 ("fiscal 2020 period") as compared to \$42,044,000 for the twenty-six weeks ended September 23, 2018 ("fiscal 2019 period"). Foodservice sales from the Branded Product Program increased by 1.4% to \$32,295,000 for the fiscal 2020 period as compared to sales of \$31,855,000 in the fiscal 2019 period. During the fiscal 2020 period, the volume of business increased by approximately 2.2% and the average selling prices decreased by approximately 0.4%.

During the fiscal 2018 period, we added a new distributor to our distribution network that increased our sales during implementation of the new distributor. In addition to the additional business realized, beginning in the third quarter fiscal 2018, this distributor temporarily provided distribution to a number of significant contract accounts, further increasing their fiscal 2018 purchases. During the first quarter of fiscal 2019, the temporary distribution to our significant contract accounts began reverting to our traditional methodology, although not fully completed until the second quarter of fiscal 2019. Excluding the effects of the re-distributors' purchases in both years, we estimate that customer shipments decreased by approximately 1.0% during the fiscal 2020 period.

Total Company-owned restaurant sales decreased by 1.4% to \$10,048,000 during the fiscal 2020 period compared to \$10,189,000 during the fiscal 2019. Comparable Company-owned restaurant sales, excluding sales from the restaurant that was sold last year, increased by approximately \$633,000 or 6.7% due primarily to higher sales at our Coney Island locations where weather conditions were very favorable as compared to the comparable period last year in addition to higher sales at our traditional restaurants in Oceanside and Yonkers, New York.

License royalties increased by 2.2% to \$14,147,000 in the fiscal 2020 period as compared to \$13,844,000 in the fiscal 2019 period. Total royalties earned on sales of hot dogs from our license agreement with John Morrell & Co. at retail, substantially from sales of hot dogs to Sam's Club and WalMart, increased 2.3% to \$13,092,000 for the 2020 fiscal period as compared to \$12,795,000 in the fiscal 2019 period. The increase is due to a 5.3% increase in volume during the fiscal 2020 period as compared to the fiscal 2019 period, which was partly offset by a decline in average net selling price of 2.7%. Additionally, the foodservice business earned higher royalties of \$61,000 as compared to the fiscal 2019 period. Royalties earned from all other licensing agreements for the manufacture and sale of Nathan's products increased by \$6,000 during the fiscal 2020 period as compared to the fiscal 2019 period.

Franchise fees and royalties were \$2,575,000 in the fiscal 2020 period as compared to \$2,343,000 in the fiscal 2019 period. Total royalties were \$2,027,000 in the fiscal 2020 period as compared to \$2,101,000 in the fiscal 2019 period. Royalties earned under the Branded Menu program were \$429,000 in the fiscal 2020 period as compared to \$465,000 in the fiscal 2019 period. Royalties earned under the Branded Menu Program are not based upon a percentage of restaurant sales but are based upon product purchases. Traditional franchise royalties were \$1,598,000 in the fiscal 2020 period as compared to \$1,619,000 in the fiscal 2019 period. Franchise restaurant sales decreased to \$35,838,000 in the fiscal 2020 period as compared to \$35,932,000 in the fiscal 2019 period primarily due to a 2.8% increase in comparable domestic sales which was partly offset by the impact of units closed in the previous fiscal year, net of units opened in the current year. Comparable domestic franchise sales (consisting of 85 Nathan's outlets, excluding sales under the Branded Menu Program) were \$28,795,000 in the fiscal 2020 period as compared to \$28,016,000 in the fiscal 2019 period.

At September 29, 2019, 241 franchised outlets, including domestic, international and Branded Menu Program outlets were operating compared to 265 domestic and international franchised or Branded Menu Program franchise outlets at September 23, 2018. Total franchise fee income was \$548,000 in the fiscal 2020 period compared to \$242,000 in the fiscal 2019 period. Domestic franchise fee income was \$73,000 in the fiscal 2020 period compared to \$79,000 in the fiscal 2019 period. International franchise fee income was \$82,000 in the fiscal 2020 period compared to \$85,000 during the fiscal 2019 period. We recognized \$393,000 of forfeited fees in the fiscal 2020 period primarily from the termination of our Master Franchise Agreement for Russia and Kyrgyzstan as compared to forfeited fees of \$78,000 in the fiscal 2019 period. During the fiscal 2020 period, 13 franchised outlets opened, including four new Branded Menu Program outlets. During the fiscal 2019 period, nine new franchised outlets opened, including four new Branded Menu Program outlets.

Advertising fund revenue, after eliminating Company contributions, was \$1,179,000 in the fiscal 2020 period, as compared to \$1,267,000 during the fiscal 2019 period.

Costs and Expenses

Overall, our cost of sales increased by 3.6% to \$31,711,000 in the fiscal 2020 period as compared to \$30,606,000 in the fiscal 2019 period. Our gross profit (representing the difference between sales and cost of sales) decreased to \$10,632,000 or 25.1% of sales during the fiscal 2020 period as compared to \$11,438,000 or 27.2% of sales during the fiscal 2019 period. The reduction in margin was primarily due to the higher cost of beef in the Branded Product Program which was partly offset by the higher margin at the comparable four Company-operated restaurants due principally to the effects of higher sales.

Cost of sales in the Branded Product Program increased by approximately \$1,308,000 during the fiscal 2020 period as compared to the fiscal 2019 period, primarily due to the 3.1% increase in the average cost per pound of our hot dogs and the 2.2% increase in the volume of product sold discussed above. We did not make any purchase commitments for beef during the fiscal 2020 and 2019 periods. If the cost of beef and beef trimmings increases and we are unable to pass on these higher costs through price increases or otherwise reduce any increase in our costs through the use of purchase commitments, our margins will be adversely impacted.

With respect to Company-owned restaurants, our cost of sales during the fiscal 2020 period was \$5,232,000 or 52.1% of restaurant sales, as compared to \$5,435,000 or 53.5% of restaurant sales in the fiscal 2019 period. Excluding the restaurant that was sold, cost of sales would have been 52.2% of restaurant sales in the fiscal 2019 period. Lower food and paper costs, despite higher beef costs, offset higher labor and associated costs. Higher wages, principally associated with the effects of the New York State minimum wage increase, were partly offset by the impact of higher sales at the comparable four Company-owned restaurants. We expect that our future labor costs at our restaurants outside of New York City will continue to be impacted by the remaining multi-year increase in minimum wage requirements in New York State, as well as other new labor regulations and any increase in commodity costs.

Restaurant operating expenses were \$2,027,000 in the fiscal 2020 period as compared to \$2,051,000 in the fiscal 2019 period. Excluding \$178,000 of restaurant operating expenses from the fiscal 2019 period for the restaurant that was sold, we incurred higher occupancy costs of \$54,000, primarily percentage rent on higher sales and property taxes, marketing expenses of \$40,000 and higher insurance costs of \$33,000.

Depreciation and amortization was \$647,000 in the fiscal 2020 period as compared to \$684,000 in the fiscal 2019 period as a result of lower capital spending and reduced depreciation and amortization attributable to the restaurant that was sold of \$16,000 which were partly offset by amortization of the Arthur Treachers' Intellectual Property.

General and administrative expenses increased by \$173,000 or 2.4% to \$7,496,000 in the fiscal 2020 period as compared to \$7,323,000 in the fiscal 2019 period. The increase in general and administrative expenses was primarily attributable to higher compensation and recruiting expenses of \$259,000, which were partly offset by lower professional fees of \$121,000.

Advertising fund expense, after eliminating Company contributions, was \$1,549,000 in the fiscal 2020 period, as compared to \$1,267,000 in the fiscal 2019 period. Nathan's has determined that the Advertising Funds' normal seasonal deficit is not expected to be fully recovered during the remainder of the fiscal year and has reflected the projected deficit in its second quarter fiscal 2020 results of operations.

Other Items

Interest expense of \$5,301,000 in the fiscal 2020 and fiscal 2019 periods represented accrued interest of \$4,955,000 on the 2025 Notes at 6.625% per annum and amortization of debt issuance costs of \$346,000.

Interest income was \$736,000 for the fiscal 2020 period as compared to \$176,000 in the fiscal 2019 period.

Gain (loss) on disposal of property and equipment related to asset retirements incurred due to the replacement of certain kitchen equipment. During the second quarter fiscal 2019 we recognized a gain on the sale of our Florida office of \$323,000.

Other income, primarily relates to a sublease of a franchised restaurant, was \$41,000 in the fiscal 2020 period. Other income in the fiscal 2019 period of \$217,000, was comprised of a fee of \$175,000 to extend the closing date of the sale of our restaurant located in Bay Ridge, Brooklyn, NY and sublease income of a franchised restaurant, of \$42,000.

Provision for Income Taxes

The income tax provision for the twenty-six week periods ended September 29, 2019 and September 23, 2018 reflect effective tax rates of 26.5% and 28.5%, respectively. Nathan's effective tax rate for the twenty-six week periods ended September 29, 2019 and September 23, 2018 were reduced by 1.9% and 0.4%, respectively, as a result of the tax benefits associated with stock compensation. For the twenty-six weeks ended September 29, 2019 and September 23, 2018, excess tax benefits of \$228,000 and \$46,000, respectively, were reflected in the Consolidated Statements of Earnings as a reduction to the provision for income taxes. Nathan's effective tax rates without these adjustments would have been 28.4% for the fiscal 2020 period and 28.9% for the fiscal 2019 period.

The amount of unrecognized tax benefits at September 29, 2019 was \$280,000 all of which would impact Nathan's effective tax rate, if recognized. As of September 29 2019, Nathan's had \$267,000 of accrued interest and penalties in connection with unrecognized tax benefits.

Nathan's estimates that its unrecognized tax benefit excluding accrued interest and penalties could be further reduced by up to \$11,000 during the fiscal year ending March 29, 2020.

Off-Balance Sheet Arrangements

At September 29, 2019 and September 23, 2018, Nathan's did not have any open purchase commitments for hot dogs. Nathan's may enter into purchase commitments in the future as favorable market conditions become available.

Liquidity and Capital Resources

Cash and cash equivalents at September 29, 2019 aggregated \$79,471,000 a \$4,025,000 increase as compared to cash and cash equivalents of \$75,446,000 at March 31, 2019. Net working capital increased to \$78,878,000 from \$72,237,000 at March 31, 2019. On May 1, 2019, we paid our first semi-annual interest payment on the 2025 Notes of \$4,968,750 for fiscal 2020. On November 1, 2019, we paid our second semi-annual interest payment on the 2025 Notes of \$4,968,750 for fiscal 2020. We expect to pay our third quarter dividend on December 6, 2019.

In November 2017, the Company refinanced its then-outstanding 2020 Notes totaling \$135.0 million at 10.000% per annum by issuing \$150.0 million 2025 Notes at 6.625% per annum. Please refer to Note O – Long Term Debt in the accompanying Consolidated Financial Statements, for further discussion of the Redemption.

The 2025 Notes bear interest at 6.625% per annum, payable semi-annually on May 1st and November 1st of each year, beginning on May 1, 2018. Semi-annual interest payments are \$4,968,750. During the twenty-six week period ended September 29, 2019, we paid interest of \$4,968,750 on May 1, 2019 for the 2025 Notes. On November 1, 2019, we paid our second semi-annual interest payment of \$4,968,750. The 2025 Notes have no scheduled principal amortization payments prior to its final maturity on November 1, 2025.

The Indenture for the 2025 Notes contains certain covenants limiting the Company's ability and the ability of its restricted subsidiaries (as defined in the Indenture) to, subject to certain exceptions and qualifications: (i) incur additional indebtedness; (ii) pay dividends or make other distributions on, redeem or repurchase, capital stock; (iii) make investments or other restricted payments; (iv) create or incur certain liens; (v) incur restrictions on the payment of dividends or other distributions from its restricted subsidiaries; (vi) enter into certain transactions with affiliates; (vii) sell assets; or (viii) effect a consolidation or merger.

Certain Restricted Payments which may be made or indebtedness incurred by Nathan's or its Restricted Subsidiaries may require compliance with the following financial ratios:

Fixed Charge Coverage Ratio: the ratio of the Consolidated Cash Flow to the Fixed Charges for the relevant period, currently set at 2.0 to 1.0 in the Indenture. The Fixed Charge Coverage Ratio applies to determining whether additional Restricted Payments may be made, certain additional debt may be incurred and acquisitions may be made.

Priority Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Priority Lien to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate; currently set at 0.40 to 1.00 in the Indenture.

Secured Leverage Ratio: the ratio of (a) Consolidated Net Debt outstanding as of such date that is secured by a Lien on any property of Nathan's or any Guarantor to (b) Consolidated Cash Flow of Nathan's for the Test Period then most recently ended, in each case with such pro forma adjustments as are appropriate. The Secured Leverage Ratio under the Indenture is 3.75 to 1.00 and applies if Nathan's wants to incur additional debt on the same terms as the 2025 Notes.

The Indenture for the 2025 Notes also contains customary events of default, including, among other things, failure to pay interest, failure to comply with agreements related to the Indenture, failure to pay at maturity or acceleration of other indebtedness, failure to pay certain judgments, and certain events of insolvency or bankruptcy. Generally, if any event of default occurs, the Trustee or the holders of at least 25% in principal amount of the 2025 Notes may declare the 2025 Notes due and payable by providing notice to the Company. In case of default arising from certain events of bankruptcy or insolvency, the 2025 Notes will become immediately due and payable.

As of September 29, 2019, Nathan's was in compliance with all covenants associated with the 2025 Notes.

The 2025 Notes are general senior secured obligations, are fully and unconditionally guaranteed by substantially all of the Company's wholly-owned subsidiaries and rank *pari passu* in right of payment with all of the Company's existing and future indebtedness that is not subordinated, are senior in right of payment to any of the Company's existing and future subordinated indebtedness, are structurally subordinated to any existing and future indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the 2025 Notes, and are effectively junior to all existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes. Pursuant to the terms of a collateral trust agreement, the liens securing the 2025 Notes and the guarantees will be contractually subordinated to the liens securing any future credit facility.

The 2025 Notes and the guarantees will be the Company and the guarantors' senior secured obligations and will rank:

- senior in right of payment to all of the Company and the guarantors' future subordinated indebtedness;
- effectively senior to all unsecured senior indebtedness to the extent of the value of the collateral securing the 2025 Notes and the guarantees;
- *pari passu* with all of the Company and the guarantors' other senior indebtedness;
- effectively junior to any future credit facility to the extent of the value of the collateral securing any future credit facility and the 2025 Notes and the guarantees and certain other assets;
- effectively junior to any of the Company and the guarantors' existing and future indebtedness that is secured by assets other than the collateral securing the 2025 Notes and the guarantees to the extent of the value of any such assets; and
- structurally subordinated to the indebtedness of any of the Company's current and future subsidiaries that do not guarantee the 2025 Notes.

The Company may redeem the 2025 Notes in whole or in part prior to November 1, 2020, at a redemption price of 100% of the principal amount of the 2025 Notes redeemed plus the Applicable Premium, plus accrued and unpaid interest. An Applicable Premium is the greater of 1% of the principal amount of the 2025 Notes; or the excess of the present value at such redemption date of (i) the redemption price of the 2025 Notes at November 1, 2020 plus (ii) all required interest payments due on the 2025 Notes through November 1, 2020 (excluding accrued but unpaid interest to the redemption date), computed using a discount rate equal to the Treasury Rate as of such redemption date plus 50 basis points; over the then outstanding principal amount of the 2025 Notes.

Prior to November 1, 2020, if using the net cash proceeds of certain equity offerings, the Company has the option to redeem up to 35% of the aggregate principal amount of the 2025 Notes at a redemption price equal to 106.625% of the principal amount of the 2025 Notes redeemed, plus accrued and unpaid interest and any additional interest.

On or after November 1, 2020, the Company may redeem some or all of the 2025 Notes at a decreasing premium over time, plus accrued and unpaid interest as follows:

YEAR	PERCENTAGE
On or after November 1, 2020 and prior to November 1, 2021	103.313%
On or after November 1, 2021 and prior to November 1, 2022	101.656%
On or after November 1, 2022	100.000%

In certain circumstances involving a change of control, the Company will be required to make an offer to repurchase all or, at the holder's option, any part, of each holder's 2025 Notes pursuant to the offer described below (the "Change of Control Offer"). In the Change of Control Offer, the Company will be required to offer payment in cash equal to 101% of the aggregate principal amount of 2025 Notes repurchased plus accrued and unpaid interest, to the date of purchase.

If the Company sells certain collateralized assets and does not use the net proceeds as required, the Company will be required to use such net proceeds to repurchase the 2025 Notes at 100% of the principal amount thereof, plus accrued and unpaid interest and additional interest penalty, if any, to the date of repurchase.

The 2025 Notes may be traded between qualified institutional buyers pursuant to Rule 144A of the Securities Act. We have recorded the 2025 Notes at cost.

Cash provided by operations of \$6,095,000 in the fiscal 2020 period is primarily attributable to net income of \$9,027,000 in addition to other non-cash operating items of \$1,288,000, offset by changes in other operating assets and liabilities of \$4,220,000. Non-cash operating expenses consist principally of \$647,000 of depreciation and amortization, \$346,000 amortization of debt issuance cost, \$228,000 of excess income tax benefits from stock-based compensation arrangements as a result of the accounting for certain aspects of its share-based payments to employees, share-based compensation expense of \$58,000 and bad debts of \$23,000. In the fiscal 2020 period, accounts and other receivables increased by \$2,020,000 due primarily to higher receivables from Branded Product Program sales of \$1,292,000 and higher seasonal receivables due on behalf of the Advertising Fund of \$707,000. In the fiscal 2020 period, accounts payable, accrued expenses and other current liabilities decreased by \$2,171,000 due the reduction in accrued payroll and other benefits of \$1,178,000 resulting from the payment of year-end incentive compensation and earned deferred revenue of \$551,000. Accounts payable decreased by \$308,000 due principally to fluctuations of the Branded Product Program sales. Accrued corporate taxes were lower by \$62,000 due to lower earnings and excess tax benefits from the exercise of employee stock options.

Cash used in investing activities was \$182,000 in the fiscal 2020 period primarily in connection with capital expenditures incurred for our Branded Product Program and select restaurant improvements.

Cash used in financing activities of \$1,888,000 in the fiscal 2020 period relates to the payments of the Company's quarterly \$0.35 per share cash dividend totaling \$2,958,000. The Company also received \$1,078,000 of proceeds from the exercise of stock options.

During the period from October 2001 through September 29, 2019, Nathan's purchased 5,141,763 shares of its common stock at a cost of approximately \$78,303,000 pursuant to its stock repurchase plans previously authorized by the Board of Directors. Since March 26, 2007, we have repurchased 3,250,663 shares at a total cost of approximately \$71,145,000, reducing the number of shares then-outstanding by 54.0%.

In 2016, the Company's Board of Directors authorized increases to the sixth stock repurchase plan for the purchase of up to 1,200,000 shares of its common stock on behalf of the Company. As of September 29, 2019, Nathan's has repurchased 954,132 shares at a cost of \$30,641,000 under the sixth stock repurchase plan. At September 29, 2019, there were 245,868 shares remaining to be repurchased pursuant to the sixth stock repurchase plan. The plan does not have a set expiration date. Purchases under the Company's stock repurchase program may be made from time to time, depending on market conditions, in open market or privately-negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the repurchases.

As discussed above, we had cash and cash equivalents at September 29, 2019 aggregating \$79,471,000. Our Board routinely monitors and assesses its cash position and our current and potential capital requirements. In November 2017, we refinanced our 2020 Notes through the issuance of the 2025 Notes and, our Board of Directors announced the payment of a \$5.00 per share special dividend to the shareholders of record as of the close of business on December 22, 2017. Effective June 14, 2019, Nathans' Board of Directors authorized the increase of its regular quarterly dividend to \$0.35 from \$0.25, and the Company paid its first quarter dividend on June 28, 2019 and its second quarter dividend on September 6, 2019.

Effective November 8, 2019, the Company declared its third quarter dividend of \$0.35 per common share to stockholders of record as of the close of business on November 25, 2019, which is payable on December 6, 2019.

We expect that in the future we will make investments in certain existing or select new restaurants, support the growth of the Branded Product and Branded Menu Programs, service the outstanding debt, fund dividend distributions and continue our stock repurchase programs, funding those investments from our operating cash flow. We may also incur capital and other expenditures or engage in investing activities in connection with opportunistic situations that may arise on a case-by-case basis. During the fiscal year ending March 29, 2020, we will be required to make interest payments of \$9,937,500, of which all have been made as of November 1, 2019.

Management believes that available cash, and cash generated from operations should provide sufficient capital to finance our operations, satisfy our debt service requirements, fund dividend distributions and stock repurchases for at least the next 12 months.

At September 29, 2019, we sublet one property to a franchisee that we lease from a third party. We remain contingently liable for all costs associated with this property including: rent, property taxes and insurance. We may incur future cash payments with respect to such property, consisting primarily of future lease payments, including costs and expenses associated with terminating such lease.

The following schedule represents Nathan's cash contractual obligations and commitments by maturity as of September 29, 2019 (in thousands):

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Cash Contractual Obligations					
Long term debt (a)	\$ 150,000	\$ -	\$ -	\$ -	\$ 150,000
Employment Agreements	4,975	1,500	2,125	950	400
Operating Leases (b)	12,104	1,009	3,014	2,892	5,189
Gross Cash Contractual Obligations	167,079	2,509	5,139	3,842	155,589
Sublease Income (b)	1,477	270	432	338	437
Net Cash Contractual Obligations	\$ 165,602	\$ 2,239	\$ 4,707	\$ 3,504	\$ 155,152

- a) Represents the principal due on the 2025 Notes, but does not include interest expense.
- b) See Note P to the Consolidated Financial Statements for additional information on the Company's lease commitments.

At September 29, 2019, the Company had unrecognized tax benefits of \$280,000. The Company believes that is reasonably possible that the unrecognized tax benefits may decrease by \$11,000 within the next year. A reasonable estimate of the timing of the remaining liabilities is not practicable.

On February 27, 2017, a wholly-owned subsidiary of the Company executed a Guaranty of Lease (the "Brooklyn Guaranty") in connection with its re-franchising of a restaurant located in Brooklyn, New York. The Company is obligated to make payments under the Brooklyn Guaranty in the event of a default by the tenant/franchisee. The Brooklyn Guaranty has an initial term of 10 years and one 5-year option and is limited to 24 months of rent for the first three years of the term. Nathan's has recorded a liability of \$217,000 in connection with the Brooklyn Guaranty which does not include potential percentage rent, real estate tax increases, attorney's fees and other costs as these amounts are not reasonably determinable at this time. Nathan's has received a personal guaranty from the franchisee for all obligations under the Brooklyn Guaranty. For the remainder of the term, the Brooklyn Guaranty is limited to 12 months of rent plus reasonable costs of collection and attorney's fees.

Inflationary Impact

We do not believe that general inflation has materially impacted earnings since 2006. However, we have experienced significant volatility in our costs for our hot dogs and certain food products, distribution costs and utilities. Since April 2018 our commodity cost for hot dogs had been stable before beginning to decline in September 2018 into December 2018. Beef prices have begun moderately escalating between January and June 2019. Beef prices remained consistently higher during the summer 2019 than during the summer 2018. As such, our market price for hot dogs during our fiscal 2020 period was approximately 3.1% higher than the fiscal 2019 period.

We are unable to predict the future cost of our hot dogs and expect to experience price volatility for our beef products during fiscal 2020. To the extent that beef prices increase as compared to earlier periods, it could impact our results of operations. In the past, we entered into purchase commitments for a portion of our hot dogs to reduce the impact of increasing market prices. Our most recent purchase commitment was completed in 2016 for approximately 2,600,000 pounds of hot dogs. We may attempt to enter into similar purchase arrangements for hot dogs and other products in the future. Additionally, we expect to continue experiencing volatility in oil and gas prices on our distribution costs for our food products and utility costs in the Company-owned restaurants and volatile insurance costs resulting from the uncertainty of the insurance markets.

New York State passed legislation increasing the minimum hourly wage for fast food workers of restaurant chains with 30 or more locations nationwide. The increase is being phased in differently between New York City and the rest of New York State. Effective December 31, 2018, the minimum wage increased to \$15.00 and \$12.75 in New York City and outside of New York City, respectively.

The minimum hourly rate of pay for the remainder of New York State will increase to \$13.75 on Dec. 31, 2019; and will increase to \$14.50 on Dec. 31, 2020; and \$15.00 on July 1, 2021.

All of Nathan's Company-operated restaurants are within New York State, two of which operate within New York City that have been significantly affected by this new legislation.

The Company is further monitoring the impact on the Company's operations and is executing strategies and tactics, including pricing and potential operating efficiencies, to minimize the effects of these increases and future increases. We have increased certain selling prices to pass on recent cost of sales increases. However, if we are unable to fully offset these and future increases through pricing and operating efficiencies, our margins and profits will be negatively affected.

Effective April 1, 2014, the City of New York, passed legislation requiring employers to offer paid sick leave to all employees, including part-time employees, who work more than 80 hours for the employer. Nathan's operates two restaurants that have been affected by this legislation.

Effective November 27, 2017, the City of New York Fair Work Week Legislation package of bills took effect that the city estimates will cover some 65,000 fast food workers by giving them more predictable work schedules. A key component of the package is a requirement that fast food restaurants schedule their workers at least two weeks in advance or pay employees between \$10 to \$75 per scheduling change, depending on the situation. Due to Nathan's dependency on weather conditions at our two Coney Island beach locations during the summer season, we are unable to determine the potential impact on our results of operations, which could be material. We believe that we have been able to implement tools to minimize the financial impact of this legislation. Nevertheless, we incurred approximately \$5,000 of additional costs due to this legislation during the fiscal 2020 period.

Continued increases in labor, food and other operating expenses, including health care, could adversely affect our operations and those of the restaurant industry and we might have to further reconsider our pricing strategy as a means to offset reduced operating margins.

We believe that these increases in the minimum wage and other changes in employment law have had a significant financial impact on our financial results and the results of our franchisees that operate in New York State. Our business could be negatively impacted if the decrease in margins for our franchisees results in the potential loss of new franchisees or the closing of a significant number of franchised restaurants.

The Company's business, financial condition, operating results and cash flows can be impacted by a number of factors, including but not limited to those set forth above in "Management's Discussion and Analysis of Financial Condition and Results of Operations," any one of which could cause our actual results to vary materially from recent results or from our anticipated future results. For a discussion identifying additional risk factors and important factors that could cause actual results to differ materially from those anticipated, also see the discussions in "Forward-Looking Statements" and "Notes to Consolidated Financial Statements" in this Form 10-Q and "Risk Factors" in our Form 10-K for our fiscal year ended March 31, 2019.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Cash

We have historically invested our cash and cash equivalents in money market funds or short-term, fixed rate, highly rated and highly liquid instruments which are generally reinvested when they mature. Although these existing investments are not considered at risk with respect to changes in interest rates or markets for these instruments, our rate of return on short-term investments could be affected at the time of reinvestment as a result of intervening events. As of September 29, 2019, Nathan's cash and cash equivalents aggregated \$79,471,000. Earnings on this cash would increase or decrease by approximately \$199,000 per annum for each 0.25% change in interest rates.

Borrowings

At September 29, 2019, we had \$150,000,000 of 2025 Notes outstanding which are due in November 2025. Interest expense on these borrowings would increase or decrease by approximately \$375,000 per annum for each 0.25% change in interest rates. We currently do not anticipate entering into interest rate swaps or other financial instruments to hedge our borrowings.

Commodity Costs

We do not believe that general inflation has materially impacted earnings since 2006. However, we have experienced significant volatility in our costs for our hot dogs and certain food products, distribution costs and utilities. Since April 2018 our commodity cost for hot dogs had been stable before beginning to decline in September 2018 into December 2018. Beef prices have begun moderately escalating between January and June 2019. Beef prices remained consistently higher during the summer 2019 than during the summer 2018. As such, our market price for hot dogs during our fiscal 2020 period was approximately 3.1% higher than the fiscal 2019 period.

We are unable to predict the future cost of our hot dogs and expect to experience price volatility for our beef products during fiscal 2020. To the extent that beef prices increase as compared to earlier periods, it could impact our results of operations. In the past, we entered into purchase commitments for a portion of our hot dogs to reduce the impact of increasing market prices. Our most recent purchase commitment was completed in 2016 for approximately 2,600,000 pounds of hot dogs. We may attempt to enter into similar purchase arrangements for hot dogs and other products in the future. Additionally, we expect to continue experiencing volatility in oil and gas prices on our distribution costs for our food products and utility costs in the Company-owned restaurants and volatile insurance costs resulting from the uncertainty of the insurance markets.

With the exception of purchase commitments, we have not attempted to hedge against fluctuations in the prices of the commodities we purchase using future, forward, option or other instruments. As a result, we expect that the majority of our future commodity purchases will be subject to market changes in the prices of such commodities. We have attempted to enter sales agreements with our customers that are correlated to our cost of beef, thus reducing our market volatility, or have passed through permanent increases in our commodity prices to our customers that are not on formula pricing, thereby reducing the impact of long-term increases on our financial results. A short-term increase or decrease of 10.0% in the cost of our food and paper products for the twenty-six weeks ended September 29, 2019 would have increased or decreased our cost of sales by approximately \$2,812,000.

Foreign Currencies

Foreign franchisees generally conduct business with us and make payments in United States dollars, reducing the risks inherent with changes in the values of foreign currencies. As a result, we have not purchased future contracts, options or other instruments to hedge against changes in values of foreign currencies and we do not believe fluctuations in the value of foreign currencies would have a material impact on our financial results.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as required by Exchange Act Rule 13a-15(e) and Exchange Act Rule 15d-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

There were no changes in our internal controls over financial reporting that occurred during the quarter ended September 29, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and our Chief Executive Officer and Chief Financial Officer have concluded that such controls and procedures are effective at the reasonable assurance level.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in the Annual Report on Form 10-K for the fiscal year ended March 31, 2019, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Nathan's. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

Effective November 8, 2019, the Board declared its quarterly cash dividend of \$0.35 per share which is payable on December 6, 2019 to shareholders of record as of the close of business on November 25, 2019.

Item 6. Exhibits.

- 31.1 [*Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 31.2 [*Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 32.1 [*Certification by Eric Gatoff, CEO, Nathan's Famous, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 [*Certification by Ronald G. DeVos, CFO, Nathan's Famous, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101.1 *The following materials from the Nathan's Famous, Inc., Quarterly Report on Form 10-Q for the quarter ended September 29, 2019 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Earnings, (iii) the Consolidated Statements of Stockholders' (Deficit), (iv) the Consolidated Statements of Cash Flows and (v) related notes.

*Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NATHAN'S FAMOUS, INC.

Date: November 8, 2019

By: /s/ Eric Gatoff
Eric Gatoff
Chief Executive Officer
(Principal Executive Officer)

Date: November 8, 2019

By: /s/ Ronald G. DeVos
Ronald G. DeVos
Vice President - Finance
and Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit Index.

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*Filed herewith.

CERTIFICATION

I, Eric Gatoff, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 29, 2019 of Nathan's Famous, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Eric Gatoff
Eric Gatoff
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION

I, Ronald G. DeVos, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 29, 2019 of Nathan's Famous, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Ronald G. DeVos _____
Ronald G. DeVos
Chief Financial Officer
(Principal Financial Officer and
Principle Accounting Officer)

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Eric Gatoff, Chief Executive Officer of Nathan's Famous, Inc., certify that:

The quarterly report on Form 10-Q of Nathan's Famous, Inc. for the period ended September 29, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

The information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Nathan's Famous, Inc.

/s/ Eric Gatoff

Eric Gatoff

Chief Executive Officer

(Principal Executive

Officer)

Date: November 8, 2019

A signed original of this written statement required by Section 906 has been provided to Nathan's Famous, Inc. and will be retained by Nathan's Famous, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Ronald G. DeVos, Chief Financial Officer of Nathan's Famous, Inc., certify that:

The quarterly report on Form 10-Q of Nathan's Famous, Inc. for the period ended September 29, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

The information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Nathan's Famous, Inc.

/s/ Ronald G. DeVos
Ronald G. DeVos
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)
Date: November 8, 2019

A signed original of this written statement required by Section 906 has been provided to Nathan's Famous, Inc. and will be retained by Nathan's Famous, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.