

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 23, 2020

or

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

For the transition period from _____ to _____

Commission File Number: 001-36556

EL POLLO LOCO HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

3535 Harbor Blvd., Suite 100, Costa Mesa, California
(Address of principal executive offices)

20-3563182
(I.R.S. Employer Identification No.)

92626
(Zip Code)

(714) 599-5000
(Registrant's telephone number, including area code)

N/A
(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 \$0.01 per share	LOCO	The Nasdaq Stock Market LLC

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, 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
Non-accelerated Filer Smaller Reporting Company
Emerging Growth Company

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

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

As of October 23, 2020, there were 36,446,736 shares of the issuer's common stock outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

**EL POLLO LOCO HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

(Amounts in thousands, except share data)

	September 23, 2020	December 25, 2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 29,529	\$ 8,070
Accounts and other receivables, net	10,842	8,505
Inventories	1,937	2,009
Prepaid expenses and other current assets	2,555	5,718
Income tax receivable	—	376
Total current assets	44,863	24,678
Property and equipment owned, net	80,545	91,778
Property and equipment held under finance lease, net	52	—
Property and equipment held under operating leases, net ("ROU asset")	180,781	192,395
Goodwill	248,674	248,674
Trademarks	61,888	61,888
Deferred tax assets	3,565	3,709
Other assets	1,280	1,630
Total assets	\$ 621,648	\$ 624,752
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of obligations under finance leases	\$ 50	\$ 34
Current portion of obligations under operating leases	19,847	16,406
Accounts payable	6,238	5,627
Accrued salaries and vacation	9,929	8,618
Accrued insurance	10,256	9,440
Accrued income taxes payable	1,888	—
Accrued interest	143	302
Current portion of income tax receivable agreement payable	5,160	4,935
Other accrued expenses and current liabilities	16,216	28,597
Total current liabilities	69,727	73,959
Revolver loan	83,800	97,000
Obligations under finance leases, net of current portion	94	83
Obligations under operating leases, net of current portion	182,753	197,492
Deferred taxes	1,325	1,672
Income tax receivable agreement payable, net of current portion	3,101	3,301
Other noncurrent liabilities	9,772	5,679
Total liabilities	350,572	379,186
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$0.01 par value, 200,000,000 shares authorized; 36,441,369 and 35,126,582 shares issued and outstanding	364	351
Additional paid-in-capital	338,622	330,950
Accumulated deficit	(66,969)	(85,988)
Accumulated other comprehensive (loss) income	(941)	253
Total stockholders' equity	271,076	245,566
Total liabilities and stockholders' equity	\$ 621,648	\$ 624,752

See notes to condensed consolidated financial statements (unaudited).

EL POLLO LOCO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(Amounts in thousands, except share data)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Revenue				
Company-operated restaurant revenue	\$ 97,276	\$ 99,052	\$ 277,617	\$ 296,341
Franchise revenue	7,781	7,273	21,562	21,635
Franchise advertising fee revenue	5,922	5,742	16,567	16,808
Total revenue	110,979	112,067	315,746	334,784
Cost of operations				
Food and paper cost	24,922	27,512	73,357	82,550
Labor and related expenses	28,756	29,292	83,208	88,140
Occupancy and other operating expenses	23,836	23,844	67,867	70,103
Gain on recovery of insurance proceeds, lost profits	(2,000)	—	(2,000)	—
Company restaurant expenses	75,514	80,648	222,432	240,793
General and administrative expenses	9,803	9,539	29,599	30,235
Franchise expenses	7,572	7,006	21,110	20,692
Depreciation and amortization	4,092	4,343	12,629	13,558
Loss on disposal of assets	29	35	156	213
Recovery of securities lawsuits related legal expenses and other insurance claims	—	—	(123)	(10,000)
Impairment and closed-store reserves	1,776	367	4,615	1,241
Loss on disposition of restaurants	—	11	—	5,062
Total expenses	98,786	101,949	290,418	301,794
Income from operations	12,193	10,118	25,328	32,990
Interest expense, net	770	973	2,583	2,754
Income tax receivable agreement (income) expense	(144)	(197)	26	(120)
Income before provision for income taxes	11,567	9,342	22,719	30,356
Provision for income taxes	1,647	2,940	3,700	8,954
Net income	\$ 9,920	\$ 6,402	\$ 19,019	\$ 21,402
Net income per share				
Basic	\$ 0.28	\$ 0.18	\$ 0.54	\$ 0.57
Diluted	\$ 0.28	\$ 0.18	\$ 0.53	\$ 0.56
Weighted-average shares used in computing net income per share				
Basic	35,471,452	35,859,502	34,989,007	37,484,372
Diluted	36,064,559	36,397,368	35,609,320	38,173,097

See notes to condensed consolidated financial statements (unaudited).

EL POLLO LOCO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(Amounts in thousands)

	<u>Thirteen Weeks Ended</u>		<u>Thirty-Nine Weeks Ended</u>	
	<u>September 23, 2020</u>	<u>September 25, 2019</u>	<u>September 23, 2020</u>	<u>September 25, 2019</u>
Net income	\$ 9,920	\$ 6,402	\$ 19,019	\$ 21,402
Other comprehensive income (loss)				
Changes in derivative instruments				
Unrealized net (losses) gains arising during the period from interest rate swap	(36)	171	(1,791)	171
Reclassifications of losses (gains) into net income	114	(29)	156	(29)
Income tax (expense) benefit	(20)	(38)	441	(38)
Other comprehensive income (loss), net of taxes	58	104	(1,194)	104
Comprehensive income	<u>\$ 9,978</u>	<u>\$ 6,506</u>	<u>\$ 17,825</u>	<u>\$ 21,506</u>

EL POLLO LOCO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)
(Amounts in thousands, except share data)

	Thirteen Weeks Ended September 23, 2020					
	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
	Shares	Amount				
Balance, June 24, 2020	35,854,122	\$ 359	\$ 334,088	\$ (76,889)	\$ (999)	\$ 256,559
Stock-based compensation	—	—	909	—	—	909
Issuance of common stock related to restricted stock	2,798	—	—	—	—	—
Issuance of common stock upon exercise of stock options	593,180	6	3,675	—	—	3,681
Shares repurchased for employee tax withholdings	(2,925)	—	(51)	—	—	(51)
Forfeiture of common stock related to restricted shares	(5,806)	(1)	1	—	—	—
Other comprehensive income, net of tax	—	—	—	—	58	58
Net income	—	—	—	9,920	—	9,920
Balance, September 23, 2020	<u>36,441,369</u>	<u>\$ 364</u>	<u>\$ 338,622</u>	<u>\$ (66,969)</u>	<u>\$ (941)</u>	<u>\$ 271,076</u>

	Thirteen Weeks Ended September 25, 2019					
	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balance, June 26, 2019	37,732,948	\$ 377	\$ 358,335	\$ (95,888)	\$ —	\$ 262,824
Stock-based compensation	—	—	668	—	—	668
Shares repurchased for employee tax withholdings	(4,176)	—	(46)	—	—	(46)
Forfeiture of common stock related to restricted shares	(9,160)	—	—	—	—	—
Repurchase of common stock	(2,825,896)	(28)	(29,910)	—	—	(29,938)
Other comprehensive income, net of tax	—	—	—	—	104	104
Net income	—	—	—	6,402	—	6,402
Balance, September 25, 2019	<u>34,893,716</u>	<u>\$ 349</u>	<u>\$ 329,047</u>	<u>\$ (89,486)</u>	<u>\$ 104</u>	<u>\$ 240,014</u>

	Thirty-Nine Weeks Ended September 23, 2020					
	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
Balance, December 25, 2019	35,126,582	\$ 351	\$ 330,950	\$ (85,988)	\$ 253	\$ 245,566
Stock-based compensation	—	—	2,170	—	—	2,170
Issuance of common stock related to restricted stock	439,061	4	(4)	—	—	—
Issuance of common stock upon exercise of stock options	965,736	10	5,836	—	—	5,846
Shares repurchased for employee tax withholdings	(23,118)	—	(331)	—	—	(331)
Forfeiture of common stock related to restricted shares	(66,892)	(1)	1	—	—	—
Other comprehensive loss, net of tax	—	—	—	—	(1,194)	(1,194)
Net income	—	—	—	19,019	—	19,019
Balance, September 23, 2020	<u>36,441,369</u>	<u>\$ 364</u>	<u>\$ 338,622</u>	<u>\$ (66,969)</u>	<u>\$ (941)</u>	<u>\$ 271,076</u>

	Thirty-Nine Weeks Ended September 25, 2019					
	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balance, December 26, 2018	39,009,451	\$ 390	\$ 375,734	\$ (110,888)	\$ —	\$ 265,236
Stock-based compensation	—	—	1,797	—	—	1,797
Issuance of common stock related to restricted shares	292,211	3	(3)	—	—	—
Issuance of common stock upon exercise of stock options	6,709	—	34	—	—	34
Shares repurchased for employee tax withholdings	(29,923)	(1)	(294)	—	—	(295)
Repurchase of common stock	(4,384,732)	(43)	(48,221)	—	—	(48,264)
Other comprehensive income, net of tax	—	—	—	—	104	104
Net income	—	—	—	21,402	—	21,402
Balance, September 25, 2019	<u>34,893,716</u>	<u>\$ 349</u>	<u>\$ 329,047</u>	<u>\$ (89,486)</u>	<u>\$ 104</u>	<u>\$ 240,014</u>

EL POLLO LOCO HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

El Pollo Loco Holdings, Inc. (“Holdings”) is a Delaware corporation headquartered in Costa Mesa, California. Holdings and its direct and indirect subsidiaries are collectively referred to herein as “we,” “us” or the “Company.” The Company’s activities are conducted principally through its indirect wholly-owned subsidiary, El Pollo Loco, Inc. (“EPL”), which develops, franchises, licenses, and operates quick-service restaurants under the name El Pollo Loco® and operates under one operating segment. At September 23, 2020, the Company operated 196 and franchised 282 El Pollo Loco restaurants.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the Company’s consolidated financial position and results of operations and cash flows for the periods presented. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The condensed consolidated financial statements and related notes do not include all information and footnotes required by GAAP for annual reports. This quarterly report should be read in conjunction with the consolidated financial statements included in the Company’s annual report on Form 10-K for the year ended December 25, 2019.

The Company uses a 52- or 53-week fiscal year ending on the last Wednesday of the calendar year. In a 52-week fiscal year, each quarter includes 13 weeks of operations; in a 53-week fiscal year, the first, second and third quarters each include 13 weeks of operations, and the fourth quarter includes 14 weeks of operations. Every six or seven years, a 53-week fiscal year occurs. Fiscal 2020 is a 53-week year ending on December 30, 2020, and fiscal 2019 was a 52-week year ending on December 25, 2019. Revenues, expenses, and other financial and operational figures may be elevated in a 53-week year.

Holdings has no material assets or operations. Holdings and Holdings’ direct subsidiary, EPL Intermediate, Inc. (“Intermediate”), guarantee EPL’s 2018 Revolver (as defined below) on a full and unconditional basis (see Note 4), and Intermediate has no subsidiaries other than EPL. EPL is a separate and distinct legal entity and has no obligation to make funds available to Intermediate. EPL and Intermediate may pay dividends to Intermediate and to Holdings, respectively, subject to the terms of the 2018 Revolver.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Holdings and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and revenue and expenses during the periods reported. Actual results could materially differ from those estimates. The Company’s significant estimates include estimates for impairment of goodwill, intangible assets and property and equipment, insurance reserves, lease accounting matters, stock-based compensation, income tax receivable agreement liability, contingent liabilities and income tax valuation allowances.

COVID-19

On January 30, 2020, the World Health Organization (“WHO”) announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (“COVID-19”) and the risks to the international community as the virus spreads globally beyond its point of origin. On March 11, 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally.

The COVID-19 pandemic has significantly disrupted consumer demand, as well as the Company’s restaurant operations. Following the pandemic declaration in March 2020, federal, state and local governments began to respond to the public health crisis by requiring social distancing, “stay at home” directives, and restaurant restrictions - including government-mandated dining room closures - that limited business to off-premise services only (take-out, drive-thru and delivery). Historically, approximately 20% of the Company’s sales are associated with dine-in service. In May 2020, the “stay at home” directive was modified in most areas in which the Company operates, allowing for the opening of lower-risk workplaces, including restaurants, but with restrictions such as limited capacity. However, in July a surge in the COVID-19 pandemic caused many state and local governments to re-implement certain additional restrictions to try and contain the spread of the virus. As of September 23, 2020, the majority of the Company’s restaurants were permitted to be open with limited capacity; however, while most of the Company’s markets outside of California have dining rooms open at a limited capacity, the majority of the Company’s restaurants in California are continuing to operate on a take-away, mobile pick-up and delivery basis, as well as maintaining drive-thru operations where available, in order to protect their employees and customers from the spread of the COVID-19 pandemic and to comply with the government mandates. Due to the impact of the COVID-19 pandemic, during the thirteen and thirty-nine weeks ended September 23, 2020, we temporarily closed 40 restaurants and 65 restaurants, respectively, of which all but three have reopened as of September 23, 2020. Similarly, during the thirteen and thirty-nine weeks ended September 23, 2020, franchisees temporarily closed 15 restaurants and 36 restaurants, respectively, of which all but three have reopened as of September 23, 2020. As of September 23, 2020, the Company had not permanently closed any restaurants due to the COVID-19 pandemic.

The full impact of the COVID-19 outbreak continues to evolve as of the date of this report. Management has taken precautionary actions, such as initially drawing on its 2018 Revolver, which has since been paid down (see Note 4), temporarily suspending all but essential capital spending and share repurchase activity, reevaluating essential support center general and administrative expenses and fine-tuning its restaurant labor model based on indoor dining room restrictions, limited dining room capacity in restaurants located in geographies where indoor dining is permitted, dining room closures and fluctuating sales volumes. Additionally, management delayed making April, May and June rent payments on the majority of its leased properties and has reached agreements for rent abatement and/or deferment with the Company’s landlords for those properties. See Note 5 “Other Accrued Expenses and Current Liabilities” and Note 6 “Other Noncurrent Liabilities” for details of these balances. For our franchisees, we deferred 50% of their April royalties until July 1, 2020, when such royalties began to be repaid in even monthly installments over the remainder of fiscal 2020. In addition, we deferred 100% of our franchisees’ 2020 remodel and new restaurant build requirements until 2021. Management is continually evaluating the impact of the global crisis on its financial condition, liquidity, operations, suppliers, industry, and workforce and will take additional actions as necessary. The disruption in operations led to the Company considering the impact of the COVID-19 pandemic on its liquidity, debt covenant compliance, and recoverability of long-lived and ROU assets, goodwill and intangible assets, among others. If these disruptions to the Company’s operations from the COVID-19 pandemic continue or worsen, they may have a material negative impact on the Company’s consolidated financial condition, future results of operations and liquidity. The extent of such negative impact will depend, in part, on the longevity and severity of the COVID-19 pandemic.

Due to the rapid development and fluidity of this situation, the Company cannot determine the ultimate impact that the COVID-19 pandemic will have on the Company’s consolidated financial condition, liquidity, and future results of operations, and therefore any prediction as to the ultimate materiality of the adverse impact on the Company’s consolidated financial condition, liquidity, and future results of operations is uncertain.

Subsequent Events

Subsequent to September 23, 2020, the Company has temporarily closed eight restaurants, typically for one to three days, and franchisees have not temporarily closed any restaurants. As of October 29, 2020, two company-operated and three franchise locations remained closed.

Subsequent to September 23, 2020, the Company made a voluntary \$28.0 million pre-payment on its 2018 Revolver. As of October 30, 2020, the Company had \$55.8 million in outstanding borrowings under the 2018 Revolver and \$85.8 million in borrowing availability.

The Company has evaluated subsequent events that have occurred after September 23, 2020, and determined that there were no other events or transactions occurring during this reporting period that require recognition or disclosure in the condensed consolidated financial statements.

Cash and Cash Equivalents

The Company considers all highly-liquid instruments with an original maturity of three months or less at the date of purchase to be cash equivalents.

Liquidity

The Company's principal liquidity and capital requirements are new restaurants, existing restaurant capital investments (remodels and maintenance), interest payments on our debt, lease obligations and working capital and general corporate needs. At September 23, 2020, the Company's total debt was \$83.8 million. The Company's ability to make payments on its indebtedness and to fund planned capital expenditures depends on available cash and its ability to generate adequate cash flows in the future, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory, and other factors that are beyond the Company's control. Based on current operations, the Company believes that its cash flow from operations and available cash of \$29.5 million at September 23, 2020 will be adequate to meet the Company's liquidity needs for the next twelve months from the date of filing of these condensed consolidated financial statements. However, depending on the severity and longevity of the COVID-19 pandemic, the Company's financial performance and liquidity could be further impacted and could impact the Company's ability to meet certain covenants required in its 2018 Credit Agreement (as defined below), specifically the lease-adjusted coverage ratio and fixed-charge coverage ratio.

Gain on Recovery of Insurance Proceeds, Lost Profits

During the thirteen and thirty-nine weeks ended September 23, 2020, the Company received business interruption insurance proceeds of \$2.0 million, primarily related to restaurant sales losses and expenses related to the COVID-19 pandemic and resulting dining room closures.

Recovery of Securities Class Action Legal Expenses and Other Insurance Claims

During the thirty-nine weeks ended September 23, 2020, the Company received insurance proceeds of \$0.1 million related to a property claim. During the thirty-nine weeks ended September 25, 2019, the Company received insurance proceeds of \$10.0 million related to the settlement of a securities class action lawsuit. See Note 7, "Commitments and Contingencies, Legal Matters."

Loss on Disposition of Restaurants

During the thirty-nine weeks ended September 25, 2019, the Company completed the sale of four company-operated restaurants within the San Francisco area to an existing franchisee and seven company-operated restaurants in the Phoenix area to another existing franchisee. The Company determined that these restaurant dispositions represent multiple element arrangements, and as a result, the cash consideration received was allocated to the separate elements based on their relative standalone selling price. Cash proceeds included upfront consideration for the sale of the restaurants and franchise fees, as well as future cash consideration for royalties and lease payments. The Company considered the future lease payments in allocating the initial cash consideration received. The cash consideration per restaurant for franchise fees is consistent with the amounts stated in the related franchise agreements, which are charged for separate standalone arrangements. The Company initially defers and subsequently recognizes the franchise fees over the term of the franchise agreement. Future royalty income is also recognized in revenue as earned.

These sales resulted in cash proceeds of \$4.8 million and a net loss on sale of restaurants of \$5.1 million for the thirty-nine weeks ended September 25, 2019. These restaurants have been included in the total number of franchised El Pollo Loco restaurants since completion of their sales.

Recently Adopted Accounting Pronouncements

In March 2020, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting," which provides optional guidance, for a limited time, to ease the potential burden in accounting for or recognizing the effects of reference rate reform on financial reporting. ASU 2020-04 is effective for a limited time, from March 12, 2020, through December 31, 2022. The Company adopted this ASU on March 12, 2020. The adoption of ASU 2020-04 did not have a significant impact on the Company's consolidated financial position or results of operations.

In February 2018, the FASB issued ASU No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement," which finalizes proposed ASU No. 2015-350, and of the same name as part of its disclosure framework project, which focuses on improving the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by U.S. GAAP that is most important to users of each entity's financial statements. The Company adopted ASU No. 2018-13 during the first quarter of 2020. The adoption of ASU 2018-13 did not have a significant impact on the Company's consolidated financial position or results of operations.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which finalizes proposed ASU No. 2012-260 "Financial Instruments—Credit Losses (Subtopic 825-15)" and adds Topic 326 "Financial Instruments—Credit Losses", to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The Company adopted ASU No. 2016-13 during the first quarter of 2020. The adoption of ASU 2016-03 did not have a significant impact on the Company's consolidated financial position or results of operations.

Recent Accounting Pronouncements Not Yet Adopted

In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes", which modifies Topic 740 to simplify the accounting for income taxes. ASU 2019-12 is effective for financial statements issued for annual periods beginning after December 15, 2020, and for the interim periods therein. The adoption of ASU 2019-12 is not expected to have a significant impact on the Company's consolidated financial position or results of operations.

Concentration of Risk

Cash and cash equivalents are maintained at financial institutions and, at times, these balances may exceed federally-insured limits. The Company has never experienced any losses related to these balances.

The Company had no supplier to whom amounts due totaled more than 10% of the Company's accounts payable at September 23, 2020. At December 25, 2019, the Company had one supplier to whom amounts due totaled 11.7% of the Company's accounts payable. Purchases from the Company's largest supplier totaled 26.7% and 26.8% of total expenses for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, and 29.0% and 28.9% of total expenses for the thirteen and thirty-nine weeks ended September 25, 2019.

Company-operated and franchised restaurants in the greater Los Angeles area generated, in the aggregate, approximately 71.2% and 71.5% of total revenue for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, and 71.5% and 70.0% for the thirteen and thirty-nine weeks ended September 25, 2019.

Goodwill and Indefinite Lived Intangible Assets

The Company's indefinite-lived intangible assets consist of trademarks. Goodwill represents the excess of cost over fair value of net identified assets acquired in business combinations accounted for under the purchase method. The Company does not amortize its goodwill and indefinite-lived intangible assets. Goodwill resulted from the acquisition of certain franchise locations.

Upon the sale or closure of a restaurant, the Company evaluates whether there is a decrement of goodwill. The amount of goodwill included in the cost basis of the asset sold is determined based on the relative fair value of the portion of the reporting unit disposed of compared to the fair value of the reporting unit retained. The Company determined there was no decrement of goodwill related to the disposition of restaurants during the thirteen and thirty-nine weeks ended September 25, 2019.

The Company performs an annual impairment test for goodwill during the fourth fiscal quarter of each year, or more frequently if impairment indicators arise.

The Company reviews goodwill for impairment utilizing either a qualitative assessment or a fair value test by comparing the fair value of a reporting unit with its carrying amount. If the Company decides that it is appropriate to perform a qualitative assessment and concludes that the fair value of a reporting unit more likely than not exceeds its carrying value, no further evaluation is necessary. If the Company performs the fair value test, the Company will compare the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, the Company will recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit.

The Company performs an annual impairment test for indefinite-lived intangible assets during the fourth fiscal quarter of each year, or more frequently if impairment indicators arise. An impairment test consists of either a qualitative assessment or a comparison of the fair value of an intangible asset with its carrying amount. The excess of the carrying amount of an intangible asset over its fair value is recognized as an impairment loss.

The assumptions used in the estimate of fair value are generally consistent with the past performance of the Company's reporting segment and are also consistent with the projections and assumptions that are used in current operating plans. These assumptions are subject to change as a result of changing economic and competitive conditions.

Due to the recent impact of the COVID-19 pandemic to the global economy, including but not limited to, the volatility of the Company's stock price as well as that of its competitors and the challenging environment for the restaurant industry generally, the Company determined that there were indicators of potential impairment of its goodwill and indefinite-lived intangible assets during the thirteen and thirty-nine weeks ended September 23, 2020. As such, the Company performed an impairment assessment for both goodwill and indefinite-lived intangible assets and concluded that the fair value of these assets substantially exceeded their carrying values. Accordingly, the Company did not record any impairment to its goodwill or indefinite-lived intangible assets during the thirteen and thirty-nine weeks ended September 23, 2020. The ultimate severity and longevity of the COVID-19 pandemic is unknown, and therefore, it is possible that impairments could be identified in future periods, and such amounts could be material.

Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

- Level 1: Quoted prices for identical instruments in active markets.
- Level 2: Observable prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs or significant value drivers are observable.

- Level 3: Unobservable inputs used when little or no market data is available.

During fiscal 2019, the Company entered into an interest rate swap, which is required to be measured at fair value on a recurring basis. The fair value was determined based on Level 2 inputs, which include valuation models, as reported by the Company's counterparty. These valuation models use a discounted cash flow analysis on the cash flows of the derivative based on the terms of the contract and the forward yield curves adjusted for the Company's credit risk. The key inputs for the valuation models are observable market prices, discount rates, and forward yield curves. See Note 4. "Long-Term Debt" for further discussion regarding our interest rate swaps. The following table presents fair value for the interest rate swap at September 23, 2020 (in thousands):

	Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Other non-current liabilities - Interest rate swap	\$ 1,328	\$ —	\$ 1,328	\$ —

The following table presents fair value for the interest rate swap at December 25, 2019 (in thousands):

	Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Other assets - Interest rate swap	\$ 360	\$ —	\$ 360	\$ —

Certain assets and liabilities are measured at fair value on a nonrecurring basis. In other words, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments only in certain circumstances (e.g. when there is evidence of impairment).

The following non-financial instruments were measured at fair value, on a nonrecurring basis, as of and for the thirteen and thirty-nine weeks ended September 23, 2020, reflecting certain property and equipment assets and right-of-use ("ROU") assets, for which an impairment loss was recognized during the corresponding periods, as discussed immediately below under "Impairment of Long-Lived Assets and ROU Assets." (in thousands):

	Total	Fair Value Measurements at September 23, 2020 Using			Thirteen Weeks	Thirty-Nine Weeks
		Level 1	Level 2	Level 3	Ended September 23, 2020	Ended September 23, 2020
					Impairment Losses	Impairment Losses
Certain property and equipment owned, net	\$ —	\$ —	\$ —	\$ —	\$ 1,506	\$ 2,935
Certain ROU assets, net	\$ 911	\$ —	\$ —	\$ 911	\$ —	\$ 543

The following non-financial instruments were measured at fair value on a nonrecurring basis as of and for the thirteen and thirty-nine weeks ended September 25, 2019, reflecting certain property and equipment assets for which an impairment loss was recognized during the corresponding periods, as discussed immediately below under "Impairment of Long-Lived Assets and ROU Assets" (in thousands):

	Total	Fair Value Measurements at September 25, 2019 Using			Thirteen Weeks	Thirty-Nine Weeks
		Level 1	Level 2	Level 3	Ended September 25, 2019	Ended September 25, 2019
					Impairment Losses	Impairment Losses
Certain property and equipment owned, net	\$ —	\$ —	\$ —	\$ —	\$ 56	\$ 283

Impairment of Long-Lived Assets and ROU Assets

The Company reviews its long-lived and ROU assets for impairment on a restaurant-by-restaurant basis whenever events or changes in circumstances indicate that the carrying value of certain long-lived and ROU assets may not be recoverable. The Company considers a triggering event related to long-lived assets or ROU assets in a net asset position to have occurred related to a specific restaurant if the restaurant's cash flows for the last twelve months are less than a minimum threshold or if consistent levels of undiscounted cash flows for the remaining lease period are less than the

carrying value of the restaurant's assets. Additionally, the Company considers a triggering event related to ROU assets to have occurred related to a specific lease if the location has been subleased and future estimated sublease income is less than lease payments under the head lease. If the Company concludes that the carrying value of certain long-lived and ROU assets will not be recovered based on expected undiscounted future cash flows, an impairment loss is recorded to reduce the long-lived or ROU assets to their estimated fair value. The fair value is measured on a nonrecurring basis using unobservable (Level 3) inputs. There is uncertainty in the projected undiscounted future cash flows used in the Company's impairment review analysis, which requires the use of estimates and assumptions. If actual performance does not achieve the projections, or if the assumptions used change in the future, the Company may be required to recognize impairment charges in future periods, and such charges could be material. The Company determined that triggering events occurred during each of the thirteen and thirty-nine weeks ended September 23, 2020 that required an impairment review of the Company's long-lived and ROU assets. Based on the results of the analysis, the Company recorded non-cash impairment charges of \$1.5 million and \$3.5 million for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, primarily related to the carrying value of the ROU assets of one restaurant in Texas and the long-lived assets of four restaurants in California.

The Company recorded a non-cash impairment charge of \$0.1 million and \$0.3 million for the thirteen and thirty-nine weeks ended September 25, 2019, respectively, primarily related to the carrying value of one restaurant in California. Given the inherent uncertainty in projecting results for newer restaurants in newer markets, as well as the impact of the COVID-19 pandemic, the Company is monitoring the recoverability of the carrying value of the assets of several restaurants on an ongoing basis. For these restaurants, if expected performance is not realized, an impairment charge may be recognized in future periods, and such charge could be material.

Closed-Store Reserves

When a restaurant is closed, the Company will evaluate the ROU asset for impairment, based on anticipated sublease recoveries. The remaining value of the ROU asset is amortized on a straight-line basis, with the expense recognized in closed-store reserve expense. Additionally, any property tax and common area maintenance ("CAM") payments relating to closed restaurants are included within closed-store expense. During the thirteen and thirty-nine weeks ended September 23, 2020, the Company recognized \$0.3 million and \$1.1 million of closed-store reserve expense related to the amortization of ROU assets, property taxes and CAM payments for its closed locations. During the thirty-nine weeks ended September 25, 2019, the Company closed one restaurant in California and one restaurant in Texas, and recognized \$0.3 million and \$1.0 million of closed-store reserve expense for the thirteen and thirty-nine weeks ended September 25, 2019, respectively, primarily related to the amortization of ROU assets, property taxes and CAM payments for its closed locations.

Derivative Financial Instruments

The Company uses an interest rate swap, a derivative instrument, to hedge interest rate risk and not for trading purposes. The derivative contract is entered into with a financial institution.

The Company records the derivative instrument on its condensed consolidated balance sheets at fair value. The derivative instrument qualifies as a hedging instrument in a qualifying cash flow hedge relationship, and the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive (loss) income ("AOCI") and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. For any derivative instruments not designated as hedging instruments, the gain or loss will be recognized in earnings immediately. If a derivative previously designated as a hedge is terminated, or no longer meets the qualifications for hedge accounting, any balances in AOCI will be reclassified to earnings immediately.

As a result of the use of an interest rate swap, the Company is exposed to risk that the counterparty will fail to meet their contractual obligations. To mitigate the counterparty credit risk, the Company will only enter into contracts with major financial institutions, based upon their credit ratings and other factors, and will continue to assess the creditworthiness of the counterparty. As of September 23, 2020, the counterparty to the Company's interest rate swap has performed in accordance with its contractual obligation.

Income Taxes

The provision for income taxes, income taxes payable and deferred income taxes is determined using the asset and liability method. Deferred tax assets and liabilities are determined based on temporary differences between the financial carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the temporary differences are expected to reverse. On a periodic basis, the Company assesses the probability that its net deferred tax assets, if any, will be recovered. If, after evaluating all of the positive and negative evidence, a conclusion is made that it is more likely than not that some portion or all of the net deferred tax assets will not be recovered, a valuation allowance is provided by charging to tax expense to reserve the portion of deferred tax assets which are not expected to be realized.

The Company reviews its filing positions for all open tax years in all U.S. federal and state jurisdictions where the Company is required to file.

When there are uncertainties related to potential income tax benefits, in order to qualify for recognition, the position the Company takes has to have at least a "more likely than not" chance of being sustained (based on the position's technical merits) upon challenge by the respective authorities. The term "more likely than not" means a likelihood of more than 50 percent. Otherwise, the Company may not recognize any of the potential tax benefit associated with the position. The Company recognizes a benefit for a tax position that meets the "more likely than not" criterion at the largest amount of tax benefit that is greater than 50 percent likely of being realized upon its effective resolution. Unrecognized tax benefits involve management's judgment regarding the likelihood of the benefit being sustained. The final resolution of uncertain tax positions could result in adjustments to recorded amounts and may affect the Company's consolidated financial position, results of operations, and cash flows.

The Company's policy is to recognize interest and penalties related to income tax matters in income tax expense. The Company had no accrual for interest or penalties at September 23, 2020 or at December 25, 2019. During the thirteen and thirty-nine weeks ended September 23, 2020 the Company recognized interest of \$0.1 million related to the Notice of Proposed Adjustment ("NOPA"), discussed below. The Company did not recognize interest or penalties during the thirteen and thirty-nine weeks ended September 25, 2019, since there were no material unrecognized tax benefits. Management believes no material changes to the amount of unrecognized tax benefits will occur within the next twelve months.

On July 30, 2014, the Company entered into the income tax receivable agreement (the "TRA"), which calls for the Company to pay to its pre-IPO stockholders 85% of the savings in cash that the Company realizes in its income taxes as a result of utilizing its net operating losses and other tax attributes attributable to preceding periods. For the thirteen and thirty-nine weeks ended September 23, 2020, the Company recorded income tax receivable agreement income of \$0.1 million and income tax receivable expense of less than \$0.1 million, respectively, and for the thirteen and thirty-nine weeks ended September 25, 2019, the Company recorded income tax receivable agreement income of \$0.2 million and \$0.1 million, respectively, related to the amortization of interest expense related to our total expected TRA payments and changes in estimates for actual tax returns filed and future forecasted taxable income.

On March 27, 2020, President Trump signed into a law a stimulus package, the Coronavirus Aid, Relief and Economic Security ("CARES") Act, which contains several tax provisions and deferral of employer Social Security taxes that are otherwise owed for wage payments. The tax provisions include a correction of a previous drafting error related to quality improvement property ("QIP") and immediate refundability of all remaining alternative minimum tax ("AMT") credits. The new provisions did not have a material impact on the Company's condensed consolidated financial statements.

During the thirty-nine weeks ended September 23, 2020, the Company received a NOPA for the years ended December 27, 2017 and December 28, 2016, related to the Company's methodology regarding its ordering of utilization of AMT net operating losses ("NOL"). This resulted in payment of \$0.4 million, and the audit is closed. As a result of the CARES Act, discussed above, this amount is immediately refundable upon filing of a Form 1139, which the Company filed during the thirty-nine weeks ended September 23, 2020 and recognized a receivable, included in Accounts and other receivables within the condensed consolidated balance sheet as of September 23, 2020.

2. PROPERTY AND EQUIPMENT

The costs and related accumulated depreciation and amortization of major classes of property and equipment are as follows (in thousands):

	September 23, 2020	December 25, 2019
Land	\$ 12,323	\$ 12,323
Buildings and improvements	147,413	144,794
Other property and equipment	76,142	75,234
Construction in progress	2,120	4,213
	<u>237,998</u>	<u>236,564</u>
Less: accumulated depreciation and amortization	(157,453)	(144,786)
	<u>\$ 80,545</u>	<u>\$ 91,778</u>

Depreciation expense was \$4.1 million and \$4.3 million for the thirteen weeks ended September 23, 2020 and September 25, 2019, respectively, and \$12.6 million and \$13.6 million for the thirty-nine weeks September 23, 2020 and September 25, 2019, respectively.

Based on the Company's review of its long-lived assets for impairment, the Company recorded non-cash impairment charges of \$1.5 million and \$2.9 million for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, primarily related to the carrying value of the assets of four restaurants in California. During the thirteen and thirty-nine weeks ended September 25, 2019, the Company recorded non-cash impairment charges of \$0.1 million and \$0.3 million, respectively, primarily related to the carrying value of one restaurant in California. Depending on the severity and longevity of the COVID-19 pandemic, the Company's financial performance could be further impacted and it is possible that material impairments could be identified in future periods. See "Impairment of Long-Lived Assets and ROU Assets" in Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" for additional information.

3. STOCK-BASED COMPENSATION

At September 23, 2020, options to purchase 1,035,866 shares of common stock were outstanding, including 689,166 vested and 346,700 unvested. Unvested options vest over time; however, upon a change in control, the Board of Directors may accelerate vesting. At September 23, 2020, 303,786 premium options, options granted above the stock price at date of grant, remained outstanding. A summary of stock option activity as of September 23, 2020 and changes during the thirty-nine weeks ended September 23, 2020 is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding - December 25, 2019	2,077,570	\$ 8.14
Exercised	(965,736)	6.05
Forfeited, cancelled or expired	(75,968)	12.14
Outstanding - September 23, 2020	1,035,866	\$ 9.79
Vested and expected to vest at September 23, 2020	<u>1,030,329</u>	<u>\$ 9.78</u>
Exercisable at September 23, 2020	<u>689,166</u>	<u>\$ 8.98</u>

At September 23, 2020, the Company had total unrecognized compensation expense of \$1.1 million related to unvested stock options, which it expects to recognize over a weighted-average period of 2.23 years.

A summary of restricted share activity as of September 23, 2020 and changes during the thirty-nine weeks ended September 23, 2020 is as follows:

	Shares	Weighted-Average Fair Value
Unvested shares at December 25, 2019	588,008	\$ 11.23
Granted	415,022	\$ 12.50
Released	(154,620)	\$ 11.68
Forfeited, cancelled, or expired	(79,303)	\$ 12.20
Unvested shares at September 23, 2020	<u>769,107</u>	<u>\$ 11.72</u>

Unvested shares at September 23, 2020, included 684,971 unvested restricted shares, 36,058 unvested performance stock units and 48,078 unvested restricted units.

At September 23, 2020, the Company had unrecognized compensation expense of \$7.3 million related to unvested restricted shares, which it expects to recognize over a weighted-average period of 3.01 years, unrecognized compensation expense of \$0.1 million related to performance stock units, which it expects to recognize over a weighted-average period of 2.62 years and unrecognized compensation expense of \$0.4 million related to unvested restricted units, which it expects to recognize over a weighted-average period of 1.62 years.

Total stock-based compensation expense was \$0.9 million and \$2.2 million for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, and \$0.7 million and \$1.8 million for the thirteen and thirty-nine weeks ended September 25, 2019, respectively.

4. LONG-TERM DEBT

On July 13, 2018, the Company refinanced a credit agreement with Bank of America, N.A., initially entered into on December 11, 2014 (the "2014 Revolver"), pursuant to a credit agreement (the "2018 Credit Agreement") among EPL, as borrower, and the Company and Intermediate, as guarantors, Bank of America, N.A., as administrative agent, swingline lender, and letter of credit issuer, the lenders party thereto, and the other parties thereto, which provides for a \$150.0 million five-year senior secured revolving credit facility (the "2018 Revolver"). The 2018 Revolver includes a sub limit of \$15.0 million for letters of credit and a sub limit of \$15.0 million for swingline loans. The 2018 Revolver and 2018 Credit Agreement will mature on July 13, 2023. The obligations under the 2018 Credit Agreement and related loan documents are guaranteed by the Company and Intermediate. The obligations of the Company, EPL and Intermediate under the 2018 Credit Agreement and related loan documents are secured by a first priority lien on substantially all of their respective assets.

Under the 2018 Revolver, Holdings may not make certain payments such as cash dividends, except that it may, inter alia, (i) pay up to \$1.0 million per year to repurchase or redeem qualified equity interests of Holdings held by past or present officers, directors, or employees (or their estates) of the Company upon death, disability, or termination of employment, (ii) pay under its TRA, and (iii) so long as no default or event of default has occurred and is continuing, (a) make non-cash repurchases of equity interests in connection with the exercise of stock options by directors, officers and management, provided that those equity interests represent a portion of the consideration of the exercise price of those stock options, (b) pay up to \$0.5 million in any 12 month consecutive period to redeem, repurchase or otherwise acquire equity interests of any subsidiary that is not a wholly-owned subsidiary from any holder of equity interest in such subsidiary, (c) pay up to \$2.5 million per year pursuant to stock option plans, employment agreements, or incentive plans, (d) make up to \$5.0 million in other restricted payments per year, and (e) make other restricted payments, subject to its compliance, on a pro forma basis, with (x) a lease-adjusted consolidated leverage ratio not to exceed 4.25 times and (y) the financial covenants applicable to the 2018 Revolver.

Borrowings under the 2018 Credit Agreement (other than any swingline loans) bear interest, at the borrower's option, at rates based upon either LIBOR or a base rate, plus, for each rate, a margin determined in accordance with a lease-adjusted consolidated leverage ratio-based pricing grid. The base rate is calculated as the highest of (a) the federal funds rate plus 0.50%, (b) the published Bank of America prime rate, or (c) LIBOR plus 1.00%. For LIBOR loans, the margin is in the range of 1.25% to 2.25%, and for base rate loans the margin is in a range of 0.25% to 1.25%. Borrowings under the 2018 Revolver may be repaid and reborrowed. The interest rate range was 1.67% to 1.68% and 1.67% to 3.29% for

the thirteen and thirty-nine weeks ended September 23, 2020, respectively, and 3.65% to 3.90% and 3.65% to 6.00% for the thirteen and thirty-nine weeks ended September 25, 2019, respectively.

The 2018 Credit Agreement contains certain financial covenants. The Company was in compliance with the financial covenants as of September 23, 2020. However, depending on the severity and longevity of the COVID-19 pandemic, the Company's financial performance and liquidity could be further impacted and could impact the Company's ability to comply with certain financial covenants required in the 2018 Credit Agreement, specifically the lease-adjusted coverage ratio and fixed-charge coverage ratio.

At September 23, 2020, \$8.4 million of letters of credit and \$83.8 million in borrowings under the 2018 Revolver were outstanding. The Company had \$57.8 million in borrowing availability under the 2018 Revolver at September 23, 2020.

Maturities

During the thirteen weeks ended September 23, 2020, the Company elected to pay down \$55.0 million on its 2018 Revolver. During the thirty-nine weeks ended September 23, 2020, the Company paid down \$13.2 million, net of borrowings of \$52.5 million on its 2018 Revolver. During the thirteen and thirty-nine weeks ended September 25, 2019, the Company borrowed \$16.0 million and \$27.0 million, respectively, net of pay downs of \$15.0 million during the thirty-nine week period, on the Company's 2018 Revolver, primarily to fund settlement payments. There are no required principal payments prior to maturity for the 2018 Revolver. See "Subsequent Events" in Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" for information regarding a \$28.0 million pre-payment on the 2018 Revolver subsequent to September 23, 2020.

Interest Rate Swap

During the year ended December 25, 2019, the Company entered into a variable-to-fixed interest rate swap agreement with a notional amount of \$40.0 million that matures in June 2023. The objective of the interest rate swap was to reduce the Company's exposure to interest rate risk for a portion of its variable-rate interest payments on its borrowings under the 2018 Revolver. Under the terms of the swap agreement, the variable LIBOR-based component of interest payments was converted to a fixed rate of 1.31%, plus applicable margin, which is currently 1.5%. The interest rate swap was designated as a cash flow hedge, as the changes in the future cash flows of the swap were expected to offset changes in expected future interest payments on the related variable-rate debt, in accordance with ASC 815 "Derivatives and Hedging."

The changes in the fair value of the interest rate swap are not included in earnings, but are included in other comprehensive (loss) income ("OCI"). These changes in fair value are subsequently reclassified into net earnings as a component of interest expense as the hedged interest payments are made on the variable rate borrowings.

For the thirteen and thirty-nine weeks ended September 23, 2020, the swap was a highly effective cash flow hedge.

As of September 23, 2020, the estimated net loss included in AOCI related to the Company's cash flow hedge that will be reclassified into earnings in the next 12 months is \$0.5 million, based on current LIBOR interest rates.

The following table shows the financial statement line item and amount of the Company's cash flow hedge accounting on the condensed consolidated balance sheets (in thousands):

	September 23, 2020		December 25, 2019	
	Notional	Fair value	Notional	Fair value
Other assets - Interest rate swap	—	—	\$ 40,000	\$ 360
Other liabilities - Interest rate swap	\$ 40,000	\$ 1,328	—	—

The following table summarizes the effect of the Company's cash flow hedge accounting on the condensed consolidated statements of income (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Interest expense on hedged portion of debt	\$ 169	122	\$ 810	122
Interest expense (income) on interest rate swap	114	(29)	156	(29)
Interest expense on debt and derivatives, net	<u>\$ 283</u>	<u>\$ 93</u>	<u>\$ 966</u>	<u>\$ 93</u>

The following table summarizes the effect of the Company's cash flow hedge accounting on AOCI for the thirteen and thirty-nine weeks ended September 23, 2020 and September 25, 2019 (in thousands):

	Thirteen Weeks Ended				Thirty-Nine Weeks Ended			
	Net (Loss) Gain Recognized in OCI		Loss (Gain) Reclassified from AOCI into Interest expense		Net (Loss) Gain Recognized in OCI		Loss (Gain) Reclassified from AOCI into Interest expense	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Interest rate swap	\$ (36)	171	\$ 114	(29)	\$ (1,791)	171	\$ 156	(29)

See Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" for information about the fair value of the Company's derivative asset.

5. OTHER ACCRUED EXPENSES AND CURRENT LIABILITIES

Other accrued expenses and current liabilities consist of the following (in thousands):

	September 23, 2020	December 25, 2019
Accrued sales and property taxes	\$ 5,774	\$ 4,665
Gift card liability	2,764	3,006
Accrued legal settlements and professional fees	562	16,901
Deferred franchise and development fees	534	705
Current portion of lease payment deferrals	2,277	—
Other	4,305	3,320
Total other accrued expenses and current liabilities	<u>\$ 16,216</u>	<u>\$ 28,597</u>

6. OTHER NONCURRENT LIABILITIES

Other noncurrent liabilities consist of the following (in thousands):

	September 23, 2020	December 25, 2019
Deferred franchise and development fees	\$ 4,893	\$ 5,612
Derivative liability	1,288	—
Lease payment deferrals - net of current portion	378	—
Employer social security tax deferral	3,029	—
Other	184	67
Total other noncurrent liabilities	<u>\$ 9,772</u>	<u>\$ 5,679</u>

7. COMMITMENTS AND CONTINGENCIES

Legal Matters

On or about February 24, 2014, a former employee filed a class action in the Superior Court of the State of California, County of Orange, under the caption Elliott Olvera, et al v. El Pollo Loco, Inc., et al (Case No. 30-2014-00707367-CU-OE-CXC) on behalf of all putative class members (all hourly employees from 2010 to the present) alleging certain violations of California labor laws, including failure to pay overtime compensation, failure to provide meal periods and rest breaks, and failure to provide itemized wage statements. The putative lead plaintiff's requested remedies include compensatory and punitive damages, injunctive relief, disgorgement of profits, and reasonable attorneys' fees and costs. No specific amount of damages sought was specified in the complaint. The court recently certified two classes of plaintiffs - one class encompasses restaurant employees who were not provided proper rest breaks because they were not allowed to leave the premises during their breaks and the other class encompasses restaurant employees who were required to wait at the restaurant after they finished working for the night until the manager set the alarm for safety purposes. The parties reached a settlement in principle on January 24, 2019 of all claims brought on behalf of the 32,000+ putative class members in the Olvera, as well as all claims for failure to pay overtime compensation, failure to provide meal periods and rest breaks, and failure to provide itemized wage statements brought in the class actions captioned Martha Perez v. El Pollo Loco, Inc. (Los Angeles Superior Court Case No. BC624001), Maria Vega, et al. v. El Pollo Loco, Inc. (Los Angeles Superior Court Case No. BC649719), and Gonzalez v. El Pollo Loco, Inc. (Los Angeles Superior Court Case No. BC712867). The settlement reached in principle in the Olvera, Perez, Vega, and Gonzalez actions resolves all potential claims from April 12, 2010 through April 1, 2019 that El Pollo Loco restaurant employees may have against El Pollo Loco for failure to pay for all compensation owed, failure to pay overtime compensation, failure to provide meal periods and rest breaks and failure to provide itemized wage statements, among other wage and hour related claims. A \$16.3 million accrual of an expected settlement amount related to this matter was recorded as of December 26, 2018, and the court formally approved the settlement on January 31, 2020. The settlement payment was made on February 28, 2020. Purported class actions alleging wage and hour violations are commonly filed against California employers. The Company fully expects to have to defend against similar lawsuits in the future.

Daniel Turocy, et al. v. El Pollo Loco Holdings, Inc., et al. (Case No. 8:15-cv-01343) was filed in the United States District Court for the Central District of California on August 24, 2015, and Ron Huston, et al. v. El Pollo Loco Holdings, Inc., et al. (Case No. 8:15-cv-01710) was filed in the United States District Court for the Central District of California on October 22, 2015. The two lawsuits have been consolidated, with co-lead plaintiffs and class counsel. A consolidated complaint was filed on January 29, 2016, on behalf of co-lead plaintiffs and others similarly situated, alleging violations of federal securities laws in connection with Holdings common stock purchased or otherwise acquired and the purchase of call options or the sale of put options, between May 1, 2015 and August 13, 2015 (the "Class Period"). The named defendants are Holdings; Stephen J. Sather, Laurance Roberts, and Edward J. Valle (collectively, the "Individual Defendants"); and Trimaran Pollo Partners, LLC, Trimaran Capital Partners, and Freeman Spogli & Co. (collectively, the "Controlling Shareholder Defendants"). Among other things, Plaintiffs allege that, in 2014 and early 2015, Holdings suffered losses due to rising labor costs in California and, in an attempt to mitigate the effects of such rising costs, removed a \$5 value option from the Company's menu, which resulted in a decrease in traffic from value-conscious consumers. Plaintiffs further allege that during the Class Period, Holdings and the Individual Defendants made a series of materially false and misleading statements that concealed the effect that these factors were having on store sales growth, resulting in Holdings stock continuing to be traded at artificially inflated prices. As a result, Plaintiffs and other members of the putative class allegedly suffered damages in connection with their purchase of Holdings' stock during the Class Period. In addition, Plaintiffs allege that the Individual Defendants and Controlling Shareholder Defendants had direct involvement in, and responsibility over, the operations of Holdings, and are presumed to have had, among other things, the power to control or influence the transactions giving rise to the alleged securities law violations. In both cases, Plaintiffs seek an unspecified amount of damages, as well as costs and expenses (including attorneys' fees).

On July 25, 2016, the Court issued an order granting, without prejudice, Defendants' Motion to Dismiss plaintiff's complaint for failure to state a claim. Plaintiffs were granted leave to amend their complaint, and filed an amended complaint on August 22, 2016. Defendants moved to dismiss the amended complaint, and on March 20, 2017, the Court dismissed the amended complaint and granted Plaintiffs leave to file another amended complaint. Plaintiffs filed another amended complaint on April 17, 2017. Defendants filed a motion to dismiss the amended complaint on or about May 17, 2017. The Court denied Defendants' motion to dismiss the third amended complaint on August 4, 2017. On December 8, 2017, Plaintiffs filed a motion for class certification, and on July 3, 2018, the Court granted Plaintiffs' motion and

certified a class as to all of Plaintiffs' claims. Defendants filed a petition for appellate review of a portion of the Court's July 3, 2018 class certification order. On October 19, 2018 the Ninth Circuit Court of Appeals denied the petition.

On January 23, 2019, the parties filed a Notice of Settlement and Joint Request for Order to Stay Proceedings, stating the parties have reached an agreement in principle to settle the claims and allegations in the action and are negotiating the terms of a Stipulation of Settlement. On January 24, 2019, the Court ordered that all proceedings in the action be stayed until April 3, 2019, on or before which the parties were to file and did so file a Stipulation of Settlement and a motion for preliminary approval of the settlement. The court granted preliminary approval of the settlement on May 13, 2019. Defendants maintain that the Plaintiffs' claims are without merit, and entered into the settlement with Plaintiffs to eliminate the uncertainties, burden and expense of further protracted litigation. A \$20.0 million accrual of an expected settlement amount related to this matter was recorded as of December 26, 2018 and all settlement payments were made during the year ended December 25, 2019.

On or about November 5, 2015, a purported Holdings shareholder filed a derivative complaint on behalf of Holdings in the Court of Chancery of the State of Delaware against certain Holdings officers, directors and Trimaran Pollo Partners, L.L.C., under the caption Armen Galustyan v. Sather, et al. (Case No. 11676-VCL). The derivative complaint alleges that these defendants breached their fiduciary duties to Holdings and were unjustly enriched when they sold shares of Holdings at artificially inflated prices due to alleged misrepresentations and omissions regarding EPL's comparable store sales in the second quarter of 2015. The Holdings shareholder's requested remedies include an award of compensatory damages to Holdings, as well as a court order to improve corporate governance by putting forward for stockholder vote certain resolutions for amendments to Holdings' Bylaws or Certificate of Incorporation. The parties have stipulated to, which the court has ordered, a stay of these proceedings pending the outcome of Turocy v. El Pollo Loco Holdings, Inc., discussed above. A second purported Holdings shareholder filed a derivative complaint on or about September 23, 2016, under the caption Diep v. Sather, CA 12760-VCL in the Delaware Court of Chancery. The Diep action is also purportedly brought on behalf of Holdings, names the same defendants and asserts substantially the same claims on substantially the same alleged facts as does Galustyan. Defendants moved to stay or dismiss the Diep action.

On March 17, 2017, the Delaware court granted in part, and denied in part, the motion to stay the Diep action. The court denied defendants' motion to dismiss the complaint for failure to state a claim. On January 17, 2018, the court entered an order granting the parties' stipulation staying all proceedings in the Diep action for five months or until the completion of an investigation of the allegations in the action by a special litigation committee of the Holdings board of directors (the "SLC"). On February 13, 2019, after concluding its investigation, the SLC filed a motion to dismiss the Diep action. The SLC filed its investigative report under seal as an exhibit to the motion to dismiss. Following discovery related to the SLC's motion, on September 25, 2020, the SLC filed its opening brief with the Delaware court in support of the motion to dismiss. Further briefing on the motion is ongoing.

Janice P. Handlers-Bryman and Michael D. Bryman v. El Pollo Loco, Inc., Los Angeles Superior Court (Case No. MC026045) (the "Lancaster Lawsuit") was filed on February 9, 2016. Existing El Pollo Loco franchisees, Janice P. Handlers-Bryman and Michael D. Bryman, as individuals and in their capacities as trustees of the Handlers Bryman Trust (collectively, "Plaintiffs"), filed suit against us alleging, among other things, that we "imposed unreasonable time limitations" on their development of additional restaurant locations in Lancaster, California, and that we thereafter developed company-operated El Pollo Loco restaurants in the "market area" of Plaintiffs' existing El Pollo Loco restaurant in Lancaster. Plaintiffs asserted claims against us for, among other things, (i) breach of the implied covenant of good faith and fair dealing, (ii) intentional interference with prospective business, and (iii) unfair business practices. In addition to an unspecified amount of damages and costs of the lawsuit, Plaintiffs sought reformation of the contract, declaratory relief, disgorgement of alleged revenues and profits, injunctive relief, and a judicial mandate requiring us to either transfer the company-operated locations to Plaintiffs or to continuously disgorge to Plaintiffs the unjust enrichment allegedly obtained by us through the operation of the company-operated restaurants in Lancaster. We denied Plaintiffs' allegations as the franchise agreement did not grant Plaintiffs any exclusive territorial rights and, instead, expressly reserved for us the right to open and operate - and the right to grant others the right to open and operate - El Pollo Loco restaurants "in the immediate vicinity of or adjacent to" Plaintiffs' restaurant in Lancaster. On April 24, 2017, four days before the commencement of trial, Plaintiffs filed a voluntary dismissal, without prejudice, of the Lancaster Lawsuit without any payment or other concession by us. The corresponding dismissal was entered by the court on April 25, 2017. On May 22, 2017, Plaintiffs filed a motion for relief from the dismissal which was granted by the court on June 29, 2017. The trial in the case was bifurcated between the liability and damages phases. The liability phase commenced on November 16, 2017. The only cause of action that the court allowed to go to the jury was the cause of action for breach of the covenant of good faith and fair dealing. The court elected not to present the cause of action for

intentional interference with prospective business to the jury. (The causes of action for reformation due to mistake and unconscionability, unfair business practices under California Business & Professions Code §17200 et seq., and declaratory relief were not presented to the jury as these types of equitable claims are to be decided by the court as a matter of law.) On December 11, 2017, the jury returned a verdict in favor of Plaintiffs finding that the Company breached the implied covenant of good faith and fair dealing by (1) constructing the two new company-operated El Pollo Loco restaurants in Lancaster, and (2) not offering the two new company-operated El Pollo Loco restaurants in Lancaster to Plaintiffs. Because the trial was bifurcated, the December 11, 2017 verdict did not include a determination of damages.

The damages phase of the trial commenced on April 20, 2018. On May 1, 2018, the jury returned a verdict on damages in favor of Plaintiffs in the following amounts: (1) \$4,356,600 in “impact damages” arising out of our construction of the two new company-owned El Pollo Loco restaurants in Lancaster, and (2) \$4,481,206 in “lost opportunity damages” arising out of our failure to offer the two new company-operated El Pollo Loco restaurants in Lancaster to Plaintiffs. On August 1, 2018, the court issued a final judgment and decision on the unfair business practices claim under California Business & Professions Code § 17200 et seq. As part of the final judgment, the court found El Pollo Loco liable and issued injunctive relief requiring El Pollo Loco to revise its franchise disclosure document and franchise agreement. The court also awarded Plaintiffs restitution of \$4,356,600 for “impact damages” arising out of our construction of the two new company-operated El Pollo Loco restaurants in Lancaster. The court, reversing its previous position, held that these damages could be awarded in addition to the “lost opportunity damages” awarded by the jury. Thus, the court entered a total monetary judgment of \$8,837,806. There was no ruling on the causes of action for reformation due to mistake and declaratory relief, and on January 27, 2020, the court entered an amended judgment dismissing these claims. The trial court subsequently awarded the Plaintiffs \$249,728 in costs and \$1,391,703 in attorney fees. Post judgment interest is running at 10% simple interest per year on the total amount of the monetary judgment, costs, and attorney fees.

On August 27, 2018, the Company filed a notice of appeal as to the entire judgment. As required by California law, on or about August 16, 2018, the Company obtained an appeal bond through a Surety company to secure the trial court’s judgment during the pendency of the appeal.

On March 19, 2020, the Surety, One Beacon, from whom the Company procured the appeal bond to secure the judgment against the Company in the matter of Janice P. Handlers-Bryman and Michael D. Bryman v. El Pollo Loco, Inc., issued a collateral demand to the Company. On April 17, 2020, the Company provided to One Beacon a Letter of Credit in the amount of \$2,651,342 to satisfy the Surety’s collateral demand. On July 13, 2020, One Beacon agreed to release its collateral demand and returned the Letter of Credit to the Company.

During the thirteen and thirty-nine weeks ended September 23, 2020, the Company reached an agreement with the Plaintiffs to resolve the lawsuit for a payment by the Company of \$2.5 million, which was recorded within operating expenses in the Company’s condensed consolidated statement of income for the thirty-nine weeks ended September 23, 2020. Additionally, during the thirteen and thirty-nine weeks ended September 23, 2020, the matter was formally resolved. On September 2, 2020, the California Court of Appeals entered an order, following a motion for stipulated reversal of the trial court’s judgment jointly filed by the parties, reversing the trial court’s judgment in the case and instructing the trial court to dismiss the matter with prejudice. On September 10, 2020, the trial court entered an order reversing its judgment and dismissing the case with prejudice. The settlement payment of \$2.5 million has been made and the appeal bond has been released.

The Company is also involved in various other claims and legal actions that arise in the ordinary course of business. The Company does not believe that the ultimate resolution of these other actions will have a material adverse effect on its financial position, results of operations, liquidity, or capital resources. A significant increase in the number of claims, or an increase in amounts owing under successful claims, could materially and adversely affect its business, consolidated financial condition, results of operations, and cash flows.

Purchasing Commitments

The Company has long-term beverage supply agreements with certain major beverage vendors. Pursuant to the terms of these arrangements, marketing rebates are provided to the Company and its franchisees from the beverage vendors based upon the dollar volume of purchases for system-wide restaurants which will vary according to their demand for beverage syrup and fluctuations in the market rates for beverage syrup. These contracts have terms extending through the end of 2024.

At September 23, 2020, the Company's total estimated commitment to purchase chicken was \$3.7 million.

Contingent Lease Obligations

As a result of assigning the Company's interest in obligations under real estate leases in connection with the sale of company-operated restaurants to some of the Company's franchisees, the Company is contingently liable on four lease agreements. These leases have various terms, the latest of which expires in 2036. As of September 23, 2020, the potential amount of undiscounted payments the Company could be required to make in the event of non-payment by the primary lessee was \$3.1 million. The present value of these potential payments discounted at the Company's estimated pre-tax cost of debt at September 23, 2020 was \$2.8 million. The Company's franchisees are primarily liable on the leases. The Company has cross-default provisions with these franchisees that would put them in default of their franchise agreements in the event of non-payment under the leases. The Company believes that these cross-default provisions reduce the risk that payments will be required to be made under these leases. Due to the current uncertainty related to the COVID-19 pandemic and the impact it has had on the ability of the Company's franchisees to make their lease payments, the Company has recorded a \$0.1 million liability in the Company's condensed consolidated financial statements related to these contingent liabilities.

Employment Agreements

The Company has employment agreements with three of the officers of the Company. These agreements provide for minimum salary levels, possible annual adjustments for cost-of-living changes, and incentive bonuses that are payable under certain business conditions.

Indemnification Agreements

The Company has entered into indemnification agreements with each of its current directors and officers. These agreements require the Company to indemnify these individuals to the fullest extent permitted under Delaware law against liabilities that may arise by reason of their service to the Company and to advance expenses incurred as a result of any proceeding against them as to which they could be indemnified. The Company also intends to enter into indemnification agreements with future directors and officers.

8. NET INCOME PER SHARE

Basic earnings per share ("EPS") is calculated using the weighted-average number of shares of common stock outstanding during the thirteen and thirty-nine weeks ended September 23, 2020 and September 25, 2019. Diluted EPS is calculated using the weighted-average number of shares of common stock outstanding and potentially dilutive during the period, using the treasury stock method.

On August 2, 2018, the Company announced that the Board of Directors had authorized a stock repurchase program. The Company entered into a stock repurchase plan on August 28, 2018 (the "2018 Stock Repurchase Plan"), which allowed for the repurchase of up to \$20.0 million of the Company's common stock. The 2018 Stock Repurchase Plan commenced on November 6, 2018 and terminated on June 26, 2019.

On April 30, 2019, as part of the Company's focus on stockholder returns, the Board of Directors approved a new stock repurchase program. The Company entered into a stock repurchase plan May 17, 2019 (the "2019 Stock Repurchase Plan"), which allowed for the repurchase up to \$30.0 million of the Company's common stock. The 2019 Stock Repurchase Plan commenced on June 27, 2019, and was exhausted on September 26, 2019.

Under the 2019 Stock Repurchase Plan, the Company was permitted to repurchase its common stock from time to time, in amounts and at prices that the Company deemed appropriate, subject to market conditions and other considerations. The Company's repurchases were executed using open market purchases, including pursuant to Rule 10b5-1 trading plans, and/or through privately negotiated transactions.

For the thirteen weeks ended September 25, 2019, the Company repurchased 2,825,896 shares of common stock under the 2019 Stock Repurchase Plan, using open market purchases, for total consideration of approximately \$29.9 million. For the thirty-nine weeks ended September 25, 2019, the Company repurchased 1,558,836 shares of common stock under the 2018 Stock Repurchase Plan and 2,825,896 shares of common stock under the 2019 Stock Repurchase Plan,

using open market purchases, for total consideration of approximately \$48.3 million. The common stock repurchased under both the 2018 Stock Repurchase Plan and the 2019 Stock Repurchase Plan was retired upon repurchase.

Below are basic and diluted EPS data for the periods indicated (in thousands except for share and per share data):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Numerator:				
Net income	\$ 9,920	\$ 6,402	\$ 19,019	\$ 21,402
Denominator:				
Weighted-average shares outstanding—basic	35,471,452	35,859,502	34,989,007	37,484,372
Weighted-average shares outstanding—diluted	36,064,559	36,397,368	35,609,320	38,173,097
Net income per share—basic	\$ 0.28	\$ 0.18	\$ 0.54	\$ 0.57
Net income per share—diluted	\$ 0.28	\$ 0.18	\$ 0.53	\$ 0.56
Anti-dilutive securities not considered in diluted EPS calculation	4,071	882,253	129,218	636,099

Below is a reconciliation of basic and diluted share counts:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Weighted-average shares outstanding—basic	35,471,452	35,859,502	34,989,007	37,484,372
Dilutive effect of stock options and restricted shares	593,107	537,866	620,313	688,725
Weighted-average shares outstanding—diluted	36,064,559	36,397,368	35,609,320	38,173,097

9. RELATED PARTY TRANSACTIONS

Trimaran Pollo Partners, L.L.C. (“LLC”) owns approximately 46.0% of the Company’s outstanding common stock. This large position means that LLC and its majority owners—predecessors and affiliates of, and certain funds managed by, Trimaran Capital Partners and Freeman Spogli & Co. (collectively, “Trimaran” and “Freeman Spogli,” respectively)—possess significant influence when stockholders vote on matters such as election of directors, mergers, consolidations and acquisitions, the sale of all or substantially all of the Company’s assets, decisions affecting the Company’s capital structure, amendments to the Company’s amended and restated certificate of incorporation or amended and restated by-laws, and the Company’s winding up and dissolution. The Company’s amended and restated certificate of incorporation provides that (i) so long as LLC beneficially owns, directly or indirectly, more than 40% of the Company’s common stock, any member of the Board of Directors or the entire Board of Directors may be removed from office at any time with or without cause by the affirmative vote of a majority of the Company’s common stock, and (ii) prior to the date the LLC ceases to beneficially own, directly or indirectly, 40% or more of the Company’s common stock, stockholders representing at least 40% of the Company’s common stock may call a special meeting of the Company’s stockholders.

10. REVENUE FROM CONTRACTS WITH CUSTOMERS

Revenue Recognition

Nature of products and services

The Company has two revenue streams, company-operated restaurant revenue and franchise related revenue.

Company-operated restaurant revenue

Revenues from the operation of company-operated restaurants are recognized as food and beverage products are delivered to customers and payment is tendered at the time of sale. The Company presents sales, net of sales-related taxes and promotional allowances.

The Company offers a loyalty rewards program, which awards a customer points for dollars spent. Customers earn points for each dollar spent and as of August 4, 2020, 50 points can be redeemed for a \$5 reward to be used for a future

purchase. Prior to August 4, 2020, 100 points could be redeemed for a \$10 reward. If a customer does not earn or use points within a one-year period, their account is deactivated and all points expire. Additionally, if a reward is not used within six months, it expires. When a customer is part of the rewards program, the obligation to provide future discounts related to points earned is considered a separate performance obligation, to which a portion of the transaction price is allocated. The performance obligation related to loyalty points is deemed to have been satisfied, and the amount deferred in the balance sheet is recognized as revenue, when the points are transferred to a reward and redeemed, the reward or points have expired, or the likelihood of redemption is remote. A portion of the transaction price is allocated to loyalty points, if necessary, on a pro-rata basis, based on stand-alone selling price, as determined by menu pricing and loyalty points terms. As of September 23, 2020 and December 25, 2019, the revenue allocated to loyalty points that have not been redeemed was \$1.0 million and \$1.1 million, respectively, which is reflected in the Company's accompanying condensed consolidated balance sheets within other accrued expenses and current liabilities. The Company expects the loyalty points to be redeemed and recognized over a one-year period.

The Company sells gift cards to its customers in the restaurants and through selected third parties. The gift cards sold to customers have no stated expiration dates and are subject to actual and/or potential escheatment rights in several of the jurisdictions in which the Company operates. Furthermore, due to these escheatment rights, the Company does not recognize breakage related to the sale of gift cards due to the immateriality of the amount remaining after escheatment. The Company recognizes income from gift cards when redeemed by the customer. Unredeemed gift card balances are deferred and recorded as other accrued expenses on the accompanying condensed consolidated balance sheets.

Franchise and franchise advertising revenue

Franchise revenue consists of franchise royalties, initial franchise fees, license fees due from franchisees, IT support services, and rental income for subleases to franchisees. Franchise advertising revenue consists of advertising contributions received from franchisees. These revenue streams are made up of the following performance obligations:

- Franchise license - inclusive of advertising services, development agreements, training, access to plans and help desk services.
- Discounted renewal option.
- Hardware services.

The Company satisfies the performance obligation related to the franchise license over the term of the franchise agreement, which is typically 20 years. Payment for the franchise license consists of three components, a fixed-fee related to the franchise/development agreement, a sales-based royalty fee and a sales-based advertising fee. The fixed fee, as determined by the signed development and/or franchise agreement, is due at the time the development agreement is entered into, and/or when the franchise agreement is signed, and does not include a finance component.

The sales-based royalty fee and sales-based advertising fee are considered variable consideration and will continue to be recognized as revenue as such sales are earned by the franchisees. Both sales-based fees qualify under the royalty constraint exception, and do not require an estimate of future transaction price. Additionally, the Company is utilizing the practical expedient available under ASC Topic 606, "Revenue from Contracts with Customers" ("Topic 606") regarding disclosure of the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied for sales-based royalties.

In certain franchise agreements, the Company offers a discounted renewal to incentivize future renewals after the end of the initial franchise term. As this is considered a separate performance obligation, the Company allocates a portion of the initial franchise fee to this discounted renewal, on a pro-rata basis, assuming a 20-year renewal. This performance obligation is satisfied over the renewal term, typically 10 or 20 years, while payment is fixed and due at the time the renewal is signed.

The Company purchases hardware, such as scanners, printers, cash registers and tablets, from third party vendors, which it then sells to franchisees. As the Company is considered the principal in this relationship, payment for the hardware is considered revenue, and is received upon transfer of the goods from the Company to the franchisee. As of September 23, 2020, there were no performance obligations related to hardware services that were unsatisfied or partially satisfied.

Disaggregated revenue

The following table presents our revenues disaggregated by revenue source and market (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Core Market⁽¹⁾:				
Company-operated restaurant revenue	\$ 90,207	\$ 90,277	\$ 257,493	\$ 264,391
Franchise revenue	3,660	3,696	10,376	11,369
Franchise advertising fee revenue	2,748	2,809	7,773	8,332
Total core market	\$ 96,615	\$ 96,782	\$ 275,642	\$ 284,092
Non-Core Market⁽²⁾:				
Company-operated restaurant revenue	\$ 7,069	\$ 8,775	\$ 20,124	\$ 31,950
Franchise revenue	4,121	3,577	11,186	10,266
Franchise advertising fee revenue	3,174	2,933	8,794	8,476
Total non-core market	\$ 14,364	\$ 15,285	\$ 40,104	\$ 50,692
Total revenue	\$ 110,979	\$ 112,067	\$ 315,746	\$ 334,784

(1) Core Market includes markets with existing company-operated restaurants at the time of the Company's Initial Public Offering ("IPO") on July 28, 2014.

(2) Non-Core Market includes markets entered into by the Company subsequent to the IPO date.

The following table presents our revenues disaggregated by geographic market:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Greater Los Angeles area market	71.2 %	71.5 %	71.5 %	70.0 %
Other markets	28.8 %	28.5 %	28.5 %	30.0 %
Total	100 %	100 %	100 %	100 %

Contract balances

The following table provides information about the change in the franchise contract liability balances during the thirty-nine weeks ended September 23, 2020 and September 25, 2019 (in thousands):

December 25, 2019	\$ 6,317
Revenue recognized - beginning balance	(900)
Additional contract liability	10
September 23, 2020	\$ 5,427
December 26, 2018	\$ 5,593
Revenue recognized - beginning balance	(283)
Additional contract liability	1,367
Revenue recognized - additional contract liability	(211)
September 25, 2019	\$ 6,466

The Company's franchise contract liability includes development fees, initial franchise and license fees, franchise renewal fees, lease subsidies and royalty discounts and is included within other accrued expenses and current liabilities and other noncurrent liabilities within the accompanying condensed consolidated balance sheets. The Company receives area development fees from franchisees when they execute multi-unit area development agreements. Initial franchise and license fees, or franchise renewal fees, are received from franchisees upon the execution of, or renewal of, a franchise agreement. Revenue is recognized from these agreements as the underlying performance obligation is satisfied, which is over the term of the agreement.

The following table illustrates the estimated revenue to be recognized in future periods related to performance obligations under the applicable contracts that are unsatisfied as of September 23, 2020 (in thousands):

Franchise revenues:	
2020 (remaining)	\$ 166
2021	490
2022	409
2023	395
2024	381
Thereafter	3,586
Total	\$ 5,427

Contract Costs

The Company does not currently incur costs to obtain or fulfill a contract that would be considered contract assets under Topic 606.

11. LEASES

Adoption of Topic 842 "Leases"

On December 27, 2018, the Company adopted Topic 842, using the effective date method, recognizing and measuring all leases that existed as of December 27, 2018. The Company recorded a cumulative-effect adjustment as of December 27, 2018. All leases that either (1) commenced, or (2) were modified or re-measured after December 27, 2018 are accounted for under Topic 842.

As a result of Topic 842, the Company recognized a ROU asset of \$205.2 million and a lease liability of \$222.3 million on its consolidated balance sheet as of December 27, 2018. However, the adoption of Topic 842 did not result in a material impact on the Company's consolidated statement of operations or consolidated statement of cash flows.

Nature of leases

The Company's operations utilize property, facilities, equipment and vehicles leased from others. Additionally, the Company has various contracts with vendors that have been determined to contain an embedded lease in accordance with Topic 842.

As of September 23, 2020, the Company had three leases that it had entered into, but had not yet commenced. The Company does not have control of the property until lease commencement.

Building and facility leases

The majority of the Company's building and facilities leases are classified as operating leases; however, the Company currently has one facility and two equipment leases that are classified as finance leases.

Restaurants are operated under lease arrangements that generally provide for a fixed base rent and, in some instances, contingent rent based on a percentage of gross operating profit or net revenues in excess of a defined amount. Additionally, a number of the Company's leases have payments, which increase at pre-determined dates based on the change in the consumer price index. For all leases, the Company also reimburses the landlord for non-lease components, or items that are not considered components of a contract, such as common area maintenance, property tax and insurance costs. While the Company determined not to separate lease and non-lease components, these payments are based on actual costs, making them variable consideration and excluding them from the calculations of the ROU asset and lease liability.

The initial terms of land and restaurant building leases are generally 20 years, exclusive of options to renew. These leases typically have four 5-year renewal options, which have generally been excluded in the calculation of the ROU asset and lease liability, as they are not considered reasonably certain to be exercised, unless (1) the renewal had already occurred as of the time of adoption of Topic 842, or (2) there have been significant leasehold improvements that have a

useful life that extend past the original lease term. Furthermore, there are no residual value guarantees and no restrictions imposed by the lease.

During the thirteen and thirty-nine weeks ended September 23, 2020, the Company reassessed the lease terms on two and nine restaurants, respectively, due to certain triggering events, such as the addition of significant leasehold improvements, the decision to terminate a lease, or the decision to renew. As a result of the reassessment, an additional \$0.3 million and \$2.0 million of ROU asset and lease liabilities for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, were recognized and will be amortized over the new lease term. During the thirteen and thirty-nine weeks ended September 25, 2019, the Company reassessed the lease terms on three and six restaurants, respectively, due to the addition of significant leasehold improvements with useful lives that extend past the current lease expiration, the decision to terminate a lease or the decision to renew leases. This resulted in an additional \$2.0 million and \$3.3 million of ROU asset and lease liability for the thirteen and thirty-nine weeks ended September 25, 2019, respectively, which will be recognized over the new lease term. The reassessments did not have any impact on the original lease classification. Additionally, as the Company adopted all practical expedients available under Topic 842, no reallocation between lease and non-lease components was necessary.

The Company also subleases facilities to certain franchisees and other non-related parties which are also considered operating leases. Sublease income also includes contingent rental income based on net revenues. The vast majority of these leases have rights to extend terms via fixed rental increases. However, none of these leases have early termination rights, the right to purchase the premises or any residual value guarantees. The Company does not have any related party leases.

During the thirty-nine weeks ended September 23, 2020, the Company determined that the carrying value of ROU assets at one restaurant was not recoverable. As a result, the Company recorded a \$0.5 million non-cash impairment charge for the thirty-nine weeks ended September 23, 2020, related to one restaurant in Texas, sold to franchisees in the prior year. The Company did not recognize any impairment related to ROU assets during the thirteen and thirty-nine ended September 25, 2019. See "Impairment of Long-Lived Assets and ROU Assets" in Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" for additional information.

Equipment

Leases of equipment primarily consist of restaurant equipment, copiers and vehicles. These leases are fixed payments with no variable component. Additionally, no optional renewal periods have been included in the calculation of the ROU asset, there are no residual value guarantees and no restrictions imposed.

Significant Assumptions and Judgments

In applying the requirements of Topic 842 the Company made significant assumptions and judgments related to determination of whether a contract contains a lease and the discount rate used for the lease.

In determining if any of the Company's contracts contain a lease the Company made assumptions and judgments related to its ability to direct the use of any assets stated in the contract and the likelihood of renewing any short-term contracts for a period extending past twelve months.

The Company also made significant assumptions and judgments in determining an appropriate discount rate for property leases. These included using a consistent discount rate for a portfolio of leases entered into at varying dates, using the full 20-year term of the lease, excluding any options, and using the total minimum lease payments. The Company utilizes a third-party valuation firm in determining the discount rate, based on the above assumptions. For all other leases, the Company uses the discount rate implicit in the lease, or the Company's incremental borrowing rate.

As the Company has adopted the practical expedient not to separate lease and non-lease components, no significant assumptions or judgments were necessary in allocating consideration between these components, for all classes of underlying assets.

The following table presents the Company's total lease cost, disaggregated by underlying asset (in thousands):

	Thirteen Weeks Ended					
	September 23, 2020			September 25, 2019		
	Property Leases	Equipment Leases	Total	Property Leases	Equipment Leases	Total
Finance lease cost:						
Interest on lease liabilities	\$ 5	\$ —	\$ 5	\$ 9	\$ —	\$ 9
Operating lease cost	6,502	297	6,799	6,534	313	6,847
Short-term lease cost	—	6	6	—	9	9
Variable lease cost	116	50	166	121	38	159
Sublease income	(883)	—	(883)	(722)	—	(722)
Total lease cost	\$ 5,740	\$ 353	\$ 6,093	\$ 5,942	\$ 360	\$ 6,302

	Thirty-Nine Weeks Ended					
	September 23, 2020			September 25, 2019		
	Property Leases	Equipment Leases	Total	Property Leases	Equipment Leases	Total
Finance lease cost:						
Amortization of right-of-use assets	\$ —	\$ —	\$ —	\$ 9	\$ —	\$ 9
Interest on lease liabilities	16	—	16	24	—	24
Operating lease cost	19,577	911	20,488	19,721	967	20,688
Short-term lease cost	—	18	18	—	26	26
Variable lease cost	325	120	445	346	136	482
Sublease income	(2,424)	—	(2,424)	(1,623)	—	(1,623)
Total lease cost	\$ 17,494	\$ 1,049	\$ 18,543	\$ 18,477	\$ 1,129	\$ 19,606

The following table presents the Company's total lease cost on the condensed consolidated statements of income (in thousands):

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Lease cost – Occupancy and other operating expenses	\$ 5,786	\$ 6,015	\$ 17,582	\$ 18,675
Lease cost – General & administrative	114	116	344	348
Lease cost – Depreciation and amortization	5	—	16	9
Lease cost – Interest expense	—	9	—	24
Lease cost - Closed-store reserve	188	162	601	550
Total lease cost	\$ 6,093	\$ 6,302	\$ 18,543	\$ 19,606

During the thirty-nine weeks ended September 23, 2020 and September 25, 2019, the Company had the following cash and non-cash activities associated with its leases (in thousands):

	Thirty-Nine Weeks Ended September 23, 2020			Thirty-Nine Weeks Ended September 25, 2019		
	Property Leases	Equipment Leases	Total	Property Leases	Equipment Leases	Total
Cash paid for amounts included in the measurement of lease liabilities						
Operating cash flows used for operating leases	\$ 16,348	\$ 928	\$ 17,276	\$ 18,819	\$ 970	\$ 19,789
Financing cash flows used for finance leases	\$ 24	\$ 2	\$ 26	\$ 61	\$ —	\$ 61
Non-cash investing and financing activities:						
Operating lease ROU assets obtained in exchange for lease liabilities:						
Operating lease ROU assets	\$ 3,180	\$ 41	\$ 3,221	8,832	36	8,868
Derecognition of ROU assets due to terminations, impairment or modifications						
	\$ (543)	\$ (26)	\$ (569)	—	—	—
Other Information						
Weighted-average remaining lease term						
—finance leases	2.08	4.83		3.08	—	
Weighted-average remaining lease term						
—operating leases	11.62	2.59		12.21	3.08	
Weighted-average discount rate—						
finance leases	11.10 %	1.68 %		11.10 %	—	
Weighted-average discount rate—						
operating leases	4.31 %	3.89 %		4.40 %	4.00 %	

Information regarding the Company's minimum future lease obligations as of September 23, 2020 is as follows (in thousands):

For the Years Ending	Finance	Operating Leases	
	Minimum Lease Payments	Minimum Lease Payments	Minimum Sublease Income
December 30, 2020	\$ 16	\$ 7,611	\$ 693
December 29, 2021	66	28,901	2,887
December 28, 2022	57	26,112	3,284
December 27, 2023	11	23,763	3,318
December 25, 2024	11	21,469	3,203
Thereafter	6	142,716	27,265
Total	\$ 167	\$ 250,572	\$ 40,650
Less: imputed interest (2.33% - 11.10%)	(23)	(47,972)	
Present value of lease obligations	144	202,600	
Less: current maturities	(50)	(19,847)	
Noncurrent portion	\$ 94	\$ 182,753	

Information regarding the Company's minimum future lease obligations as of December 25, 2019 is as follows (in thousands):

For the Years Ending	Finance Leases	Operating Leases	
	Minimum Lease Payments	Minimum Lease Payments	Minimum Sublease Income
December 30, 2020	\$ 54	\$ 26,808	\$ 2,754
December 29, 2021	54	25,978	2,887
December 28, 2022	45	24,871	3,284
December 27, 2023	—	22,309	3,318
December 25, 2024	—	19,751	3,203
Thereafter	—	139,454	27,265
Total	\$ 153	\$ 259,171	\$ 42,711
Less: imputed interest (3.96% to 11.10%)	(36)	(45,273)	
Present value of capital lease obligations	117	213,898	
Less: current maturities	(34)	(16,406)	
Noncurrent portion	\$ 83	\$ 197,492	

Short-Term Leases

The Company has multiple short-term leases, which have terms of less than 12 months, and thus were excluded from the recognition requirements of Topic 842. The Company has recognized these lease payments in its consolidated statements of operations on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments was incurred.

Lessor

The Company is a lessor for certain property, facilities and equipment owned by the Company and leased to others, principally franchisees, under non-cancelable leases with initial terms ranging from three to 20 years. These lease agreements generally provide for a fixed base rent and, in some instances, contingent rent based on a percentage of gross operating profit or net revenues. All leases are considered operating leases.

For the leases in which the Company is the lessor, there are options to extend the lease. However, there are no terms and conditions to terminate the lease, no right to purchase premises and no residual value guarantees. Additionally, there are no related party leases.

The Company received \$0.1 million of lease income from company-owned locations for both the thirteen weeks ended September 23, 2020 and September 25, 2019. For both the thirty-nine weeks ended September 23, 2020 and September 25, 2019, the Company received \$0.4 million of lease income from company-owned locations.

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

Cautionary Statement Concerning Forward-Looking Statements

This report contains forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical fact included in this report are forward-looking statements. Forward-looking statements discuss our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements because they do not relate strictly to historical or current facts. These statements may include words such as "aim," "anticipate," "believe," "estimate," "expect," "forecast," "outlook," "potential," "project," "projection," "plan," "intend," "seek," "may," "could," "would," "will," "should," "can," "can have," "likely," the negatives thereof and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events. They appear in a number of places throughout this report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industry in which we operate. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those that we expected.

While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results. All forward-looking statements are expressly qualified in their entirety by these cautionary statements. You should evaluate all forward-looking statements made in this report in the context of the factors that could cause outcomes to differ materially from our expectations. These factors include, but are not limited to:

- the impacts of the novel coronavirus (COVID-19) pandemic on our company, our employees, our customers, our partners, our industry and the economy as a whole, as well as our franchisees ability to maintain operations in their individual restaurants;
- the adverse impact of economic conditions on our (i) operating results and financial condition, (ii) ability to comply with the terms and covenants of our debt agreements, and (iii) ability to pay or refinance our existing debt or to obtain additional financing;
- our ability to open new restaurants in new and existing markets, including difficulty in finding sites and in negotiating acceptable leases;
- our ability to compete successfully with other quick-service and fast casual restaurants;
- vulnerability to changes in consumer preferences and economic conditions;
- vulnerability to conditions in the greater Los Angeles area;
- vulnerability to natural disasters given the geographic concentration and real estate intensive nature of our business;
- our ability to effectively identify and secure appropriate new sites for restaurants;
- changes to food and supply costs, especially for chicken;
- negative publicity, whether or not valid, and our ability to respond to and effectively manage the accelerated impact of social media;
- our ability to continue to expand our digital business, delivery orders and catering;
- concerns about food safety and quality and about food-borne illness, particularly avian flu;
- dependence on frequent and timely deliveries of food and supplies and our dependence on a single supplier to distribute substantially all of our products to our restaurants;
- our ability to service our level of indebtedness;
- our reliance on our franchisees, who may incur financial hardships, lose access to credit, close restaurants, or declare bankruptcy, and our limited control over our franchisees and potential liability for their acts;
- the impact of any security breaches of confidential customer information in connection with our electronic process of credit and debit card transactions;
- the impact of any failure of our information technology system or any breach of our network security;
- ability to protect our name and logo and other proprietary intellectual property; and
- other risks set forth in our filings with the SEC from time to time, including under Item 1A, Risk Factors in our annual report on Form 10-K for the year ended December 25, 2019, under Item 1A, Risk Factors in our quarterly report on Form 10-Q for the quarter ended March 25, 2020 and under Item 1A, Risk Factors in our quarterly report on Form 10-Q for the quarter ended June 24, 2020, which such filings are available online at www.sec.gov, at www.elpolloloco.com or upon request from El Pollo Loco.

We caution you that the important factors referenced above may not contain all of the factors that are important to you. In addition, we cannot assure you that we will realize the results or developments we expect or anticipate or, even if substantially realized, that they will result in the consequences we anticipate or affect us or our operations in the ways that we expect. The forward-looking statements included in this report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as required by law. If we do update one or more forward-looking statements, no inference should be made that we will make additional updates with respect to those or other forward-looking statements. We qualify all of our forward-looking statements by these cautionary statements.

Overview

El Pollo Loco is a differentiated and growing restaurant concept that specializes in fire-grilling citrus-marinated chicken and operates in the limited service restaurant (“LSR”) segment. We strive to offer food that integrates the culinary traditions of Mexico with the healthier lifestyle of Los Angeles, a combination that we call “LA-Mex”. Our distinctive menu features our signature product--citrus-marinated fire-grilled chicken--and a variety of Mexican and LA-inspired entrees that we create from our chicken. We serve individual and family-sized chicken meals, a variety of Mexican and

LA-inspired entrees, and sides, and, throughout the year, on a limited-time basis, additional proteins like shrimp. Our entrees include favorites such as our Chicken Avocado Burrito, Under 500 Calorie entrees, chicken tostada salads, and Pollo Bowls. Our famous Creamy Cilantro dressings and salsas are prepared fresh daily, allowing our customers to create their favorite flavor profiles to enhance their culinary experience. Our distinctive menu with healthier alternatives appeals to consumers across a wide variety of socio-economic backgrounds and drives our balanced composition of sales throughout the day (our “day-part mix”), including at lunch and dinner.

COVID-19 Impact

On January 30, 2020, the World Health Organization (“WHO”) announced a global health emergency because of a new strain of coronavirus (“COVID-19”) originating in Wuhan, China and the risks to the international community as the virus spreads globally beyond its point of origin. On March 11, 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally.

The COVID-19 pandemic has significantly disrupted our restaurant operations. Following the pandemic declaration in March 2020, federal, state and local governments began to respond to the public health crisis by requiring social distancing, “stay at home” directives, and restaurant restrictions - including government-mandated dining room closures - that limited business to off-premise services only (take-out, drive-thru and delivery). Historically, approximately 20% of the Company’s sales are associated with dine-in service. In May 2020, the “stay at home” directive was temporarily modified in most areas in which the Company operates, allowing for the opening of lower-risk workplaces, including restaurants, but with restrictions such as limited capacity. However, in July a surge in the COVID-19 pandemic caused many state and local governments to re-implement certain additional restrictions to try and contain the spread of the virus. As of September 23, 2020 the majority of the Company’s restaurants were permitted to be open with limited capacity; however, while most of the Company’s markets outside of California have dining rooms open at a limited capacity, the majority of the Company’s restaurants in California are continuing to operate on a take-away, mobile pick-up and delivery basis, as well as maintaining drive-thru operations where available, in order to protect their employees and customers from the spread of the COVID-19 pandemic and to comply with the government mandates. Due to the impact of the COVID-19 pandemic, during the thirteen and thirty-nine weeks ended September 23, 2020, we temporarily closed 40 restaurants and 65 restaurants, respectively, of which all but three have reopened as of September 23, 2020. Similarly, during the thirteen and thirty-nine weeks ended September 23, 2020, franchisees temporarily closed 15 restaurants and 36 restaurants, respectively, of which all but three have reopened as of September 23, 2020. As of September 23, 2020, we have not permanently closed any restaurants due to the COVID-19 pandemic.

Below is a summary of other actions we have taken to enhance financial and operating flexibility for the Company and for our franchisees, and to protect our employees and customers:

- As a precautionary measure, we initially bolstered our existing cash position by fully drawing down our \$150 million 2018 Revolver, adding \$34.5 million of cash to our balance sheet. However, subsequent to the initial drawdown, we paid down \$57.7 million on our 2018 Revolver. See Note 4 to Item 1 above for further details regarding our current debt balances. Subsequent to September 23, 2020, we made an additional voluntary pre-payment of \$28.0 million on the 2018 Revolver. Refer to “Subsequent Events” in Note 1 to Item 1 above.
- We have temporarily suspended all share repurchase activity, significantly reduced capital spending, reevaluated essential support center general and administrative expenses, and fine-tuned our restaurant labor model based on indoor dining room restrictions, limited dining room capacity in restaurants located in geographies where indoor dining is permitted, dining room closures and fluctuating sales volume.
- For our franchisees, we deferred 50% of their April royalties until July 1, 2020, when such royalties began to be repaid in even monthly installments over the remainder of fiscal 2020. In addition, we deferred 100% of our franchisees’ 2020 remodel and new restaurant build requirements until 2021. We also established a support team to assist franchisees in accessing funds and benefits provided by the CARES Act legislation.
- For our employees, we continue to implement actions to help protect them from the coronavirus while working in our restaurants. These include implementing pre-shift health assessments, enhanced cleaning procedures in our restaurants, providing gloves and masks to all system restaurant employees, installing plexiglass shields at company restaurant cashier stations and initiating other social distancing measures. We are providing extended sick leave benefits to employees impacted by COVID-19, and we have granted two weeks paid leave for employees who are 65 or older.

- We have shifted our marketing to highlight our free delivery program; our Family Meals as a healthier and affordable option; and our meaningful value platform. Additionally, we have added curbside pick-up, enabling customers to pick-up their orders from the safety of their own cars.
- We delayed making April, May and June rent payments on the majority of our leased properties, and we have reached rent abatement and/or deferment agreements with our landlords for those properties.
- We have taken advantage of provisions available under the CARES Act. Specifically, we have deferred payment of employer Social Security taxes that are otherwise owed for wage payments.

The full impact of the COVID-19 outbreak continues to evolve as of the date of this report. Management is continually evaluating the impact of the global crisis on its financial condition, liquidity, operations, suppliers, industry, and workforce and will take additional actions as necessary. The disruption in operations has led to us considering the impact of the COVID-19 pandemic on our liquidity, debt covenant compliance, and recoverability of long-lived and ROU assets, goodwill and intangible assets, among others. If these disruptions to our operations from COVID-19 pandemic continue, they may have a material negative impact on our financial results, future operations and liquidity. The extent of such negative impact will depend, in part, on the longevity and severity of the COVID-19 pandemic.

Due to the rapid development and fluidity of this situation, we cannot determine the ultimate impact that the COVID-19 pandemic will have on our consolidated financial condition, liquidity, and future results of operations, and therefore any prediction as to the ultimate materiality of the adverse impact on our consolidated financial condition, liquidity, and future results of operations is uncertain.

Growth Strategies and Outlook

As of September 23, 2020, we had 478 locations in six states. In fiscal 2019, we opened two new company-operated and two new franchised restaurants all in California. For the thirty-nine weeks ended September 23, 2020, one new company-operated restaurant was opened in Nevada, which was in process prior to the COVID-19 pandemic, and two franchised restaurants were opened, one in California and one in Arizona. As a result of the COVID-19 crisis, we have suspended company-operated new unit development until the timing of the economic recovery and our business improvement becomes more clear. In addition, we are allowing franchisees to defer their 2020 new unit development obligations until 2021. As a result, we do not expect to open any additional company-operated or franchised restaurant during the remainder of 2020.

It is our intention to return to the following long-term growth strategy after the impact of the COVID-19 pandemic subsides. We plan to continue to expand our business, drive restaurant sales growth, and enhance our competitive positioning, by executing the following strategies:

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

To increase comparable restaurant sales, we plan to increase customer frequency, attract new customers, and improve per-person spend. Success of these growth plans is not guaranteed.

Highlights and Trends

Comparable Restaurant Sales

System-wide, for the thirteen and thirty-nine weeks ended September 23, 2020, comparable restaurant sales increased by 1.8% and decreased by 3.2%, respectively, from the comparable period in the prior year. For company-operated restaurants, comparable restaurant sales for the thirteen and thirty-nine weeks ended September 23, 2020 increased by 0.2% and decreased by 3.0%, respectively. For company-operated restaurants, the quarter's change in comparable restaurant sales consisted of an approximately 18.1% increase in average check size, partially offset by a decline in transactions of 15.2%, and the year-to-date change in comparable restaurant sales consisted of a 15.2% decline in transactions, partially offset by a 14.4% increase in average check size. For franchised restaurants, comparable restaurant

sales increased 3.0% and decreased 3.3% for the thirteen and thirty-nine weeks ended September 23, 2020, respectively. Refer to Comparable Restaurant Sales definition in "Key Performance Indicators" section below.

Restaurant Development

Our restaurant counts at the beginning and end of each of the last three fiscal years and the thirty-nine weeks ended September 23, 2020, were as follows.

	<u>Thirty-Nine Weeks Ended</u>	<u>Fiscal Year Ended</u>		
	<u>September 23, 2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Company-operated restaurant activity:				
Beginning of period	195	213	212	201
Openings	1	2	8	16
Restaurant sale to franchisee	—	(16)	—	—
Closures	—	(4)	(7)	(5)
Restaurants at end of period	196	195	213	212
Franchised restaurant activity:				
Beginning of period	287	271	265	259
Openings	2	2	9	7
Restaurant sale to franchisee	—	16	—	—
Closures	(7)	(2)	(3)	(1)
Restaurants at end of period	282	287	271	265
System-wide restaurant activity:				
Beginning of period	482	484	477	460
Openings	3	4	17	23
Closures	(7)	(6)	(10)	(6)
Restaurants at end of period	478	482	484	477

Restaurant Remodeling

As of September 23, 2020, together with our franchisees, we had remodeled 34 company-operated and 45 franchised restaurants using our newest Vision restaurant design. The Vision design elevates the brand image with exterior and interior features that embrace the brand's authentic roots with warm textures, rustic elements and a focus on the signature open kitchen layout established in previous designs. As of September 23, 2020, including new builds and remodels, we had 120 restaurants open with the Vision design in our system. Remodeling is a use of cash and has implications for our net property and equipment owned and depreciation and amortization line items on our condensed consolidated balance sheets and consolidated statements of income, among others. The cost of our Vision design restaurant remodels varied depending on the scope of work required, but on average, the investment was \$0.3 million to \$0.4 million per restaurant. We believe that our Vision design remodeling program resulted in higher restaurant revenue and a strengthened brand. In addition, we are currently working on a new asset design that we believe will clearly differentiate and communicate our brand, both on the exterior and interior. We believe that this new design will deliver improved unit volumes and cash on cash returns in both existing and new markets. We also believe that our remodels using this new design will result in higher restaurant revenue and a strengthened brand. If tests are successful, this new design will replace our "Vision" design, which was implemented in 2016. However, given the uncertainty surrounding the severity and longevity of the COVID-19 pandemic, as a precautionary measure we have significantly reduced capital spending in 2020 and plan to limit our remodels to two restaurants using the new design in the fourth quarter. We do not expect our franchisees to complete any remodels in 2020 as we have deferred their remodel requirements until 2021.

Loco Rewards

During the second quarter of 2017, we introduced a new loyalty rewards points program in an effort to increase sales and loyalty among our customers, by offering rewards that incentivize customers to visit our restaurants more often each month. Customers earn points for each dollar spent and as of August 4, 2020, 50 points can be redeemed for a \$5 reward to be used for a future purchase. Prior to August 4, 2020, 100 points could be redeemed for a \$10 reward. If a customer does not earn or use points within a one-year period, their account is deactivated and all points expire. Additionally, if a reward is not used within six months, it expires. When a customer is part of the rewards program, the obligation to provide future discounts related to points earned is considered a separate performance obligation, to which

a portion of the transaction price is allocated. The performance obligation related to loyalty points is deemed to have been satisfied, and the amount deferred in the balance sheet is recognized as revenue, when the points are transferred to a reward and redeemed, the reward or points have expired, or the likelihood of redemption is remote. A portion of the transaction price is allocated to loyalty points, if necessary, on a pro-rata basis, based on stand-alone selling price, as determined by menu pricing and loyalty point's terms.

In addition, customers can earn additional points and free entrées for a variety of engagement activities. As points are available for redemption past the quarter earned, a portion of the revenue associated with the earned points will be deferred until redemption or expiration. As of both September 23, 2020 and December 25, 2019, the revenue allocated to loyalty points that have not been redeemed is \$1.0 million and \$1.1 million, respectively, which is reflected in the Company's accompanying condensed consolidated balance sheets within other accrued expenses and current liabilities. The Company had almost 2.0 million loyalty program members as of September 23, 2020.

Critical Accounting Policies and Use of Estimates

The preparation of our condensed consolidated financial statements in accordance with GAAP requires us to make estimates and judgments that affect our reported amounts of assets, liabilities, revenue, and expenses, and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under current circumstances in making judgments about the carrying value of assets and liabilities that are not readily available from other sources. We evaluate our estimates on an on-going basis. Actual results may differ from these estimates under different assumptions or conditions.

Accounting policies are an integral part of our condensed consolidated financial statements. A thorough understanding of these accounting policies is essential when reviewing our reported results of operations and our financial position. Management believes that the critical accounting policies and estimates discussed below involve the most difficult management judgments, due to the sensitivity of the methods and assumptions used. For a summary of our critical accounting policies and a discussion of our use of estimates, see "Critical Accounting Policies and Use of Estimates" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our annual report on Form 10-K for the year ended December 25, 2019.

There have been no material changes to our critical accounting policies or uses of estimates since our annual report on Form 10-K.

Recent Accounting Pronouncements

Recent accounting pronouncements are described in Note 1 to our condensed consolidated financial statements included in Item 1 above.

Key Financial Definitions

Revenue

Our revenue is derived from three primary sources: company-operated restaurant revenue, franchise revenue, which is comprised primarily of franchise royalties and, to a lesser extent, franchise fees and sublease rental income, and franchise advertising fee revenue. See Note 10 to Item 1 above for further details regarding our revenue recognition policy.

Food and Paper Costs

Food and paper costs include the direct costs associated with food, beverage and packaging of our menu items. The components of food and paper costs are variable in nature, change with sales volume, are impacted by menu mix, and are subject to increases or decreases in commodity costs.

Labor and Related Expenses

Labor and related expenses include wages, payroll taxes, workers' compensation expense, benefits, and bonuses paid to our restaurant management teams. Like other expense items, we expect labor costs to grow proportionately as our

restaurant revenue grows. Factors that influence labor costs include minimum wage and payroll tax legislation, the frequency and severity of workers' compensation claims, health care costs, and the performance of our restaurants.

Occupancy Costs and Other Operating Expenses

Occupancy costs include rent, common area maintenance, and real estate taxes. Other restaurant operating expenses include the costs of utilities, advertising, credit card processing fees, restaurant supplies, repairs and maintenance, and other restaurant operating costs.

General and Administrative Expenses

General and administrative expenses are comprised of expenses associated with corporate and administrative functions that support the development and operations of our restaurants, including compensation and benefits, travel expenses, stock compensation costs, legal and professional fees, and other related corporate costs. Also included are pre-opening costs, and expenses above the restaurant level, including salaries for field management, such as area and regional managers, and franchise field operational support.

Legal Settlements

Legal settlements include expenses such as judgments or settlements related to legal matters, legal claims and class action lawsuits.

Franchise Expenses

Franchise expenses are primarily comprised of rent expenses incurred on properties leased by us and then sublet to franchisees, expenses incurred in support of franchisee information technology systems, and the franchisee's portion of advertising expenses.

Depreciation and Amortization

Depreciation and amortization primarily consists of the depreciation of property and equipment, including leasehold improvements and equipment.

Loss on Disposal of Assets

Loss on disposal of assets includes the loss on disposal of assets related to retirements and replacement or write-off of leasehold improvements or equipment.

Impairment and Closed-Store Reserves

We review long-lived assets such as property, equipment, and intangibles on a unit-by-unit basis for impairment when events or circumstances indicate a carrying value of the assets that may not be recoverable. We determine if there is impairment at the restaurant level by comparing undiscounted future cash flows from the related long-lived assets to their respective carrying values and record an impairment charge when appropriate. In determining future cash flows, significant estimates are made by us with respect to future operating results of each restaurant over its remaining lease term, including sales trends, labor rates, commodity costs and other operating cost assumptions. If assets are determined to be impaired, the impairment charge is measured by calculating the amount by which the asset carrying amount exceeds its fair value. This process of assessing fair values requires the use of estimates and assumptions, including our ability to sell or reuse the related assets and market conditions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets and these charges could be material.

When the Company closes a restaurant, it will evaluate the right-of-use ("ROU") asset for impairment, based on anticipated sublease recoveries. The remaining value of the ROU asset is amortized on a straight-line basis, with the expense recognized in closed-store reserve expense, in addition to property tax and common area maintenance ("CAM") charges for closed restaurants.

Interest Expense, Net

Interest expense, net, consists primarily of interest on our outstanding debt. Debt issuance costs are amortized at cost over the life of the related debt.

Provision for Income Taxes

Provision for income taxes consists of federal and state taxes on our income.

Comparison of Results of Income

Our operating results for the thirteen weeks ended September 23, 2020 and September 25, 2019 and expressed as percentages of total revenue, with the exception of cost of operations and company restaurant expenses, which are expressed as a percentage of company-operated restaurant revenue, are compared below.

	Thirteen Weeks Ended					
	September 23, 2020		September 25, 2019		Increase / (Decrease)	
	(\$,000)	(%)	(\$,000)	(%)	(\$,000)	(%)
Statements of Income Data						
Company-operated restaurant revenue	\$ 97,276	87.7	\$ 99,052	88.4	\$ (1,776)	(1.8)
Franchise revenue	7,781	7.0	7,273	6.5	508	7.0
Franchise advertising fee revenue	5,922	5.3	5,742	5.1	180	3.1
Total revenue	110,979	100.0	112,067	100.0	(1,088)	(1.0)
Cost of operations						
Food and paper costs (1)	24,922	25.6	27,512	27.8	(2,590)	(9.4)
Labor and related expenses (1)	28,756	29.6	29,292	29.6	(536)	(1.8)
Occupancy and other operating expenses (1)	23,836	24.5	23,844	24.1	(8)	(0.0)
Gain on recovery of insurance proceeds, lost profits (1)	(2,000)	(2.1)	—	—	(2,000)	N/A
Company restaurant expenses (1)	75,514	77.6	80,648	81.4	(5,134)	(6.4)
General and administrative expenses	9,803	8.8	9,539	8.5	264	2.8
Franchise expenses	7,572	6.8	7,006	6.3	566	8.1
Depreciation and amortization	4,092	3.7	4,343	3.9	(251)	(5.8)
Loss on disposal of assets	29	0.0	35	0.0	(6)	(17.1)
Impairment and closed-store reserves	1,776	1.6	367	0.3	1,409	383.9
Loss on disposition of restaurants	—	—	11	0.0	(11)	(100.0)
Total expenses	98,786	89.0	101,949	91.0	(3,163)	(3.1)
Income from operations	12,193	11.0	10,118	9.0	2,075	20.5
Interest expense, net of interest income	770	0.7	973	0.9	(203)	(20.9)
Income tax receivable agreement income	(144)	(0.1)	(197)	(0.2)	53	(26.9)
Income before provision for income taxes	11,567	10.4	9,342	8.3	2,225	23.8
Provision for income taxes	1,647	1.5	2,940	2.6	(1,293)	(44.0)
Net income	\$ 9,920	8.9	\$ 6,402	5.7	\$ 3,518	55.0

(1) Percentages for line items relating to cost of operations and company restaurant expenses are calculated with company-operated restaurant revenue as the denominator. All other percentages use total revenue.

Our operating results for the thirty-nine weeks ended September 23, 2020 and September 25, 2019 and expressed as percentages of total revenue, with the exception of cost of operations and company restaurant expenses, which are expressed as a percentage of company-operated restaurant revenue, are compared below.

	Thirty-Nine Weeks Ended					
	September 23, 2020		September 25, 2019		Increase / (Decrease)	
	(\$,000)	(%)	(\$,000)	(%)	(\$,000)	(%)
Statements of Income Data						
Company-operated restaurant revenue	\$ 277,617	87.9	\$ 296,341	88.5	\$ (18,724)	(6.3)
Franchise revenue	21,562	6.8	21,635	6.5	(73)	(0.3)
Franchise advertising fee revenue	16,567	5.2	16,808	5.0	(241)	(1.4)
Total revenue	315,746	100.0	334,784	100.0	(19,038)	(5.7)
Cost of operations						
Food and paper costs(1)	73,357	26.4	82,550	27.9	(9,193)	(11.1)
Labor and related expenses(1)	83,208	30.0	88,140	29.7	(4,932)	(5.6)
Occupancy and other operating expenses(1)	67,867	24.4	70,103	23.7	(2,236)	(3.2)
Gain on recovery of insurance proceeds, lost profits(1)	(2,000)	(0.7)	—	—	(2,000)	N/A
Company restaurant expenses(1)	222,432	80.1	240,793	81.3	(18,361)	(7.6)
General and administrative expenses	29,599	9.4	30,235	9.0	(636)	(2.1)
Franchise expenses	21,110	6.7	20,692	6.2	418	2.0
Depreciation and amortization	12,629	4.0	13,558	4.0	(929)	(6.9)
Loss on disposal of assets	156	0.0	213	0.1	(57)	(26.8)
Recovery of securities lawsuits related legal expenses and other insurance claims	(123)	(0.0)	(10,000)	(3.0)	9,877	(98.8)
Impairment and closed-store reserves	4,615	1.5	1,241	0.4	3,374	271.9
Loss on disposition of restaurants	—	—	5,062	1.5	(5,062)	(100.0)
Total expenses	290,418	92.0	301,794	90.1	(11,376)	(3.8)
Income from operations	25,328	8.0	32,990	9.9	(7,662)	(23.2)
Interest expense, net of interest income	2,583	0.8	2,754	0.8	(171)	(6.2)
Income tax receivable agreement expense (income)	26	0.0	(120)	—	146	(121.7)
Income before provision for income taxes	22,719	7.2	30,356	9.1	(7,637)	(25.2)
Provision for income taxes	3,700	1.2	8,954	2.7	(5,254)	(58.7)
Net income	\$ 19,019	6.0	\$ 21,402	6.4	\$ (2,383)	(11.1)

(1) Percentages for line items relating to cost of operations and company restaurant expenses are calculated with company-operated restaurant revenue as the denominator. All other percentages use total revenue.

Company-Operated Restaurant Revenue

For the quarter, company-operated restaurant revenue decreased \$1.8 million, or 1.8%, from the comparable period in the prior year. The decline in company-operated restaurant sales was primarily due to a decrease in company-operated restaurant revenue of \$1.9 million from the closure of two restaurants and the five company-operated restaurants sold by the Company to franchisees during or subsequent to the third quarter of 2019, a \$0.6 million decrease due to temporary restaurant closures due to the COVID-19 pandemic and a \$0.2 million decrease in revenue recognized for our loyalty points program. This company-operated restaurant sales decrease was partially offset by an increase of \$0.7 million of non-comparable restaurant sales on restaurants that had not been open the fifteen months required to be included in comparable restaurant sales and an increase of \$0.2 million due to a 0.2% increase in company-operated comparable restaurant sales. The company-operated comparable restaurant sales increase consisted of an approximately 18.1% increase in average check size, partially offset by a decline in transactions of 15.2%. It is uncertain whether the increase in average check size will persist once the pandemic ends.

Year-to-date, company-operated restaurant revenue decreased \$18.7 million, or 6.3%, from the comparable period in the prior year. The decline in company-operated restaurant sales was primarily due to a \$11.3 million decrease in revenue from the closure of four restaurants and the 16 company-operated restaurants sold by the Company to franchisees during or subsequent to the first quarter of 2019, a decrease in company-operated restaurant revenue of \$8.5 million due to a 3.0% decrease in company-operated comparable restaurant sales, which we believe was primarily related to the impact of the COVID-19 pandemic, and a \$1.0 million decrease due to temporary restaurant closures due to the COVID-19

pandemic. See above under “COVID-19 Impact” for additional information related to the impact of the COVID-19 pandemic on our business. This company-operated restaurant sales decrease was partially offset by an increase of \$2.1 million of non-comparable restaurant sales on restaurants that had not been open the fifteen months required to be included in comparable restaurant sales. The company-operated comparable restaurant sales decrease consisted of a decline in transactions of 15.2%, partially offset by a 14.4% increase in average check size. It is uncertain whether the increase in average check size will persist once the pandemic ends.

Franchise Revenue

For the quarter, franchise revenue increased \$0.5 million, or 7.0%, from the comparable period in the prior year. This increase was primarily due to a franchise comparable restaurant sales increase of 3.0%, the opening of two new franchised restaurants and revenue generated from five company-operated restaurants sold by the Company to franchisees during or subsequent to the third quarter of 2019, and revenue recognized related to franchise development agreements. This franchise revenue increase was partially offset by the closure of nine franchise locations during or subsequent to the third quarter of 2019.

Year-to-date, franchise revenue decreased less than \$0.1 million, or 0.3%, from the comparable period in the prior year. This decrease was primarily due to a franchise comparable restaurant sales decrease of 3.3%, which we believe was primarily due to the COVID-19 pandemic, the closure of nine franchise locations during or subsequent to the first quarter of 2019 and a decrease in fees received from franchised restaurants related to their use of our point-of-sales system. See above under “COVID-19 Impact” for additional information related to the impact of the COVID-19 pandemic on our business. This franchise revenue decrease was almost fully offset by the opening of four new franchised restaurants and revenue generated from 16 company-operated restaurants sold by the Company to franchisees during or subsequent to the first quarter of 2019.

Franchise Advertising Fee Revenue

For the quarter, franchise advertising fee revenue increased \$0.2 million, or 3.1%, from the comparable period in the prior year. Year-to-date, franchise advertising fee revenue decreased \$0.2 million, or 1.4%, from the comparable period in the prior year. As advertising fee revenue is a percentage of franchisees’ revenue, both the quarter and year-to-date fluctuations were due to the increases and decreases noted in franchise revenue above.

Food and Paper Costs

For the quarter, food and paper costs decreased \$2.6 million, or 9.4%, from the comparable period in the prior year, primarily due to a \$2.5 million decrease in food costs and a \$0.1 million decrease in paper costs. Year-to-date, food and paper costs decreased \$9.2 million, or 11.1%, from the comparable period in the prior year, due to a \$8.1 million decrease in food costs and a \$1.1 million decrease in paper costs. The decrease in food and paper costs, for the quarter and year-to-date periods, resulted primarily from lower company transactions, due to the COVID-19 pandemic, lower food waste and a vendor rebate received. For the quarter, food and paper costs as a percentage of company-operated restaurant revenue were 25.6%, down from 27.8% in the comparable period of the prior year. Year-to-date, food and paper costs as a percentage of company-operated restaurant revenue were 26.4%, down from 27.9% in the comparable period of the prior year. The percentage decrease for the quarter and year-to-date periods was due primarily to an increase in pricing, lower food usage, effective waste management and favorable sales mix, partially offset by commodity inflation.

Labor and Related Expenses

For the quarter, labor and related expenses decreased \$0.5 million, or 1.8%, from the comparable period in the prior year. Year-to-date, labor and related expenses decreased \$4.9 million, or 5.6%, from the comparable period in the prior year. The decrease for the quarter and year-to-date periods was due primarily to a reduction in labor by restaurants closed or sold to franchisees, adjustments to the labor model based on dining room closures, operating hours and lower sales volumes and lower group insurance and workers compensation expense due to decreased claims activity. These decreases were partially offset by higher wages primarily due to minimum wage increases in California during fiscal 2019 and 2020, and labor costs associated with the COVID-19 pandemic.

For the quarter, labor and related expenses as a percentage of company-operated restaurant revenue were 29.6%, consistent with the comparable period in the prior year. This percentage was impacted by wage increases in California and labor costs associated with the COVID-19 pandemic, offset by an increase in pricing and labor efficiencies. Year-to-date payroll and benefit expenses as a percentage of company-operated restaurant revenue were 30.0%, up from 29.7% in the comparable period in the prior year. The increase for the year-to-date period was due primarily to sales deleverage, wage increases in California, and labor costs associated with the COVID-19 pandemic. Partially offsetting these increases were the positive impacts of an increase in pricing and labor efficiencies.

Occupancy and Other Operating Expenses

For the quarter, occupancy and other operating expenses was flat from the comparable period of the prior year. Fluctuations in occupancy and other expenses consisted primarily of a \$0.6 million increase in customer order delivery fees payable to third parties due to an increase in delivery orders and a \$0.2 million increase in other operating expenses. These increases were offset by a \$0.3 million decrease in utilities costs, a \$0.2 million decrease in occupancy costs, primarily related to a reduction in rent expense from restaurants closed or sold to franchisees, and a decrease in other operating expenses of \$0.3 million. Year-to-date, occupancy and other operating expenses decreased \$2.2 million, or 3.2%, from the comparable period of the prior year. The decrease was primarily due to a \$1.0 million decrease in repair and maintenance costs, a \$1.0 million decrease in utilities costs, a \$0.9 million decrease in occupancy costs, primarily related to a reduction in rent expense from restaurants closed or sold to franchisees, a \$0.8 million decrease in advertising expenses, a \$0.4 million decrease in credit card fees primarily related to a decrease in rates and transactions and a \$0.1 million decrease in other operating expenses. These decreases were partially offset by a \$2.0 million increase in customer order delivery fees payable to third parties due to an increase in delivery orders.

For the quarter, occupancy and other operating expenses as a percentage of company-operated restaurant revenue were 24.5% up from 24.1% in the comparable period in the prior year. Year-to-date, occupancy and other operating expenses as a percentage of company-operated restaurant revenue were 24.4%, up from 23.7% in the comparable period of the prior year. The increases for the quarter and year-to-date periods resulted primarily from the increases noted above and sales deleverage.

Gain on Recovery of Insurance Proceeds, Lost Profits

During the thirteen and thirty-nine weeks ended September 23, 2020, we received business interruption insurance proceeds of \$2.0 million, primarily related to restaurant sales losses and expenses related to the COVID-19 pandemic and resulting dining room closures.

General and Administrative Expenses

For the quarter, general and administrative expenses increased \$0.3 million, or 2.8%, from the comparable period in the prior year. The increase for the quarter was due primarily to a \$0.8 million increase in labor related costs, primarily related to an increase in management bonus expense, and a \$0.4 million increase in stock compensation expenses. This increase was partially offset by a \$0.4 million decrease in legal expenses, a \$0.2 million decrease in restaurant pre-opening costs, a \$0.2 million decrease in recruiting costs and a \$0.1 million decrease in other general and administrative expenses. Year-to-date, general and administrative expenses decreased \$0.6 million, or 2.1%, from the comparable period in the prior year. The decrease for the year-to-date period was due primarily to a \$0.6 million decrease in labor related costs, largely related to a decrease in management bonus expense, decrease in severance expense and lower group insurance costs. Additionally, there was a \$0.1 million decrease in legal expenses related primarily to a decrease in securities class action litigation costs, partially offset by a \$2.5 million legal settlement related to the resolution of the longstanding lawsuit involving a contract dispute with one of the Company's franchisees concerning asserted territory rights. These decreases were partially offset by a \$0.1 million increase in other general and administrative expenses.

For the quarter, general and administrative expenses as a percentage of total revenue were 8.8%, up from 8.5% in the comparable period of the prior year. Year-to-date, general and administrative expenses as a percentage of total revenue were 9.4%, up from 9.0% in the comparable period of the prior year. The percentage increase for the quarter and year-to-date periods resulted primarily from the decline in revenue, as well as the cost increases discussed above.

Recovery of Securities Class Action Legal Expenses and Other Insurance Claims

During the thirty-nine weeks ended September 23, 2020, we received insurance proceeds of \$0.1 million related to a property claim. During the thirty-nine weeks ended September 25, 2019, we received insurance proceeds of \$10.0 million related to the settlement of the securities class action lawsuit. See Note 7, “Commitments and Contingencies, Legal Matters.”

Loss on Disposition of Restaurants

During the thirteen and thirty-nine weeks ended September 25, 2019, we completed the sale of four company-operated restaurants within the San Francisco area to an existing franchisee and seven company-operated restaurants in the Phoenix area to another existing franchisee. We determined that these restaurant dispositions represent multiple element arrangements, and as a result, the cash consideration received was allocated to the separate elements based on their relative selling price. Cash proceeds included upfront consideration for the sale of the restaurants and franchise fees, as well as future cash consideration for royalties and lease payments. We also considered the future lease payments in allocating the initial cash consideration received. The cash consideration per restaurant for franchise fees is consistent with the amounts stated in the related franchise agreements, which are charged for separate standalone arrangements. We initially defer and subsequently recognize the franchise fees over the term of the franchise agreement. Future royalty income is also recognized in revenue as earned.

These sales resulted in cash proceeds of \$4.8 million and a net loss on sale of restaurants of \$5.1 million for the thirty-nine weeks ended September 25, 2019. These restaurants are included in the total number of franchised El Pollo Loco restaurants.

Impairment and Closed-Store Reserves

During the thirteen and thirty-nine weeks ended September 23, 2020, we recognized a \$1.5 million and \$3.5 million non-cash impairment charge, respectively, primarily related to the carrying value of the ROU assets of one restaurant in Texas and the long-lived assets of four restaurants in California. During the thirteen and thirty-nine weeks ended September 25, 2019, we recorded a non-cash impairment charge of \$0.1 million and \$0.3 million, respectively, primarily related to the carrying value of the assets of one restaurant in California. Given the inherent uncertainty in projecting results for newer restaurants in newer markets, as well as the impact of the COVID-19 pandemic, the Company is monitoring the recoverability of the carrying value of the assets of several restaurants on an ongoing basis. For these restaurants, if expected performance is not realized, an impairment charge may be recognized in future periods, and such charge could be material.

When a restaurant is closed, we will evaluate the ROU asset for impairment, based on anticipated sublease recoveries. The remaining value of the ROU asset is amortized on a straight-line basis, with the expense recognized in closed-store reserve expense. Additionally, any property tax and CAM payments relating to closed restaurants are included within closed-store expense. During the thirteen and thirty-nine weeks ended September 23, 2020, we recognized \$0.3 million and \$1.1 million, respectively, of closed-store reserve expense related to the amortization of ROU assets, property taxes and CAM payments for our closed locations. During the thirty-nine weeks ended September 25, 2019, we closed one restaurant in California and one restaurant in Texas and recognized \$0.3 million and \$1.0 million of closed-store reserve expense for the thirteen and thirty-nine weeks ended September 25, 2019, respectively, primarily related to the amortization of ROU assets, property taxes and CAM payments for our closed locations.

Interest Expense, Net

For each of the quarter and year-to-date periods, interest expense, net, decreased \$0.2 million from the comparable period in the prior year. The decrease is primarily related to lower interest rates and lower outstanding balances on our 2018 Revolver.

Income Tax Receivable Agreement

On July 30, 2014, we entered into the TRA. The TRA calls for us to pay to our pre-IPO stockholders 85% of the savings in cash that we realize in our taxes as a result of utilizing our net operating losses and other tax attributes attributable to preceding periods. For the thirteen and thirty-nine weeks ended September 23, 2020, we recorded income tax receivable

agreement income of \$0.1 million and income tax receivable expense of less than \$0.1 million, respectively, and for the thirteen and thirty-nine weeks ended September 25, 2019 we recorded income tax receivable agreement income of \$0.2 million and \$0.1 million, respectively.

Provision for Income Taxes

For the quarter ended September 23, 2020, we recorded an income tax provision of \$1.6 million, reflecting an estimated effective tax rate of 14.2%. For the quarter ended September 25, 2019, we recorded an income tax provision of \$2.9 million, reflecting an estimated effective tax rate of approximately 31.5%. Year-to-date ended September 23, 2020, we recorded an income tax provision of \$3.7 million, reflecting an estimated effective tax rate of approximately 16.3%. Year-to-date ended September 25, 2019, we recorded an income tax provision of \$9.0 million, reflecting an estimated effective tax rate of approximately 29.5%. The difference between the 21.0% statutory rate and the Company's effective tax rate of 16.3% for the year-to-date ended September 23, 2020 is primarily a result of state taxes, a Work Opportunity Tax Credit benefit, the change in valuation allowance against certain state credits as a result of future forecasted income apportioned to the state jurisdiction, non-deductible executive compensation, changes to total expected TRA payments due to changes in future forecasted taxable income and windfall tax benefit related to stock options exercised, recorded as a discrete item during the thirteen and thirty-nine weeks ended September 23, 2020.

Key Performance Indicators

To evaluate the performance of our business, we utilize a variety of financial and performance measures. These key measures include company-operated restaurant revenue, comparable restaurant sales, company-operated average unit volumes, restaurant contribution, restaurant contribution margin, new restaurant openings, EBITDA, and Adjusted EBITDA.

Company-Operated Restaurant Revenue

Company-operated restaurant revenue consists of sales of food and beverages in company-operated restaurants net of promotional allowances, employee meals, and other discounts. Company-operated restaurant revenue in any period is directly influenced by the number of operating weeks in such period, the number of open restaurants, and comparable restaurant sales.

Seasonal factors and the timing of holidays cause our revenue to fluctuate from quarter to quarter. Our revenue per restaurant is typically lower in the first and fourth quarters due to reduced January and December traffic and higher in the second and third quarters. As a result of seasonality, our quarterly and annual results of operations and key performance indicators such as company-operated restaurant revenue and comparable restaurant sales may fluctuate. In addition, we expect our quarterly company-operated restaurant revenue and comparable restaurant sales to continue to fluctuate significantly due to the current COVID-19 pandemic. See above under "COVID-19 Impact" for additional information related to the impact of the COVID-19 pandemic on our business.

Comparable Restaurant Sales

Comparable restaurant sales reflect year-over-year sales changes for comparable company-operated, franchised, and system-wide restaurants. A restaurant enters our comparable restaurant base the first full week after it has operated for fifteen months. Comparable restaurant sales exclude restaurants closed during the applicable period. At September 23, 2020 and September 25, 2019, there were 468 and 462 comparable restaurants, 191 and 198 company-operated restaurants and 277 and 264 franchised restaurants, respectively. Comparable restaurant sales indicate the performance of existing restaurants, since new restaurants are excluded.

Comparable restaurant sales growth can be generated by an increase in the number of meals sold and/or by increases in the average check amount, resulting from a shift in menu mix and/or higher prices resulting from new products or price increases.

Company-Operated Average Unit Volumes

We measure company-operated average unit volumes ("AUVs") on both a weekly and an annual basis. Weekly AUVs consist of comparable restaurant sales over a seven-day period from Thursday to Wednesday. Annual AUVs are

calculated using the following methodology: First, we divide our total net sales for all company-operated restaurants for the fiscal year by the total number of restaurant operating weeks during the same period. Second, we annualize that average weekly per-restaurant sales figure by multiplying it by 52. An operating week is defined as a restaurant open for business over a seven-day period from Thursday to Wednesday. This measurement allows management to assess changes in consumer spending patterns at our restaurants and the overall performance of our restaurant base.

Restaurant Contribution and Restaurant Contribution Margin

Restaurant contribution and restaurant contribution margin are neither required by, nor presented in accordance with, GAAP. Restaurant contribution is defined as company-operated restaurant revenue less company restaurant expenses which includes food and paper cost, labor and related expenses and occupancy and other operating expenses, where applicable. Restaurant contribution excludes certain costs, such as general and administrative expenses, depreciation and amortization, impairment and closed-store reserve and other costs that are considered normal operating costs and accordingly, restaurant contribution is not indicative of overall Company results and does not accrue directly to the benefit of stockholders because of the exclusion of certain corporate-level expenses. Restaurant contribution margin is defined as restaurant contribution as a percentage of net company-operated restaurant revenue.

Restaurant contribution and restaurant contribution margin are supplemental measures of operating performance of our restaurants, and our calculations thereof may not be comparable to those reported by other companies. Restaurant contribution and restaurant contribution margin have limitations as analytical tools, and you should not consider them in isolation, or superior to, or as substitutes for the analysis of our results as reported under GAAP. Management uses restaurant contribution and restaurant contribution margin as key metrics to evaluate the profitability of incremental sales at our restaurants, to evaluate our restaurant performance across periods, and to evaluate our restaurant financial performance compared with our competitors. Management believes that restaurant contribution and restaurant contribution margin are important tools for investors, because they are widely-used metrics within the restaurant industry to evaluate restaurant-level productivity, efficiency, and performance. Restaurant contribution and restaurant contribution margin may also assist investors in evaluating our business and performance relative to industry peers and provide greater transparency with respect to the Company's financial condition and results of operation.

A reconciliation of restaurant contribution and restaurant contribution margin to company-operated restaurant revenue is provided below:

(Dollar amounts in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Restaurant contribution:				
Income from operations	\$ 12,193	\$ 10,118	\$ 25,328	\$ 32,990
Add (less):				
General and administrative expenses	9,803	9,539	29,599	30,235
Franchise expenses	7,572	7,006	21,110	20,692
Depreciation and amortization	4,092	4,343	12,629	13,558
Loss on disposal of assets	29	35	156	213
Franchise revenue	(7,781)	(7,273)	(21,562)	(21,635)
Franchise advertising fee revenue	(5,922)	(5,742)	(16,567)	(16,808)
Recovery of securities lawsuits related legal expenses and other insurance claims	—	—	(123)	(10,000)
Impairment and closed-store reserves	1,776	367	4,615	1,241
Loss on sale of restaurants	—	11	—	5,062
Restaurant contribution	\$ 21,762	\$ 18,404	\$ 55,185	\$ 55,548
Company-operated restaurant revenue:				
Total revenue	\$ 110,979	\$ 112,067	\$ 315,746	\$ 334,784
Less:				
Franchise revenue	(7,781)	(7,273)	(21,562)	(21,635)
Franchise advertising fee revenue	(5,922)	(5,742)	(16,567)	(16,808)
Company-operated restaurant revenue	\$ 97,276	\$ 99,052	\$ 277,617	\$ 296,341
Restaurant contribution margin (%)	<u>22.4 %</u>	<u>18.6 %</u>	<u>19.9 %</u>	<u>18.7 %</u>

New Restaurant Openings

The number of restaurant openings reflects the number of new restaurants opened by us and our franchisees during a particular reporting period. Before a new restaurant opens, we and our franchisees incur pre-opening costs, as described below. New restaurants often open with an initial start-up period of higher than normal sales volumes, which subsequently decrease to stabilized levels. New restaurants typically experience normal inefficiencies in the form of higher food and paper, labor, and other direct operating expenses and, as a result, restaurant contribution margins are generally lower during the start-up period of operation. The average start-up period after which our new restaurants' revenue and expenses normalize is approximately fourteen weeks. When we enter new markets, we may be exposed to start-up times and restaurant contribution margins that are longer and lower than reflected in our average historical experience.

EBITDA and Adjusted EBITDA

EBITDA represents net income before interest expense, provision for income taxes, depreciation, and amortization. Adjusted EBITDA represents net income before interest expense, provision for income taxes, depreciation, amortization, and items that we do not consider representative of our on-going operating performance, as identified in the reconciliation table below.

EBITDA and Adjusted EBITDA as presented in this report are supplemental measures of our performance that are neither required by, nor presented in accordance with, GAAP. EBITDA and Adjusted EBITDA are not measurements of our financial performance under GAAP and should not be considered as alternatives to net income, operating income, or any other performance measures derived in accordance with GAAP, or as alternatives to cash flow from operating

activities as a measure of our liquidity. In addition, in evaluating EBITDA and Adjusted EBITDA, you should be aware that in the future we will incur expenses or charges such as those added back to calculate EBITDA and Adjusted EBITDA. Our presentation of EBITDA and Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or nonrecurring items.

EBITDA and Adjusted EBITDA have limitations as analytical tools, and you should not consider them in isolation, or as substitutes for analysis of our results as reported under GAAP. Some of these limitations are (i) they do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments, (ii) they do not reflect changes in, or cash requirements for, our working capital needs, (iii) they do not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt, (iv) although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect any cash requirements for such replacements, (v) they do not adjust for all non-cash income or expense items that are reflected in our statements of cash flows, (vi) they do not reflect the impact of earnings or charges resulting from matters we consider not to be indicative of our on-going operations, and (vii) other companies in our industry may calculate these measures differently than we do, limiting their usefulness as comparative measures.

We compensate for these limitations by providing specific information regarding the GAAP amounts excluded from such non-GAAP financial measures. We further compensate for the limitations in our use of non-GAAP financial measures by presenting comparable GAAP measures more prominently.

We believe that EBITDA and Adjusted EBITDA facilitate operating performance comparisons from period to period by isolating the effects of some items that vary from period to period without any correlation to core operating performance or that vary widely among similar companies. These potential differences may be caused by variations in capital structures (affecting interest expense), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses) and the age and book depreciation of facilities and equipment (affecting relative depreciation expense). We also present EBITDA and Adjusted EBITDA because (i) we believe that these measures are frequently used by securities analysts, investors and other interested parties to evaluate companies in our industry, (ii) we believe that investors will find these measures useful in assessing our ability to service or incur indebtedness, and (iii) we use EBITDA and Adjusted EBITDA internally for a number of benchmarks including to compare our performance to that of our competitors and for compensation performance benchmarks.

The following table sets forth reconciliations of EBITDA and Adjusted EBITDA to our net income:

(Amounts in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 23, 2020	September 25, 2019	September 23, 2020	September 25, 2019
Net income	\$ 9,920	\$ 6,402	\$ 19,019	\$ 21,402
Non-GAAP adjustments:				
Provision for income taxes	1,647	2,940	3,700	8,954
Interest expense, net of interest income	770	973	2,583	2,754
Depreciation and amortization	4,092	4,343	12,629	13,558
EBITDA	\$ 16,429	\$ 14,658	\$ 37,931	\$ 46,668
Stock-based compensation expense (a)	909	668	2,170	1,797
Loss on disposal of assets (b)	29	35	156	213
Recovery of securities lawsuits related legal expense and other insurance claims (c)	—	—	(123)	(10,000)
Impairment and closed-store reserves (d)	1,776	367	4,615	1,241
Loss on disposition of restaurants (e)	—	11	—	5,062
Income tax receivable agreement (income) expense (f)	(144)	(197)	26	(120)
Securities class action legal expense (g)	289	179	527	2,809
Legal settlements (h)	—	—	2,566	—
Pre-opening costs (i)	—	158	110	193
Executive transition costs (j)	—	51	—	151
Adjusted EBITDA	\$ 19,288	\$ 15,930	\$ 47,978	\$ 48,014

(a) Includes non-cash, stock-based compensation.

- (b) Loss on disposal of assets includes the loss on disposal of assets related to retirements and replacement or write-off of leasehold improvements or equipment.
- (c) During thirty-nine weeks ended September 23, 2020, we received insurance proceeds of \$0.1 million related to a property claim. During the thirteen and thirty-nine weeks ended September 25, 2019, we received insurance proceeds of \$10.0 million related to the settlement of the securities class action lawsuit. See Note 7, "Commitments and Contingencies, Legal Matters."
- (d) Includes costs related to impairment of long-lived assets and closing restaurants. During the thirteen and thirty-nine weeks ended September 23, 2020, we recognized \$1.5 million and a \$3.5 million, respectively, non-cash impairment charge, primarily related to the carrying value of the ROU assets of one restaurant in Texas and the long-lived assets of four restaurants in California. During the thirteen and thirty-nine weeks ended September 25, 2019, we recorded a non-cash impairment charge of \$0.1 million and \$0.3 million, respectively, primarily related to the carrying value of the assets of one restaurant in California. Given the difficulty in projecting results for newer restaurants in newer markets, as well as the impact of the COVID-19 pandemic, we are monitoring the recoverability of the carrying value of the assets of several restaurants on an ongoing basis. For these restaurants, if expected performance is not realized, an impairment charge may be recognized in future periods, and such charge could be material.

When a restaurant is closed, we will evaluate the ROU asset for impairment, based on anticipated sublease recoveries. The remaining value of the ROU asset is amortized on a straight-line basis, with the expense recognized in closed-store reserve expense. Additionally, any property tax and CAM payments relating to closed restaurants are included within closed-store expense. During the thirteen and thirty-nine weeks ended September 23, 2020, we recognized \$0.3 million and \$1.1 million, respectively, of closed-store reserve expense related to the amortization of ROU assets, property taxes and CAM payments for our closed locations. During the thirty-nine weeks ended September 25, 2019, we closed one restaurant in California and one restaurant in Texas, and recognized \$0.3 million and \$1.0 million of closed-store reserve expense for the thirteen and thirty-nine weeks ended September 25, 2019, respectively, primarily related to the amortization of ROU assets, property taxes and CAM payments for our closed locations.

- (e) During the thirteen and thirty-nine weeks ended September 25, 2019, we completed the sale of four company-operated restaurants within the San Francisco area to an existing franchisee and seven company-operated restaurants in the Phoenix area to another existing franchisee. These sales resulted in cash proceeds of \$4.8 million and a net loss on sale of restaurants of \$0.9 million and \$5.1 million for the thirteen and thirty-nine weeks ended September 25, 2019, respectively. These restaurants are now included in our franchised restaurant totals.
- (f) On July 30, 2014, we entered into the TRA. This agreement calls for us to pay to our pre-IPO stockholders 85% of the savings in cash that we realize in our taxes as a result of utilizing our net operating losses and other tax attributes attributable to preceding periods. For the thirteen and thirty-nine weeks ended September 23, 2020 and September 25, 2019, income tax receivable agreement (income) expense consisted of the amortization of interest expense and changes in estimates for actual tax returns filed, related to our total expected TRA payments.
- (g) Consists of costs related to the defense of securities lawsuits. See Note 7, "Commitments and Contingencies, Legal Matters."
- (h) Includes an expense related to resolution of the longstanding lawsuit involving a contract dispute with one of the Company's franchisees concerning asserted territory rights, as well as amounts incurred related to the payment of the final settlement amounts for consolidated wage and hour class action lawsuits resolved in prior quarters.
- (i) Pre-opening costs are a component of general and administrative expenses, and consist of costs directly associated with the opening of new restaurants and incurred prior to opening, including management labor costs, staff labor costs during training, food and supplies used during training, marketing costs, and other related pre-opening costs. These are generally incurred over the three to five months prior to opening. Pre-opening costs also include occupancy costs incurred between the date of possession and the opening date for a restaurant.
- (j) Includes costs associated with the transition of our CEO, such as CEO sign-on bonus.

Liquidity and Capital Resources

Our primary sources of liquidity and capital resources have been cash provided from operations, cash and cash equivalents, and the 2018 Revolver. Our primary requirements for liquidity and capital are new restaurants, existing restaurant capital investments (remodels and maintenance), interest payments on our debt, lease obligations, and working capital and general corporate needs. However, in light of the COVID-19 pandemic, we have temporarily suspended all new restaurants and capital investments. Our working capital requirements are not significant, since our customers pay for their purchases in cash or by payment card (credit or debit) at the time of sale. Thus, we are able to sell many of our inventory items before we have to pay our suppliers for them. Our restaurants do not require significant inventories or

receivables. We believe that our sources of liquidity and capital are sufficient to finance our continued operations for at least the next twelve months from the filing of the condensed consolidated financial statements. However, depending on the severity and longevity of the COVID-19 pandemic, the efforts taken to reduce its spread (including government-mandated closures of our dining rooms) and the possibility of a subsequent resurgence of the COVID-19 outbreak after the current outbreak subsides, our financial performance and liquidity could be further impacted and could impact our ability to meet certain financial covenants required in our 2018 Credit Agreement, specifically the lease-adjusted coverage ratio and fixed-charge coverage ratio.

The following table presents summary cash flow information for the periods indicated.

<u>(Amounts in thousands)</u>	<u>Thirty-Nine Weeks Ended</u>	
	<u>September 23, 2020</u>	<u>September 25, 2019</u>
Net cash provided by (used in)		
Operating activities	\$ 33,519	\$ 31,895
Investing activities	(4,349)	(6,078)
Financing activities	(7,711)	(20,717)
Net increase in cash	<u>\$ 21,459</u>	<u>\$ 5,100</u>

Operating Activities

For the thirty-nine weeks ended September 23, 2020, net cash provided by operating activities increased by approximately \$1.6 million from the comparable period of the prior year. This increase was due primarily to favorable working capital fluctuations, partially offset by a decline in profitability after non-cash items for the thirty-nine weeks ended September 23, 2020 compared to the prior year, which we believe related to the COVID-19 pandemic.

Investing Activities

For the thirty-nine weeks ended September 23, 2020, net cash used in investing activities decreased by \$1.7 million from the comparable period of the prior year. This was due primarily to purchases of property and equipment of \$4.3 million in the thirty-nine weeks ended September 23, 2020 compared to \$10.8 million in the thirty-nine weeks ended September 25, 2019. This was partially offset by cash proceeds of \$4.8 million received during the thirty-nine weeks ended September 25, 2019 related to the sale of four company-operated restaurants within the San Francisco area to an existing franchisee and seven company-operated restaurants in the Phoenix area to another existing franchisee.

Given the uncertainty surrounding the severity and longevity of the COVID-19 pandemic, as a precautionary measure we have significantly reduced capital spending.

Financing Activities

For the thirty-nine weeks ended September 23, 2020, net cash used in financing activities decreased by \$13.0 million from the comparable period of the prior year. This decrease was due primarily to \$47.4 million of cash outflow related to stock buybacks during the thirty-nine weeks ended September 25, 2019 and \$5.8 million of proceeds received from the issuance of common stock upon exercise of stock options during the thirty-nine weeks ended September 23, 2020. This was partially offset by \$13.2 million of net pay downs on the 2018 Revolver during the thirty-nine weeks ended September 23, 2020, compared to net borrowings of \$27.0 million for the thirty-nine weeks ended September 25, 2019.

Debt and Other Obligations

On July 13, 2018, the Company entered into the 2018 Credit Agreement, which provides for the 2018 Revolver to refinance the previous 2014 Revolver. The 2018 Revolver includes a sub limit of \$15.0 million for letters of credit and a sub limit of \$15.0 million for swingline loans. The 2018 Revolver and 2018 Credit Agreement will mature on July 13, 2023. The obligations under the 2018 Credit Agreement and related loan documents are guaranteed by the Company and Intermediate. The obligations of the Company, EPL and Intermediate under the 2018 Credit Agreement and related loan documents are secured by a first priority lien on substantially all of their respective assets.

Under the 2018 Revolver, Holdings may not make certain payments such as cash dividends, except that it may, inter alia, (i) pay up to \$1.0 million per year to repurchase or redeem qualified equity interests of Holdings held by past or present

officers, directors, or employees (or their estates) of the Company upon death, disability, or termination of employment, (ii) pay under its TRA, and (iii) so long as no default or event of default has occurred and is continuing, (a) make non-cash repurchases of equity interests in connection with the exercise of stock options by directors, officers and management, provided that those equity interests represent a portion of the consideration of the exercise price of those stock options, (b) pay up to \$0.5 million in any 12 month consecutive period to redeem, repurchase or otherwise acquire equity interests of any subsidiary that is not a wholly-owned subsidiary from any holder of equity interest in such subsidiary, (c) pay up to \$2.5 million per year pursuant to stock option plans, employment agreements, or incentive plans, (d) make up to \$5.0 million in other restricted payments per year, and (e) make other restricted payments, subject to its compliance, on a pro forma basis, with (x) a lease-adjusted consolidated leverage ratio not to exceed 4.25 times and (y) the financial covenants applicable to the 2018 Revolver.

Borrowings under the 2018 Credit Agreement (other than any swingline loans) bear interest, at the borrower's option, at rates based upon either LIBOR or a base rate, plus, for each rate, a margin determined in accordance with a lease-adjusted consolidated leverage ratio-based pricing grid. The base rate is calculated as the highest of (a) the federal funds rate plus 0.50%, (b) the published Bank of America prime rate, or (c) LIBOR plus 1.00%. For LIBOR loans, the margin is in the range of 1.25% to 2.25%, and for base rate loans the margin is in a range of 0.25% to 1.25%. Borrowings under the 2018 Revolver may be repaid and reborrowed. The interest rate range was 1.67% to 1.68% and 1.67% to 3.29% for the thirteen and thirty-nine weeks ended September 23, 2020, respectively, and 3.65% to 3.90% and 3.65% to 6.00% for the thirteen and thirty-nine weeks ended September 25, 2019, respectively.

The 2018 Credit Agreement contains certain financial covenants. The Company was in compliance with the financial covenants as of September 23, 2020. However, depending on the severity and longevity of the COVID-19 pandemic, the efforts taken to reduce its spread and the possibility of a resurgence of the COVID-19 outbreak after the initial outbreak subside, the Company's financial performance and liquidity could be further impacted and could impact the Company's ability to comply with certain financial covenants required in our 2018 Credit Agreement, specifically the lease-adjusted coverage ratio and fixed-charge coverage ratio.

At September 23, 2020, \$8.4 million of letters of credit and \$83.8 million of borrowings were outstanding under the 2018 Revolver. There were \$57.8 million remaining borrowings available under the 2018 Revolver at September 23, 2020. Subsequent to September 23, 2020, the Company made a voluntary \$28.0 million pre-payment on its 2018 Revolver. As of October 30, 2020, the Company had \$55.8 million in outstanding borrowings under the 2018 Revolver and \$85.8 million in borrowing availability.

During the year ended December 25, 2019, we entered into an interest rate swap with a notional amount of \$40.0 million, related to the outstanding borrowings under our 2018 Revolver. The interest rate swap was designated as a cash flow hedge and effectively converted a portion of our outstanding borrowings to a fixed rate of 1.31%, plus the applicable margin spread, which is currently 1.5%. The interest rate swap matures in June 2023.

Contractual Obligations

Our contractual obligations outstanding on September 23, 2020 have not changed materially since those disclosed under "Debt and Other Obligations – Contractual Obligations" in Part II, Item 7 of our annual report on Form 10-K for the year ended December 25, 2019 other than (i) the impact of our delay in making April, May and June rent payments on the majority of our leased properties as discussed under to COVID-19 Impact in the "Overview" section above and (ii) subsequent borrowings and pre-payments under our 2018 Revolver as disclosed under Note 4, "Long-Term Debt" in Item 1 above. Our contractual commitments relate to future (i) debt payments, including expected interest expense, calculated based on current interest rates, (ii) restaurant operating lease payments, (iii) income tax receivable agreement payments, and (iv) purchasing commitments for chicken.

Off-Balance Sheet and Other Arrangements

As of September 23, 2020 and December 25, 2019, we were using \$8.4 million of borrowing capacity on the 2018 Revolver for letters of credit in support of our insurance programs.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

We are exposed to market risk from changes in the interest rate on our debt, which bears interest, at our option, at rates based on LIBOR or a base rate, plus, for each rate, a margin determined in accordance with the terms of the 2018 Credit Agreement. For LIBOR loans, the margin is in the range of 1.25% and 2.25%. As of September 23, 2020, we had outstanding borrowings of \$83.8 million under our 2018 Revolver, \$8.4 million of letters of credit in support of our insurance programs, and the applicable margin on outstanding borrowings under 2018 Revolver was 1.5%. In addition, there is currently uncertainty around whether LIBOR will continue to exist after 2021. If LIBOR ceases to exist, we may need to enter into an amendment to the 2018 Credit Agreement and we cannot predict what alternative index would be negotiated with our lenders. If our lenders have increased costs due to changes in LIBOR, we may experience potential increases in interest rates on our variable rate debt, which could adversely impact our interest expense, results of operations and cash flows. After giving effect to the \$40.0 million of interest rate swaps described below, we effectively had \$43.8 million of long-term debt subject to variations in interest rates as of September 23, 2020 and a one percent increase in the variable rate of interest would increase annual interest expense by \$0.4 million.

We manage our interest rate risk through normal operating and financing activities and, when determined appropriate, through the use of derivative financial instruments. To balance our portfolio, we entered into an interest rate swap with a notional amount of \$40.0 million, related to the outstanding borrowings under our 2018 Revolver. The interest rate swap was designated as a cash flow hedge and effectively converted a portion of our outstanding borrowings to a fixed rate of 1.31%, plus applicable margin, which is currently 1.5%. The interest rate swap matures in June 2023.

Inflation

Inflation has an impact on food, paper, construction, utility, labor and benefits, general and administrative, and other costs, all of which can materially impact our operations. We have a substantial number of hourly employees who are paid wage rates at or based on the applicable federal, state, or local minimum wage, and increases in the minimum wage will increase our labor costs. In general, we have been able to substantially offset cost increases resulting from inflation by increasing menu prices, managing menu mix, improving productivity, or making other adjustments. We may not be able to offset cost increases in the future.

Commodity Price Risk

We are exposed to market price fluctuation in food product prices. Given the historical volatility of certain of our food product prices, including chicken, other proteins, grains, produce, dairy products, and cooking oil, these fluctuations can materially impact our food and beverage costs. While our purchasing commitments partially mitigate the risk of such fluctuations, there is no assurance that supply and demand factors such as disease or inclement weather will not cause the prices of the commodities used in our restaurant operations to fluctuate. In periods when the prices of commodities drop, we may pay higher prices under our purchasing commitments. In rapidly fluctuating commodities markets, it may prove difficult for us to adjust our menu prices in accordance with input price fluctuations. Therefore, to the extent that we do not pass along cost increases to our customers, our results of operations may be adversely affected. At this time, we do not use financial instruments to hedge our commodity risk.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) of the Exchange Act) that are designed to ensure that 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 in the SEC'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.

Our disclosure controls and procedures are based on assumptions about the likelihood of future events, and even effective disclosure controls and procedures can only provide reasonable assurance of achieving their objectives. Because of their inherent limitations, we cannot guarantee that our disclosure controls and procedures will succeed in

achieving their stated objectives in all cases, that they will be complied with in all cases, or that they will prevent or detect all misstatements.

Our management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective, at the reasonable assurance level, as of September 23, 2020.

Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting occurred during the quarter ended September 23, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

For information regarding legal proceedings, see Note 7. "Commitments and Contingencies—Legal Matters" in the accompanying "Notes to Condensed Consolidated Financial Statements" in this Quarterly Report, which information is incorporated by reference into this Item 1.

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 25, 2019 filed with the SEC on March 6, 2020, our quarterly report on Form 10-Q for the quarter ended March 25, 2020 filed with the SEC on May 1, 2020, and our Form 10-Q for the quarter ended June 24, 2020 filed with the SEC on July 31, 2020.

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

None.

Item 3. Defaults of Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Index

<u>Number</u>	<u>Description</u>	<u>Filed Herewith</u>	<u>Form</u>	<u>Period Ended</u>	<u>Exhibit</u>	<u>Filing Date</u>	<u>SEC File Number</u>
3.1	Amended and Restated Certificate of Incorporation of El Pollo Loco Holdings, Inc.		10-Q	6/25/2014	3.1	9/5/2014	001-36556
3.2	Amended and Restated By-Laws of El Pollo Loco Holdings, Inc.		10-Q	6/25/2014	3.2	9/5/2014	001-36556
31.1	Certification of Principal Executive Officer under section 302 of the Sarbanes-Oxley Act of 2002	X					
31.2	Certification of Principal Financial Officer under section 302 of the Sarbanes-Oxley Act of 2002	X					
32.1	Certification of Chief Executive Officer and Chief Financial Officer under 18 U.S.C. section 1350, adopted by section 906 of the Sarbanes-Oxley Act of 2002	*					
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document	X					
101.SCH	XBRL Taxonomy Extension Schema Document	X					
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X					
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X					
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X					
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X					
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	X					

* Pursuant to Item 601(b)(32)(ii) of Regulation S-K (17 C.F.R. § 229.601(b)(32)(ii)), this certification is deemed furnished, not filed, for purposes of section 18 of the Exchange Act, nor is it otherwise subject to liability under that section. It will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except if the registrant specifically incorporates it by reference.

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.

	<u>El Pollo Loco Holdings, Inc.</u> (Registrant)
October 30, 2020 Date	<u>/s/ Bernard Acoca</u> Bernard Acoca President and Chief Executive Officer <i>(duly authorized officer)</i>
October 30, 2020 Date	<u>/s/ Laurance Roberts</u> Laurance Roberts Chief Financial Officer <i>(principal financial officer)</i>

CERTIFICATIONS

I, Bernard Acoca, certify that:

1. I have reviewed this quarterly report on Form 10-Q of El Pollo Loco Holdings, 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 (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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: October 30, 2020

/s/Bernard Acoca

Bernard Acoca

President and Chief Executive Officer

(Principal Executive Officer)

CERTIFICATIONS

I, Laurance Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of El Pollo Loco Holdings, 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 (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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: October 30, 2020

/s/ Laurance Roberts

Laurance Roberts
Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION

Under 18 U.S.C. section 1350, adopted by section 906 of the Sarbanes-Oxley Act of 2002, in connection with the attached periodic report, the undersigned each certify that (i) the periodic report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

Date: October 30, 2020

/s/ Bernard Acoca

Bernard Acoca
President and Chief Executive Officer

/s/ Laurance Roberts

Laurance Roberts
Chief Financial Officer
