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Zoe's Kitchen, Inc.
Form 10-Q
August 17, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended July 10, 2017

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. 001-36411

ZOE'S KITCHEN, INC.

(Exact name of registrant as specified in its charter)

Delaware	51-0653504
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

5760 State Highway 121, Suite 250	75024
Plano, Texas	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(214) 436-8765

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 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Emerging growth company ☐

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

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

On August 17, 2017 there were 19,535,008 shares of common stock outstanding.

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Part I - Financial Information

Item 1. Financial Statements

Zoe's Kitchen, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	July 10, 2017	December 26, 2016
Assets		
Current Assets:		
Cash and cash equivalents	\$4,549	\$ 5,493
Trade accounts receivable, net of allowance for doubtful accounts	2,118	2,287
Other accounts receivable	3,752	3,708
Inventories	2,378	1,878
Prepaid expenses and other	3,931	1,818
Total current assets	16,728	15,184
Property and equipment, net	184,961	162,033
Goodwill	29,528	29,528
Intangibles, net	7,123	7,962
Other long-term assets, net	546	512
Total long-term assets	222,158	200,035
Total assets	\$238,886	\$ 215,219
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$11,762	\$ 7,229
Accrued expenses and other	14,885	14,260
Total current liabilities	26,647	21,489
Long-term liabilities:		
Long-term debt	10,000	—
Deemed landlord financing	32,367	29,777
Deferred rent	32,165	28,375
Deferred income taxes	5,368	5,476
Other long-term liabilities, net	79	136
Total long-term liabilities	79,979	63,764
Total liabilities	106,626	85,253
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock: \$0.01 par value, 135,000,000 shares authorized as of July 10, 2017 and December 26, 2016; 19,535,008 and 19,460,467 issued and outstanding as of July 10, 2017 and December 26, 2016, respectively.	\$195	\$ 195
Additional paid-in capital	150,461	148,482
Accumulated deficit	(18,396)	(18,711)
Total stockholders' equity	132,260	129,966
Total liabilities and stockholders' equity	\$238,886	\$ 215,219

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

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Zoe's Kitchen, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except share and per share data)

	Twelve Weeks Ended		Twenty-eight Weeks Ended	
	July 10, 2017	July 11, 2016	July 10, 2017	July 11, 2016
Revenue:				
Restaurant sales	\$74,261	\$ 66,222	\$164,765	\$146,570
Royalty fees	44	51	101	114
Total revenue	74,305	66,273	164,866	146,684
Operating expenses:				
Restaurant operating costs (excluding depreciation and amortization):				
Cost of sales	21,791	19,995	48,287	43,984
Labor	22,113	18,810	49,065	42,109
Store operating expenses	16,242	13,075	35,291	28,448
General and administrative expenses	7,124	7,270	17,109	16,715
Depreciation	4,161	3,292	9,213	7,284
Amortization	350	373	839	873
Pre-opening costs	679	552	1,246	1,292
Loss from disposal of equipment	748	100	1,007	337
Total operating expenses	73,208	63,467	162,057	141,042
Income from operations	1,097	2,806	2,809	5,642
Other income and expenses:				
Interest expense, net	1,018	861	2,386	1,983
Other income	(20)	(20)	(49)	(47)
Total other income and expenses	998	841	2,337	1,936
Income before provision for income taxes	99	1,965	472	3,706
Provision (benefit) for income taxes	(480)	764	(126)	1,109
Net income	\$579	\$ 1,201	\$598	\$2,597
Earnings per share:				
Basic	\$0.03	\$ 0.06	\$0.03	\$ 0.13
Diluted	\$0.03	\$ 0.06	\$0.03	\$ 0.13
Weighted average shares of common stock outstanding:				
Basic	19,488,851	19,436,315	19,479,293	19,413,132
Diluted	19,493,514	19,631,272	19,513,743	19,595,542

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

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Zoe's Kitchen, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Twenty-eight Weeks Ended July 10, 2017	July 11, 2016
Cash flows from operating activities:		
Net income	\$ 598	\$ 2,597
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,213	7,284
Amortization of intangible assets	839	873
Equity-based compensation	1,696	1,204
Deferred income taxes	(108)	1,021
Amortization of loan costs	12	12
Bad debt expense	12	35
Loss from disposal of equipment	1,007	337
Accretion of deemed landlord financing	159	182
Changes in operating assets and liabilities:		
Trade accounts receivable	157	(394)
Other accounts receivable	(44)	(1,958)
Inventories	(499)	(237)
Prepaid expenses and other	(2,159)	(1,982)
Accounts payable	2,159	1,528
Accrued expenses and other	110	(417)
Deferred rent	3,877	4,823
Net cash provided by operating activities	17,029	14,908
Cash flows from investing activities:		
Purchase of property and equipment	(28,255)	(22,820)
Proceeds from sale-leaseback	—	2,089

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transactions

Proceeds from sale of

property and

equipment

—

13

Net cash used in

investing activities

(28,255

)

(20,718

)

Cash flows from

financing activities:

Proceeds from line of

credit

10,000

—

Proceeds from

deemed landlord

282

71

financing

Proceeds from

exercise of stock

—

1,050

options

Net cash provided by

financing activities

10,282

1,121

Net change in cash

and cash equivalents

(944

)

(4,689

)

Cash and cash

equivalents:

Beginning of period

5,493

19,131

End of period

\$ 4,549

\$ 14,442

Supplemental disclosure of cash flow information:

Cash paid for interest related to long-term debt

\$ 12 \$ —

Cash paid for interest related to deemed landlord financing

2,363 1,984

Non-cash deemed landlord financing

2,150 (850

Change in accrued purchases of property and equipment

2,802 3,504

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

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Zoe's Kitchen, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation

Nature of Operations

Zoe's Kitchen, Inc. (the "Company", "Zoës", "we" or "us") primarily develops and operates fast-casual restaurants serving a distinct menu of freshly prepared Mediterranean-inspired dishes. As of July 10, 2017, we operated 224 Company-owned restaurants and three franchise restaurants in 20 states across the United States. We have determined that we have one operating and reportable segment. All of our revenues are derived in the United States. All of our assets are located in the United States.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles and practices of the United States of America ("GAAP") for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of the results for interim periods have been included.

Certain information and footnote disclosures normally included in audited consolidated financial statements presented in accordance with GAAP have been omitted pursuant to rules and regulations of the Securities and Exchange Commission (the "SEC"). Due to the seasonality of our business, results for any interim financial period are not necessarily indicative of the results that may be achieved for a full fiscal year. In addition, quarterly results of operations may be impacted by the timing and amount of sales and costs associated with the opening of new restaurants. These interim unaudited condensed consolidated financial statements do not represent complete financial statements and should be read in conjunction with our annual financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 26, 2016 (the "2016 Form 10-K"). While the condensed consolidated balance sheet data as of December 26, 2016 was derived from audited financial statements, it does not include all disclosures required by GAAP.

Comprehensive Income (Loss)

Comprehensive income (loss) is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) is the same as net income (loss) for all periods presented. Therefore, a separate statement of comprehensive income (loss) is not included in the accompanying condensed consolidated financial statements.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of Zoe's Kitchen, Inc. and its wholly owned subsidiaries, Zoe's Kitchen USA, LLC and Soho Franchising, LLC. All intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements presented herein reflect our financial position, results of operations and cash flows in conformity with GAAP.

Fiscal Year

We operate on a 52- or 53-week fiscal year that ends on the last Monday of the calendar year. Fiscal years ended December 25, 2017 and December 26, 2016 consist of 52 weeks. Our first fiscal quarter consists of 16 weeks, and each of our second, third and fourth fiscal quarters consists of 12 weeks, except for a 53-week year when the fourth quarter has 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, such as valuation of long-lived, definite and indefinite-lived assets, estimated useful lives of assets, the reasonably assured lease terms of operating leases, the construction costs of leases where the Company is considered the owner during and after the construction period, allowance for doubtful accounts, the fair value related to equity-based compensation, the calculation of self-insurance

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reserves, and deferred tax valuation allowances, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Recently Adopted Accounting Standards

In March 2016, the FASB issued Accounting Standard Update ("ASU") No. 2016-09, "Compensation – Stock Compensation (Topic 718)." The pronouncement was issued to simplify the accounting for share-based payment transactions, including income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. This pronouncement is effective for reporting periods beginning after December 15, 2016. We adopted ASU 2016-09 effective December 27, 2016. The portion of ASU 2016-09 related to the accounting for income taxes was adopted using a modified retrospective approach and resulted in a net zero effect on our statement of financial position. As permitted under the new standard, the Company elected to recognize forfeitures as they occur rather than using an estimated forfeiture rate. Adopted using a modified retrospective approach, this election resulted in an increase to Accumulated deficit of \$0.3 million offset by an equal increase to Additional paid-in capital.

Recently Issued Accounting Standards

In May 2017, the FASB issued ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting," which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity will account for the effects of a modification unless the fair value of the modified award is the same as the original award, the vesting conditions of the modified award are the same as the original award, and the classification of the modified award as an equity instrument or liability instrument is the same as the original award. This pronouncement is effective for reporting periods beginning after December 15, 2017 and early adoption is permitted. We do not expect the adoption of ASU 2017-09 to have a material impact on our financial position or results of operations.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment," which eliminates Step 2 from the goodwill impairment test. Under the new standard, annual and interim goodwill impairment tests will compare the fair value of a reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill. The pronouncement is effective for goodwill impairments tests in fiscal years beginning after December 15, 2019 and should will be applied on a prospective basis. Early adoption is permitted for goodwill impairment tests performed after January 1, 2017. We are currently evaluating the impact of adopting this update.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments," which provides specific guidance regarding presentation and classification on a variety of cash payments and receipts. Among the issues addressed is the classification of proceeds from the settlement of insurance claims. This pronouncement is effective for reporting periods beginning after December 15, 2017 and early adoption is permitted. We do not expect the adoption of ASU 2016-15 to have a material impact on our financial position or results of operations.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities - Extinguishments of Liabilities (Subtopic 405-20)", which amends subtopic 405-20 to provide a scope exception that requires breakage for prepaid stored-value product liabilities to be accounted for consistent with the breakage guidance in Topic 606. The amendment is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. We do not expect the adoption of ASU 2016-04 to have a material impact on our financial position or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires entities to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements.

Previous lease accounting did not require certain lease types to be recognized on the balance sheet. This update is an amendment to the codification and is effective for fiscal years beginning after December 15, 2018 including interim periods within those fiscal years applied using a modified retrospective approach. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 on our financial position and results of operations,

but expect that it will result in a significant increase in our long-term assets and liabilities given we have a significant number of leases. In addition, rental payments under most of our leases for which we are the

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accounting owner will no longer be considered debt service applied to deemed landlord financing and interest expense. Instead, these rental payments will be classified as rent expense.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." This update was issued to replace the current revenue recognition guidance, creating a more comprehensive revenue model. In August 2015, the FASB issued ASU 2015-14 to defer the effective date for adoption. The update is now effective for reporting periods beginning after December 15, 2017. In March 2016, April 2016, May 2016, and December 2016 the FASB also issued ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20, respectively, to further clarify performance obligations and licensing implementation guidance and other general topics. We expect to adopt the new standard using the modified retrospective approach for the fiscal year and quarter beginning December 26, 2017. We do not expect the adoption to have an impact on revenue from Company-owned restaurants or the recognition of royalty fees from our franchise agreement. In addition, we do not expect a material impact related to recognition of gift card breakage.

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2. Supplemental Information

Property and equipment, net consisted of the following (in thousands):

	July 10, 2017	December 26, 2016
Land	\$813	\$ —
Buildings under deemed landlord financing	25,980	23,830
Leasehold improvements	141,475	125,666
Machinery and equipment	36,692	32,566
Furniture and fixtures	7,335	6,604
Automobiles	4,019	4,019
Computer equipment	12,412	9,848
Construction in progress	10,720	6,256
Property and equipment, gross	239,446	208,789
Less: Accumulated depreciation	(54,485)	(46,756)
Total Property and equipment, net	\$184,961	\$ 162,033

Accrued expenses and other consisted of the following (in thousands):

	July 10, 2017	December 26, 2016
Accrued payroll and payroll taxes	\$4,687	\$ 5,448
Accrued capital purchases	2,775	2,347
Sales tax payable	2,364	1,218
Gift card payable	796	1,200
Other accrued expenses	4,263	4,047
Total Accrued expenses and other	\$14,885	\$ 14,260

3. Fair Value Measurements

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate fair values due to the short maturities of these instruments.

4. Bank Line of Credit and Term Loan

On February 6, 2015, we entered into a credit facility with Wells Fargo Bank, National Association (the "2015 Credit Facility"). The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, and an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of July 10, 2017, we had \$10.0 million indebtedness under the 2015 Credit Facility. As of July 10, 2017 the amount available under the 2015 Credit Facility was \$40.0 million.

Revolving credit loans under the 2015 Credit Facility bear interest, at the Company's election, at either the base rate plus an applicable margin, or LIBOR plus an applicable margin. The base rate consists of the highest of the prime rate, the federal funds rate plus 0.5% and LIBOR plus 1.0%. The applicable margin and associated loan commitment fee consists of two pricing levels based on the Company's consolidated total debt ratio. If this debt ratio is greater than or equal to 2.50 to 1, then the unused commitment fee is 0.15% per annum, and the applicable margin is LIBOR plus 1.5% or the base rate plus 0.5%. If this debt ratio is less than 2.50 to 1, then the unused commitment fee is 0.125% per annum and the applicable margin is LIBOR plus 1.0% or the base rate. The weighted-average interest rate for the 2015 Credit Facility was 2.4% for the twelve weeks ended July 10, 2017.

The 2015 Credit Facility includes specific financial covenants such as a leverage ratio and an interest coverage ratio. We are also subject to other customary covenants, including limitations on additional borrowings, dividend payments and acquisitions. As of July 10, 2017, we were in compliance with these financial and other customary covenants.

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5. Equity-based Compensation

In connection with our initial public offering in April 2014 (the "IPO"), we adopted the 2014 Omnibus Incentive Plan (the "2014 Incentive Plan"), which provides for grants of stock options, stock appreciation rights, restricted stock, other stock-based awards and other cash-based awards available to directors, officers and other employees of us and our subsidiaries, as well as others performing consulting or advisory services to us. The number of shares of common stock available for issuance under the 2014 Incentive Plan may not exceed 1,905,799.

The following table summarizes our stock option plan activity during the twenty-eight weeks ended July 10, 2017:

	Stock Options	Weighted Average Exercise Price
Outstanding as of December 26, 2016	710,597	\$ 26.28
Granted	449,121	20.31
Exercised	—	—
Forfeited	(3,987)	32.09
Expired	(468)	42.05
Outstanding as of July 10, 2017	1,155,263	\$ 23.93

Included in the summary of stock option plan activity are 250,000 stock options outstanding as of December 26, 2016 that vested immediately upon completion of the IPO and 130,000 stock options granted that vest in five equal annual installments following the date of the grant. All other options vest in four equal annual installments following the date of the grant. All options have a contractual term of 10 years.

The following table reflects the weighted-average assumptions utilized in the Black-Scholes option-pricing model to value the stock options granted.

	Twenty-eight Weeks Ended July 10, 2017
Expected volatility ⁽¹⁾	31.5%
Risk-free rate of return	2.0%
Expected life (in years) ⁽²⁾	6.3
Dividend yield	0%
Weighted-average fair value per share at date of grant	\$7.15

(1) Expected volatility was based on competitors within the industry.

(2) Expected life was calculated using the simplified method, which is an average of the contractual term of the option and its ordinary vesting period, as we do not have sufficient historical data for determining the expected term of our stock option awards.

The following table summarizes our restricted stock unit plan activity twenty-eight weeks ended July 10, 2017:

	Restricted Stock Units	Weighted Average Grant Date Fair Value
Non-vested at December 26, 2016	83,411	\$28.13
Granted	64,821	21.54
Vested	(28,541)	27.94
Forfeited	(945)	26.47
Non-vested at July 10, 2017	118,746	24.59

The fair value of the non-vested restricted stock units is based on the closing price on the date of grant. All of our outstanding restricted stock units vest in three equal annual installments following the date of the grant.

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During the twenty-eight weeks ended July 10, 2017, 46,000 shares of restricted stock were granted. All shares of restricted stock vest in five equal annual installments following the date of the grant.

We recognized equity-based compensation as a component of general and administrative expenses of \$0.8 million and \$0.5 million during the twelve weeks ended July 10, 2017 and July 11, 2016, respectively, and \$1.7 million and \$1.2 million during the twenty-eight weeks ended July 10, 2017 and July 11, 2016, respectively. As of July 10, 2017, total unrecognized compensation expense related to non-vested stock awards was \$8.8 million, which is expected to be recognized over a weighted-average period of 3.1 years.

6. Earnings Per Share

Basic net income per share is calculated by dividing net income by the weighted average shares outstanding during the period, without consideration of common stock equivalents. Diluted net income per share is calculated by adjusting weighted average shares outstanding for the dilutive effect of common stock equivalents outstanding for the period, determined using the treasury-stock method.

The following table presents the computation of basic and diluted net income per share for the period indicated:

	Twelve Weeks Ended July 10, 2017		Twenty-eight Weeks Ended July 11, 2016	
Net income (in thousands):	\$579	\$ 1,201	\$598	\$ 2,597
Shares:				
Basic weighted average shares outstanding	19,488,854	136,315	19,479,093	113,132
Diluted weighted average shares outstanding	19,493,194	131,272	19,513,174	95,542
Earnings per share:				
Basic EPS	\$0.03	\$ 0.06	\$0.03	\$ 0.13
Diluted EPS	\$0.03	\$ 0.06	\$0.03	\$ 0.13

During the twelve weeks ended July 10, 2017, there were 957,463 stock options and 116,441 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive. During the twelve weeks ended July 11, 2016, there were 327,995 stock options and 300 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive.

During the twenty-eight weeks ended July 10, 2017, there were 757,258 stock options and 98,528 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive.

During the twenty-eight weeks ended July 11, 2016, there were 387,556 stock options and 367 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive.

7. Income Taxes

Benefit for income taxes was \$0.1 million for the twenty-eight weeks ended July 10, 2017 compared to provision for income taxes of \$1.1 million for the twenty-eight weeks ended July 11, 2016, respectively. The effective tax rate was (27)% and 30% for the twenty-eight weeks ended July 10, 2017 and July 11, 2016, respectively. Our tax expense for the year typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. Our quarterly provision for income taxes is measured using an annual estimated effective tax rate for the full year applied to period earnings. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year.

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We continue to monitor and evaluate the rationale for recording a full valuation allowance for the net amount of the deferred tax assets which are in excess of the indefinite-lived intangible asset deferred tax liabilities. We intend to continue maintaining a full valuation allowance on these net deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. However, given our current earnings and anticipated future earnings, we believe that there is a reasonable possibility within the foreseeable future, sufficient positive evidence may become available to allow us to reach a conclusion that a significant portion of the valuation allowance will no longer be needed. Release of the valuation allowance would result in the recognition of certain deferred tax assets and a decrease to income tax expense for the period the release is recorded. However, the exact timing and amount of the valuation allowance release are subject to change on the basis of the level of profitability that we are able to actually achieve.

8. Commitments and Contingencies

Franchise Agreement

Our Kentucky franchise agreement, which requires the franchisee to remit continuing royalty fees at a specified percentage of the franchisee's gross sales revenue, provides that we as franchisor, or its authorized representative, will: (a) provide franchisee with written schedules of all foods, food products, beverages, and other items for sale, and the furniture, fixtures, supplies and equipment necessary and required for the operation of the restaurant; (b) provide franchisee with a list of approved suppliers for the products and services necessary and required for the restaurant; (c) upon the reasonable written request of franchisee, render reasonable advisory services by telephone or in writing pertaining to the operation of the restaurant; (d) provide franchisee with a sample of the standard Zoës Kitchen menu, and any modifications to the menu; (e) loan franchisee a copy of the System's operating manual and any supplements to the manual that may be published by us; and, (f) provide franchisee the opportunity to participate in group purchasing programs that we may use, develop, sponsor or provide on terms and conditions determined solely by us. In addition, as a condition to the commencement of business by any of our franchises, the franchisee must attend and successfully complete our training program. The costs related to our franchise agreement are not significant.

Litigation

We are currently involved in various claims and legal actions that arise in the ordinary course of our business, including claims resulting from employment related matters. None of these claims, most of which are covered by insurance, has had a material effect on us, and as of the date of this report, other than as set forth below, we are not party to any material pending legal proceedings and are not aware of any claims that could have a material adverse effect on our business, financial condition, results of operations or cash flows. However, a significant increase in the number of these claims or an increase in amounts owing under successful claims could materially and adversely affect our business, financial condition, results of operations or cash flows.

On October 31, 2014, Forsyth Consulting, Inc. ("Forsyth"), a former music vendor for the Company, filed a complaint against the Company in the Circuit Court of Jefferson County, Alabama alleging breach of contract with respect to its prior music service contract. We have removed the action to federal court and, on December 19, 2014, we filed a counterclaim in the United States District Court for the Northern District of Alabama, alleging breach of contract and tortious interference with business relations claims against Forsyth. On August 3, 2017, the parties resolved this dispute and thereafter entered into a settlement agreement.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and cash flows as of and for the periods presented below. The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our 2016 Form 10-K.

In addition to historical information, this discussion and analysis contains forward-looking statements based on current expectations that involve risks, uncertainties and assumptions, such as our plans, objectives, expectations, and intentions set forth under the sections entitled "Risk Factors" and "Forward-Looking Statements" as filed in our 2016 Form 10-K.

Overview

Zoës Kitchen is a fast growing, fast-casual restaurant concept serving a distinct menu of fresh, wholesome, Mediterranean-inspired dishes delivered with Southern hospitality. Founded in 1995 in Birmingham, Alabama, Zoës Kitchen is a natural extension of Zoë Cassimus' lifetime passion for cooking Mediterranean meals for family and friends. Since opening our first restaurant, we have never wavered from our commitment to make our food fresh daily and to serve our customers in a warm and welcoming environment.

Growth Strategies and Outlook

We plan to execute the following strategies to continue to enhance our brand awareness and grow our revenue and achieve profitability:

- grow our restaurant base;
- increase our comparable restaurant sales; and
- enhance our operations and leverage infrastructure.

We have expanded our restaurant base from 21 restaurants in seven states in 2008 to 227 restaurants in 20 states as of July 10, 2017, including three franchise restaurants. We opened 23 Company-owned restaurants during the twenty-eight weeks ended July 10, 2017. We plan to open 38 to 40 restaurants in 2017, including the restaurants opened in the twenty-eight weeks ended July 10, 2017. In fiscal year 2017 we have opened 28 restaurants as of August 17, 2017. We believe we are well positioned for future growth with a developed infrastructure capable of supporting a restaurant base that is greater than our existing footprint. Additionally, we believe we have an opportunity to optimize costs and achieve profitability as we benefit from economies of scale.

Growing sales and traffic in the restaurant sector continues to be a challenge. This challenge is due to a number of factors including increased competition, heavy discounting in the casual dining industry, and recent macroeconomic pressures such as slower wage growth, among other factors. These macroeconomic pressures can reduce the availability of our guests' discretionary spending for restaurant visits. In response to these factors we have undertaken a number of significant initiatives which we believe will help us drive profitable sales and traffic growth and improve the guest experience in our restaurants. First, we are continuing to innovate our menu including new snack boxes, appetizers, salads, sauces and entrées. Second, we are making investments in technology to advance our e-commerce, marketing and in-store operational capabilities which are designed to provide a superior guest experience. Third, we are investing in our capabilities to meet the off-premise dining demand through delivery and catering. Lastly, we continue to focus on improving our operational efficiencies. These strategies are intended to differentiate us from the competition, reduce the costs associated with managing our restaurants, and establish a strong presence for our brand in key markets in the United States. There can be no assurance that our strategies and initiatives will be successful solutions to the current challenges.

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Key Measures We Use to Evaluate Our Performance

In assessing the performance of our business, we consider a variety of performance and financial measures. The key measures used by our management for determining how our business is performing are restaurant sales, comparable restaurant sales growth, number of new restaurant openings, restaurant contribution, EBITDA and Adjusted EBITDA.

Restaurant Sales

Restaurant sales represents sales of food and beverages in Company-owned restaurants. Several factors affect our restaurant sales in any given period, including the number of restaurants in operation and per restaurant sales.

Comparable Restaurant Sales Growth

Comparable restaurant sales refers to year-over-year sales comparisons for the comparable Company-owned restaurant base. We define the comparable restaurant base to include those restaurants open for eighteen fiscal periods or longer. Each fiscal period consists of 28 days. As of July 10, 2017 and July 11, 2016, there were 169 and 134 restaurants, respectively, in our comparable Company-owned restaurant base. This measure highlights performance of existing restaurants, as the impact of new Company-owned restaurant openings is excluded.

Comparable restaurant sales growth is generated by an increase in transactions or changes in per customer spend. Per customer spend can be influenced by changes in menu prices and/or the mix and number of items sold per check.

Measuring our comparable restaurant sales allows us to evaluate the performance of our existing restaurant base.

Various factors impact comparable restaurant sales, including:

- consumer recognition of our brand and our ability to respond to changing consumer preferences;
- overall economic trends, particularly those related to consumer spending;
- our ability to operate restaurants effectively and efficiently to meet consumer expectations;
- pricing;
- customer traffic;
- per-customer spend and average check amount;
- marketing and promotional efforts;
- local competition;
- trade area dynamics;
- introduction of new menu items; and
- opening of new restaurants in the vicinity of existing locations.

Consistent with common industry practice, we present comparable restaurant sales on a fiscal year basis that aligns current year sales weeks with comparable periods in the prior year, regardless of whether they belong to the same calendar period or not. Since opening new Company-owned restaurants will be a significant component of our revenue growth, comparable restaurant sales is only one measure of how we evaluate our performance.

Number of New Restaurant Openings

The number of Company-owned restaurant openings reflects the number of restaurants opened during a particular reporting period. Before we open new Company-owned restaurants, we incur pre-opening costs. Some of our restaurants open with an initial start-up period of higher than normal sales volumes, which subsequently decrease to stabilized levels. Typically, our new restaurants have stabilized sales after approximately 12 to 24 weeks of operation, at which time the restaurant's sales typically begin to grow on a consistent basis. In new markets, the length of time before average sales for new restaurants stabilize is less predictable and can be longer as a result of our limited knowledge of these markets and consumers' limited awareness of our brand. New restaurants may not be profitable, and their sales performance may not follow historical patterns. The number and timing of restaurant openings has had, and is expected to continue to have, an impact on our results of operations.

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The following table shows the growth in our Company-owned and franchise restaurant base:

	Twelve Weeks Ended July 10, 2017		Twenty-eight Weeks Ended July 11, 2016	
Company-owned Restaurant Base				
Beginning of period	211	174	201	163
Openings	13	9	23	20
Restaurants at end of period	224	183	224	183
Franchise Restaurant Base				
Beginning of period	3	3	3	3
Restaurants at end of period	3	3	3	3
Total restaurants	227	186	227	186

Key Financial Definitions

Restaurant sales. Restaurant sales represent sales of food and beverages in Company-owned restaurants, net of promotional allowances and employee meals. Restaurant sales in a given period are directly impacted by the number of operating weeks in the period, the number of restaurants we operate and comparable restaurant sales growth.

Royalty fees. Royalty fees represent royalty income from the three franchised restaurants.

Cost of sales. Cost of sales consists primarily of food, beverage and packaging costs. The components of cost of sales are variable in nature, change with sales volume and are influenced by menu mix and subject to increases or decreases based on fluctuations in commodity costs.

Labor. Labor includes all restaurant-level management and hourly labor costs, including salaries, wages, benefits and bonuses, payroll taxes and other indirect labor costs.

Store operating expenses. Store operating expenses include all other restaurant-level operating expenses, such as supplies, utilities, repairs and maintenance, travel costs, credit card fees, recruiting, delivery service, restaurant-level marketing costs, security and occupancy expenses.

General and administrative expenses. General and administrative expenses include expenses associated with corporate and regional functions that support the development and operations of restaurants, including compensation and benefits, travel expenses, stock compensation costs, legal and professional fees, information systems, corporate office rent and other related corporate costs.

Depreciation. Depreciation consists of depreciation of fixed assets, including equipment and capitalized leasehold improvements.

Amortization. Amortization consists of amortization of certain intangible assets including franchise agreements, trademarks, reacquired rights and favorable leases.

Pre-opening costs. Pre-opening costs consist of expenses incurred prior to opening a new restaurant and are made up primarily of manager salaries, relocation costs, supplies, recruiting expenses, employee payroll and training costs.

Pre-opening costs also include occupancy costs recorded during the period between date of possession and the restaurant's opening date.

Loss from disposal of equipment. Loss from disposal of equipment is composed of the loss on disposal of assets related to retirements and replacements of leasehold improvements or equipment. These losses are related to normal disposals in the ordinary course of business, along with disposals related to selected restaurant remodeling activities.

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Interest expense, net. Interest expense includes cash and imputed non-cash charges related to our deemed landlord financing, non-cash charges related to our residual value obligations, amortization of debt issue costs as well as cash payments and accrued charges related to our 2015 Credit Facility.

Provision for income taxes. Provision for income taxes represents federal, state and local current and deferred income tax expense.

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Consolidated Results of Operations

The following table summarizes key components of our results of operations for the periods indicated as a percentage of our total revenue, except for the components of restaurant operating costs, which are expressed as a percentage of restaurant sales.

	Twelve Weeks Ended July 10, 2017		July 11, 2016		Twenty-eight Weeks Ended July 10, 2017		July 11, 2016	
Revenue:								
Restaurant sales	99.9	%	99.9	%	99.9	%	99.9	%
Royalty fees	0.1	%	0.1	%	0.1	%	0.1	%
Total revenue	100.0	%	100.0	%	100.0	%	100.0	%
Operating expenses ⁽¹⁾ :								
Restaurant operating costs (excluding depreciation and amortization) ⁽¹⁾ :								
Cost of sales	29.3	%	30.2	%	29.3	%	30.0	%
Labor	29.8	%	28.4	%	29.8	%	28.7	%
Store operating expenses	21.9	%	19.7	%	21.4	%	19.4	%
General and administrative expenses	9.6	%	11.0	%	10.4	%	11.4	%
Depreciation	5.6	%	5.0	%	5.6	%	5.0	%
Amortization	0.5	%	0.6	%	0.5	%	0.6	%
Pre-opening costs	0.9	%	0.8	%	0.8	%	0.9	%
Loss from disposal of equipment	1.0	%	0.2	%	0.6	%	0.2	%
Total operating expenses	98.5	%	95.8	%	98.3	%	96.2	%
Income from operations	1.5	%	4.2	%	1.7	%	3.8	%
Other income and expenses:								
Interest expense, net	1.4	%	1.3	%	1.4	%	1.4	%
Other income	(0.0))%	(0.0))%	(0.0))%	(0.0))%
Total other income and expenses	1.3	%	1.3	%	1.4	%	1.3	%
Income before provision for income taxes	0.1	%	3.0	%	0.3	%	2.5	%
Provision (benefit) for income taxes	(0.6))%	1.2	%	(0.1)	%	0.8	%
Net income	0.8	%	1.8	%	0.4	%	1.8	%

(1) As a percentage of restaurant sales.

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Twelve Weeks Ended July 10, 2017 compared to Twelve Weeks Ended July 11, 2016

The following table presents selected consolidated comparative results of operations from our unaudited condensed consolidated financial statements for the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016:

	Twelve Weeks Ended		Increase /		
	July 10, 2017	July 11, 2016	(Decrease)	Dollars	Percentage
(Dollars in thousands)					
Consolidated Statement of Operations Data:					
Revenue:					
Restaurant sales	\$74,261	\$66,222	\$8,039	12.1	%
Royalty fees	44	51	(7)	(13.7)%
Total revenue	74,305	66,273	8,032	12.1	%
Operating expenses:					
Restaurant operating costs (excluding depreciation and amortization):					
Cost of sales	21,791	19,995	1,796	9.0	%
Labor	22,113	18,810	3,303	17.6	%
Store operating expenses	16,242	13,075	3,167	24.2	%
General and administrative expenses	7,124	7,270	(146)	(2.0)%
Depreciation	4,161	3,292	869	26.4	%
Amortization	350	373	(23)	(6.2)%
Pre-opening costs	679	552	127	23.0	%
Loss from disposal of equipment	748	100	648	648.0	%
Total operating expenses	73,208	63,467	9,741	15.3	%
Income from operations	1,097	2,806	(1,709)	(60.9)%
Other income and expenses:					
Interest expense, net	1,018	861	157	18.2	%
Other income	(20)	(20)	—	—	%
Total other income and expenses	998	841	157	18.7	%
Income before provision for income taxes	99	1,965	(1,866)	(95.0)%
Provision (benefit) for income taxes	(480)	764	(1,244)	(162.8)%
Net income	\$579	\$1,201	\$(622)	(51.8)%

Restaurant sales. The following table summarizes the growth in restaurant sales from the twelve weeks ended July 11, 2016 to the twelve weeks ended July 10, 2017 (dollars in thousands):

	Net Sales
Restaurant sales for twelve weeks ended July 11, 2016	\$66,222
Incremental restaurant sales increase due to:	
Comparable restaurant sales	(2,385)
Restaurants not in comparable restaurant base	10,424
Restaurant sales for the twelve weeks ended July 10, 2017	\$74,261

Restaurant sales increased by \$8.0 million, or 12.1%, in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016. Restaurants not in the comparable restaurant base and other sales accounted for \$10.4 million of this increase. Comparable restaurant sales decreased \$2.4 million, or 3.8%, in the twelve weeks ended July 10, 2017, comprised primarily of a 5.0% decrease in transactions and product mix offset by a 1.2% increase in price.

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Royalty fees. Royalty fees remained flat in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016.

Cost of sales. Cost of sales increased \$1.8 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 30.2% in the twelve weeks ended July 11, 2016 to 29.3% in the twelve weeks ended July 10, 2017. This decrease was primarily driven by lower costs in poultry, paper products and beef, offset by higher costs in seafood.

Labor. Labor increased by \$3.3 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of restaurant sales, labor increased from 28.4% in the twelve weeks ended July 11, 2016 to 29.8% in the twelve weeks ended July 10, 2017. The increase was primarily driven by the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes as well as an increase in wage rates.

Store operating expenses. Store operating expenses increased by \$3.2 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of restaurant sales, store operating expense increased from 19.7% in the twelve weeks ended July 11, 2016 to 21.9% in the twelve weeks ended July 10, 2017. This increase was primarily attributable to the dilutive effect on margins from our newest restaurants, which, on average, initially operate at less than system-wide average sales volumes as well as increased costs related to in-store technology investments and marketing.

General and administrative expenses. General and administrative expenses decreased by \$0.1 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016. As a percentage of revenue, general and administrative expenses decreased from 11.0% in the twelve weeks ended July 11, 2016 to 9.6% in the twelve weeks ended July 10, 2017. The decrease was primarily driven by lower consulting fees related to a variety of one-time projects from the prior year and lower variable incentive compensation.

Depreciation. Depreciation increased by \$0.9 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of revenue, depreciation increased from 5.0% in the twelve weeks ended July 11, 2016 to 5.6% in the twelve weeks ended July 10, 2017 primarily due to corporate and in-store technology investments which typically have shorter useful lives.

Amortization. Amortization remained flat in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016.

Pre-opening costs. Pre-opening costs increased by \$0.1 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016. As a percent of revenue, pre-opening costs increased from 0.8% in the twelve weeks ended July 11, 2016 to 0.9% in the twelve weeks ended July 10, 2017.

Interest expense. Interest expense increased by \$0.2 million in the twelve weeks ended July 10, 2017 compared to the twelve weeks ended July 11, 2016, due primarily to increased interest from deemed landlord financing.

Provision (benefit) for income taxes. Benefit for income taxes was \$0.5 million for the twelve weeks ended July 10, 2017 compared to provision for income taxes of \$0.8 million for the twelve weeks ended July 11, 2016. Our tax expense for the year typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year.

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Twenty-eight Weeks Ended July 10, 2017 compared to Twenty-eight Weeks Ended July 11, 2016

The following table presents selected consolidated comparative results of operations from our unaudited condensed consolidated financial statements for the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016:

	Twenty-eight Weeks Ended			
	July 10, 2017	July 11, 2016	Increase / (Decrease) Dollars	Percentage
(Dollars in thousands)				
Consolidated Statement of Operations Data:				
Revenue:				
Restaurant sales	\$164,765	\$146,570	\$18,195	12.4 %
Royalty fees	101	114	(13)	(11.4)%
Total revenue	164,866	146,684	18,182	12.4 %
Operating expenses:				
Restaurant operating costs (excluding depreciation and amortization):				
Cost of sales	48,287	43,984	4,303	9.8 %
Labor	49,065	42,109	6,956	16.5 %
Store operating expenses	35,291	28,448	6,843	24.1 %
General and administrative expenses	17,109	16,715	394	2.4 %
Depreciation	9,213	7,284	1,929	26.5 %
Amortization	839	873	(34)	(3.9)%
Pre-opening costs	1,246	1,292	(46)	(3.6)%
Loss from disposal of equipment	1,007	337	670	198.8 %
Total operating expenses	162,057	141,042	21,015	14.9 %
Income from operations	2,809	5,642	(2,833)	(50.2)%
Other income and expenses:				
Interest expense, net	2,386	1,983	403	20.3 %
Other income	(49)	(47)	(2)	4.3 %
Total other income and expenses	2,337	1,936	401	20.7 %
Income before provision for income taxes	472	3,706	(3,234)	(87.3)%
Provision (benefit) for income taxes	(126)	1,109	(1,235)	(111.4)%
Net income	\$598	\$2,597	\$(1,999)	(77.0)%

Restaurant sales. The following table summarizes the growth in restaurant sales from the twenty-eight weeks ended July 11, 2016 to the twenty-eight weeks ended July 10, 2017 (dollars in thousands):

	Net Sales
Restaurant sales for the twenty-eight weeks ended July 11, 2016	\$146,570
Incremental restaurant sales increase due to:	
Comparable restaurant sales	(4,918)
Restaurants not in comparable restaurant base	23,113
Restaurant sales for the twenty-eight weeks ended July 10, 2017	\$164,765

Restaurant sales increased by \$18.2 million, or 12.4%, in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016. Restaurants not in the comparable restaurant base and other sales accounted for \$23.1 million of this increase. Comparable restaurant sales decreased \$4.9 million, or 3.6%, in the twenty-eight weeks ended July 10, 2017, comprised primarily of a 4.8% decrease in transactions and product mix offset by a 1.2% increase in price.

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Royalty fees. Royalty fees remained flat in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016.

Cost of sales. Cost of sales increased \$4.3 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 30.0% in the twenty-eight weeks ended July 11, 2016 to 29.3% in the twenty-eight weeks ended July 10, 2017. This decrease was primarily driven by lower costs in beef, poultry, paper products and produce, offset by higher costs in seafood.

Labor. Labor increased by \$7.0 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of restaurant sales, labor increased from 28.7% in the twenty-eight weeks ended July 11, 2016 to 29.8% in the twenty-eight weeks ended July 10, 2017. The increase was primarily driven by the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes as well as an increase in wage rates.

Store operating expenses. Store operating expenses increased by \$6.8 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of restaurant sales, store operating expense increased from 19.4% in the twenty-eight weeks ended July 11, 2016 to 21.4% in the twenty-eight weeks ended July 10, 2017. This increase was primarily attributable to the dilutive effect on margins from our newest restaurants, which, on average, initially operate at less than system-wide average sales volumes as well as increased costs related to in-store technology investments and marketing.

General and administrative expenses. General and administrative expenses increased by \$0.4 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016. As a percentage of revenue, general and administrative expenses decreased from 11.4% in the twenty-eight weeks ended July 11, 2016 to 10.4% in the twenty-eight weeks ended July 10, 2017. The decrease was primarily driven by lower consulting fees related to a variety of one-time projects from the prior year and lower variable incentive compensation.

Depreciation. Depreciation increased by \$1.9 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016, due primarily to opening 41 new Company-owned restaurants. As a percentage of revenue, depreciation increased from 5.0% in the twenty-eight weeks ended July 11, 2016 to 5.6% in the twenty-eight weeks ended July 10, 2017 primarily due to corporate and in-store technology investments which typically have shorter useful lives.

Amortization. Amortization remained flat in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016.

Pre-opening costs. Pre-opening costs remained flat in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016. As a percent of revenue, pre-opening costs decreased from 0.9% in the twenty-eight weeks ended July 11, 2016 to 0.8% in the twenty-eight weeks ended July 10, 2017. The decrease was driven by improved project management and better control of pre-opening expenses.

Interest expense. Interest expense increased by \$0.4 million in the twenty-eight weeks ended July 10, 2017 compared to the twenty-eight weeks ended July 11, 2016, due primarily to increased interest from deemed landlord financing.

Provision (benefit) for income taxes. Benefit for income taxes was \$0.1 million for the twenty-eight weeks ended July 10, 2017 compared to provision for income taxes of \$1.1 million for the twenty-eight weeks ended July 11, 2016. Our tax expense for the year typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year.

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Non-GAAP Financial Measures

To supplement its unaudited condensed consolidated financial statements, which are prepared and presented in accordance with GAAP, the Company uses the following non-GAAP financial measures: restaurant contribution, EBITDA and adjusted EBITDA (collectively, the "non-GAAP financial measures"). The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. The Company uses these non-GAAP financial measures for financial and operational decision making and as a means to evaluate period-to-period comparisons. The Company believes that they provide useful information about operating results, enhance the overall understanding of past financial performance and future prospects, and allow for greater transparency with respect to key metrics used by management in its financial and operational decision making. The non-GAAP measures used by the Company may be different from the methods used by other companies.

Restaurant Contribution

Restaurant contribution is defined as restaurant sales less restaurant operating costs, which are cost of sales, labor and store operating expenses. Restaurant contribution margin is restaurant contribution as a percentage of restaurant sales. When used in conjunction with GAAP financial measures, restaurant contribution and restaurant contribution margin are supplemental measures that we believe are useful in evaluating operating performance and profitability of our restaurants. Additionally, restaurant contribution and restaurant contribution margin are key metrics used internally by our management to develop budgets and forecast, as well as assess the performance of our restaurants relative to budget and against prior periods. We believe the supplemental presentation of restaurant and restaurant contribution margin provides investors with a meaningful view of our operating performance as these measures depict the operating results that are directly impacted by our restaurants and exclude items that may not be indicative of, or are unrelated to, the ongoing operations of our restaurants. It may also assist investors to evaluate our performance relative to peers of various sizes and maturities and provide greater transparency to how our management evaluates our business as well as our financial and operational decision making.

Our management does not consider restaurant contribution or restaurant contribution margin in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of restaurant contribution and restaurant contribution margin is that they exclude significant expenses and income that are required by GAAP to be recorded in the Company's financial statements. Restaurant contribution excludes general and administrative expenses and pre-opening costs, which are considered normal, recurring cash operating expenses and are essential to support the operation and development of our restaurants. Therefore, this measure may not provide a complete understanding of the operating results of our Company as a whole.

We compensate for this limitation by relying primarily on our GAAP results and using restaurant contribution and restaurant contribution margin only supplementally. You should review the reconciliation of income from operations to restaurant contribution and restaurant contribution margin below and not rely on any single financial measure to evaluate our business.

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The following table reconciles income from operations, which is a GAAP financial measure, to restaurant contribution and restaurant contribution margin:

	Twelve Weeks Ended		Twenty-eight Weeks Ended	
	July 10, 2017	July 11, 2016	July 10, 2017	July 11, 2016
(Dollars in thousands)				
Restaurant Contribution:				
Income from operations	\$1,097	\$2,806	\$2,809	\$5,642
Less:				
Royalty fees	44	51	101	114
Add:				
General and administrative expenses	7,124	7,270	17,109	16,715
Depreciation and amortization	4,511	3,665	10,052	8,157
Pre-opening costs ⁽¹⁾	679	552	1,246	1,292
Loss from disposal of equipment	748	100	1,007	337
Restaurant Contribution	\$14,115	\$14,342	\$32,122	\$32,029
 Total revenue	 \$74,305	 \$66,273	 \$164,866	 \$146,684
Less: Royalty fees	44	51	101	114
Restaurant sales	\$74,261	\$66,222	\$164,765	\$146,570
 Restaurant contribution margin	 19.0	 % 21.7	 % 19.5	 % 21.9

(1) Represent expenses directly associated with the opening of new restaurants that are incurred prior to opening, including pre-opening rent.

Adjusted EBITDA

EBITDA is defined as net income before interest, income taxes and depreciation and amortization.

We define Adjusted EBITDA as EBITDA plus loss from disposal of equipment and pre-opening costs. EBITDA and Adjusted EBITDA are intended as supplemental measures of our performance that are not required by, or presented in accordance with, GAAP. We believe that EBITDA and Adjusted EBITDA provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and operating results. Our management uses EBITDA and Adjusted EBITDA (i) as a factor in evaluating management's performance when determining incentive compensation and (ii) to evaluate the effectiveness of our business strategies.

We believe that the use of EBITDA and Adjusted EBITDA provides an additional tool for investors to use in evaluating ongoing operating results and trends and in comparing the Company's financial measures with other fast casual restaurants, which may present similar non-GAAP financial measures to investors. In addition, you should be aware when evaluating EBITDA and Adjusted EBITDA that in the future we may incur expenses similar to those excluded when calculating these measures. Our presentation of these measures should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Our computation of Adjusted EBITDA may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate Adjusted EBITDA in the same fashion.

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Our management does not consider EBITDA or Adjusted EBITDA in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of EBITDA and Adjusted EBITDA is that they exclude significant expenses and income that are required by GAAP to be recorded in the Company's financial statements. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debts;

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;

- Adjusted EBITDA does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing operations; and

- other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, EBITDA and Adjusted EBITDA should not be considered in isolation or as a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA and Adjusted EBITDA only supplementally. You should review the reconciliation of net income to EBITDA and Adjusted EBITDA below and not rely on any single financial measure to evaluate our business.

The following table reconciles net income to EBITDA and Adjusted EBITDA:

	Twelve Weeks Ended		Twenty-eight Weeks Ended	
	July 10, 2017	July 11, 2016	July 10, 2017	July 11, 2016

(Dollars in thousands)

Adjusted EBITDA:

Net income, as reported	\$579	\$ 1,201	\$598	\$2,597
Depreciation and amortization	4,511	3,665	10,052	8,157
Interest expense, net	1,018	861	2,386	1,983
Provision (benefit) for income taxes	(480)) 764	(126)) 1,109
EBITDA	5,628	6,491	12,910	13,846
Pre-opening costs ⁽¹⁾	679	552	1,246	1,292
Loss from disposal of equipment	748	100	1,007	337
Adjusted EBITDA	\$7,055	\$ 7,143	\$15,163	\$15,475

(1) Represents expenses directly associated with the opening of new restaurants that are incurred prior to opening, including pre-opening rent.

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Liquidity and Capital Resources

Summary of Cash Flows

Our primary sources of liquidity and cash flows are operating cash flows and available borrowings under our 2015 Credit Facility. We are using these sources to fund capital expenditures for new Company-owned restaurant openings, reinvest in our existing restaurants, repurchase restaurants from our franchisees, invest in infrastructure and information technology and maintain working capital. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day, or in the case of credit or debit card transactions, within several days of the related sale, and we typically have at least 20 days to pay our vendors.

We had negative working capital of \$9.9 million as of July 10, 2017 compared to negative working capital of \$6.3 million as of December 26, 2016. The increase in negative working capital resulted primarily from capital expenditures related to new store openings. We believe that cash and cash equivalents, expected cash flow from operations and available borrowings on our 2015 Credit Facility in 2017 are adequate to fund our operating lease obligations, capital expenditures and working capital obligations for the next 12 months. However, our ability to continue to meet these requirements and obligations will depend on, among other things, our ability to achieve anticipated levels of revenue and cash flow from operations and our ability to manage costs and working capital successfully.

The following table summarizes consolidated cash flow data for the periods indicated:

Twenty-eight
Weeks Ended
July 10, July 11,
2017 2016

(Dollars in
thousands)

Consolidated Statement of Cash Flows Data:

Net cash provided by operating activities	\$17,029	\$14,908
Net cash used in investing activities	(28,255)	(20,718)
Net cash provided by financing activities	10,282	1,121

Cash Flows Provided by Operating Activities

Net cash provided by operating activities increased to \$17.0 million for the twenty-eight weeks ended July 10, 2017 from \$14.9 million for the twenty-eight weeks ended July 11, 2016. Net cash provided by operating activities consists primarily of net income, adjusted for non-cash expenses such as depreciation and amortization, and the net change in operating assets and liabilities.

Net cash provided by operating activities for the twenty-eight weeks ended July 10, 2017 consisted primarily of net income adjusted for non-cash expenses and increases in accounts payable and deferred rent offset by an increase in prepaid expenses and other. The increase in accounts payable was primarily related to seasonality at stores and timing of corporate invoices. The increase in deferred rent is related to new store openings. The increase in prepaid expenses and other is primarily related to the timing of several annual corporate invoices and prepaid rent.

Cash Flows Used in Investing Activities

Net cash used in investing activities increased to \$28.3 million for the twenty-eight weeks ended July 10, 2017 from \$20.7 million for the twenty-eight weeks ended July 11, 2016. The increase was primarily due to new store openings as well as technology investments in 2017.

Cash Flows Provided by Financing Activities

Cash flows provided by financing activities increased to \$10.3 million for the twenty-eight weeks ended July 10, 2017 from \$1.1 million for the twenty-eight weeks ended July 11, 2016, primarily due to borrowings on our 2015 Credit Facility.

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Credit Facility

On February 6, 2015, we entered into the 2015 Credit Facility with Wells Fargo Bank, National Association. The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, and an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of July 10, 2017, we had \$10.0 million indebtedness under the 2015 Credit Facility. The proceeds are being used to fund capital expenditures and working capital obligations.

Off-Balance Sheet Arrangements

As of July 10, 2017, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Our discussion and analysis of operating results and financial condition are based upon our financial statements. The preparation of our financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. Our critical accounting policies are those that materially affect our financial statements and involve difficult, subjective or complex judgments by management. Although these estimates are based on management's best knowledge of current events and actions that may impact us in the future, actual results may be materially different from the estimates.

We believe our critical accounting policies are affected by significant judgments and estimates used in the preparation of our consolidated financial statements and that the judgments and estimates are reasonable. Our critical accounting policies and estimates are described in our annual consolidated financial statements and the related notes in our 2016 Form 10-K. There have been no material changes affecting our critical accounting policies and estimates for the twelve weeks ended July 10, 2017.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

We are exposed to interest rate risk through fluctuations of interest rates on our investments and debt, as applicable. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations.

Commodity Price Risk

We are exposed to commodity price risks. Many of the ingredients we use to prepare our food, as well as our packaging materials, are commodities or ingredients that are affected by the price of other commodities, exchange rates, foreign demand, weather, seasonality, production, availability and other factors outside our control. We work closely with our suppliers and use a mix of forward pricing protocols under which we agree with our supplier on fixed prices for deliveries at some time in the future, fixed pricing protocols under which we agree on a fixed price with our supplier for the duration of that protocol, and formula pricing protocols under which the prices we pay are based on a specified formula related to the prices of the goods, such as spot prices. However, a majority of the dollar value of goods purchased by us is effectively at spot prices. Generally our pricing protocols with suppliers can remain in effect for periods ranging from one to 18 months, depending on the outlook for prices of the particular ingredient. We have tried to increase, where necessary, the number of suppliers for our ingredients, which we believe can help mitigate pricing volatility, and we follow industry news, trade issues, exchange rates, weather, crises and other world events that may affect our ingredient prices. Increases in ingredient prices could adversely affect our results if we choose for competitive or other reasons not to increase menu prices at the same rate at which ingredient costs increase, or if menu price increases result in customer resistance.

Inflation

The primary inflationary factors affecting our operations are food, labor costs, energy costs and materials used in the construction of new restaurants. Increases in the minimum wage directly affect our labor costs. Many of our leases require us to pay taxes, maintenance, repairs, insurance and utilities, all of which are generally subject to inflationary increases. Finally, the cost of constructing our restaurants is subject to inflationary increases in the costs of labor and material. Over the past five years, inflation has not significantly affected our operating results.

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Item 4. Controls and Procedures

As of July 10, 2017, the Company's management carried out an evaluation with the participation of Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, were effective to provide reasonable assurance that the information we are required to file under the Exchange Act is recorded and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in internal control over financial reporting during the quarter ended July 10, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Part II - Other Information

Item 1. Legal Proceedings

Refer to Note 8, Commitments and Contingencies, of the Notes to the Unaudited Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 26, 2016.

Item 2. Unregistered Sales of Equity and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Index

Exhibit Number	Description of Exhibit
31.1	<u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1*	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* This certification is deemed not filed for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

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SIGNATURES

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

Date: August 17, 2017

ZOE'S KITCHEN, INC.

By: /s/ Kevin Miles

Name: Kevin Miles

Title: President and Chief Executive Officer

By: /s/ Sunil Doshi

Name: Sunil Doshi

Title: Chief Financial Officer