SEARS HOLDINGS CORP
Form 10-K/A
March 17, 2006

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United States
Securities And Exchange Commission

Washington, D.C. 20549

FORM 10-K/A
(Amendment No. 1)

For Annual and Transition Reports pursuant to
Section 13 or 15(d) of the Securities Exchange Act of 1934

ý **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Fiscal Year Ended January 28, 2006

Or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file number 000-51217

SEARS HOLDINGS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**20-1920798**
(State of Incorporation)	(I.R.S. Employer Identification No.)
3333 Beverly Road, Hoffman Estates, Illinois	**60179**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(847) 286-2500**

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

Title of each class	Name of Each Exchange on Which Registered
None	

Securities registered pursuant to Section 12(g) of the Act:
Common Shares, par value $0.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

On February 25, 2006, the Registrant had 158,997,881 common shares outstanding. The aggregate market value (based on the closing price of the Registrant's common shares as reported in a summary of composite transactions in *The Wall Street Journal* for stocks quoted on the NASDAQ National Market) of the Registrant's common shares owned by non-affiliates (which are assumed, solely for the purpose of this calculation, to be stockholders other than (i) directors and executive officers of the Registrant and (ii) any person known by the Registrant to beneficially own five percent or more of the Registrant's common shares), as of July 30, 2005 was approximately $15 billion.

Documents Incorporated By Reference

Part III of this Form 10-K/A incorporates by reference certain information from the Registrant's proxy statement relating to its Annual Meeting of Stockholders to be held on April 12, 2006 (the "2006 Proxy Statement"), which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Form 10-K/A relates.

Explanatory Note

This Form 10-K/A (Amendment No. 1) is being filed to correct an error in the disclosure of rental expense for the 2005 fiscal year contained in Note 17 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2006. For ease of reference, this Amendment restates the Form 10-K in its entirety.

The correction is reflected in the following table:

Rental Expense for Operating Leases

millions	**2005** ***(As previously reported)***	**2005** ***(As restated)***
Minimum rentals	$ 1,301	$ 895
Percentage rentals	49	43
Less Sublease rentals	(52)	(52)
Total	$ 1,298	$ 886

PART I

Item 1. Business

General

Sears Holdings Corporation ("Holdings" or the "Company") is the parent company of Kmart Holding Corporation ("Kmart") and Sears, Roebuck and Co. ("Sears"). Holdings was formed as a Delaware corporation in 2004 in connection with the merger of Kmart and Sears (the "Merger"). The Merger, completed on March 24, 2005, combined two of America's oldest existing retail entities, both with origins dating to the late 1800s. The Company is a broadline retailer with approximately 2,300 full-line and 1,100 specialty retail stores in the United States operating through Kmart and Sears and approximately 370 full-line and specialty retail stores in Canada operating through Sears Canada Inc. ("Sears Canada"), a 54%-owned subsidiary.

The Merger

The Merger has provided Holdings with an opportunity to significantly improve the earnings and cash flow performance of both Kmart and Sears given the scale of the combined entity. The Merger has also provided a means for leveraging the historical strengths of Kmart and Sears with the goal of making the Company's products, brands and service offerings more responsive to the needs of customers, thereby building long-term, value-added customer relationships.

Sears has a long-standing reputation for offering customers a wide variety of merchandise and related services, with a particular emphasis on a number of strong proprietary brands such as Kenmore, Craftsman, Diehard and Lands' End. Historically, Sears conducted its business primarily using a mall-based format. At the time of the Merger, Sears operated 874 domestic full-line stores mainly located in such on-mall locations. In response to off-mall competitor growth, Sears commenced a strategy prior to the Merger to increase the number of its off-mall stores in order to expand distribution points for its brands, merchandise and services. Kmart, on the other hand, historically used large format, off-mall locations in selling a selection of general merchandise goods. At the time of the Merger, Kmart operated approximately 1,400 off-mall stores and sought to further improve its operational performance by pursuing opportunities to offer customers a differentiated high-quality product selection to distinguish itself from competitors.

With Kmart's approximately 1,400 off-mall locations, Holdings is in a position to offer a greater number of customers an opportunity to purchase Sears products and services outside of Sears' traditional mall-based stores. This increase in distribution points brought about by the Merger provides a more rapid and lower-cost store base growth than Sears would have been able to accomplish on its own. At the same time, the addition of Sears-owned brands and services, including Sears' credit products, to Kmart stores enhances the selection and value proposition offered to Kmart customers and helps to differentiate Kmart from its general merchandise competitors. Furthermore, its combined store base of approximately 2,300 full-line stores places Holdings in a position to compete on a scale larger than that of many of its national competitors.

The scale of the combined enterprise has also generated significant opportunities for realizing cost synergies across a number of areas, including merchandise and non-merchandise purchasing, delivery and distribution and within other selling, general and administrative expense areas. While the Company will continue to operate both the Sears and Kmart store formats in the foreseeable future, many of the functions supporting these formats have been integrated. This integration will continue.

From an accounting perspective, the Merger has been treated as a purchase business combination, with Kmart acquiring Sears. In identifying Kmart as the acquiring entity, the companies took into account the relative share ownership of the Company after the Merger, the composition of the governing body of the combined entity and the designation of certain senior management positions.

Accordingly, the historical financial statements of Kmart serve as the historical financial statements of Holdings, the registrant.

In connection with the Merger, Kmart shareholders received one share of Holdings common stock for each Kmart share owned. In all, approximately 94.9 million shares of Holdings common stock were issued in exchange for all outstanding common stock of Kmart. Sears shareholders were issued an aggregate of 62.2 million shares of Holdings common stock at a total value of approximately $6.5 billion (based on the average closing price of $104.33 of Kmart's common stock during the period from November 15, 2004 through November 19, 2004, two business days before and after the date the Merger was announced). In addition, approximately $5.4 billion in cash was paid in consideration for (i) all outstanding shares of common stock of Sears, based upon the proration provisions of the agreement pursuant to which the Merger was effected, and (ii) all outstanding stock options of Sears. Including transaction costs of approximately $18 million, the total consideration paid was approximately $11.9 billion.

Additional information concerning the Merger is contained in Note 2 of Notes to Consolidated Financial Statements.

Bankruptcy of Kmart Corporation

Kmart Corporation (the "Predecessor Company") is a predecessor operating company of Kmart (the "Successor Company"). In January 2002, the Predecessor Company and 37 of its U.S. subsidiaries (collectively, the "Debtors") filed voluntary petitions for reorganization under Chapter 11 of the federal bankruptcy laws ("Chapter 11"). The Debtors decided to seek bankruptcy reorganization based upon a rapid decline in their liquidity resulting from below-plan sales and earnings performance in the fourth quarter of fiscal 2001, the evaporation of the surety bond market, an erosion of supplier confidence, intense competition and unsuccessful sales and marketing initiatives, as well as the continued recession and capital market volatility in existence at that time. The Predecessor Company utilized Chapter 11 to strengthen its balance sheet and reduce debt, focus its store portfolio on the most productive locations and terminate leases for closed stores, develop a more efficient organization and lower overall operating costs.

On May 6, 2003 (the "Effective Date"), the Predecessor Company emerged from reorganization proceedings under Chapter 11 pursuant to the terms of an Amended Joint Plan of Reorganization (the "Plan of Reorganization") and related amended Disclosure Statement. This Plan received formal endorsement of the statutory creditors' committee and, as modified, was confirmed by the U.S. Bankruptcy Court in April 2003. The Predecessor Company is presently an indirect wholly-owned subsidiary of Holdings.

Sale of Sears Canada's Credit and Financial Services Business

On November 15, 2005, Sears Canada completed the sale of substantially all of the assets and liabilities of its Credit and Financial Services operations to JPMorgan Chase & Co. ("JPMorgan Chase") for approximately $2.0 billion in cash proceeds net of securitized receivables and other related costs and taxes. In addition, Sears Canada and JPMorgan Chase concurrently entered into a long-term marketing and servicing alliance with an initial term of ten years. Sears Canada used a substantial portion of the proceeds generated from this sale to fund an extraordinary cash dividend and a tax-free return of stated capital to shareholders of record on December 16, 2005. Holdings, as beneficial owner of approximately 54% of the outstanding common stock of Sears Canada, received $877 million in after-tax proceeds from this distribution. Additional information concerning the sale is contained in Note 4 of Notes to Consolidated Financial Statements.

Sears Canada Take-Over Bid

In December 2005, Holdings announced its intention to acquire the remaining 46% interest in Sears Canada that it does not already own. The Company commenced a take-over bid for the remaining interest in Sears Canada on February 9, 2006. The Company has offered C$16.86 (Canadian dollars) per share, or approximately C$835 million ($720 million U.S. dollars), for the minority interest. The take-over bid is open for acceptance until March 17, 2006. The Company believes that 100% ownership of Sears Canada would allow Sears Canada to be able to compete with the other Canadian retailers and the Canadian operations of major U.S. retailers.

In December 2005, the Company entered into a lock-up agreement with Natcan Investment Management, Inc. ("Natcan"), pursuant to which Natcan agreed to tender all Sears Canada common shares (representing approximately 9% of the outstanding common shares of Sears Canada) that it owns or controls in response to the Company's take-over bid, at a price of C$16.86 per share. This agreement obligates the Company to spend approximately $141 million to purchase the Natcan shares.

Real Estate Transactions

In the normal course of business, the Company considers opportunities to purchase leased operating properties, as well as offers to sell owned, or assign leased, operating and non-operating properties. These transactions may, individually or in the aggregate, result in material proceeds or outlays of cash. In addition, the Company reviews leases that will expire in the short term in order to determine the appropriate action to take with respect to them.

Further information concerning the Company's real estate transactions is contained in Note 16 of Notes to Consolidated Financial Statements.

Business Segments

Holdings has integrated many Kmart and Sears store-support functions to more efficiently serve both formats; however, for purposes of reviewing operating performance and making asset-allocation decisions, senior management has continued to utilize principally the reporting structures that existed independently for Kmart and Sears prior to the Merger. As a result, the following discussion of the Company's business segments is organized into three segments: Kmart, Sears Domestic and Sears Canada.

Financial information, including revenues, operating income and total assets for each of these business segments is contained in Note 21 of Notes to Consolidated Financial Statements. Information regarding the components of revenue for Holdings is included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Kmart

As of January 28, 2006, Holdings operated a total of 1,416 Kmart stores across 49 states, Guam, Puerto Rico, and the U.S. Virgin Islands. This store count included 1,361 discount stores, averaging 92,000 square feet, and 55 Super Centers, averaging 165,000 square feet. Most Kmart stores are one-floor, free-standing units that carry a wide assortment of general merchandise, including products sold under such well-known labels as Jaclyn Smith, Joe Boxer, and Martha Stewart Everyday. Subsequent to the Merger, the Company began selling certain Sears brand products and services within certain Kmart stores. As of January 28, 2006, approximately 100 Kmart stores were selling an assortment of Sears brand products, mainly within home appliances and tools. Approximately 1,100 Kmart stores also contain in-store pharmacies. The Super Centers generally operate 24-hours a day and combine a full-service grocery along with the general merchandise selection of a discount store. Kmart also sells its products through its kmart.com website.

Sears Domestic

As of January 28, 2006, Sears Domestic operations consisted of the following:

Full-line Stores 866 Full-line stores located across all 50 states and Puerto Rico, primarily mall-based locations averaging 132,000 square feet. Full-line stores offer a wide array of products across many merchandise categories, including home appliances, consumer electronics, tools, fitness and lawn and garden equipment, certain automotive services and products such as tires and batteries, home fashion products, as well as apparel, footwear and accessories for the whole family, including Lands' End merchandise. Also, as of January 28, 2006, the Company operated a total of 58 Sears Essentials and Sears Grand stores located in 22 states, primarily free-standing units averaging 122,000 square feet and offering health and beauty, pantry, household products and toys in addition to the offerings of the typical mall-based store. In February 2006, management decided that, on a go-forward basis, Sears Essentials and Sears Grand stores will all be operated under the Sears Grand name. Management expects to begin the conversion to the Sears Grand nameplate in the first half of fiscal 2006. Sears also extends the availability of its product selection through the use of its sears.com website, which offers a more limited assortment of home, apparel and accessory merchandise and provides customers the option of buying through the internet and picking up their merchandise in Sears Full-line stores.

Specialty Stores 1,128 specialty stores located across all 50 states and Puerto Rico, located primarily in free-standing, off-mall locations or high-traffic neighborhood shopping centers, and including the operations of:

809 Dealer Stores Primarily independently-owned stores, predominantly located in smaller communities and averaging 8,900 square feet offering appliances, consumer electronics, lawn and garden equipment, hardware and automotive batteries. Dealer stores carry proprietary Sears brands, such as Craftsman, Kenmore and DieHard, as well as a wide assortment of national brands.

147 Sears Hardware Stores and 84 Orchard Supply Hardware Stores Neighborhood hardware stores averaging 37,000 square feet that carry Craftsman tools and lawn and garden equipment, a wide assortment of national brands and other home improvement products. Approximately 120 locations also offer a limited selection of home appliances.

16 The Great Indoors Stores Home decorating and remodeling superstores, averaging 143,000 square feet, dedicated to the four main rooms of the house: kitchen, bedroom, bathroom and great room.

50 Outlet Stores Locations offering overstock and/or distressed appliances, consumer electronics and lawn and garden equipment at a discount.

Commercial Sales This business primarily targets home builders, remodelers and property managers for appliance purchases.

Direct to Customer The Direct to Customer business includes the direct merchant business of Lands' End, Inc. ("Lands' End"). Lands' End is a leading direct merchant of traditionally-styled casual clothing, accessories and footwear for men, women and children, as well as home products and soft luggage. These products are offered through multiple selling channels including Landsend.com, one of the leading apparel websites, as well as catalog mailings, international businesses and 17 Lands' End retail stores. These retail stores, averaging 7,700 square feet, offer Lands' End merchandise primarily from catalog and internet channel overstocks. Direct to Customer also includes direct marketing of Sears goods through specialty catalogs.

Home Services Product Repair Services, the nation's largest product repair service provider, is a key element in the Company's active relationship with more than 46 million households. With over 10,000 service technicians making over 13 million service calls annually, this business delivers a broad range of retail-related residential and commercial services across all 50 states and Puerto Rico under the Sears Parts & Repair Services and A&E Factory Service brand names. Commercial and residential customers can obtain parts and repair services for all major brands of products within the home appliances, lawn and garden equipment, consumer electronics, floorcare products, and heating and cooling systems categories. Smaller items for repair can be brought into Sears Parts & Repair Centers located throughout the United States or to any Sears Full-line store. This business also offers protection agreements, product installation services and Kenmore and Carrier residential heating and cooling systems. Home Services also includes home improvement services (primarily siding, windows, cabinet refacing, kitchen remodeling, HVAC and carpet cleaning) provided through Sears Home Improvement Services.

Sears Canada

Sears Canada, a consolidated, 54%-owned subsidiary of Sears, conducts retail operations in Canada similar to those conducted by Sears Domestic, with a greater emphasis on apparel and other softlines than in the U.S. stores. In addition, Sears Canada conducted credit operations prior to the November 15, 2005 sale of its Credit and Financial Services operations to JPMorgan Chase.

As of January 28, 2006, Sears Canada operated a total of 123 full-line stores, 252 specialty stores (49 furniture and appliance stores, 159 dealer stores operated under independent local ownership, five appliances and mattresses stores, 28 Corbeil stores and 11 outlet stores), 50 floor covering stores, approximately 2,116 catalog pick-up locations and 112 travel offices. Sears Canada also conducts business over the internet through its website, sears.ca.

Trademarks, Trade Names and Licenses

The "KMART®" and "SEARS®" trade names, service marks and trademarks, used by the Company both in the United States and internationally, are material to the Company's retail and other related businesses.

The Company sells proprietary branded merchandise under a number of brand names that are important to its operations. The Company's KENMORE®, CRAFTSMAN®, DIEHARD® and LANDS' END® brands are among the most recognized proprietary brands in retailing. These marks are the subject of numerous United States and foreign trademark registrations. Other well-recognized Company trademarks and service marks include THE GREAT INDOORS®, OSH®, CANYON RIVER BLUES®, COVINGTON®, and ATHLETECH®. The Company also has the right to sell an exclusive line of Martha Stewart Everyday® products in its Kmart locations over the next four years, as well as within Sears Canada stores through August 2008.

Seasonality

The retail business is seasonal in nature, and the Company generates a high proportion of its revenues and operating cash flows during the fourth quarter of its fiscal year, which includes the holiday season. As a result, the Company's overall profitability is heavily impacted by its fourth quarter operating results. Additionally, in preparation for the fourth quarter holiday season, the Company significantly increases its merchandise inventory levels, which have traditionally been financed from operating cash flows and credit terms received from vendors. Fourth quarter reported revenues accounted for 33% of total reported revenues in fiscal 2005.

Competition

The Company's business is subject to highly competitive conditions. The Company competes with a wide variety of retailers, including other department stores, discounters, home improvement stores, consumer electronics dealers, auto parts and auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level along with internet and catalog businesses, which handle similar lines of merchandise. Wal-Mart, Target, Kohl's, JC Penney, Home Depot, Lowe's and Best Buy are some of the major competitors with which the Company competes. Home Depot, Lowe's and Best Buy are major competitors in relation to the Company's home appliance business, which accounted for approximately 15% of the Company's fiscal 2005 reported revenues. Sears Canada competes in Canada with Hudson's Bay Company and U.S.-based competitors, including those mentioned above, that are expanding into Canada. Success in this competitive marketplace is based on factors such as price, convenience, product assortment and quality, and service, including availability of retail-related services such as access to credit, product delivery, repair and installation.

Employees

As of January 28, 2006, the Company had approximately 317,000 employees in the United States and U.S. territories, and approximately 38,000 employees in Canada through Sears Canada including, in each case, part-time employees.

Our Website; Availability of SEC Reports and Other Information

The Company's corporate website is located at *www.searsholdings.com*. The Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports are available, free of charge, through the SEC filings portion of the Investor Information section of the Company's website as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission.

The Corporate Governance Guidelines of the Company's Board of Directors, the charters of the Audit, Compensation, Finance and Nominating and Governance Committees of the Board of Directors, the Company's Code of Conduct and the Board of Directors Code of Conduct are available on the Corporate Governance section of *www.searsholdings.com*. References to the Company's website address do not constitute incorporation by reference of the information contained on the website, and the information contained on the website is not part of this document.

Item 1A. Risk Factors

References to "us", "we" and "our" refer to the Company. The following risk factors could adversely affect our business, results of operations and financial condition. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us may also negatively impact us.

If we fail to offer merchandise and services that our customers want, our sales may be limited, which would reduce our revenues and profits.

In order for our business to be successful, we must identify, obtain supplies of, and offer to our customers attractive, innovative and high-quality merchandise on a continuous basis. Our products and services must satisfy the desires of our customers, whose preferences may change in the future. If we misjudge either the demand for products and services we sell or our customers' purchasing habits and tastes, we may be faced with excess inventories of some products and missed opportunities for products and services we chose not to offer. In addition, our sales may decline or we may be required to sell the merchandise we have obtained at lower prices. This would have a negative effect on our business and results of operations.

If we do not successfully manage our inventory levels, our operating results will be adversely affected.

We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory as we seek to minimize out-of-stock levels across all product categories and to maintain in-stock levels. We obtain a significant portion of our inventory from vendors located outside the United States. These vendors often require lengthy advance notice of our requirements in order to be able to supply products in the quantities we request. This usually requires us to order merchandise, and enter into purchase order contracts for the purchase and manufacture of such merchandise, well in advance of the time these products will be offered for sale. As a result, we may experience difficulty in responding to a changing retail environment, which makes us vulnerable to changes in price. If we do not accurately anticipate the future demand for a particular product or the time it will take to obtain new inventory, our inventory levels will not be appropriate and our results of operations may be negatively impacted.

If we are unable to compete effectively in the highly competitive retail industry, our business and results of operations could be materially adversely affected.

The retail industry is highly competitive with few barriers to entry. We compete with a wide variety of retailers including other department stores, discounters, home improvement stores, consumer electronics dealers, auto parts and auto service providers, specialty retailers, wholesale clubs and many other competitors operating on a national, regional or local level. Internet and catalog businesses which handle similar lines of merchandise also compete with us. In this competitive marketplace, success is based on factors such as price, product assortment and quality, service, and convenience.

Our success depends on our ability to differentiate ourselves from our competitors with respect to shopping convenience, a quality assortment of available merchandise and superior customer service. We must also successfully respond to our customers' changing tastes. The performance of our competitors, as well as changes in their pricing policies, marketing activities, new store openings and other business strategies, could have a material adverse effect on our business, financial condition and results of operations.

Our failure to successfully integrate Kmart and Sears may cause us to fail to realize cost savings and other benefits, which could adversely affect our future results.

We may fail to successfully complete the integration of Kmart and Sears and, as a result, may fail to realize synergies, cost savings and other benefits expected from the Merger. The eventual success of the Merger depends, in part, on our ability to realize the anticipated growth opportunities and cost savings from combining the businesses of Kmart and Sears. In particular, expanding the offering and distribution of proprietary brands may impact the value of those brands and lead to cannibalization of sales from either Sears or Kmart. In addition, we may be unable to successfully differentiate product offerings at our various locations. If we do not achieve these benefits, our results of operations could be materially adversely affected.

Also, we may fail to achieve sufficient cost savings through the integration of purchasing functions, supply chain, administrative and other operational activities. Furthermore, we must achieve these savings without adversely affecting our revenues. If we are not able to successfully achieve these objectives, the anticipated benefits of the Merger may not be realized fully or at all, or it may take longer to realize them than expected, and our results of operations could be materially adversely affected.

Due to the seasonality of our business, our annual operating results would be adversely affected if our fourth quarter results fail to meet our expectations.

Our business is seasonal, with a high proportion of revenues and operating cash flows being generated during the fourth quarter of our fiscal year, which includes the holiday season. As a result, our fourth quarter operating results significantly impact our annual operating results. Our fourth quarter operating results may fluctuate significantly, based on many factors, including holiday spending patterns and weather conditions.

Our comparable store sales may fluctuate for a variety of reasons, which could adversely affect our results of operations.

Our business is sensitive to customers' spending patterns, which in turn are subject to prevailing economic conditions. Our comparable store sales and results of operations have fluctuated in the past, and we expect them to continue to fluctuate in the future. A variety of other factors affect our comparable store sales and financial performance, including:

- actions by our competitors, including opening of new stores in our existing markets,
- seasonal fluctuations due to weather conditions,
- changes in our merchandise strategy and mix,
- changes in population and other demographics, and
- timing of our promotional events.

Accordingly, our results for any one fiscal quarter are not necessarily indicative of the results to be expected for any other quarter, and comparable store sales for any particular future period may decrease. For more information on our results of operations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Form 10-K.

We rely on foreign sources for significant amounts of our merchandise, and our business may therefore be negatively affected by the risks associated with international trade.

We depend on a large number of products produced in foreign markets. We face risks associated with the delivery of merchandise originating outside the United States, including:

- potential economic and political instability in countries where our suppliers are located,
- increases in shipping costs,
- transportation delays and interruptions,
- adverse fluctuations in currency exchange rates, and
- changes in U.S. and foreign laws affecting the importation and taxation of goods, including duties, tariffs and quotas, or changes in the enforcement of those laws.

A decline in general economic conditions, consumer spending levels and other conditions could lead to reduced consumer demand for our merchandise thereby reducing our revenues and gross margins.

Many economic and other factors outside our control, including consumer confidence, consumer spending levels, employment levels, prevailing interest rates, housing starts and remodels, and consumer debt levels, as well as fuel costs and the availability of consumer credit, affect consumer spending habits. In addition, disposable income levels may influence consumer purchasing patterns. A general slowdown in the United States economy or an uncertain economic outlook could adversely affect consumer spending habits and our operating results.

The domestic and international political situation also affects consumer confidence. The threat, outbreak or escalation of terrorism, military conflicts or other hostilities could lead to a decrease in consumer spending. Any of these events and factors could cause us to increase inventory markdowns and promotional expenses, thereby reducing our gross margins and operating results.

We rely extensively on computer systems to process transactions, summarize results and manage our business. Disruptions in these systems could harm our ability to run our business.

Given the number of individual transactions we have each year, it is critical that we maintain uninterrupted operation of our computer and communications hardware and software systems. Our primary computer systems and operations are located at our corporate headquarters in Hoffman Estates, Illinois and our facilities in Troy, Michigan. In addition, each of our stores is connected to our computerized inventory management and other systems. Our systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees. If our systems are damaged or cease to function properly, we may have to make a significant investment to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruption in our computer operations may have a material adverse effect on our business or results of operations.

The loss of key personnel may disrupt our business and adversely affect our financial results.

We depend on the contributions of our senior management team, including Aylwin B. Lewis (Chief Executive Officer and President) and other key employees, for our future success. Although certain executives, including Mr. Lewis, have employment agreements with us, changes in our senior management and any future departures of key employees may disrupt our business and materially adversely affect our results of operations.

Affiliates of our Chairman, whose interests may be different than your interests, exert substantial influence over our company.

Affiliates of Edward S. Lampert, the Chairman of our Board of Directors, beneficially own approximately 41% of the outstanding shares of our common stock. These affiliates are controlled, directly or indirectly, by Mr. Lampert. Accordingly, these affiliates, and thus Mr. Lampert, have substantial influence over many if not all actions to be taken or approved by our stockholders, including the election of directors and any transactions involving a change of control.

The interests of these affiliates, which have investments in other companies, may from time to time diverge from the interests of our other stockholders, particularly with regard to new investment opportunities. This substantial influence may have the effect of discouraging offers to acquire our company because the consummation of any such acquisition would likely require the consent of these affiliates.

We may be subject to product liability claims if people or property are harmed by the products we sell.

Some of the products we sell may expose us to product liability claims relating to personal injury, death, or property damage caused by such products, and may require us to take actions such as product recalls. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.

We may be subject to periodic litigation and other regulatory proceedings. These proceedings may be affected by changes in laws and government regulations or changes in the enforcement thereof.

From time to time we may be involved in lawsuits and regulatory actions relating to our business. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition and results of operations. In addition, regardless of the outcome of any litigation or regulatory proceedings, these proceedings could result in substantial costs and may require that we devote substantial resources to defend our company. Further, changes in governmental regulations both in the United States and in the other countries where we operate could have adverse effects on our business and subject us to additional regulatory actions. For a description of current legal proceedings, see Item 3, "Legal Proceedings" in this Form 10-K.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The following table summarizes the locations of the Company's Kmart and Sears Domestic stores as of January 28, 2006:

	Kmart		Sears Domestic		
State/Territory	**Discount Stores**	**Super Centers**	**Full-line Mall Stores**	**Sears Grand/ Essentials**	**Specialty Stores**
Alabama	26		13	3	32
Alaska			3		3
Arizona	18	2	14	1	12
Arkansas	6		7		30
California	107	1	81	10	131
Colorado	17	4	13	2	18
Connecticut	7		8	1	10
Delaware	6		4		4
District of Columbia					
Florida	98		56	10	25
Georgia	38	1	22		37
Hawaii	7		6		1
Idaho	8		6		7
Illinois	60	4	38	6	52
Indiana	38	5	21	2	34
Iowa	24		12		13
Kansas	13		10		21
Kentucky	30		11	1	24
Louisiana	11		13		19
Maine	6		6		10
Maryland	23		19	1	8
Massachusetts	19		21	1	8
Michigan	79	7	27	3	39
Minnesota	32		12		35
Mississippi	6		9		20
Missouri	28		14	1	42
Montana	10		3		7
Nebraska	8		5		10
Nevada	9	2	4	1	6
New Hampshire	6		6	3	8
New Jersey	37		20	5	20
New Mexico	15		7		11
New York	60	1	48		35
North Carolina	43	4	27		36
North Dakota	7		4		4
Ohio	75	11	42		52
Oklahoma	9		11		20
Oregon	14		9		19
Pennsylvania	100	2	45	2	38
Rhode Island	1		2		2
South Carolina	27	1	14	1	18
South Dakota	9		2		7
Tennessee	33	3	24	1	26
Texas	19	1	60	1	81
Utah	18		5	1	5
Vermont	3		2		6
Virginia	40	4	23	1	19
Washington	21		23		12
West Virginia	16	1	8		7
Wisconsin	38		15		32

	Kmart		**Sears Domestic**		
Wyoming	9		2		6
Puerto Rico	22	1	9		6
U.S. Virgin Islands	4				
Guam	1				
Totals	1,361	55	866	58	1,128

	Kmart		Sears Domestic			Sears Canada		
	Discount Stores	Super Centers	Full-line Mall Stores	Sears Grand/ Essentials	Specialty Stores	Full-line Stores	Specialty Stores	Total
Stores as of January 28, 2006								
Owned	134	34	516	15	44	17	2	762
Leased	1,227	21	350	43	275	106	91	2,113
Independently-owned and operated stores					809		159	968
Totals	1,361	55	866	58	1,128	123	252	3,843

In addition, as of January 28, 2006, the Company had 42 domestic supply chain distribution centers, of which 14 are owned and 28 are leased for terms ranging from one to 15 years. Of the total, 15 primarily support Kmart locations and the remaining 27 primarily support Sears stores. In addition, the Company had 651 domestic store warehouses, customer call centers and service facilities, most of which are leased for terms ranging from one to 10 years or are part of other facilities included in the above table.

The Company's principal executive offices are located on a 200-acre site owned by the Company at the Prairie Stone office park in Hoffman Estates, Illinois. The complex consists of six interconnected office buildings totaling approximately two million gross square feet of office space.

In December 2005, the Company sold the former Kmart headquarters building in Troy, Michigan. The Company still owns an 86,000 square foot office building in Troy, Michigan which houses the Company's data center.

As of January 28, 2006, Sears Canada operated a total of 123 full-line stores, 252 specialty stores (49 furniture and appliance stores, 159 dealer stores operated under independent local ownership, five appliances and mattresses stores, 28 Corbeil stores and 11 outlet stores), 50 floor covering stores, approximately 2,116 catalog pick-up locations and 112 travel offices.

A description of the Company's leasing arrangements appears in Note 17 of Notes to Consolidated Financial Statements.

Item 3. Legal Proceedings

See Part II, Item 8, "Financial Statements and Supplementary Data" "Notes to Consolidated Financial Statements", Note 11 "Emergence from Chapter 11 Bankruptcy Protection and Fresh-Start Accounting," and Note 22 "Legal Proceedings", for information regarding legal proceedings, which information is incorporated herein by this reference.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 4A. Executive Officers of the Registrant

The following table and information sets forth the names of the executive officers of the Company, their current positions and offices with the Company, the date they first became executive officers of the Company, their current ages, and their principal employment during the past five years.

Name	Position	Date First Became an Executive Officer	Age
Aylwin B. Lewis	Chief Executive Officer and President	2005*	51
Alan J. Lacy	Vice Chairman	2005*	52
Karen A. Austin	Executive Vice President, Chief Information Officer	2005*	44
Kristine K. Crow	Senior Vice President/General Manager, Financial Services	2005*	46
William C. Crowley	Executive Vice President, Chief Financial and Administrative Officer	2005*	48
Mark C. Good	Executive Vice President and General Manager, Home Services	2005*	49
William R. Harker	Vice President, Acting General Counsel and Corporate Secretary	2006	33
W. Bruce Johnson	Executive Vice President, Supply Chain and Operations	2005*	54
Daniel F. Laughlin	Senior Vice President, Merchandising	2005	55
Robert D. Luse	Senior Vice President, Human Resources	2005*	43
Maureen A. McGuire	Executive Vice President, Chief Marketing Officer	2005	54
William K. Phelan	Vice President, Controller and Chief Accounting Officer	2005*	43
Peter J. Whitsett	Senior Vice President, Merchandising	2005	40
Corwin M. Yulinsky	Executive Vice President, Strategy and Customer Insight	2005	51

* Became an executive officer of Holdings upon the completion of the Merger on March 24, 2005.

Mr. Lewis became Chief Executive Officer and President in October 2005, after serving as the Chief Executive Officer and President of Kmart and Sears Retail as well as President of Holdings from March 2005 until September 2005. He was previously a director and the Chief Executive Officer and President of Kmart from October 2004 to March 2005. Prior to joining Kmart in October 2004, Mr. Lewis was President, Chief Multi-Branding and Operating Officer of YUM! Brands, Inc. (franchisor and licensor of quick-service restaurants) from 2000 until October 2004.

Mr. Lacy was previously Chief Executive Officer and Vice Chairman of the Company from March 2005 to September 2005. He served as Chairman of the Board, Chief Executive Officer and President of Sears from December 2000 until March 2005.

Ms. Austin became Executive Vice President, Chief Information Officer in February 2006 and was Senior Vice President and Chief Information Officer prior thereto. She was Senior Vice President,

Chief Information Officer of Kmart from April 2002 to March 2005. She previously served as its Vice President, IT Applications from 2001 to 2002.

Ms. Crow became Senior Vice President, Financial Services of Sears in May 2004. From December 2000 to April 2004, she was Vice President, Customer Relationship Management for Sears.

Mr. Crowley was previously Senior Vice President, Finance of Kmart, and had served as an officer of Kmart since 2003. Mr. Crowley is also the President and Chief Operating Officer of ESL Investments, Inc., a private investment firm, and has served in that capacity since 1999.

Mr. Good was previously Executive Vice President and General Manager, Home Services (formerly Product Repair Services) of Sears from August 1999 to March 2005, when he assumed the same role with Sears Holdings.

Mr. Harker joined the Company as Vice President and Chief Counsel in September 2005. He became Acting General Counsel and Corporate Secretary in January 2006. Prior to joining Sears Holdings, he practiced corporate law with the law firm of Wachtell, Lipton, Rosen and Katz from September 2000 to August 2005.

Mr. Johnson was previously Kmart's Senior Vice President, Supply Chain and Operations. He joined Kmart in October 2003, after serving as Director, Organization and Systems for Carrefour S.A. from March 1998 to October 2003.

Mr. Laughlin was elected Senior Vice President, Merchandising in December 2005. Previously, he served as Sears' Senior Vice President/General Merchandise Manager, Sears Home, from October 2003 to December 2005, Senior Vice President/General Manager, Home Stores from May 2003 to September 2003, and Vice President/General Merchandise Manager, Tools and Paint prior thereto.

Mr. Luse joined Sears as Vice President, HR Retail and Related Services in 2001.

Ms. McGuire joined the Company as Executive Vice President and Chief Marketing Officer in October 2005. Prior to joining Sears Holdings, she spent over 30 years at International Business Machines Corporation, most recently as Vice President, Worldwide Strategy and Marketing, IBM Systems and Technology Group from January 2005 to September 2005. Previously she served as IBM's Vice President, Worldwide Marketing and Strategy, IBM Global Services from August 2003 to January 2005 and Vice President, Worldwide Market Management and Integrated Marketing Communications from 1995 to August 2003.

Mr. Phelan was elected Vice President and Controller of Sears Holdings effective March 2005. From December 2000 to March 2005 he served as Assistant Controller of Sears.

Mr. Whitsett was elected Senior Vice President, Kmart Merchandising Officer in July 2005. He joined Kmart in 1999 as Director, Merchandise Planning & Replenishment and has served in a variety of positions, including Divisional Vice President, Merchandise Planning from 2000 to 2003, Divisional Vice President, Merchandising Consumables in 2003, Vice President/General Merchandise Manager, Drug Store and Food from 2003 to 2004, and Vice President/General Merchandise Manager from 2004 to 2005.

Mr. Yulinsky joined the Company as Executive Vice President, Strategy and Customer Insight in October 2005. Previously, he was a leader of the Financial Institutions and Marketing/CRM practice at McKinsey and Co., a consulting firm, from August 1999 to October 2005.

The Company's Code of Conduct applies to all employees, including the Company's principal executive officer, principal financial officer and principal accounting officer. The Code of Conduct is available on the "Corporate Governance" portion of the Company's corporate website at searsholdings.com. The Company intends to disclose on this website any amendment to, or waiver of, a provision of its Code of Conduct that applies to any of those three officers of the Company.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Holdings common stock is quoted on The NASDAQ Stock Market under the ticker symbol SHLD. There were approximately 25,000 registered stockholders of Holdings common stock as of January 28, 2006.

The common stock of Holdings began trading on March 28, 2005, the first trading day after the consummation of the Merger. Prior to that date, Kmart's common stock was quoted on The NASDAQ Stock Market, under the ticker symbol KMRT. The quarterly high and low sales prices for Holdings' common stock (for the 2005 fiscal year) and for Kmart's common stock (for the 2004 fiscal year) are set forth below.

	2005			
	Sears Holdings			
	First Quarter[1]	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Common stock price				
High	$ 149.50	$ 163.50	$ 155.90	$ 127.66
Low	125.90	133.24	113.30	111.64

	2004			
	Kmart			
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Common stock price				
High	$ 48.50	$ 84.50	$ 93.18	$ 119.69
Low	26.10	40.66		
			11,709	14,902

Accrued expenses	6,545	11,672
Deferred revenue	27,483	38,155
Other current liabilities	4,962	7,622
Total current liabilities	58,341	79,415
Long-term debt	30,000	25,000
Deferred rent	22,230	21,737
Other liabilities	2,132	2,311
Total liabilities	112,703	128,463
Commitments and contingencies (Note 11)	—	—

	2004	
Shareholders' equity:		
Common stock, par value $.01 per share; 100,000,000 shares authorized, 30,093,180 shares issued and outstanding at September 24, 2017, 30,549,283 shares issued and outstanding at December 25, 2016	301	305
Additional paid-in capital	84,643	95,266
Accumulated deficit	(4,575)	(16,562)
Treasury stock, at cost; 71,950 shares at September 24, 2017 and December 25, 2016	—	—
Total shareholders' equity	80,369	79,009
Total liabilities and shareholders' equity	$ 193,072	$ 207,472

See accompanying notes to condensed consolidated financial statements.

RUTH'S HOSPITALITY GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income—Unaudited

(Amounts in thousands, except share and per share data)

	13 Weeks Ended		39 Weeks Ended	
	September 24, 2017	September 25, 2016	September 24, 2017	September 25, 2016
Revenues:				
Restaurant sales	$79,442	$78,760	$273,042	$261,941
Franchise income	4,218	3,928	12,865	12,463
Other operating income	1,507	1,086	4,813	3,914
Total revenues	85,167	83,774	290,720	278,318
Costs and expenses:				
Food and beverage costs	25,319	23,723	82,012	78,022
Restaurant operating expenses	42,595	40,549	133,046	127,026
Marketing and advertising	3,197	2,546	9,056	7,134
General and administrative costs	7,096	7,346	23,267	22,068
Depreciation and amortization expenses	3,852	3,435	11,089	9,907
Pre-opening costs	121	574	1,473	1,665
Total costs and expenses	82,180	78,173	259,943	245,822
Operating income	2,987	5,601	30,777	32,496
Other income (expense):				
Interest expense, net	(197)	(333)	(521)	(799)
Other	(6)	(92)	33	60
Income from continuing operations before income tax expense	2,784	5,176	30,289	31,757
Income tax expense	1,017	1,668	9,632	10,410
Income from continuing operations	1,767	3,508	20,657	21,347
Income (loss) from discontinued operations, net of income taxes	(71)	75	(101)	(94)
Net income	$1,696	$3,583	$20,556	$21,253
Basic earnings (loss) per common share:				
Continuing operations	$0.06	$0.11	$0.68	$0.67
Discontinued operations	—	—	(0.01)	—
Basic earnings per share	$0.06	$0.11	$0.67	$0.67
Diluted earnings (loss) per common share:				
Continuing operations	$0.06	$0.11	$0.67	$0.66
Discontinued operations	(0.01)	—	(0.01)	—
Diluted earnings per share	$0.05	$0.11	$0.66	$0.66
Shares used in computing net income (loss) per common share:				
Basic	30,348,180	31,305,952	30,490,554	32,023,814
Diluted	30,877,192	31,737,036	31,040,640	32,437,142
Cash dividends declared per common share	$0.09	$0.07	$0.27	$0.21

See accompanying notes to condensed consolidated financial statements.

RUTH'S HOSPITALITY GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Shareholders' Equity—Unaudited

(Amounts in thousands)

	Common Shares	Stock Value	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock Shares	Value	Shareholders' Equity
Balance at December 25, 2016	30,549	$ 305	$ 95,266	$ (16,562)	72	$ —	$ 79,009
Net income	—	—	—	20,556	—	—	20,556
Cash dividends	—	—	—	(8,568)	—	—	(8,568)
Repurchase of common stock	(719)	(7)	(14,536)	—	—	—	(14,543)
Shares issued under stock compensation plan net of shares withheld for tax effects	263	3	(1,167)	—	—	—	(1,164)
Stock-based compensation	—	—	5,080	—	—	—	5,080
Balance at September 24, 2017	30,093	$ 301	$ 84,643	$ (4,575)	72	$ —	$ 80,369
Balance at December 27, 2015	33,146	$ 331	$ 135,403	$ (37,832)	72	$ —	$ 97,902
Net income	—	—	—	21,253	—	—	21,253
Cash dividends	—	—	—	(6,969)	—	—	(6,969)
Repurchase of common stock	(2,477)	(25)	(39,948)	—	—	—	(39,973)
Shares issued under stock compensation plan net of shares withheld for tax effects	213	3	(1,430)	—	—	—	(1,427)
Excess tax benefit from stock based compensation	—	—	395	—	—	—	395
Stock-based compensation	—	—	4,259	—	—	—	4,259
Balance at September 25, 2016	30,882	$ 309	$ 98,679	$ (23,548)	72	$ —	$ 75,440

See accompanying notes to condensed consolidated financial statements.

RUTH'S HOSPITALITY GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows—Unaudited

(Amounts in thousands)

	39 Weeks Ended September 24, 2017	September 25, 2016
Cash flows from operating activities:		
Net income	$ 20,556	$ 21,253
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,089	9,907
Deferred income taxes	4,472	6,065
Non-cash interest expense	97	315
Debt issuance costs written-off	16	—
Gain on the disposal of property and equipment, net	—	(128)
Stock-based compensation expense	5,080	4,259
Changes in operating assets and liabilities:		
Accounts receivable	11,002	9,793
Inventories	149	341
Prepaid expenses and other	217	(2,012)
Other assets	356	198
Accounts payable and accrued expenses	(6,064)	(10,731)
Deferred revenue	(10,671)	(11,736)
Deferred rent	493	978
Other liabilities	(1,702)	623
Net cash provided by operating activities	35,090	29,125
Cash flows from investing activities:		
Acquisition of property and	(14,326)	(19,094)

equipment				
Proceeds from sale of property and equipment		—		802
Net cash used in investing activities		(14,326)		(18,292)
Cash flows from financing activities:				
Principal borrowings on long-term debt		26,000		47,000
Principal repayments on long-term debt		(21,000)		(9,000)
Repurchase of common stock		(14,543)		(39,973)
Cash dividend payments		(8,568)		(6,969)
Tax payments from the vesting of restricted stock and option exercises		(2,079)		(1,503)
Excess tax benefits from stock compensation		—		395
Proceeds from the exercise of stock options		913		76
Deferred financing costs		(413)		—
Net cash used in financing activities		(19,690)		(9,974)
Net increase in cash and cash equivalents		1,074		859
Cash and cash equivalents at beginning of period		3,788		3,095
Cash and cash equivalents at end of period	$	4,862	$	3,954
Supplemental disclosures of cash flow information:				
Cash paid during the period for:				
Interest, net of capitalized interest	$	405	$	461
Income taxes	$	6,539	$	2,223
Noncash investing and financing activities:				
Accrued acquisition of property and	$	1,023	$	389

equipment

See accompanying notes to condensed consolidated financial statements.

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RUTH'S HOSPITALITY GROUP, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements—Unaudited

(1) The Company and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Ruth's Hospitality Group, Inc. and its subsidiaries (collectively, the Company) as of September 24, 2017 and December 25, 2016 and for the thirteen and thirty-nine week periods ended September 24, 2017 and September 25, 2016 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The condensed consolidated financial statements include the financial statements of Ruth's Hospitality Group, Inc. and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

Ruth's Hospitality Group, Inc. is a restaurant company focused on the upscale dining segment. Ruth's Hospitality Group, Inc. operates Company-owned Ruth's Chris Steak House restaurants and sells franchise rights to Ruth's Chris Steak House franchisees giving the franchisees the exclusive right to operate similar restaurants in a particular area designated in the franchise agreement. As of September 24, 2017, there were 153 Ruth's Chris Steak House restaurants, including 70 Company-owned restaurants, two restaurants operating under contractual agreements and 81 franchisee-owned restaurants, including 21 international franchisee-owned restaurants in Aruba, Canada, China, Hong Kong, Indonesia, Japan, Mexico, Panama, Singapore, Taiwan and the United Arab Emirates. All Company-owned restaurants are located in the United States. New Company-owned Ruth's Chris Steak House restaurants opened in Waltham, MA in January 2017 and Cleveland, OH in March 2017 and a new frachisee-owned Ruth's Chris Steak House restaurant opened in Chengdu, China in September 2017. A new restaurant operated by the Company under a contractual agreement also opened in Tulsa, OK in January 2017. A franchisee-owned Ruth's Chris Steak House restaurant was closed permanently in San Juan, Puerto Rico in September 2017 as a result of severe damage from Hurricane Maria.

The information furnished herein reflects all adjustments (consisting of normal recurring accruals and adjustments), which are, in the opinion of management, necessary to fairly present the operating results for the respective periods. The interim results of operations for the periods ended September 24, 2017 and September 25, 2016 are not necessarily indicative of the results that may be achieved for the full year. Certain information and footnote disclosures normally presented in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the SEC's rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2016.

The Company operates on a 52- or 53-week fiscal year ending on the last Sunday in December. The fiscal quarters ended September 24, 2017 and September 25, 2016 each contained thirteen weeks and are referred to herein as the third quarter of fiscal year 2017 and the third quarter of fiscal year 2016, respectively. Fiscal year 2017 is a 53-week year. Fiscal year 2016 is a 52-week year.

Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reporting of revenue and expenses during the periods to prepare these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles. Significant items subject to such estimates and assumptions include the carrying amounts of property and equipment, goodwill, franchise rights, and obligations related to gift cards, incentive compensation, workers' compensation and medical insurance. Actual results could differ from those estimates.

Recent Accounting Pronouncements for Future Application

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, (ASU 2014-09), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers, and will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for interim and annual periods in fiscal years beginning after December 15, 2017, which will require the Company to adopt these provisions in the first quarter of fiscal year 2018. The standard permits the use of either the retrospective or cumulative effect transition method and is expected to impact the Company's recognition of revenue related to franchise development and site specific fees. The Company currently recognizes franchise development and site specific fees when new franchisee-owned restaurants open. Under ASU 2014-09, development and site specific fees will be recognized over the life of the applicable franchise agreements. The Company expects that the new standard will have a material effect on the consolidated financial statements. The Company now expects that the most significant change relates to an increase of approximately $3 million to $4 million to the deferred revenue liability on the consolidated balance sheet for previously recognized franchise development and site specific fees that will be recognized over the life of the applicable franchise agreements under the new standard. In addition, ASU 2014-09 is expected to impact the classification of advertising contributions from franchisees. The

Company currently records advertising contributions from franchisees as a liability against which specified advertising and marketing costs are charged. Under the new standard, advertising contributions from franchisees will be classified as franchise income on the consolidated statements of income. The Company recognized advertising contributions from franchisees totaling $1.3 million and $1.4 million during fiscal years 2016 and 2015, respectively, as a reduction to marketing and advertising expense on the consolidated statements of income. The Company is evaluating other potential effects that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update requires a lessee to recognize on the balance sheet a liability to make lease payments and a corresponding right-of-use asset. The guidance also requires certain qualitative and quantitative disclosures about the amount, timing and uncertainty of cash flows arising from leases. This update is effective for annual and interim periods beginning after December 15, 2018, which will require the Company to adopt these provisions in the first quarter of fiscal year 2019 using a modified retrospective approach. The Company's restaurants operate under facility lease agreements that provide for material future lease payments. The restaurant facility leases comprise the majority of the Company's material lease agreements. The Company is currently evaluating the effect of the standard on its ongoing financial reporting, but expects that the adoption of ASU 2016-02 will have a material effect on its consolidated financial statements. The Company expects that the most significant changes relate to 1) the recognition of new right–of–use assets and lease liabilities on the consolidated balance sheet for restaurant facility operating leases; and 2) the derecognition of existing lease liabilities on the consolidated balance sheet related to scheduled rent increases.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (Topic 230). This update was issued to standardize how certain transactions are classified on the statement of cash flows. This update is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. The adoption of ASU 2016-15 is not expected to have a significant impact of the Company's ongoing financial reporting.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740). This update addresses the income tax consequences of intra-entity transfers of assets other than inventory. Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. In addition, interpretations of this guidance have developed in practice over the years for transfers of certain intangible and tangible assets. The amendments in the update will require recognition of current and deferred income taxes resulting from an intra-entity transfer of an asset other than inventory when the transfer occurs. This update is effective for annual and interim periods beginning after December 15, 2017, which will require us to adopt these provisions in the first quarter of fiscal year 2018 using a modified retrospective approach. Early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350). This update eliminates the current two-step approach used to test goodwill for impairment and requires an entity to apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective for fiscal years beginning after December 15, 2019 (upon the first goodwill impairment test performed during that fiscal year). Early adoption is permitted for interim or annual goodwill impairment tests after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on our consolidated financial statements.

(2) Mitchell's Restaurants

As of December 28, 2014, the Company operated eighteen Mitchell's Fish Markets and three Mitchell's/Cameron's Steakhouse restaurants (collectively, the Mitchell's Restaurants).

In November 2014, the Company and Landry's, Inc. and Mitchell's Entertainment, Inc., an affiliate of Landry's Inc. (together with Landry's Inc., Landry's), entered into an asset purchase agreement (the Agreement). Pursuant to the Agreement, the Company agreed to sell the Mitchell's Restaurants and related assets to Landry's for $10 million. The sale of the Mitchell's Restaurants closed on January 21, 2015. The assets sold consisted primarily of leasehold interests, leasehold improvements, restaurant equipment and furnishings, inventory, and related intangible assets, including brand names and trademarks associated with the 21 Mitchell's Restaurants. The results of operations have been classified as discontinued operations in the consolidated statements of income for all periods presented. No amounts for shared general and administrative costs or interest expense were allocated to discontinued operations. Substantially all direct cash flows related to operating these restaurants were eliminated at the closing date of the sale. The Company's continuing involvement was limited to transition services up to four months with minimal impact on cash flows.

Under the terms of the Agreement, Landry's assumed the Mitchell's Restaurants' facility lease obligations and the Company reimbursed Landry's for gift cards that were sold prior to the closing date and used at the Mitchell's Restaurants during the eighteen months following the closing date. In the Agreement, the Company and Landry's made customary representations and warranties and

agreed to customary covenants relating to the sale of the Mitchell's Restaurants. The Company and Landry's have agreed to indemnify each other for losses arising from certain breaches of the Agreement and for certain other liabilities.

The Company guaranteed Landry's lease obligations aggregating $33.8 million under nine of the Mitchell's Restaurants' leases. The Company did not record a financial accounting liability for the lease guarantees, because the likelihood of Landry's defaulting on the lease agreements was deemed to be remote. Landry's also indemnified the Company in the event of a default under any of the leases.

(3) Discontinued Operations

The Company accounts for its closed restaurants in accordance with the provisions of FASB ASC Topic 360-10, "Property, Plant and Equipment." As of December 29, 2014, the Company adopted ASU 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which changed the criteria for reporting discontinued operations and requires additional disclosures about discontinued operations. ASU 2014-08 requires that an entity report as a discontinued operation only a disposal that represents a strategic shift in operations that has a major effect on its operations and financial results. Therefore, individual restaurants which are closed after December 28, 2014 will not be classified as discontinued operations. Prior to the Company's adoption of ASU 2014-08, when a restaurant was closed or the restaurant was either held for sale or abandoned, the restaurant's operations were eliminated from the ongoing operations. Accordingly, the operations of such restaurants, net of applicable income taxes, are presented as discontinued operations and prior period operations of such restaurants, net of applicable income taxes, were reclassified. For the thirteen and thirty-nine week periods ended September 24, 2017 and September 25, 2016, all restaurant sales, direct costs and expenses and income taxes attributable to restaurants classified as discontinued operations have been aggregated to a single caption entitled results from discontinued operations, net of income taxes in the condensed consolidated statements of income for all periods presented. Results from discontinued operations, net of income taxes is comprised of the following (in thousands):

	13 Weeks Ended		39 Weeks Ended	
	September 24, 2017	September 25, 2016	September 24, 2017	September 25, 2016
Revenues				
Mitchell's Restaurants	$—	$ —	$—	$ —
Other Restaurants	—	—	—	—
Total revenues	—	—	—	—
Costs and expenses				
Recurring costs and expenses				
Mitchell's Restaurants	131	(448)	220	(408)
Other Restaurants	(17)	325	(57)	562
Total costs and expenses	114	(123)	163	154
(Loss) income before income taxes	(114)	123	(163)	(154)
Income tax (benefit) expense	(43)	48	(62)	(60)
(Loss) income from discontinued operations, net of income taxes	$(71)	$ 75	$(101)	$ (94)

Cash flows from discontinued operations are combined with the cash flows from continuing operations within each of the categories on our condensed consolidated statements of cash flows. We do not anticipate that the sale of the Mitchell's Restaurants or any of our closed restaurants reported as discontinued operations will have a material impact on the Company's cash flow during fiscal year 2017.

(4) Long-term Debt

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

	September 24, 2017	December 25, 2016
Senior Credit Facility:		
Revolving credit facility	$ 30,000	$ 25,000
Less current maturities	—	—
	$ 30,000	$ 25,000

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As of September 24, 2017, the Company had $30.0 million of outstanding indebtedness under its senior credit facility with approximately $55.4 million of borrowings available, net of outstanding letters of credit of approximately $4.6 million. As of September 24, 2017, the weighted average interest rate on the Company's outstanding debt was 2.7% and the weighted average interest rate on our outstanding letters of credit was 1.6%. In addition, the fee on the Company's senior credit facility was 0.2%. As of September 24, 2017, the Company was in compliance with all the covenants under its senior credit facility.

On February 2, 2017, the Company entered into a credit agreement with Wells Fargo Bank, National Association as administrative agent, and certain other lenders (the Credit Agreement). The Credit Agreement provides for a revolving credit facility of $90.0 million with a $5.0 million subfacility for letters of credit and a $5.0 million subfacility for swingline loans. Subject to the satisfaction of certain conditions and lender consent, the revolving credit facility may be increased up to a maximum of $150.0 million. The Credit Agreement has a maturity date of February 2, 2022. At the Company's option, revolving loans may bear interest at (i) LIBOR, plus an applicable margin or (ii) the highest of (a) the rate publicly announced by Wells Fargo as its prime rate, (b) the average published federal funds rate in effect on such day plus 0.50% and (c) one month LIBOR plus 1.00%, plus an applicable margin. The applicable margin is based on the Company's actual leverage ratio, ranging (a) from 1.50% to 2.25% above the applicable LIBOR rate or (b) at the Company's option, from 0.50% to 1.25% above the applicable base rate.

The Credit Agreement contains customary representations and affirmative and negative covenants (including limitations on indebtedness and liens) as well as financial covenants requiring a minimum fixed coverage charge ratio and limiting the Company's consolidated leverage ratio. The Credit Agreement also contains events of default customary for credit facilities of this type (with customary grace periods, as applicable), including nonpayment of principal or interest when due; material incorrectness of representations and warranties when made; breach of covenants; bankruptcy and insolvency; unsatisfied ERISA obligations; unstayed material judgment beyond specified periods; default under other material indebtedness; and certain changes of control of the Company. If any event of default occurs and is not cured within the applicable grace period, or waived, the outstanding loans may be accelerated by lenders holding a majority of the commitments under the Credit Agreement and the lenders' commitments may be terminated. The obligations under the Credit Agreement are guaranteed by certain of the Company's subsidiaries (the Guarantors), and are secured by a lien on substantially all of the Company's personal property assets other than any equity interest in current and future subsidiaries of the Company.

(5) Shareholders' Equity

Subsequent to the end of the third quarter of fiscal year 2017 the Company's Board of Directors approved a new share repurchase program under which the Company is authorized to repurchase up to $60 million of outstanding common stock from time to time. The new share repurchase program replaces the previous share repurchase program announced in April 2016, which has been terminated. The Company spent $48.0 million to repurchase 2.8 million shares of its common stock, at an average price of $17.05 per share, under its previous share repurchase program. During the first thirty-nine weeks of fiscal year 2017, 719,442 shares were repurchased at an aggregate cost of $14.5 million, or an average cost of $20.21 per share. Share repurchases were accounted for under the cost method and all repurchased shares were retired and cancelled. The excess of the purchase price over the par value of the shares was recorded as a reduction in additional paid-in-capital.

The Company's Board of Directors declared the following dividends during the periods presented (amounts in thousands, except per share amounts):

Declaration Date	Record Date	Payment Date

	Dividend per Share		Total Amount	
Fiscal Year 2017				
February 17, 2017	$ 0.09	February 23, 2017	$ 2,862	March 9, 2017
May 5, 2017	$ 0.09	May 18, 2017	$ 2,862	June 1, 2017
July 28, 2017	$ 0.09	August 10, 2017	$ 2,844	August 24, 2017
Fiscal Year 2016				
February 12, 2016	$ 0.07	February 25, 2016	$ 2,350	March 10, 2016
April 28, 2016	$ 0.07	May 12, 2016	$ 2,338	May 26, 2016
July 29, 2016	$ 0.07	August 11, 2016	$ 2,282	August 25, 2016

Subsequent to the end of the third quarter of fiscal year 2017, the Company’s Board of Directors declared a regular quarterly cash dividend of $0.09 per common and restricted share, or approximately $2.8 million in the aggregate based on the number of shares currently outstanding, payable on November 22, 2017 to stockholders of record as of the close of business on November 9, 2017.

Outstanding unvested restricted stock is not included in common stock outstanding amounts. Restricted stock outstanding as of September 24, 2017 aggregated 1,184,629 shares.

(6) Fair Value Measurements

The carrying amounts of cash and cash equivalents, receivables, prepaid expenses, accounts payable and accrued expenses and other current liabilities are reasonable estimates of their fair values due to their short duration. Borrowings classified as long-term debt as of September 24, 2017 and December 25, 2016 have variable interest rates that reflect currently available terms and conditions for similar debt. The carrying amount of this debt is a reasonable estimate of its fair value (Level 2).

As of September 24, 2017 and December 25, 2016, the Company had no assets or liabilities measured on a recurring or nonrecurring basis subject to the disclosure requirements of "Fair Value Measurements and Disclosures," FASB ASC Topic 820.

(7) Segment Information

The Company has two reportable segments – the Company-owned steakhouse segment and the franchise operations segment. The Company does not rely on any major customers as a source of revenue. The Company-owned Ruth's Chris Steak House restaurants, all of which are located in North America, operate within the full-service dining industry, providing similar products to similar customers. Revenues are derived principally from food and beverage sales. As of September 24, 2017, (i) the Company-owned steakhouse restaurant segment included 70 Ruth's Chris Steak House restaurants and two Ruth's Chris Steak House restaurants operating under contractual agreements and (ii) the franchise operations segment included 81 franchisee-owned Ruth's Chris Steak House restaurants. Segment profits for the Company-owned steakhouse restaurant segments equal segment revenues less segment expenses. Segment revenues for the Company-owned steakhouse restaurants include restaurant sales, management agreement income and other restaurant income. Gift card breakage revenue is not allocated to operating segments. Not all operating expenses are allocated to operating segments. Segment expenses for the Company-owned steakhouse segment include food and beverage costs and restaurant operating expenses. No other operating costs are allocated to the Company-owned steakhouse segment for the purpose of determining segment profits because such costs are not directly related to the operation of individual restaurants. The accounting policies applicable to each segment are consistent with the policies used to prepare the consolidated financial statements. The profit of the franchise operations segment equals franchise income, which consists of franchise royalty fees and franchise opening fees. No costs are allocated to the franchise operations segment.

Segment information related to the Company's two reportable business segments follows (in thousands):

	13 Weeks Ended		39 Weeks Ended	
	September 24, 2017	September 25, 2016	September 24, 2017	September 25, 2016
Revenues:				
Company-owned steakhouse restaurants	$80,390	$ 79,360	$275,732	$ 263,907
Franchise operations	4,218	3,928	12,865	12,463
Unallocated other revenue and revenue discounts	559	486	2,123	1,948
Total revenues	$85,167	$ 83,774	$290,720	$ 278,318
Segment profits:				
Company-owned steakhouse restaurants	$12,476	$ 15,088	$60,674	$ 58,859
Franchise operations	4,218	3,928	12,865	12,463
Total segment profit	16,694	19,016	73,539	71,322
Unallocated operating income	559	486	2,123	1,948
Marketing and advertising expenses	(3,197)	(2,546)	(9,056)	(7,134)
General and administrative costs	(7,096)	(7,346)	(23,267)	(22,068)
Depreciation and amortization expenses	(3,852)	(3,435)	(11,089)	(9,907)
Pre-opening costs	(121)	(574)	(1,473)	(1,665)
Interest expense, net	(197)	(333)	(521)	(799)
Other income	(6)	(92)	33	60
Income from continuing operations before income tax expense	$2,784	$ 5,176	$30,289	$ 31,757
Capital expenditures:				
Company-owned steakhouse restaurants	$3,600	$ 5,238	$13,592	$ 18,351
Corporate assets	77	387	734	743
Total capital expenditures	$3,677	$ 5,625	$14,326	$ 19,094

	September 24, 2017	December 25, 2016
Total assets:		
Company-owned steakhouse restaurants	$179,030	$ 185,820
Franchise operations	2,383	2,707
Corporate assets - unallocated	6,207	9,021
Deferred income taxes - unallocated	5,452	9,924
Total assets	$193,072	$ 207,472

(8) Stock-Based Employee Compensation

As of December 26, 2016 (the first day of fiscal year 2017), the Company adopted ASU 2016-09, Compensation – Stock Compensation (Topic 718), which affects all entities that issue share-based compensation to their

employees. The amendments in this ASU cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. Therefore, for the thirty-nine weeks of fiscal year 2017, the recognition of excess tax benefits and deficiencies were recognized as income tax benefits or expense on the consolidated statement of income and as an operating activity on the statement of cash flows. Prior to the Company's adoption of ASU 2016-09, these tax benefits and deficiencies were recognized as additional paid-in capital on the balance sheet and as a financing activity on the statement of cash flows.

Under the Amended and Restated 2005 Equity Incentive Plan, at September 24, 2017, there were 19,250 shares of common stock issuable upon exercise of currently outstanding options, 1,184,629 currently outstanding unvested restricted stock awards and 1,806,516 shares available for future grants. During the first thirty-nine weeks of fiscal year 2017, the Company issued 251,512 restricted stock awards to directors, officers and other employees of the Company. Of the 251,512 restricted stock awards issued during the first thirty-nine weeks of fiscal year 2017, 38,220 shares will vest in fiscal year 2018, 135,073 shares will vest in fiscal year 2019, 48,219 shares will vest in fiscal year 2020, 10,000 will vest in 2021, 10,000 will vest in 2022 and 10,000 will vest in 2023.

Total stock compensation expense recognized during the first thirty-nine weeks of fiscal years 2017 and 2016 was $5.1 million and $4.3 million, respectively.

(9) Income Taxes

Income tax expense differs from amounts computed by applying the federal statutory income tax rate to income from continuing operations before income taxes as follows:

	39 Weeks Ended	
	September 24, 2017	September 25, 2016
Income tax expense at statutory rates	35.0 %	35.0 %
Increase (decrease) in income taxes resulting from:		
State income taxes, net of federal benefit	3.0 %	4.2 %
Federal employment tax credits	(7.0 %)	(7.1 %)
Other	0.8 %	0.7 %
Effective tax rate	31.8 %	32.8 %

The Company utilizes the federal FICA tip credit to reduce its periodic federal income tax expense. A restaurant company employer may claim a credit against the company's federal income taxes for FICA taxes paid on certain tip wages (the FICA tip credit). The credit against income tax liability is for the full amount of eligible FICA taxes. Employers cannot deduct from taxable income the amount of FICA taxes taken into account in determining the credit.

The Company files consolidated and separate income tax returns in the United States federal jurisdiction and many state jurisdictions, respectively. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations for years before 2012.

(10) Earnings Per Share

The following table sets forth the computation of earnings per share (amounts in thousands, except share and per share amounts):

	13 Weeks Ended		39 Weeks Ended	
	September 24, 2017	September 25, 2016	September 24, 2017	September 25, 2016
Income from continuing operations	$ 1,767	$ 3,508	$ 20,657	$ 21,347
Income (loss) from discontinued operations, net of income taxes	(71)	75	(101)	(94)
Net income	$ 1,696	$ 3,583	$ 20,556	$ 21,253
Shares:				
Weighted average number of common shares	30,348,180	31,305,952	30,490,554	32,023,814

outstanding - basic				
Weighted average number of common shares				
outstanding - diluted	30,877,192	31,737,036	31,040,640	32,437,142
Basic earnings (loss) per common share:				
Continuing operations	$0.06	$0.11	$0.68	$0.67
Discontinued operations	—	—	(0.01)	—
Basic earnings per common share	$0.06	$0.11	$0.67	$0.67
Diluted earnings (loss) per common share:				
Continuing operations	$0.06	$0.11	$0.67	$0.66
Discontinued operations	(0.01)	—	(0.01)	—
Diluted earnings per common share	$0.05	$0.11	$0.66	$0.66

Diluted earnings per share for the third quarters of fiscal year 2017 and 2016 excludes stock options and restricted shares of 0 and 31,845, respectively, which were outstanding during the period but were anti-dilutive. The weighted average exercise prices of the anti-dilutive stock options for the third quarters of fiscal years 2017 and 2016 were $0 per share and $19.14 per share. Dilutive

earnings per share for the first thirty-nine weeks of fiscal years 2017 and 2016 excludes stock options and restricted shares of 857 and 24,981, respectively, which were outstanding during the period but were anti-dilutive. The weighted average exercise prices of the anti-dilutive stock options for the first thirty-nine weeks of fiscal years 2017 and 2016 were $21.60 per share and $19.04 per share, respectively.

(11) Commitments and Contingencies

The Company is subject to various claims, possible legal actions and other matters arising in the normal course of business. Management does not expect disposition of these other matters to have a material adverse effect on the financial position, results of operations or liquidity of the Company. The Company expenses legal fees as incurred.

The legislation and regulations related to tax and unclaimed property matters are complex and subject to varying interpretations by both government authorities and taxpayers. The Company remits a variety of taxes and fees to various governmental authorities, including excise taxes, property taxes, sales and use taxes, and payroll taxes. The taxes and fees remitted by the Company are subject to review and audit by the applicable governmental authorities which could assert claims for additional assessments. Although management believes that the tax positions are reasonable and consequently there are no accrued liabilities for claims which may be asserted, various taxing authorities may challenge certain of the positions taken by the Company which may result in additional liability for taxes and interest. These tax positions are reviewed periodically based on the availability of new information, the lapsing of applicable statutes of limitations, the conclusion of tax audits, the identification of new tax contingencies, or the rendering of relevant court decisions. An unfavorable resolution of assessments by a governmental authority could negatively impact the Company’s results of operations and cash flows in future periods.

The Company is subject to unclaimed or abandoned property (escheat) laws which require the Company to turn over to certain state governmental authorities the property of others held by the Company that has been unclaimed for specified periods of time. The Company is subject to audit by individual U.S. states with regard to its escheatment practices.

The Company currently buys a majority of its beef from two suppliers. Although there are a limited number of beef suppliers, management believes that other suppliers could provide similar product on comparable terms. A change in suppliers, however, could cause supply shortages and a possible loss of sales, which would affect operating results adversely.

(12) Subsequent Events

On November 2, 2017 the Company entered into an asset purchase agreement with Desert Island Restaurants, L.L.C., Honolulu Steak House, LLC, Maui Steak House LLC, Wailea Steak House LLC, Beachwalk Steak House LLC, Lava Coast Steak House, LLC and Kauai Steak House, LLC (collectively, the “Sellers”) to acquire the six franchised Ruth’s Chris Steak House restaurants in Hawaii for a cash purchase price of $35 million, subject to certain adjustments. The transaction has been approved by our Board of Directors and is subject to the satisfaction of customary closing conditions and may be terminated by the Company or the Sellers if closing has not occurred on or before 120 days following the date of the asset purchase agreement.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” that reflect, when made, the Company’s expectations or beliefs concerning future events that involve risks and uncertainties. Forward-looking statements frequently are identified by the words “believe,” “anticipate,” “expect,” “estimate,” “intend,” “project,” “targeting,” “will be,”

continue," "will likely result," or other similar words and phrases. Similarly, statements herein that describe the Company's objectives, plans or goals, including with respect to new restaurant openings, strategy, financial outlook, capital expenditures, liquidity and capital resources, the impact of healthcare inflation and minimum wage legislation, the expected timing of the closing of the Hawaii franchisee acquisition and the expected benefits of the Hawaii franchisee acquisition also are forward-looking statements. Actual results could differ materially from those projected, implied or anticipated by the Company's forward-looking statements. Some of the factors that could cause actual results to differ include: reductions in the availability of, or increases in the cost of, USDA Prime grade beef, fish and other food items; changes in economic conditions and general trends; the loss of key management personnel; the effect of market volatility on the Company's stock price; health concerns about beef or other food products; the effect of competition in the restaurant industry; changes in consumer preferences or discretionary spending; labor shortages or increases in labor costs; the impact of federal, state or local government regulations relating to income taxes, unclaimed property, Company employees, the sale or preparation of food, the sale of alcoholic beverages and the opening of new restaurants; harmful actions taken by the Company's franchisees; a material failure, interruption or security breach of the Company's information technology network; repeal or reduction of the federal FICA tip credit; the Company's indemnification obligations in connection with its sale of the Mitchell's Restaurants; the Company's ability to protect

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its name and logo and other proprietary information; an impairment in the financial statement carrying value of our goodwill, other intangible assets or property; the impact of litigation; the restrictions imposed by the Company's credit agreement; and changes in, or the discontinuation of, the Company's quarterly cash dividend payments or share repurchase program; the failure or the inability of the parties to satisfy the closing conditions for the Hawaii franchisee acquisition; unanticipated transaction costs for the Hawaii franchisee acquisition; unexpected delays in closing the Hawaii franchisee acquisition; and the Company's inability to successfully integrate the Hawaii franchisee restaurants into its operations. For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2016, which is available on the SEC's website at www.sec.gov. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this Quarterly Report on Form 10-Q to reflect events or circumstances after the date hereof. You should not assume that material events subsequent to the date of this Quarterly Report on Form 10-Q have not occurred.

Unless the context otherwise indicates, all references in this report to the "Company," "Ruth's," "we," "us," "our" or similar words are to Ruth's Hospitality Group, Inc. and its subsidiaries. Ruth's Hospitality Group, Inc. is a Delaware corporation formerly known as Ruth's Chris Steak House, Inc., and was founded in 1965.

Overview

Ruth's Hospitality Group, Inc. is a restaurant company focused on the upscale dining segment. Ruth's Hospitality Group, Inc. operates Company-owned Ruth's Chris Steak House restaurants and sells franchise rights to Ruth's Chris Steak House franchisees giving the franchisees the exclusive right to operate similar restaurants in a particular area designated in the franchise agreement. As of September 24, 2017, there were 153 Ruth's Chris Steak House restaurants, including 70 Company-owned restaurants, two restaurants operating under contractual agreements and 81 franchisee-owned restaurants.

The Ruth's Chris menu features a broad selection of USDA Prime- and high quality steaks and other premium offerings served in Ruth's Chris' signature fashion—"sizzling" and topped with butter—complemented by other traditional menu items inspired by our New Orleans heritage. The Ruth's Chris restaurants reflect over 50 years committed to the core values instilled by our founder, Ruth Fertel, of caring for our guests by delivering the highest quality food, beverages and service in a warm and inviting atmosphere.

All Company-owned Ruth's Chris Steak House restaurants are located in the United States. The franchisee-owned Ruth's Chris Steak House restaurants include 21 international franchisee-owned restaurants in Aruba, Canada, China, Hong Kong, Indonesia, Japan, Mexico, Panama, Singapore, Taiwan and the United Arab Emirates. New Company-owned Ruth's Chris Steak House restaurants opened in Waltham, MA in January 2017 and Cleveland, OH in March 2017 and a new frachisee-owned Ruth's Chris Steak House restaurant opened in Chengdu, China in September 2017. A new Ruth's Chris Steak House restaurant operating under a contractual agreement also opened in Tulsa, OK in January 2017. A franchisee-owned Ruth's Chris Steak House restaurant was closed in San Juan, Puerto Rico in September 2017.

Our business is subject to seasonal fluctuations. Historically, our first and fourth quarters have tended to be the strongest revenue quarters due largely to the year-end holiday season and the popularity of dining out during the fall and winter months. Consequently, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year and comparable restaurant sales for any particular period may decrease.

Our Annual Report on Form 10-K for the fiscal year ended December 25, 2016 provides additional information about our business, operations and financial condition.

Results of Operations

The table below sets forth certain operating data expressed as a percentage of total revenues for the periods indicated, except as otherwise noted. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	13 Weeks Ended September 24, 2017	13 Weeks Ended September 25, 2016	39 Weeks Ended September 24, 2017	39 Weeks Ended September 25, 2016
Revenues:				
Restaurant sales	93.2 %	94.0 %	93.9 %	94.1 %
Franchise income	5.0 %	4.7 %	4.4 %	4.5 %
Other operating income	1.8 %	1.3 %	1.7 %	1.4 %
Total revenues	100.0%	100.0 %	100.0%	100.0 %
Costs and expenses:				
Food and beverage costs (percentage of restaurant sales)	31.9 %	30.1 %	30.0 %	29.8 %
Restaurant operating expenses (percentage of restaurant sales)	53.6 %	51.5 %	48.7 %	48.5 %
Marketing and advertising	3.8 %	3.0 %	3.1 %	2.6 %
General and administrative costs	8.3 %	8.8 %	8.0 %	7.9 %
Depreciation and amortization expenses	4.5 %	4.1 %	3.8 %	3.6 %
Pre-opening costs	0.1 %	0.7 %	0.5 %	0.6 %
Total costs and expenses	96.5 %	93.3 %	89.4 %	88.3 %
Operating income	3.5 %	6.7 %	10.6 %	11.7 %
Other income (expense):				
Interest expense, net	(0.2 %)	(0.4 %)	(0.2 %)	(0.3 %)
Other	-	(0.1 %)	-	-
Income from continuing operations before income tax expense	3.3 %	6.2 %	10.4 %	11.4 %
Income tax expense	1.2 %	2.0 %	3.3 %	3.7 %
Income from continuing operations	2.1 %	4.2 %	7.1 %	7.7 %
Loss from discontinued operations, net of income taxes	(0.1 %)	0.1 %	-	-
Net income	2.0 %	4.3 %	7.1 %	7.7 %

Third Quarter Ended September 24, 2017 (13 Weeks) Compared to Third Quarter Ended September 25, 2016 (13 Weeks)

Overview. Operating income decreased by $2.6 million, or 46.7%, to $3.0 million for the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016. Operating income for the third quarter of fiscal year 2017 was favorably impacted by a $682 thousand increase in restaurant sales offset by a $2.0 million increase in restaurant operating expenses and a $1.6 million increase in food and beverage costs. Income from continuing operations

decreased from the third quarter of fiscal year 2016 by $1.7 million to $1.8 million. Net income for the third quarter of fiscal year 2017 decreased from the third quarter of fiscal year 2016 by $1.9 million to $1.7 million.

Segment Profits. Segment profitability information is presented in Note 7 to the condensed consolidated financial statements. Not all operating expenses are allocated to operating segments. The Ruth’s Chris Steak House Company-owned restaurants, which are all located in the United States, are managed as an operating segment. The Ruth’s Chris concept operates within the full-service dining industry, providing similar products to similar customers. The franchise operations are reported as a separate operating segment. Segment profits for the third quarter of fiscal year 2017 for the Company-owned steakhouse restaurant segment decreased by $2.6 million to $12.5 million from the third quarter of fiscal year 2016. The decrease was driven primarily by a $1.0 million increase in restaurant sales offset by a $2.0 million increase in restaurant operating expenses and a $1.6 million increase in food and beverage costs. Franchise income increased $290 thousand in the third quarter of fiscal year 2017 compared to the third quarter of fiscal year 2016 primarily due to franchise opening fees of $200 thousand.

Restaurant Sales. Restaurant sales increased by $682 thousand, or 0.9%, to $79.4 million in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016. The increase was attributable to a $1.9 million increase in restaurant sales at new restaurants offset by a decrease in Company-owned comparable restaurant sales of $1.2 million. Excluding discontinued operations, total

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operating weeks during the third quarter of fiscal year 2017 increased to 910 from 877 in the third quarter of fiscal year 2016. Company-owned comparable restaurant sales decreased 1.6%, driven by an average check decrease of 0.1% and a traffic decrease of 1.5%. During the third quarter of 2017 Hurricanes Harvey and Irma negatively impacted Company-owned comparable restaurant sales by approximately 150-200 basis points, driven by 64 lost operating days.

Franchise Income. Franchise income increased $290 thousand in the third quarter of fiscal year 2017 compared to the third quarter of fiscal year 2016. The increase was primarily due to an increase in franchise opening fees of $200 thousand.

Other Operating Income. Other operating income increased $421 thousand in the third quarter of fiscal year 2017 compared to the third quarter of fiscal year 2016. The increase in other operating income was primarily due to an increase of $371 thousand in income from restaurants operating under contractual agreements, including the new location in Tulsa, OK.

Food and Beverage Costs. Food and beverage costs increased $1.6 million in the third quarter of fiscal year 2017 compared to the third quarter of fiscal year 2016. As a percentage of restaurant sales, food and beverage costs increased to 31.9% in the third quarter of fiscal year 2017 from 30.1% in the third quarter of fiscal year 2016. The increase in food and beverage costs as a percentage of restaurant sales was primarily due to a 10.9% increase in beef costs.

Restaurant Operating Expenses. Restaurant operating expenses increased $2.0 million, or 5.0%, to $42.6 million in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016. Restaurant operating expenses, as a percentage of restaurant sales, increased to 53.6% in the third quarter of fiscal year 2017 from 51.5% in the third quarter of fiscal year 2016. The increase in restaurant operating expenses as a percentage of restaurant sales was primarily due to storm related inefficiencies and the resulting sales deleveraging. The third quarter of fiscal year 2017 had a $1.2 million increase in labor related costs and a $335 thousand benefit in the third quarter of fiscal year 2016 related to the settlement of disputed rent costs.

Marketing and Advertising. Marketing and advertising expenses increased $651 thousand to $3.2 million in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016. The increase in marketing and advertising expenses in the third quarter of fiscal year 2017 was primarily attributable to a planned increase in advertising spending.

General and Administrative Costs. General and administrative costs decreased $250 thousand to $7.1 million in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016. The decrease in general and administrative costs was primarily attributable to a decrease in performance-based compensation.

Depreciation and Amortization Expenses. Depreciation and amortization expense increased $417 thousand to $3.9 million in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016 primarily due to depreciation on new restaurant and remodel assets placed in service within the last twelve months.

Pre-opening Costs. Pre-opening costs were $121 thousand in the third quarter of fiscal year 2017 primarily due to the planned opening of a Ruth's Chris Steak House Restaurant in Denver, CO. Pre-opening costs were $574 thousand in the third quarter of fiscal year 2016 primarily due to the planned openings of two Ruth's Chris Steak House Restaurants, including El Paso, TX, which opened in the third quarter of fiscal year 2016.

Interest Expense. Interest expense decreased $136 thousand to $197 thousand in the third quarter of fiscal year 2017 from the third quarter of fiscal year 2016 primarily due to $78 thousand in lower amortization of capitalized debt costs during the third quarter of fiscal year 2017 compared to the third quarter of 2016.

Other Income and Expense. During the third quarter of fiscal year 2017, we recognized other expense of $6 thousand. During the third quarter of fiscal year 2016 we recognized other expense of $92 thousand.

Income Tax Expense. During the third quarter of fiscal year 2017, we recognized income tax expense of $1.0 million. During the third quarter of fiscal year 2016, we recognized income tax expense of $1.7 million. The effective tax rate, including the impact of discrete items, increased to 36.5% for the third quarter of fiscal year 2017 compared to 32.2% for the third quarter of fiscal year 2016. The effective tax rate increased in the third quarter of fiscal year 2017 primarily due to a discrete state income tax reserve recognized in the quarter. Fiscal year 2017 discrete items and other unexpected changes impacting the annual tax expense may cause the effective tax rate for fiscal year 2017 to differ from the effective tax rate for the third quarter 2017.

Income from Continuing Operations. Income from continuing operations of $1.8 million in the third quarter of fiscal year 2017 decreased by $1.7 million compared to the third quarter of fiscal year 2016 due to the factors noted above.

Income or Loss from Discontinued Operations, net of income taxes. Loss from discontinued operations, net of income taxes, for the third quarter of fiscal year 2017 was $71 thousand compared to income of $75 thousand during the third quarter of fiscal year 2016.

The loss in the third quarter of fiscal year 2017 was primarily due to Mitchell's Restaurants. The income in the third quarter of 2016 was primarily attributable to a $466 thousand benefit from the extinguishment of a liability related to Mitchell's Restaurant gift cards, partially offset by occupancy costs of $335 thousand from a closed Ruth's Chris Steak House restaurant.

Net Income. Net income was $1.7 million in the third quarter of fiscal year 2017 and decreased by $1.9 million compared to $3.6 million in the third quarter of fiscal year 2016. The decrease was largely attributable to the factors noted above.

Thirty-nine Weeks Ended September 24, 2017 Compared to Thirty-nine Weeks Ended September 25, 2016

Overview. Operating income decreased by $1.7 million, or 5.3%, to $30.8 million for the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016. Operating income for the first thirty-nine weeks of fiscal year 2017 was favorably impacted by a $11.1 million increase in restaurant sales, an increase in other operating income of $899 thousand and an increase in franchise income of $402 thousand offset by a $6.0 million increase in restaurant operating expenses, a $4.0 million increase in food and beverage costs, a $1.9 million increase in marketing and advertising, a $1.2 million increase in general and administrative costs and a $1.2 million increase in depreciation and amortization. Income from continuing operations decreased from the first thirty-nine weeks of fiscal year 2016 by $690 thousand to $20.7 million. Net income for the first thirty-nine weeks of fiscal year 2017 decreased from the first thirty-nine weeks of fiscal year 2016 by $697 thousand to $20.6 million.

Segment Profits. Segment profitability information is presented in Note 7 to the condensed consolidated financial statements. Not all operating expenses are allocated to operating segments. The Ruth's Chris Steak House Company-owned restaurants, which are all located in the United States, are managed as an operating segment. The Ruth's Chris concept operates within the full-service dining industry, providing similar products to similar customers. The franchise operations are reported as a separate operating segment. Segment profits for the first thirty-nine weeks of fiscal year 2017 for the Company-owned steakhouse restaurant segment increased by $1.8 million to $60.7 million from the first thirty-nine weeks of fiscal year 2016. The increase was driven primarily by a $11.8 million increase in restaurant sales partially offset by a $6.0 million increase in restaurant operating expenses and a $4.0 million increase in food and beverage costs. Franchise income increased $402 thousand in the first thirty-nine weeks of fiscal year 2017 compared to the first thirty-nine weeks of fiscal year 2016 primarily due to royalties from a 4.5% increase in franchise restaurant sales.

Restaurant Sales. Restaurant sales increased by $11.1 million, or 4.2%, to $273.0 million in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016. The increase was attributable to a $1.8 million increase in Company-owned comparable restaurant sales and a $9.3 million increase in restaurant sales at new restaurants. Excluding discontinued operations, total operating weeks during the first thirty-nine weeks of fiscal year 2017 increased to 2,715 from 2,605 in the first thirty-nine weeks of fiscal year 2016. Company-owned comparable restaurant sales increased 0.7%, driven by an average check increase of 1.1% and a traffic decrease of 0.4%.

Franchise Income. Franchise income increased $402 thousand in the first thirty-nine weeks of fiscal year 2017 compared to the first thirty-nine weeks of fiscal year 2016. The increase was primarily due to an increase in royalties from a 4.5% increase in franchise restaurant sales.

Other Operating Income. Other operating income increased $899 thousand in the first thirty-nine weeks of fiscal year 2017 compared to the first thirty-nine weeks of fiscal year 2016. The increase in other operating income was primarily due to an increase of $687 thousand in income from restaurants operated under contractual agreements, including the new location in Tulsa, OK and increased gift card breakage revenue of $175 thousand.

Food and Beverage Costs. Food and beverage costs increased $4.0 million in the first thirty-nine weeks of fiscal year 2017 compared to the first thirty-nine weeks of fiscal year 2016. As a percentage of restaurant sales, food and

beverage costs increased to 30.0% in the first thirty-nine weeks of fiscal year 2017 from 29.8% in the first thirty-nine weeks of fiscal year 2016. The increase in food and beverage costs as a percentage of restaurant sales was primarily due to an increase in beef costs.

Restaurant Operating Expenses. Restaurant operating expenses increased $6.0 million, or 4.7%, to $133.0 million in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016. Restaurant operating expenses, as a percentage of restaurant sales, increased to 48.7% in the first thirty-nine weeks of fiscal year 2017 from 48.5% in the first thirty-nine weeks of fiscal year 2016. The increase in restaurant operating expenses as a percentage of restaurant sales was primarily due to an increase in labor related expenses.

Marketing and Advertising. Marketing and advertising expenses increased $1.9 million to $9.1 million in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016. The increase in marketing and advertising expenses in the first thirty-nine weeks of fiscal year 2017 was primarily attributable to a planned increase in advertising spending.

General and Administrative Costs. General and administrative costs increased $1.2 million to $23.3 million in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016. The increase in general and administrative costs was primarily attributable to an increase of $2.0 million in compensation expense partially offset by a decrease in professional fees of $997 thousand.

Depreciation and Amortization Expenses. Depreciation and amortization expense increased $1.2 million to $11.1 million in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016 primarily due to depreciation on new restaurant and remodel assets placed in service within the last twelve months.

Pre-opening Costs. Pre-opening costs were $1.5 million in the first thirty-nine weeks of fiscal year 2017 primarily due to the openings of two Ruth's Chris Steak House restaurants in Waltham, MA and Cleveland, OH which opened in the first thirty-nine weeks of fiscal year 2017 and the anticipated opening of our second Denver, CO opening planned for the fourth quarter of 2017. Pre-opening costs were $1.7 million in the first thirty-nine weeks of fiscal year 2016 primarily due to the anticipated openings of four new Company-owned restaurants, including Albuquerque, NM, which opened in May 2016 and El Paso, TX which opened in August 2016.

Interest Expense. Interest expense decreased $278 thousand to $521 thousand in the first thirty-nine weeks of fiscal year 2017 from the first thirty-nine weeks of fiscal year 2016 primarily due to lower amortization of capitalized debt costs during the first thirty-nine weeks of fiscal year 2017.

Other Income and Expense. Other income remained relatively unchanged for the first thirty-nine weeks of fiscal year 2017, compared to the first thirty-nine weeks of fiscal year 2016.

Income Tax Expense. During the first thirty-nine weeks of fiscal year 2017, we recognized income tax expense of $9.6 million. During the first thirty-nine weeks of fiscal year 2016, we recognized income tax expense of $10.4 million. The effective tax rate, including the impact of discrete items, decreased to 31.8% for the first thirty-nine weeks of fiscal year 2017 compared to 32.8% for the first thirty-nine weeks of fiscal year 2016. The effective tax rate decreased in the first thirty-nine weeks of fiscal year 2017 primarily due to lower state income taxes recognized in the first thirty-nine weeks. Fiscal year 2017 discrete items and other unexpected changes impacting the annual tax expense may cause the effective tax rate for fiscal year 2017 to differ from the effective tax rate for the first thirty-nine weeks of 2017.

Income from Continuing Operations. Income from continuing operations of $20.7 million in the first thirty-nine weeks of fiscal year 2017 decreased by $690 thousand compared to the first thirty-nine weeks of fiscal year 2016 due to the factors noted above.

Loss from Discontinued Operations, net of income taxes. Loss from discontinued operations, net of income taxes, for the first thirty-nine weeks of fiscal year 2017 was $101 thousand compared to a loss of $94 thousand during the first thirty-nine weeks of fiscal year 2016. The loss in the first thirty-nine weeks of fiscal year 2017 was primarily attributable to Mitchell's Restaurants. The loss in the first thirty-nine weeks of 2016 was primarily attributable to occupancy costs of $581 thousand from a closed Ruth's Chris Steak House restaurant, partially offset by a benefit of $466 thousand from the extinguishment of a liability related to Mitchell's Restaurant gift cards.

Net Income. Net income was $20.6 million in the first thirty-nine weeks of fiscal year 2017 and decreased by $697 thousand compared to $21.3 million in the first thirty-nine weeks of fiscal year 2016. The decrease was largely attributable to the factors noted above.

Liquidity and Capital Resources

Overview

Our principal sources of cash during the first thirty-nine weeks of 2017 were net cash provided by operating activities and borrowings under our prior and current senior credit facilities. Our principal uses of cash during the first thirty-nine weeks of 2017 were for capital expenditures, principal repayments under our senior credit facility, stock repurchases and dividend payments. Cash flows from discontinued operations are combined with the cash flows from continuing operations within each of the categories on our statement of cash flows.

Subsequent to the end of the third quarter of fiscal year 2017 our Board of Directors approved a new share repurchase program authorizing us to repurchase up to $60 million of outstanding common stock from time to time. The new share repurchase program replaces the previous share repurchase program announced in April 2016, which has been retired. We spent $48.0 million to repurchase 2.8 million shares of its common stock, at an average price of $17.02 per share, under its previous share repurchase program. During the first thirty-nine weeks of fiscal year 2017, we repurchased 719,442 shares at an aggregate cost of $14.5 million or an average cost of $20.21 per share. All repurchased shares were retired and cancelled.

During the second quarter of fiscal year 2013, we commenced paying quarterly cash dividends to holders of common and restricted stock. We paid a quarterly cash dividend of $0.09 per share, or $2.9 million in the aggregate during the first and second quarter of fiscal year 2017 and $2.8 million in the third quarter of fiscal year 2017. On November 3, 2017, we announced that our Board of Directors declared a quarterly cash dividend of $0.09 per share, or $2.8 million in the aggregate, to be paid on November 22, 2017 to common and restricted stockholders of record as of the close of business on November 9, 2017. Future dividends will be subject to the approval of our Board of Directors.

We believe that our borrowing ability under our new senior credit facility coupled with our anticipated cash flow from operations should provide us with adequate liquidity for the next 12 months.

Senior Credit Facility

As of September 24, 2017, we had $30.0 million of outstanding indebtedness under our senior credit facility with approximately $55.4 million of borrowings available, net of outstanding letters of credit of approximately $4.6 million. As of September 24, 2017, the weighted average interest rate on our outstanding debt was 2.7% and the weighted average interest rate on our outstanding letters of credit was 1.6%. In addition, the fee on the unused portion of our senior credit facility was 0.2%.

On February 2, 2017, we entered into a credit agreement with Wells Fargo Bank, National Association as administrative agent, and certain other lenders (the Credit Agreement) governing a new senior credit facility that replaced the prior credit facility. The Credit Agreement provides for a revolving credit facility of $90.0 million with a $5.0 million subfacility for letters of credit and a $5.0 million subfacility for swingline loans. Subject to the satisfaction of certain conditions and lender consent, the revolving credit facility may be increased up to a maximum of $150.0 million. The Credit Agreement has a maturity date of February 2, 2022. At our option, revolving loans may bear interest at (i) LIBOR, plus an applicable margin or (ii) the highest of (a) the rate publicly announced by Wells Fargo as its prime rate, (b) the average published federal funds rate in effect on such day plus 0.50% and (c) one month LIBOR plus 1.00%, plus an applicable margin. The applicable margin is based on our actual leverage ratio, ranging (a) from 1.50% to 2.25% above the applicable LIBOR rate or (b) at our option, from 0.50% to 1.25% above the applicable base rate.

The Credit Agreement contains customary representations and affirmative and negative covenants (including limitations on indebtedness and liens) as well as financial covenants requiring a minimum fixed coverage charge ratio and limiting our consolidated leverage ratio. As of September 24, 2017, we were in compliance with all of the covenants in the Credit Agreement. The Credit Agreement also contains events of default customary for credit facilities of this type (with customary grace periods, as applicable), including nonpayment of principal or interest when due; material incorrectness of representations and warranties when made; breach of covenants; bankruptcy and insolvency; unsatisfied ERISA obligations; unstayed material judgment beyond specified periods; default under other material indebtedness; and certain changes of control of the Company. If any event of default occurs and is not cured within the applicable grace period, or waived, the outstanding loans may be accelerated by lenders holding a majority of the commitments under the Credit Agreement and the lenders' commitments may be terminated. The obligations under the Credit Agreement are guaranteed by certain of our subsidiaries (the Guarantors), and are secured by a lien on substantially all of our personal property assets other than any equity interest in current and future subsidiaries of the Company.

Under the Credit Agreement, restricted junior payments, which include cash dividend payments, repurchases of our equity securities and payments and prepayments of subordinated indebtedness, made subsequent to February 2, 2017 are limited to $100.0 million if our consolidated leverage ratio is greater than or equal to 2.00:1.00, and are not limited in amount if our consolidated leverage ratio is less than 2.00:1.00. As of the date of this Quarterly Report on Form 10-Q, $23.1 million in junior restricted payments have been made since February 2, 2017.

Sources and Uses of Cash

The following table presents a summary of our net cash provided by (used in) operating, investing and financing activities (in thousands):

	39 Weeks Ended	
	September 24, 2017	September 25, 2016
Net cash provided by (used in):		
Operating activities	$35,090	$ 29,125
Investing activities	(14,326)	(18,292)
Financing activities	(19,690)	(9,974)
Net increase in cash and cash equivalents	$1,074	$ 859

Operating Activities. Operating cash inflows pertain primarily to restaurant sales and franchise income. Operating cash outflows pertain primarily to expenditures for food and beverages, restaurant operating expenses, marketing and advertising, general and administrative costs and income taxes. Operating activities provided cash flow during the first thirty-nine weeks of both fiscal years 2017 and 2016 primarily because operating revenues exceeded cash-based expenses.

Investing Activities. Cash used in investing activities aggregated $14.3 million in the first thirty-nine weeks of fiscal year 2017 compared with $18.3 million cash used in the first thirty-nine weeks of fiscal year 2016. Investing cash outflows during the first thirty-nine weeks of both fiscal years 2017 and 2016 pertained primarily to capital expenditure projects. Cash used in investing projects during the first thirty-nine weeks of fiscal year 2017 primarily pertained to $6.7 million for restaurant remodel and capital replacement projects and $6.8 million for new restaurants. Cash used in investing activities during the first thirty-nine weeks of fiscal year 2016 primarily pertained to $8.6 million for restaurant remodel projects and $9.5 million for new restaurants.

Financing Activities. Financing activities used cash during the first thirty-nine weeks of both fiscal years 2017 and 2016. During the first thirty-nine weeks of fiscal year 2017, we: used $14.5 million to repurchase common stock; paid dividends of $8.6 million; increased the debt outstanding under our senior credit facility by $5.0 million; and paid $2.1 million in employee taxes in connection with the vesting of restricted stock and the exercise of stock options. We paid the $2.1 million in taxes in connection with the vesting of restricted stock and the exercise of stock options because some recipients elected to satisfy their individual tax withholding obligations by having us withhold a number of vested shares of restricted stock and/or a number of shares otherwise issuable pursuant to stock options. During the first thirty-nine weeks of fiscal year 2016, we: used $40.0 million to repurchase common stock; increased the debt outstanding under our senior credit facility by $38.0 million; paid dividends of $7.0 million; and paid $1.5 million in employee taxes related to stock based compensation.

Off-Balance Sheet Arrangements

As of September 24, 2017, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

The preparation of our financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses during the periods presented. Our Annual Report on Form 10-K for the fiscal year ended December 25, 2016 includes a summary of the critical accounting policies and estimates that we believe are the most important to aid in the understanding our financial results. There have been no material changes to these critical accounting policies and estimates that impacted our reported amounts of assets, liabilities, revenues or expenses during the first thirty-nine weeks of fiscal year 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company is exposed to market risk from fluctuations in interest rates. For fixed rate debt, interest rate changes affect the fair market value of such debt but do not impact earnings or cash flows. Conversely, for variable rate debt, including borrowings under the Company’s senior credit facility, interest rate changes generally do not affect the fair market value of such debt, but do impact future earnings and cash flows, assuming other factors are held constant. At September 24, 2017, the Company had $30.0 million in variable rate debt outstanding. The Company currently does not use financial instruments to hedge its risk to market fluctuations in interest rates. Holding other variables constant (such as debt levels), a hypothetical immediate one percentage point change in interest rates would be expected to have an impact on pre-tax earnings and cash flows for fiscal year 2017 of approximately $300 thousand.

Foreign Currency Risk

The Company believes that fluctuations in foreign exchange rates do not present a material risk to its operations due to the relatively small amount of franchise income it receives from outside the U.S. During the first thirty-nine weeks of fiscal years 2017 and 2016, franchise income attributable to international locations was approximately $2.1 million in each year.

Commodity Price Risk

The Company is exposed to market price fluctuations in beef and other food product prices, which in the past have been volatile and have impacted the Company's food and beverage costs. As the Company typically sets its menu prices in advance of its beef and other food product purchases, the Company cannot quickly react to changing costs of beef and other food items. To the extent that the Company is unable to pass the increased costs on to its guests through price increases, the Company's results of operations would be adversely affected. As of September 24, 2017, the Company has entered into negotiated set pricing for approximately 25% of its beef

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requirements for the remainder of fiscal year 2017. The market for USDA Prime grade beef is particularly volatile. If prices increase, or the supply of beef is reduced, operating margin could be materially adversely affected. Holding other variables constant, a hypothetical 10% fluctuation in beef prices would have an approximate impact on pre-tax earnings ranging from $0.5 million to $1.0 million for the remainder of fiscal year 2017.

From time to time, the Company enters into purchase price agreements for other lower-volume food products, including seafood. In the past, certain types of seafood have experienced fluctuations in availability. Seafood is also subject to fluctuations in price based on availability, which is often seasonal. If certain types of seafood are unavailable, or if the Company's costs increase, the Company's results of operations could be adversely affected.

Effects of Healthcare Inflation

The Company is exposed to market price fluctuations related to the cost of providing healthcare to its employees. Claim trends are predicted to outpace inflation throughout the upcoming year. Pharmacy costs are also rising in excess of general and medical cost inflation. If prices increase, or the Company experiences significantly more claims, operating margin could be materially adversely affected. Holding other variables constant, a hypothetical 10% fluctuation in healthcare costs would have an approximate impact on pre-tax earnings of approximately $250 thousand for the remainder of 2017.

Effects of Inflation

The Company believes that general inflation, excluding increases in food, employee wages and employee health plan costs, has not had a material impact on its results of operations in recent years. Additionally, increases in statutory minimum wage rates may increase our operating costs. Recently, governmental entities acted to increase minimum wage rates in states where Company-owned restaurants are located. The increased minimum wage rates are expected to increase employee compensation and related taxes by approximately $1.2 million in fiscal year 2017 compared to fiscal year 2016. Also, the U.S. government may consider legislation to increase the federal minimum wage rate, which, if enacted, would further increase employee compensation and related taxes.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of September 24, 2017. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 24, 2017 to ensure that information required to be disclosed in reports filed or submitted by the Company under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that information required to be disclosed by the Company is accumulated and communicated to the Company's management to allow timely decisions regarding the required disclosure.

Changes in internal control over financial reporting

During the fiscal quarter ended September 24, 2017, there was no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that in the Company's judgment has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. While litigation is subject to uncertainties and the outcome of litigated matters is not predictable with assurance, the Company is not aware of any legal proceedings pending or threatened against it that it expects to have a material adverse effect on its financial condition or results of operations.

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors included in the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2016. The impact of circumstances and events described in such risk factors could result in significant adverse effects on our financial position, results of operations and cash flows.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Stock repurchase activity during the fiscal quarter ended September 24, 2017 was as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Dollar Value that May Yet be Purchased under the Program – Amounts in thousands
June 26, 2017 to July 30, 2017	—	—	—	$ 18,158
July 31, 2017 to August 27, 2017	6,845	$ 19.52	6,845	$ 18,025
August 28, 2017 to September 24, 2017	312,597	$ 19.12	312,597	$ 12,047
Totals for the fiscal quarter	319,442	$ 19.13	319,442	$ 12,047

Subsequent to the end of the third quarter of fiscal year 2017 the Company's Board of Directors approved a new share repurchase program under which the Company is authorized to repurchase up to $60 million of outstanding common stock from time to time in the open market, through negotiated transactions or otherwise (including, without limitation, the use of Rule 10b5-1 plans), depending on share price, market conditions and other factors. The new share repurchase program replaces the Company's previous share repurchase program announced in April 2016, which has been retired. The previous share repurchase program had permitted the repurchase of up to $60 million of outstanding common stock, of which approximately $12.0 million remained unused upon its retirement. The share repurchase program does not obligate the Company to repurchase any dollar amount or number of shares, and has no termination date. The Company intends to conduct any open market share repurchase activities in compliance with the safe harbor provisions of Rule 10b-18 of the Exchange Act. During the fiscal quarter ended September 24, 2017, 319,442 shares were repurchased via open market transactions at an aggregate cash cost of $6.1 million. During the fiscal quarter ended September 25, 2016, 553,341 shares were repurchased via open market transactions at an aggregate cash cost of $8.3 million. The Company's ability to make future stock purchases under the program is currently limited by our Credit Agreement. Under our Credit Agreement, we are limited to $100.0 million of junior stock payments, which include cash dividends, repurchases of common stock and prepayments of subordinated indebtedness, if our consolidated leverage ratio is greater than or equal to 2.00:1.00. As of September 24, 2017, $23.1 million of such payments had been made.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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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.

RUTH'S HOSPITALITY GROUP, INC.

By: /S/ MICHAEL P. O'DONNELL
Michael P. O'Donnell
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

By: /S/ ARNE G. HAAK
Arne G. Haak
Executive Vice President and Chief Financial Officer of Ruth's Hospitality Group, Inc.

(Principal Financial Officer)

Date: November 3, 2017

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