Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Financial Report
January 2, 2022 and January 3, 2021

Contents

Consolidated Financial Statements

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Independent Auditor's Report

Board of Directors
Meritage Hospitality Group Inc., Subsidiaries and Affiliate
Grand Rapids, Michigan

Opinion

We have audited the consolidated financial statements of Meritage Hospitality Group Inc., Subsidiaries and Affiliate (the Company), which comprise the consolidated balance sheets as of January 2, 2022 and January 3, 2021, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of January 2, 2022 and January 3, 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements are issued or available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

BDO USA, LLP

Grand Rapids, Michigan
March 9, 2022

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Balance Sheets
(in thousands)

	January 2, 2022	January 3, 2021
Assets		
Current Assets		
Cash	$ 49,951	$ 32,319
Receivables	1,604	1,733
Inventories	4,408	3,616
Prepaid expenses and other current assets	6,159	8,515
Total Current Assets	62,122	46,183
Property and Equipment - Net	135,566	118,323
Goodwill	174,243	174,243
Intangible Assets - Net	5,209	5,039
Operating Lease Right-of-Use Assets - Net	371,026	337,575
Other Assets		
Long-term investments	1,786	1,786
Deposits and other assets	8,679	6,777
Total Assets (1)	**$ 758,631**	**$ 689,926**
Liabilities and Equity		
Current Liabilities		
Trade accounts payable	$ 21,738	$ 16,928
Lines of credit	12,526	10,040
Current portion of long-term debt	13,333	19,996
Current portion of operating lease obligations payable	24,466	22,024
Accrued liabilities	29,341	25,695
Total Current Liabilities	101,404	94,683
Unearned Vendor Allowances	1,713	2,872
Operating Lease Obligations Payable	352,177	320,876
Other Long-term Liabilities	15,550	14,553
Long-term Debt - Net of current portion	165,383	148,862
Deferred Income Taxes	13,720	9,661
Total Liabilities (1)	$ 649,947	$ 591,507
Equity	108,684	98,419
Total Liabilities and Equity (1)	**$ 758,631**	**$ 689,926**

See notes to consolidated financial statements
(1) See Note 15 for balance sheet information on the Variable Interest Entity

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Operations and Comprehensive Income

(in thousands, except per share data)

	Fiscal Year Ended January 2, 2022	Fiscal Year Ended January 3, 2021
Food and Beverage Revenue	$ 577,127	$ 516,178
Expenses		
Food and beverage	150,774	134,420
Labor and related	183,396	153,110
Occupancy	76,467	69,943
Advertising	22,295	18,164
Franchise fees	21,841	19,518
Other operating	51,761	42,652
Total Operating Expenses	506,534	437,807
General and administrative	32,225	27,824
Preopening, acquisition and closing	3,989	8,464
Depreciation and amortization	16,306	16,307
Total Expenses	559,054	490,402
Income from Operations	18,073	25,776
Other (Income) Expense		
Interest	6,709	10,784
Other	(11,934)	(3,164)
Total Other (Income) Expense	(5,225)	7,620
Income Before Income Taxes	23,298	18,156
Income Tax Expense	5,096	2,401
Consolidated Net Income	**$ 18,202**	**$ 15,755**
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	757	845
Consolidated Comprehensive Net Income Attributable to Controlling Interest	**$ 17,445**	**$ 14,910**
Other Comprehensive Income - Net of Tax		
Change in interest rate swap valuation	1,402	-
Consolidated Comprehensive Net Income	**$ 18,847**	**$ 14,910**
Earnings per share		
Basic	$ 2.30	$ 2.00
Diluted	$ 1.81	$ 1.58
Basic Weighted Average Shares Outstanding	6,703	6,453
Diluted Weighted Average Shares Outstanding	9,631	9,407

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Equity
(in thousands)

	Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interest	Total
Balance - December 29, 2019	$ 13	$ 64	$ 33,652	$ -	$ 47,120	$ 2,229	$ 83,078
Net income	-	-	-	-	14,910	845	15,755
Issuance of common stock	-	3	121	-	-	-	124
Issuance of preferred stock	1	-	2,399	-	-	-	2,400
Repurchase of common stock	-	-	(183)	-	-	-	(183)
Common stock dividends	-	-	-	-	(907)	-	(907)
Preferred stock dividends - net	-	-	-	-	(1,634)	-	(1,634)
Company-owned stock	-	-	(1,271)	-	-	-	(1,271)
Stock option expense	-	-	1,515	-	-	-	1,515
Distributions	-	-	-	-	-	(458)	(458)
Balance - January 3, 2021	$ 14	$ 67	$ 36,233	$ -	$ 59,489	$ 2,616	$ 98,419
Net income	-	-	-	-	17,445	757	18,202
Issuance of common stock	-	1	162	-	-	-	163
Repurchase of common stock	-	(2)	(4,420)	-	-	-	(4,422)
Repurchase of preferred stock	-	-	(107)	-	-	-	(107)
Common stock dividends	-	-	-	-	(2,146)	-	(2,146)
Preferred stock dividends - net	-	-	-	-	(1,655)	-	(1,655)
Interest rate swap	-	-	-	1,402	-	-	1,402
Company-owned stock	-	-	(1,958)	-	-	-	(1,958)
Stock option expense	-	-	1,233	-	-	-	1,233
Distributions	-	-	-	-	-	(447)	(447)
Balance - January 2, 2022	$ 14	$ 66	$ 31,143	$ 1,402	$ 73,133	$ 2,926	$ 108,684

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Cash Flows

(in thousands)

	Fiscal Year Ended	
	January 2, 2022	January 3, 2021
Cash Flows from Operating Activities		
Net Income	$ 18,202	$ 15,755
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	16,306	16,307
Amortization of financing costs	567	532
Deferred income taxes	4,059	1,319
Loss on disposal of fixed assets	3,040	2,231
Gain on sale and leaseback transactions	(12,338)	(4,042)
Change in fair value of swap	(1,036)	408
Change in company-owned stock	(1,958)	(1,271)
Stock option expense	1,233	1,515
Changes in assets and liabilities which provided (used) cash:		
Receivables	129	(3,936)
Inventories	(792)	(99)
Prepaid expenses and other current assets	2,356	(1,610)
Deposits and other assets	(1,394)	(997)
Accounts payable	4,810	(4,722)
Accrued liabilities	2,843	11,593
Unearned vendor allowances	(1,159)	720
Other long-term liabilities	3,707	2,638
Net cash provided by operating activities	38,575	36,341
Cash Flows from Investing Activities		
Purchase of property and equipment	(83,674)	(32,808)
Purchase of intangible assets	(434)	(1,013)
Proceeds from sale of asset	842	1,348
Net cash used in investing activities	(83,266)	(32,473)

See notes to consolidated financial statements.

Meritage Hospitality Group Inc., Subsidiaries and Affiliate

Consolidated Statements of Cash Flows

(in thousands)

	Fiscal Year Ended	
	January 2, 2022	January 3, 2021
Cash Flows from Financing Activities		
Proceeds from long-term debt	181,800	-
Principal payments on long-term debt	(169,403)	(8,306)
Proceeds from lines of credit	73,713	25,391
Payments on lines of credit	(27,647)	(7,999)
Proceeds from sale and leaseback transactions	59,163	49,833
Payments on lines of credit related to sale and leaseback transactions	(43,580)	(46,287)
Principal payments on finance leases	-	(365)
Payments for debt issuance costs	(3,109)	(100)
Repurchase of common stock	(4,422)	(183)
Repurchase of preferred stock	(107)	-
Proceeds from issuance of common stock	163	124
Proceeds from issuance of preferred stock - net	-	2,400
Common stock dividends paid	(2,146)	(907)
Preferred stock dividends paid - net	(1,655)	(1,634)
Distributions to Noncontrolling Interest	(447)	(458)
Net cash provided by financing activities	62,323	11,509
Net Increase in Cash	17,632	15,377
Cash - Beginning of period	32,319	16,942
Cash - End of period	$ 49,951	$ 32,319
Supplemental Disclosure of Cash Flow Information		
Cash paid for:		
Interest	$ 7,884	$ 9,838
Income taxes	$ 2,707	$ 2,075
Significant non-cash investing and financing activities:		
Conversion of property and equipment to asset held for sale	$ 469	$ 1,340

See notes to consolidated financial statements.

Note 1 - Nature of Business and Significant Accounting Policies

Meritage Hospitality Group Inc., Subsidiaries and Affiliate (the "Company") conducts its business in the quick-service and casual dining restaurant industries. As of January 2, 2022, the Company operated 337 Wendy's quick-service restaurants under franchise agreements with its franchisor, Quality Is Our Recipe, LLC, hereafter referred to as "the Wendy's Company" or "Wendy's," as well as eight independent concept restaurants. Operations of the Company are located in Arkansas, Connecticut, Florida, Georgia, Indiana, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas, and Virginia.

Principles of Consolidation - The consolidated financial statements include the accounts of Meritage Hospitality Group Inc., all of its wholly owned subsidiaries, its 98.5% owned subsidiary, RDG-MHG, LLC., ("RDG") a 15% partner in TRG-Meritage Bahamas, LLC., ("TRG") and its variable interest entity ("VIE"), Restaurant Holdings, LLC ("Restaurant Holdings"), for which the Company is a primary beneficiary. A VIE is consolidated when the Company has the power to direct activities that impact the VIE's economic performance, as well as the right to receive benefits or the obligation to absorb losses from the VIE that could potentially be significant.

Earnings from Restaurant Holdings are reported as a noncontrolling interest in the accompanying consolidated statement of operations. All intercompany transactions and balances between the Company, its subsidiaries and Restaurant Holdings have been eliminated in consolidation.

Segment Information – Operating segments are components of an entity for which discrete financial information is available and regularly reviewed by the chief operating officer in order to allocate resources and assess performance. Resource allocation decisions are made based on the Chief Operating Officer's evaluation of total Company operations. Accordingly, the Company views the operating results of its Wendy's and independent concept restaurants as one operating and reportable segment.

Fiscal Period – The Company operates on a 52/53-week fiscal year ending on the Sunday closest to December 31 of each year. Fiscal year 2021 ended on January 2, 2022 and contained 52 weeks. Fiscal year 2020 ended on January 3, 2021 and contained 53 weeks.

Revenue Recognition - Revenues consist of restaurant food and beverage sales and are recorded net of applicable sales taxes, and beginning in 2020, deferred revenue associated with the Wendy's Company app-based loyalty program ("Wendy's Rewards"). Food and beverage revenue is recognized at the time food is delivered to the customer and the performance obligation is satisfied. Payment in cash or credit is accepted at the time of transaction, and there is no variability in the transaction price as discounts and allowances are recognized at the point of sale. Fees paid to third party delivery providers are reported as other operating expenses on the consolidated statements of operations and are immaterial to the consolidated financial statements. The Company's gift card activity is managed by The Wendy's Company and is immaterial to the consolidated financial position.

(in thousands, except share data)

The Wendy's Rewards program is offered at all the Company's Wendy's restaurants. For every dollar of a qualifying customer purchase, ten rewards points are earned. The Company defers a portion of qualifying revenue until rewards points are redeemed, forfeited or expired within a year of the date earned. Deferred revenue associated with Wendy's Rewards was $445 and $291 as of January 2, 2022 and January 3, 2021, respectively, and is classified in accrued liabilities on the consolidated balance sheet.

As the Company generates revenue through the sale of restaurant food and beverage, it aggregates results into sales from its quick-service restaurants and independent concept restaurants. Included in the consolidated statements of operations for years ended January 2, 2022 and January 3, 2021 are the following results:

	2021	2020
Quick-service restaurants	$ 567,830	$ 509,971
Independent concept restaurants	9,297	6,207
Total Revenue	$ 577,127	$ 516,178

Cash - Cash includes cash on hand in the restaurants and cash held in banks. At times, cash balances at financial institutions are in excess of FDIC insurance coverage. The cash balances are maintained at financial institutions with high credit quality ratings, and the Company believes no significant risk of loss exists with respect to those balances.

Receivables - Receivables consist of trade and other receivables. Trade receivables consist of gift cards redeemed at the Company's restaurants and amounts due from unsettled debit and credit card sales. No allowance for doubtful accounts is deemed necessary.

Inventories - Inventories consist of restaurant food items, beverage and beverage supplies, and paper supplies. Inventories are stated at the lower of cost or net realizable value, with cost determined on the first-in, first-out (FIFO) method.

Property and Equipment - Property and equipment is stated at cost. Depreciation is computed principally using the straight-line method based upon estimated useful lives ranging from three to 15 years for furniture and equipment and up to 30 years for buildings. Leasehold improvements are amortized over the shorter of their estimated useful lives or the terms of the various leases. Repairs and maintenance costs that do not add to the value or increase the life of an asset are expensed when incurred. Interest costs on borrowings are capitalized during the construction period of the restaurant. Interest of $103 and $63 was capitalized in the years ended January 2, 2022 and January 3, 2021, respectively.

Goodwill – In accordance with ASC 805, the Company allocates purchase price of acquisitions to its identifiable assets and liabilities based on the estimated fair values using all available information. For certain valuations, the Company may engage an independent third-party valuation specialist. The excess of purchase price over the amount allocated to assets and liabilities is recorded as goodwill.

The Company reviews goodwill for impairment annually in the fourth quarter, or when indications of potential impairment or a triggering event occurs. If the carrying amounts of these assets are deemed to be less than fair value based upon a discounted cash flow analysis and comparison to comparable earnings multiples of peer companies, such assets are reduced to their estimated fair value and a charge is made to operations. For the years ended January 2, 2022 and January 3, 2021, the tests indicated no goodwill impairment.

Franchise Rights and Agreement Costs - Franchise rights and agreement costs, capitalized in connection with the Company's Wendy's restaurants, are amortized using the straight-line method over the terms of each individual franchise agreement, including extension options, given the Company's historical pattern and economic incentive to renew (see Note 3).

Financing Costs - Financing costs are capitalized and amortized using the straight-line method, which approximates the effective interest rate method, over the terms of the various loan agreements (see Note 8). These costs are a reduction in the balance of the outstanding debt.

Long-Term Investments – Investments in entities in which the Company is not able to exercise significant influence are carried at cost. Impairment losses due to a decline in the value of the investment that is other than temporary are recognized when incurred. Investments are reviewed when impairment indicators are present by comparing carrying value to fair market value, as determined by appraisals, present value of estimated future cash flows or similar third-party transactions. If the carrying value exceeds fair market value, an impairment is recognized for the amount by which the carrying amount of the asset exceeds the fair market value. There were no impairment losses recognized for the years ended January 2, 2022 and January 3, 2021.

Fair Value of Financial Instruments – Fair value measurements are defined as the price that would be received to sell an asset or paid to transfer a liability between market participants. Accounting standards require the Company to categorize its financial assets and liabilities into a three-level fair value hierarchy. Based on the nature of inputs used, the three levels of the fair value hierarchy under fair value accounting are described as follows:

Level I – Valuation is based upon quoted prices for identical assets or liabilities in active markets.

Level II – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level III – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. The unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

The Company's financial instruments which are not required to be measured at fair value on the consolidated balance sheets consist of the following:

Short-Term Financial Instruments – The fair values of short-term financial instruments, including cash, receivables, trade accounts payable, accrued liabilities, and lines of credit, approximate the carrying amounts in the accompanying consolidated financial statements due to the short maturity of such instruments.

Long-Term Obligations – The fair value of long-term debt obligations at January 2, 2022 and January 3, 2021 are based on estimated rates currently available to the Company at year-end and debt obligations with similar terms and maturities.

The Company's financial instruments which are required to be measured at fair value on the consolidated balance sheets consist of the following Level II financial instruments:

Interest rate swaps – The Company measures its interest rate swaps at fair value on a recurring basis. The fair value of these swaps are provided by a counterparty and are based primarily on inputs such as interest rates and LIBOR yield curves that are observable at commonly quoted intervals and other observable market inputs.

Deferred compensation plan - Investments under the Company's deferred compensation plan are measured and carried at fair value based on the quoted prices in active markets for identical assets, and other observable inputs reflecting market assumptions that market participants would use in pricing.

Self-Insurance – The Company's restaurants in Michigan are self-insured for workers' compensation claims up to a $500 per claim stop-loss level with no maximum aggregate. The Company determines its liability based on estimated loss reserves provided by the Company's third-party claims administrator and on management's knowledge of open claims.

Unearned Vendor Allowances - Up-front consideration received from vendors linked to future purchases is initially deferred, then recognized as earned income as the purchases occur over the term of the vendor arrangement. During the years ended January 2, 2022 and January 3, 2021, the Company received $7,522 and $8,566, respectively, in funds that are recognized as a reduction of cost of food and beverage as products are purchased.

Earnings per Share - Basic earnings per common share is computed by dividing net income attributable to controlling interest, after the deduction of preferred stock dividends, by the number of weighted average common shares outstanding and dilutive shares. Diluted earnings per common share is computed on the weighted average common shares outstanding plus dilutive shares using the treasury stock method for stock options, and the if-converted method for convertible preferred shares.

Interest Rate Swaps – The Company has interest rate swap derivatives for the purpose of hedging risks related to the variability of cash flows caused by interest rate fluctuations. Interest rate swaps are measured at fair value on a recurring basis and are recognized in other assets and other long-term liabilities on the accompanying consolidated balance sheets accordingly.

Effective with the Company's refinancing of its existing debt in August 2021, the Company designated its interest rate swaps as a cash flow hedge for financial reporting purposes. Under this designation, changes in fair value are recorded in other comprehensive income, net of tax, until the hedge transaction occurs. The Company classifies the cash flows from derivatives that are accounted for as a cash flow hedge in the same category as the cash flows from the items being hedged (see Note 9).

Prior to the August 2021 refinance, the interest rate swaps were not designated as a cash flow hedge. As a result, changes in fair value, as well as realized gains and losses, were recognized as a component of interest expense (see Note 9).

Stock-Based Compensation - The Company measures compensation expense for equity awards, including stock options, based on the fair value of the awards on the grant date. Compensation expense for grants is recognized ratably over the vesting period of the awards. Company policy recognizes forfeiture expense as incurred. The Company issues common shares when stock options are exercised.

Advertising Costs - Advertising costs and fees due under the Company's franchise agreements are based primarily on a percentage of monthly food and beverage revenue. These costs are charged to operations as incurred and are included in advertising expense on the consolidated statements of operations. Total advertising expense was $22,295 and $18,164 for the years ended January 2, 2022 and January 3, 2021, respectively.

Income Taxes - A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the year. Deferred tax liabilities or assets are recognized for the estimated future tax effects of temporary differences between financial reporting and tax accounting and are based on the difference between the financial statement and tax basis of assets and liabilities measured by the current tax rate. The deferred tax provision generally represents the net change in deferred tax assets and liabilities during the period including any changes in valuation allowances. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is established when it is more likely than not that some or all of the deferred tax assets will be realized. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities. The Company and its subsidiaries file a consolidated federal income tax return.

Restaurant Holdings is treated as a partnership for federal income tax purposes. Consequently, federal income taxes are not payable or provided for by Restaurant Holdings. Restaurant Holdings' members are taxed individually on their pro-rata ownership share of its earnings which is allocated among the members in accordance with the Restaurant Holdings operating agreement.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances; however, actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the assessment of impairment of long-lived assets, goodwill, and deferred tax assets.

Recent Developments Related to COVID-19 - In January 2020, the World Health Organization ("WHO") announced a global health emergency resulting from a new strain of coronavirus. Based on the rapid increase in global exposure, the COVID-19 outbreak was classified as a pandemic in March 2020.

As a result of governmental actions, the Company was mandated to close dine-in services for all its restaurants in mid-March 2020. In accordance with state and local executive orders, the Company began to phase in the re-opening of its dining rooms beginning in mid-June 2020. As of the date of this report, all of the Company's Wendy's dining rooms and independent concept restaurants have re-opened.

The Company continues to monitor the impact of COVID-19 on its financial condition, liquidity, operations, workforce, suppliers, and industry. Given the ongoing evolution of the pandemic and varied governmental responses, the Company is not able to fully estimate the complete impact or duration of the pandemic on its results of operations, financial condition, or liquidity.

New Accounting Principles – In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.* The update provides optional guidance, for a limited time, to ease the potential burden of accounting for reference rate reform through optional expedients and exceptions. The ASU can be applied to transactions affected by reference rate reform if certain criteria are met and includes transactions that reference London Inter Bank Offered Rate (LIBOR). The ASU is effective immediately and may be applied prospectively to contract modifications entered into or evaluated on or before December 31, 2022. The Company is currently evaluating existing contracts and the optional expedients provided by the new standard.

All other recently issued accounting pronouncements with effective dates after December 31, 2020 are not expected to have a material impact on the consolidated financial statements.

Reclassification – Certain 2020 amounts have been reclassified to conform to the 2021 presentation.

Subsequent Events - The consolidated financial statements and related disclosures include evaluation of events up through and including March 9, 2022, the date the consolidated financial statements were issued.

(in thousands, except share data)

Note 2 - Property and Equipment

Property and equipment are summarized as follows:

	2021	2020
Land and improvements	$ 25,107	$ 23,832
Buildings and improvements	61,931	53,807
Furnishings and equipment	89,356	80,916
Leasehold improvements	22,335	21,866
Construction in progress	16,741	6,335
Total cost	$ 215,470	$ 186,756
Accumulated depreciation	79,904	68,433
Net property and equipment	$ 135,566	$ 118,323

As of January 2, 2022, the Company estimates costs of $4,907 to complete construction in progress.

Depreciation expense was $16,095 and $16,108 in fiscal year 2021 and 2020, respectively.

The Company owned certain land and buildings classified as assets held for sale within other assets on the consolidated balance sheet. As of January 2, 2022 and January 3, 2021, related assets are carried at an aggregate fair market value of $469 and $795, respectively.

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(in thousands, except share data)

Note 3 – Intangible Assets

Intangible assets consist of capitalized franchise rights and agreement costs less accumulated amortization, and are summarized as follows:

	2021	2020
Franchise rights and agreement costs	$ 6,287	$ 5,966
Accumulated amortization	1,078	927
Net	$ 5,209	$ 5,039

Amortization expense for franchise rights and agreement costs in fiscal year 2021 and 2020 was $198 and $188, respectively. The weighted average remaining life through the next renewal period is approximately 18 years.

Amortization expense is projected as follows:

2022	$ 200
2023	200
2024	200
2025	200
2026	200
Thereafter	4,209
Total	$ 5,209

Note 4 - Leases

The Company has operating lease agreements for unowned restaurants, the corporate office, and certain equipment. Land and building leases used in operations have remaining lease terms ranging from one to 22 years, some of which include options to renew up to 50 years.

On the consolidated balance sheets, operating leases are included in operating lease right-of-use (“ROU”) assets, operating lease obligations payable, and current portion of operating lease obligations payable. Finance leases are included in property and equipment, long-term debt, and current portion of long-term debt.

Operating lease ROU assets and operating lease liabilities are recognized based on the present value of future minimum lease payments over the lease term upon commencement date. The Company's lease terms may include options to extend or terminate the lease. The present value of future minimum lease payments include these options only when it is reasonably certain such options will be exercised.

The Company’s leases do not provide an implicit rate. In determining present value of future minimum lease payments, the Company utilized an incremental borrowing rate congruent with its primary lending agreement, which is the rate for a fully collateralized, amortizing loan with the same term as the lease. The weighted average effective discount rate was 4.46% and 5.03% as of January 2, 2022 and January 3, 2021, respectively.

(in thousands, except share data)

Base rent expense includes non-lease components such as taxes, insurance, and maintenance when required under the lease agreements and is classified as occupancy expense in the consolidated statements of operations. As a result of adopting ASC 842, the Company elected the practical expedient to not separate non-lease components from the lease components to which they relate. For certain equipment leases, the Company applies a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Variable rent expense represents rent escalators of which the majority are contingent upon changes in the Consumer Price Index. Variable rent expense also includes percentage rentals which represent additional rent due under certain leases for which the Company is required to pay a percentage of sales in excess of minimum prescribed amounts.

Rent expense from operating leases were recognized as follows:

	2021	2020
Operating lease costs:		
Fixed base lease expense - real estate	$ 38,492	$ 36,924
Fixed base lease expense - equipment	1,594	1,398
Variable rent expense	931	694
Total	$ 41,017	$ 39,016

Throughout fiscal year 2020, the Company negotiated lease payment terms related to the effect of the COVID-19 pandemic which resulted in both deferred rent payments and rent abatements. In accordance with Financial Accounting Standards Board's recent Staff Q&A regarding rent concessions related to the effects of the COVID-19 pandemic, the Company has elected to account for concessions that do not result in a substantial increase in the obligations of the lessee as though enforceable rights and obligations for those concessions existed in the original lease agreements. Accordingly, the Company has elected not to remeasure the related lease liabilities and right-of-use assets. For rent abatements, the Company has recorded negative variable rent expense during the period of relief. Abated rent payments were approximately $526 and zero in fiscal years 2021 and 2020, respectively.

For deferred rent payments, the Company has recognized a non-interest bearing payable for lease payments that would have been made based on original terms of the various lease agreements. The payable will be reduced when the deferred payments are made in accordance with repayment terms. Total deferred rent payments were $178 and $852 at January 2, 2022 and January 3, 2021, respectively and are included in the current portion of operating lease obligations payable on the consolidated balance sheet. Deferred rent payments have various repayment terms extended through August 2022.

(in thousands, except share data)

Supplemental cash flow information related to operating leases was as follows:

	2021	2020
Cash paid for amounts included in the measurement of lease liabilities	$ 38,894	$ 36,261
Right-of-use assets obtained in exchange for lease obligations	$ 52,973	$ 35,658

The weighted-average remaining lease term for operating leases as of January 2, 2022 and January 3, 2021 was approximately 15 years.

The future payments due under operating leases as of January 2, 2022 are projected as follows:

2022	$ 40,509
2023	40,054
2024	39,724
2025	38,543
2026	34,865
Thereafter	317,481
Total	$ 511,176
Less present value discount	(134,533)
Lease liability recognized	$ 376,643

Note 5 – Sale and Leasebacks

For the year ended January 2, 2022, the Company completed 25 sale and leaseback transactions. Through these transactions, the Company netted proceeds of $59,163, and with such proceeds paid down indebtedness of $43,580. The Company recorded net gains of $12,338 related to these sale and leaseback transactions in other income on the consolidated statements of operations.

For the year ended January 3, 2021, the Company completed 23 sale and leaseback transactions. Through these transactions, the Company netted proceeds of $49,833, and with such proceeds paid down indebtedness of $46,287. The Company recorded net gains of $4,042 related to these sale and leaseback transactions in other income on the consolidated statements of operations.

(in thousands, except share data)

Note 6 - Long-Term Investments

Long-term investments consist of the following:

	2021	2020
Investment in TRG	$ 538	$ 538
Priority interest in TRG	1,248	1,248
Total Long-term Investments	$ 1,786	$ 1,786

RDG holds a 15.0% investment in TRG and approximately 13 acres of ocean-front real estate held for future development. The interest receivable in TRG has a priority preferred return upon liquidation of 16.0%, compounded quarterly.

Note 7 - Accrued Liabilities

The following is a detail of accrued liabilities:

	2021	2020
Payroll and related payroll taxes	$ 20,091	$ 18,264
Property taxes	1,629	378
Sales Tax	3,231	2,472
Self-insurance	1,543	1,388
Other	2,847	3,193
Total	$ 29,341	$ 25,695

(in thousands, except share data)

Note 8 - Long-Term Debt and Revolving Lines of Credit

Effective August 5, 2021, the Company refinanced its existing debt with its current primary lender to a $302,800 credit facility with a maturity date of April 2027. The new credit facility includes $181,800 million in long-term debt, $15,000 in revolving short-term debt, and $106,000 of available credit lines.

Long-term debt consists of the following:

	2021	2020
Mortgage note payable - variable rate, due in monthly installments of $43 plus interest of LIBOR plus a margin ranging from 1.85% through 2.50% (effective rate of 4.53% at January 2, 2022), maturing in April 2027.	$ 15,230	$ -
Term note payable - variable rate, due in monthly installments of $765 plus interest of LIBOR plus a margin ranging from 1.85% through 2.50% (effective rate of 2.45% at January 2, 2022), maturing in April 2027.	116,940	-
Term note payable - variable rate, due in monthly installments of $255 plus interest of LIBOR plus a margin ranging from 1.85% through 2.50% (effective rate of 2.48% at January 2, 2022), maturing in April 2027.	45,348	-
Term note payable - variable rate, due in quarterly installments of $100 plus monthly interest payments of LIBOR plus 4.5% (effective rate of 4.10% and 4.65% at January 2, 2022 and January 3, 2021, respectively), maturing in May 2023.	4,200	4,600

(in thousands, except share data)

	2021	2020
Mortgage notes payable - variable rate, due in monthly installments annually increasing from $38 to $39 plus interest of LIBOR plus a margin ranging from 2.25% through 2.75% (effective rate of 3.50% at January 3, 2021). Remaining principal balance was paid in full as a result of the refinancing.	-	10,781
Term notes payable - variable rate, due in monthly installments annually increasing from $1,531 to $1,563 plus interest of LIBOR plus a margin ranging from 2.25% through 2.75% (effective rate of 3.50% at January 3, 2021). Remaining principal balance was paid in full as a result of the refinancing.	-	153,939
Total	$ 181,718	$ 169,320
Less unamortized financing costs	3,002	462
Less current portion	13,333	19,996
Long-term portion	$ 165,383	$ 148,862

The total of the above debt matures as follows:

2022	$ 13,333
2023	17,262
2024	14,012
2025	14,602
2026	15,267
Thereafter	107,242
Total	$ 181,718

The Company has a revolving line of credit agreement with its primary lender that expires in April 2027 and allows for borrowings up to $35,000 and $30,000 as of January 2, 2022 and January 3, 2021, respectively. Outstanding borrowings were $3,153 and $1,865 and had effective interest rates of 2.48% and 3.50% at January 2, 2022 and January 3, 2021, respectively.

Restaurant Holdings has a $30,000 revolving credit facility that expires May 2022. Outstanding borrowings were $5,617 and $7,537 and had effective interest rates of 4.60% and 4.65% at January 2, 2022 and January 3, 2021, respectively.

(in thousands, except share data)

The Company has a flexible development line of credit with its primary lender that expires in April 2027 and allows for borrowings up to $76,250 and $35,300 as of January 2, 2022 and January 3, 2021, respectively. Outstanding borrowings were $3,756 and $683 and had effective interest rates of 2.48% and 3.5% at January 2, 2022 and January 3, 2021, respectively.

Substantially all property and equipment owned by the Company is pledged as collateral for the Company's long-term debt and lines of credit.

Loan covenants of the Company's various loan agreements include requirements for the maintenance of certain financial ratios. As of January 2, 2022 and January 3, 2021, the Company was in compliance with these covenants.

Note 9 – Interest Rate Swaps

The Company has entered into amortizing interest rate swap agreements to economically manage variability of cash flows associated with the variable rate debt that matures in April 2027. Effective with the Company's refinancing of its existing debt in August 2021, the existing interest rate swaps were consolidated and replaced with one agreement. Accordingly, the notional amounts outstanding and related fair values of the amortizing interest rate swaps at January 2, 2022 and January 3, 2021 consist of the following:

	2021		2020	
	Notional Amount Outstanding	Fair Value	Notional Amount Outstanding	Fair Value
Amortizing $40,000 interest rate swap, 2016	$ -	$ -	$ 26,522	$ (373)
Amortizing $30,000 interest rate swap, 2017	-	-	21,442	(326)
Amortizing $50,000 interest rate swap, 2018	-	-	39,478	(916)
Amortizing $120,000 interest rate swap, 2021	116,940	823	-	-
Total	$ 116,940	$ 823	$ 87,442	$ (1,615)

In conjunction with the refinancing, the Company designated its interest rate swaps as a cash flow hedge of variable rate interest payments related to its term loan payable. Under this designation, changes in fair value of the interest rate swaps are recognized through other comprehensive income, a component of equity.

For 2021, the change in fair value of the swap agreement through the date of the Company's refinancing generated unrealized gains of $1,035. Such gains which were recognized as a component of interest expense. Following the date of refinancing, the change in fair value of the swap generated unrealized gains of $1,402 recognized through other comprehensive income, a component of equity. Based on related debt balances, the Company anticipates the amount to be realized in fiscal 2022 to be immaterial.

(in thousands, except share data)

As a result of the fiscal 2020 change in fair value, unrealized losses of $408 were recognized as a component of interest expense.

Realized losses of $1,413 and $1,494 in fiscal 2021 and 2020, respectively were recognized on the interest rate swaps and reflected as a component of interest expense.

Note 10 - Taxes

Deferred tax assets and liabilities consist of:

	2021	2020
Deferred tax assets:		
Accrued rents	$ 1,545	$ 1,240
General business credit	4,829	3,450
Payroll Taxes Deferred under CARES Act	792	1,716
Other	5,667	7,046
Total deferred tax assets	12,833	13,452
Deferred tax liabilities:		
Depreciation, amortization, and basis differences	(26,553)	(23,021)
Other	-	(92)
Total deferred tax liabilities	(26,553)	(23,113)
Net deferred tax liabilities	$ (13,720)	$ (9,661)

The Company regularly assesses the realizability of its deferred tax assets and the related need for, and amount of, a valuation allowance. Management considers many factors in determining the likelihood of future realization of the deferred tax assets including recent cumulative earnings and loss experience, future reversals of existing temporary differences, and carryforwards.

The general business credits listed above expire between 2037 and 2040.

The income tax provision reconciled to the tax computed at the statutory state and federal rates for the years ended January 2, 2022 and January 3, 2021 was as follows:

(in thousands, except share data)

	2021	2020
Tax expense at statutory rate of 21% applied to income before taxes	$ 4,927	$ 3,813
State taxes (net of federal benefit)	1,855	909
Permanent differences	249	284
Impact of tax credits	(1,705)	(1,539)
Noncontrolling interest	(159)	(177)
Impact of NOL Carryback to years with higher tax rates	(300)	(570)
Other - net	229	(319)
	$ 5,096	$ 2,401

The provision for income taxes consists of the following:

	2021	2020
Current expense	$ 1,036	$ 1,082
Deferred expense	4,060	1,319
Total income tax expense	$ 5,096	$ 2,401

As of January 2, 2022 and January 3, 2021, the Company's unrecognized tax benefits were not significant. There were no significant penalties or interest recognized or accrued during 2021 and 2020.

Note 11 - Equity

The Company has 5,000,000 authorized shares of $0.01 par value preferred stock. As of January 2, 2022 and January 3, 2021, preferred stock was designated as follows:

	2021	2020
Preferred B:		
Authorized:	1,350,000	1,350,000
Outstanding:	805,900	809,067
Preferred C:		
Authorized:	1,500,000	1,500,000
Outstanding:	160,360	160,360
Preferred D:		
Authorized:	600,000	600,000
Outstanding:	310,293	310,293
Preferred E:		
Authorized:	800,000	800,000
Outstanding:	341,510	341,510

The Series B nonvoting convertible preferred stock has a cumulative annual dividend rate of $0.80 per share. After one year from the date of issuance, shares are convertible by the shareholder into common shares at $5.57 per share and have a liquidation value of $10.00 per share. The Company may (but is not required to) redeem the preferred shares at a price of $10.00 per share plus accrued but unpaid dividends. The Series B Preferred shares of the Company are quoted on the OTC Markets under the symbol "MHGUP."

The Series C nonvoting convertible preferred stock has a cumulative annual dividend rate of $1.50 per share. After one year from the date of issuance, shares are convertible by the shareholders into common shares at $13.50 per share and have a liquidation value of $25.00 per share. The Company may (but is not required to) redeem the preferred shares at a price of $28.00 per share plus accrued but unpaid dividends.

The Series D nonvoting convertible preferred stock has a cumulative annual dividend rate of $1.75 per share. After one year from the date of issuance, shares are convertible by the shareholders into common shares at $24.00 per share and have a liquidation value of $25.00 per share. The Company may (but is not required to) redeem the preferred shares at a price of $28.00 per share plus accrued but unpaid dividends.

The Series E nonvoting convertible preferred stock has a cumulative annual dividend rate of $1.75 per share. After one year from the date of issuance, shares are convertible by the shareholders into common shares at $21.00 per share and have a liquidation value of $25.00 per share. During the two years from the date of issuance, the Company may (but is not required to) redeem the preferred shares at a price of $28.00 per share plus accrued but unpaid dividends.

The Company has 30,000,000 authorized shares of $0.01 par value common stock, with 6,545,089 and 6,643,681 shares issued and outstanding as of January 2, 2022 and January 3, 2021, respectively. The common shares of the Company are quoted on the OTC Markets under the symbol "MHGU."

Note 12 - Employee Benefit Plans

The Company has a deferred compensation plan (the "Plan") for certain employees. The Plan provides for the payment of benefits for a period of up to 10 years. Deferred compensation benefit earned was $2,356 and $1,923 in fiscal year 2021 and 2020, respectively. Other long-term obligations related to deferred compensation under the Plan were $13,526 and $9,819 as of January 2, 2022 and January 3, 2021, respectively. The participants vest in accordance with a predetermined vesting schedule and are allowed to direct investments under the Plan. The Company has partially funded the Plan obligation with Company-owned life insurance policies which have a cash surrender value of $7,160 and investments of $5,606 at January 2, 2022, and a cash surrender value of $5,761 and investments of $3,648 at January 3, 2021, which are included in other assets. As of January 2, 2022 and January 3, 2021, respectively, $5,601 and $3,644 of the investments were Company stock and, therefore, presented as a reduction in equity as opposed to other assets.

Beginning January 2020, the Company sponsored a 401(k) plan for the benefit of substantially all employees. To be eligible for plan participation, employees must have completed one year of service and be 21 years of age or older. The 401(k) plan allows employees to contribute a portion of their compensation and provides for the Company to make a discretionary matching contribution that vests in accordance with a predetermined vesting schedule. Employer contributions to the plan were $371 and $346 for the year ended January 2, 2022 and January 1, 2021, respectively.

Note 13 - Stock Option Plans

The Company has management and director share-based compensation plans which are described below. The compensation expenses charged against income for the plans were $1,233 and $1,515 for the years ended January 2, 2022 and January 3, 2021, respectively. The total income tax benefit recognized in the consolidated statements of operations for share-based compensation arrangements was $161 and $192 for the years ended January 2, 2022 and January 3, 2021, respectively.

The employee equity incentive plans provide for the discretionary grant of options. The current plan authorizes 1,000,000 shares of common stock to be granted for options that may be issued under the plan. The Board of Directors has the discretion to designate an option to be an incentive share option or a non-qualified share option. The plans provide that the exercise price is not less than the fair market value of the common stock at the date of grant. Options granted under the plans become exercisable pursuant to a vesting schedule adopted by the Board of Directors which administer the plans. Options have a term of 10 years and vest ratably over three years from the grant date.

The directors' share option plans provide for the nondiscretionary grant of options to non-employee directors of the Company. The current plan allows for the grant of options for a maximum of 1,000,000 shares at option prices equal to the last closing sales price of the common stock on the date of grant. The plan provides that each non-employee director is granted options to purchase 10,000 shares on the date such person becomes a non-employee director and on the date of each annual shareholders' meeting thereafter. Additional options may be granted by the Board of Directors, from time to time, on such terms and conditions as it determines appropriate. Options granted under the plan have a term of 10 years and vest ratably over three years from the date of grant.

The fair value of each option award is estimated on the date of grant using the Black Scholes option valuation model that uses the following weighted average assumptions, ignoring dividends: risk-free interest rates of 0.84% to 0.71% in 2021 and 0.33% to 1.40% in 2020; expected life of 5.20 years to 8.77 years in 2020 and 5.07 years to 9.42 years in 2020; and expected volatility of 32.60% to 32.72% in 2021 and 21.75% to 41.50% in 2020. Expected volatilities are based on historical volatility of the Company's weekly stock price. The Company uses historical data to estimate option exercise and employee termination when determining the expected life within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

(in thousands, except share data)

A summary of option activity under the employee plans for the years ended January 2, 2022 and January 3, 2021 is presented below:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)
Outstanding at December 29, 2019	1,021,000	$ 10.53	-
Granted	135,000	20.00	-
Exercised	(239,675)	3.01	-
Forfeited or expired	(10,625)	18.35	-
Outstanding at January 3, 2021	905,700	13.84	6.1
Outstanding at January 3, 2021	905,700	$ 13.84	-
Granted	140,000	20.00	-
Exercised	(77,200)	2.45	-
Forfeited or expired	(5,000)	20.00	-
Outstanding at January 2, 2022	963,500	15.62	6.0

The breakdown of outstanding employee stock options as of January 2, 2022 is as follows:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)
Options excercisable	761,000	$ 14.58	5.4
Nonvested options	202,500	19.52	8.4

Total options outstanding represent aggregate intrinsic value of $5,269 and $5,005 as of January 2, 2022 and January 3, 2021, respectively. There were 77,200 and 239,675 options exercised with intrinsic value of $1,356 and $3,672 in 2021 and 2020, respectively. The fair value of stock options awarded during 2021 and 2020 was $855 and $600, respectively. As of January 2, 2022, total unrecognized compensation expense related to non-vested stock options was $869. This expense will be recognized over approximately 2.2 years.

(in thousands, except share data)

A summary of option activity under the directors' plans for the years ended January 2, 2022 and January 3, 2021 is presented below:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)
Outstanding at December 29, 2019	577,500	$ 9.30	-
Granted	60,000	14.45	-
Exercised	(137,500)	5.26	-
Forfeited or expired	(10,000)	1.75	-
Outstanding at January 3, 2021	490,000	11.22	5.6
Outstanding at January 3, 2021	490,000	$ 11.22	-
Granted	60,000	21.75	-
Exercised	(46,667)	8.19	-
Forfeited or expired	-	-	-
Outstanding at January 2, 2022	503,333	12.75	5.5

The breakdown of outstanding director stock options as of January 2, 2022 is as follows:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)
Options excercisable	383,333	$ 10.90	4.4
Nonvested options	120,000	18.68	8.8

Total options outstanding represent aggregate intrinsic value of $4,065 and $3,566 as of January 2, 2022 and January 3, 2021, respectively. There were 46,667 and 137,500 options exercised with intrinsic value of $326 and $1,664 in 2021 and 2020, respectively. The fair value of stock options awarded during 2021 and 2020 was $514 and $420, respectively. As of January 2, 2022, total unrecognized compensation expense related to non-vested stock options was $690. This expense will be recognized over approximately 2.4 years.

(in thousands, except share data)

Note 14 – Earnings per Share

Earnings per share as of January 2, 2022 and January 3, 2021 was calculated as follows:

	2021	2020
Income attributable to controlling interest	$ 17,445	$ 14,910
Less: Preferred stock dividends	(2,027)	(2,006)
Income available to common shareholders	$ 15,418	$ 12,904
Weighted average basic shares outstanding	6,703	6,453
Basic EPS	$ 2.30	$ 2.00
Income available to common shareholders	$ 15,418	$ 12,904
Add: Dividends on dilutive preferred stock	2,027	2,006
Income available to common shareholders	$ 17,445	$ 14,910
Weighted average basic shares outstanding plus assumed conversions	9,631	9,407
Diluted EPS	$ 1.81	$ 1.58

Note 15 – Information About Variable Interest Entity

Restaurant Holdings was formed to facilitate real estate transactions where the Company has potential economic benefits in future sale and leaseback transactions. This variable interest entity (“VIE “) is owned by related parties and not directly by the Company. Restaurant Holdings is consolidated due to the Company’s power to direct activities that impact its economic performance, as well as the right to receive benefits or the obligation to absorb losses from Restaurant Holdings that could potentially be significant.

The purpose of Restaurant Holdings is to provide a source of capital to fund the purchase of restaurant real estate and, when sold, provide potential upside to the Company. Upon acquisition of real estate, Restaurant Holdings leases such real estate to the Company and utilizes rent revenue to pay the interest expense on its bank debt. The Company’s senior credit facility requires the Company to finance acquisitions of real estate with a minimum of 25% of the purchase price in equity for which the Company believes is dilutive to its long-term real estate strategy.

Restaurant Holdings leverages a revolving credit facility with a bank other than the Company’s senior lender that allows for borrowings up to $30,000 and is secured by its interest in the real estate and personal guarantees of owners. As of January 2, 2022 and January 3, 2021, Restaurant Holdings had bank debt obligations totaling $9,818 and $12,137, respectively.

(in thousands, except share data)

Included in the consolidated balance sheets as of January 2, 2022 and January 3, 2021 are the following amounts related to Restaurant Holdings, before eliminating entries:

	2021	2020
Assets:		
Current assets	$ 4,694	$ 4,951
Property and Equipment - net	6,039	7,811
Other assets	469	420
Investment in MHGI preferred stock	5,000	5,000
Total Assets	$ 16,202	$ 18,182
Liabilities:		
Current liabilities	$ 2,464	$ 2,810
Current portion of long-term debt	400	400
Revolving line of credit	5,618	7,537
Long-term debt	3,798	4,195
Total Liabilities	$ 12,280	$ 14,943
Equity - Noncontrolling interest	3,922	3,239
Total Liabilities and Equity	$ 16,202	$ 18,182

Note 16 - Related Party Transactions

The Company's CEO has provided personal guarantees to The Wendy's Company to facilitate the granting of certain Wendy's franchise agreements.

The Company's CEO, President, and two board members are each 22.5% owners in the Company's VIE for which the Company is a primary beneficiary (see Note 1).

The Company's CEO and President are each 50.0% owners of a related party entity that leased real property to one of the Company's independent concept restaurants. Subsequent to fiscal 2021, the real property was sold to a third party and the related party relationship terminated.

During the year, the Company repurchased 159,523 common stock shares from certain Board members at market price.

Note 17 - Guarantees, Commitments, and Contingencies

The Company is involved in certain routine legal proceedings which are incidental to its business. All these proceedings arose in the ordinary course of the Company's business and, in the opinion of the Company, any potential liability of the Company with respect to these legal actions will not, in the aggregate, be material to the Company's consolidated financial statements. The Company maintains various types of insurance standard to the industry which would cover most liabilities incurred by actions brought against the Company.

As part of the Company's ongoing franchise relationship with The Wendy's Company, the Company entered into agreements which contain certain reimaging and development requirements. Through these agreements, the Company committed to reimage 100% of its portfolio by December 31, 2024 and to develop 50 new restaurants by November 30, 2025. Pursuant to these agreements, the Company is entitled to receive significant economic incentives which include royalty and national marketing fee relief. As of the date of this report, the Company has reimaged approximately 64% of its portfolio and has completed approximately 20 of the new restaurant commitments. The Company estimates that it will invest approximately $127,940 in the remaining reimaging and development of its Wendy's restaurant portfolio.

The Company additionally is required to complete certain agreed-upon improvements to facilities. As of January 2, 2022, these capital improvements have remaining estimated costs of approximately $472.

Effective August 2021, the Company entered into an Area Development Agreement with its newest franchisor, Taco John's. Subject to certain terms and conditions, the Company committed to build 50 new Taco John's restaurants by March 31, 2026 with options to develop an additional 150 restaurants thereafter. The Company estimates it will invest approximately $100,000 in the initial 50 store roll-out and is entitled to receive significant economic incentives subject to fulfilling its development schedule.

Meritage Hospitality Group Inc.
Annual Disclosures

For Fiscal Year Ended January 2, 2022

Part A General Company Information

Item 1 The exact name of the issuer and its predecessor (if any).

The name of the Company is Meritage Hospitality Group Inc. (the "Company" or "Meritage").

Item 2 The address of the issuer's principal executive offices.

45 Ottawa Ave SW, Suite 600
Grand Rapids, MI 49503
Telephone: 616.776.2600
Facsimile: 616.328-6925
Web: www.meritagehospitality.com

Item 3 The jurisdiction and date of the issuer's incorporation or organization.

The Company was incorporated under the laws of the State of Michigan in August 1986.

Part B Share Structure

Item 4 The exact title and class of securities outstanding.

The Company's Articles of Incorporation authorize 30,000,000 common shares (Par Value Per Share $0.01). There were 6,545,089 common shares outstanding at January 2, 2022. The shares are assigned CUSIP No. 59000K309 and are quoted on the OTC Markets under the symbol "MHGU".

The Company's Articles of Incorporation authorize 5,000,000 preferred shares (Par Value Per Share $0.01). Preferred shares are summarized as follows:

Title	CUSIP No.	OTC Markets Trade Symbol
Series B Convertible Preferred Shares	59000K408	MHGUP
Series C Convertible Preferred Shares	59000K507	-
Series D Convertible Preferred Shares	59000K606	-
Series E Convertible Preferred Shares	59000K705	-

Item 5 Par or stated value and description of the security.

Common Shares: The Company most recently paid cash dividends per share of $0.32 in 2021, $0.14 in 2020, $0.24 in 2019, $0.15 in 2018, and $0.10 in 2017. The Company's Board of Directors regularly considers payment of additional dividends on common shares but has not adopted a dividend policy. State law and certain of the Company's governance documents and loan agreements may limit the Company's ability to declare cash dividends.

Series B Convertible Preferred Shares: The Company authorized 500,000 Series B Convertible Preferred Shares ("Series B Preferred Shares") in 2003, an additional 850,000 shares in 2015, and has 805,900 shares outstanding. The Series B Preferred Shares have an annual dividend rate of $0.80 per share. The right to payment of dividends is cumulative. The dividend is payable in equal quarterly installments on the first day of each January, April, July and October to holders of record as of the 15th day of the preceding month. The holders may convert their Series B Preferred Shares into common shares at a conversion price of $5.57 per common share. The conversion rate is subject to adjustment in the event of stock splits, stock dividends, combinations, reclassifications and similar occurrences. The Company may, upon 15 days written notice, redeem all or part of the Series B Preferred Shares at a redemption price of $10.00 per Series B Preferred Share plus accrued but unpaid dividends. Upon any dissolution or winding up, the holder of each Series B Preferred Share will be entitled to receive a liquidation value of $10.00 per Series B Preferred Share plus all accrued but unpaid dividends after the payment of all indebtedness of the Company and before any distributions to holders of common shares. No voting rights are provided except as required by law and with the exception that, if at any time the Company fails to make six quarterly dividend payments, the holders of the Series B Preferred Shares, voting as a class with each Series B Preferred Share having one vote, would be entitled to elect two directors to the Board, which members would remain on the Board as long as any dividend payment arrearages remain outstanding.

Series C Convertible Preferred Shares: The Company authorized 1,500,000 Series C Convertible Preferred Shares ("Series C Preferred Shares") in 2016, subsequently reduced to 200,000 in 2020, and has 160,360 shares outstanding. The Series C Preferred Shares have an annual dividend rate of $1.50 per share. The right to payment of dividends is cumulative. The dividend is payable in equal quarterly installments on the first day of each January, April, July and October to holders of record as of the 15th day of the preceding month. In one year from the date of issuance, the holders may convert their Series C Preferred Shares into common shares at a conversion price of $13.50 per common share. The conversion rate is subject to adjustments for subdivisions and splits of common shares. The Company may, at its option, redeem all or part of the Series C Preferred Shares at a redemption price of $28.00 per Series C Preferred Share plus accrued but unpaid dividends. Upon any dissolution or winding up, the holder of each Series C Preferred Share will be entitled to receive a liquidation value of $25.00 per Series C Preferred Share plus all accrued but unpaid dividends after the payment of all indebtedness of the Company and before any distributions to holders of common shares. No voting rights are provided except as required by law and with the exception that, if at any time the Company fails to make six quarterly dividend payments, the holders of the Series C Preferred Shares, voting as a class with each Series C Preferred Share having one vote, would be entitled to elect two directors to the Board, which members would remain on the Board as long as any dividend payment arrearages remain outstanding.

Series D Convertible Preferred Shares: The Company authorized 600,000 Series D Convertible Preferred Shares ("Series D Preferred Shares") in 2017 and has 310,293 shares outstanding. The Series D Preferred Shares have an annual dividend rate of $1.75 per share. The right to payment of dividends is cumulative. The dividend is payable in equal quarterly installments on the first day of each January, April, July and October to holders of record as of the 15th day of the preceding month. In one year from date of issuance, the holders may convert their Series D Preferred Shares into common shares at a conversion price of $24.00 per common share. The conversion rate is subject to adjustments for subdivisions and splits of common shares. The Company may, at its option, redeem all or part of the Series D Preferred Shares at a redemption price of $28.00 per Series D Preferred Share plus accrued but unpaid dividends. Upon any dissolution or winding up, the holder of each Series D Preferred Share will be entitled to receive a liquidation value of $25.00 per Series D Preferred Share plus all accrued but unpaid dividends after the payment of all indebtedness of the Company and before any distributions to holders of common shares. No voting rights are provided except as required by law and with the exception that, if at any time the Company fails to make six quarterly dividend payments, the holders of the Series D Preferred Shares, voting as a class with each Series D Preferred Share having one vote, would be entitled to elect two directors to the Board, which members would remain on the Board as long as any dividend payment arrearages remain outstanding.

Series E Convertible Preferred Shares: The Company authorized 800,000 Series E Convertible Preferred Shares ("Series E Preferred Shares") in 2018 and has 341,510 shares outstanding. The Series E Preferred Shares have an annual dividend rate of $1.75 per share. The right to payment of dividends is cumulative. The dividend is payable in equal quarterly installments on the first day of each January, April, July and October to holders of record as of the 15th day of the preceding month. In one year from date of issuance, the holders may convert their Series E Preferred Shares into common shares at a conversion price of $21.00 per common share. The conversion rate is subject to adjustments for subdivisions and splits of common shares. The Company may, at its option, redeem all or part of the Series E Preferred Shares at a redemption price of $28.00 per Series E Preferred Share plus accrued but unpaid dividends. Upon any dissolution or winding up, the holder of each Series E Preferred Share will be entitled to receive a liquidation value of $25.00 per Series E Preferred Share plus all accrued but unpaid dividends after the payment of all indebtedness of the Company and before any distributions to holders of common shares. No voting rights are provided except as required by law and with the exception that, if at any time the Company fails to make six quarterly dividend payments, the holders of the Series E Preferred Shares, voting as a class with each Series E Preferred Share having one vote, would be entitled to elect two directors to the Board, which members would remain on the Board as long as any dividend payment arrearages remain outstanding.

While the Company's Charter documents do not have specific provisions designed to prevent a change in control, provisions in several documents (including the Company's articles of incorporation, bylaws, franchise agreements, loan agreements, equity award agreements, etc.) and certain provisions in the Michigan Business Corporate Act could effectively delay or hinder an attempted change in control.

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Item 6 The number of shares or total amount of the securities outstanding for each class of securities authorized.

	01/02/2022	01/03/2021
Common Shares		
Authorized:	30,000,000 shares	30,000,000 shares
Outstanding:	6,545,089 shares	6,643,681 shares
Freely Tradable (public float):	approx. 3,000,000 shs.	approx. 3,000,000 shs.
Number of beneficial holders owning at least 100 shares:	approx. 723	approx. 698
Number of record holders:	approx. 59	approx. 68
Preferred B:		
Authorized:	1,350,000 shares	1,350,000 shares
Outstanding:	805,900 shares	809,067 shares
Freely Tradable (public float):	300,000 shares	300,000 shares
Number of record holders:	22 holders	45 holders
Preferred C		
Authorized:	200,000 shares	200,000 shares
Outstanding:	160,360 shares	160,360 shares
Number of record holders:	7 holders	7 holders
Preferred D		
Authorized:	600,000 shares	600,000 shares
Outstanding:	310,293 shares	310,293 shares
Number of record holders:	24 holders	24 holders
Preferred E		
Authorized:	800,000 shares	800,000 shares
Outstanding:	341,510 shares	341,510 shares
Number of record holders:	14 holders	14 holders

Item 7 The name and address of the transfer agent.

American Stock Transfer and Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
Phone: (718) 921-8200

American Stock Transfer and Trust Company, LLC (“AST”) is registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). AST’s procedures and transactions are regulated and audited by the Securities and Exchange Commission (“SEC”).

Part C Business Information

Item 8 The nature of the issuer's business.

Summary

Meritage was incorporated under the laws of the State of Michigan in August 1986 and was assigned a primary SIC Code of 5812 (Retail-Eating Places). Meritage has approximately 11,000 employees, of which approximately 2,000 are full-time. The Company's consolidated financial statements include the accounts of Meritage Hospitality Group Inc. and all of its wholly-owned subsidiaries and affiliate, consisting of MHG Food Service Inc., OCM Development, LLC, WM Limited Partnership-1998, Wen South, LLC, Wen Georgia LLC, Wen Carolina's LLC, Wen Virginia LLC, Wen Ohio LLC, Wen Oklahoma LLC, Wen Tennessee LLC, Inspired by Opportunity LLC, We Love Tacos LLC, its 98.5% owned subsidiary, RDG-MHG, LLC, ("RDG"), and its variable interest entity (VIE), Restaurant Holdings, LLC ("Restaurant Holdings"), for which the Company is a primary beneficiary. RDG is a 15% partner in TRG-Meritage Bahamas, LLC ("TRG"). All intercompany transactions and balances have been eliminated in consolidation. For convenience, Meritage and its subsidiaries and affiliate are collectively referred to as "Meritage" or "the Company" throughout this report.

The Company operates on a 52/53-week fiscal year ending on the Sunday closest to December 31 of each year. Fiscal year 2021 ended on January 2, 2022 and contained 52 weeks. Fiscal year 2020 ended on January 3, 2021 and contained 53 weeks.

Meritage operates 337 Wendy's quick-service restaurants. The Company's Wendy's restaurants are a franchisee of Quality Is Our Recipe, LLC, a subsidiary of The Wendy's Company. To simplify the language in this disclosure, Quality Is Our Recipe, LLC will hereafter be referred to as The Wendy's Company. The Company operates Wendy's restaurants in 16 states, which include nine restaurants in Arkansas, 32 in Connecticut, 55 in Florida, 48 in Georgia, 12 in Indiana, 13 in Massachusetts, 55 in Michigan, seven in Mississippi, three in Missouri, two in North Carolina, 15 in Ohio, 28 in Oklahoma, one in South Carolina, 32 in Tennessee, 12 in Texas and 13 in Virginia. Through its development and acquisition efforts, the Company is one of the nation's largest Wendy's franchisees.

Effective August 2021, the Company entered into an Area Development Agreement with its newest quick-service franchisor, Taco John's. Subject to certain terms and conditions, the Company committed to build 50 new Taco John's restaurants by March 31, 2026 with options to develop an additional 150 restaurants thereafter.

The Company also owns eight independent restaurants operating under four concepts throughout Michigan which include two Morning Belle restaurants, three Stan's Tacos, one Freighters Eatery & Taproom, and two Twisted Roosters. All restaurants were launched as the Company's own original concepts, each with a unique environment and offerings tailored to consumer preferences. In an effort to refine the Company's brands and establish future development opportunities, the Company is actively pursuing consolidating its independent concepts into two primary brands: Morning Belle and Stan's Tacos.

Risks and Governmental Regulations

Meritage is subject to numerous uncertainties and risk factors inherent in the food service industry. These include, among others: competition; changes in local and national economic conditions; changes in consumer tastes and eating habits; concerns about the nutritional quality of quick-service or casual dining menu items; concerns about consumption of beef or other menu items due to food-borne diseases;

promotions and menu price discounting by competitors; severe weather; changes in travel patterns; road construction; demographic trends; the cost of food, labor, fuel and energy; the availability and cost of suitable restaurant sites; the ability to finance expansion; fluctuating interest rates; insurance costs; the availability of an adequate number of managers and hourly-paid employees; directives issued by its franchisor regarding the Company's Wendy's operations; its franchisor's national marketing and advertising programs; its franchisor's advertised pricing; the general reputation of Meritage's and its franchisor's restaurants; legal claims; security, including cyber security; credit card fraud; information technology incidents and breaches; and the recurring need for renovation and capital improvements. Meritage is subject to risks and uncertainties related to the development of pandemics, including COVID-19. See *Recent Developments Related to COVID-19* below for additional details.

The Company is also subject to various federal, state and local laws and governmental regulations relating to, among other things: zoning; restaurant operations; public health certification regarding the preparation and sale of food; alcoholic beverage control; discharge of materials into the environment; sanitation; and minimum wage laws. The Company believes its operations would be adversely affected if these permits or other applicable permits or approvals were not obtained or renewed or were terminated. While the Company has no reason to anticipate that this may occur, it can give no assurances in this regard. In addition, changes regarding minimum wage laws or other laws governing the Company's relationship with its employees (e.g., overtime wages and tips, health care coverage, employment of minors, citizenship/immigration requirements, working conditions, etc.) could have an adverse effect on the Company's operations.

Approximately 15% of the Company's independent concept restaurant sales are attributable to the sale of alcoholic beverages. Each restaurant has licenses from regulatory authorities allowing it to sell liquor, beer and wine. The failure of a restaurant to obtain or retain liquor service licenses could adversely affect the Company's operations. Once a liquor license is obtained, Meritage is subject to "dram-shop" statutes and interpretations which generally provide that a person who is injured by an intoxicated person has the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person.

The Federal Americans with Disabilities Act prohibits discrimination on the basis of disability in public accommodations and employment. The Company's restaurants are designed to be accessible to the disabled and are in substantial compliance with all current applicable regulations relating to restaurant accommodations for the disabled. The development and construction of additional restaurants will be subject to compliance with applicable zoning, land use and environment regulations.

See *Forward-Looking Statements* following Item 21 of this annual disclosure statement for additional details.

Recent Developments Related to COVID-19

In January 2020, the World Health Organization ("WHO") announced a global health emergency resulting from a new strain of coronavirus (COVID-19). As the virus spread globally, the COVID-19 outbreak was classified as a pandemic in March 2020.

As a result of associated governmental actions, the Company was mandated to close dine-in services for all its restaurants in mid-March 2020. In accordance with governmental orders, the Company began to re-open some of its dining rooms in mid-June 2020. As of the date of this report and as permitted by local executive orders, all of the Company's Wendy's dining rooms and independent concept restaurants have re-opened. While the Company is optimistic the disruption from the COVID-19 pandemic will continue to lessen, there remains a level of uncertainty around the duration and severity of future disruption. As a result, the

Company is not able to fully estimate the complete impact of the pandemic on its results of operations, financial condition, or liquidity.

The Company continues to react and adjust to the continuously evolving environment caused by COVID-19. While future financial performance remains difficult to predict, the Company believes that based on its historical responsiveness to unanticipated developments, as well as its overall financial and operational structure, it is appropriately positioned to address potential risks and future impact brought on by the COVID-19 pandemic. However, no assurance can be made in this regard.

See *Forward-Looking Statements* for further discussion of the COVID-19 pandemic on the Company's business.

Legal Proceedings

The Company is involved in various routine legal proceedings that are incidental to its business. All of these proceedings arose in the ordinary course of the Company's business and, in the opinion of the Company, any potential liability of the Company with respect to these legal proceedings will not, in the aggregate, be material to the Company's consolidated financial statements. The Company maintains various types of insurance policies standard to the industry that, subject to deductibles, are expected to insure over many claims and legal proceedings brought against the Company.

Listing Developments

The Company has fewer than 300 record common shareholders, with shares listed on the OTC Markets under the symbol "MHGU." The listing is under the OTCQX premium listing service intended to set apart a select group of issuers that the OTC Markets deem worthy of heightened consideration by investors. The OTCQX is designed to meet the needs of small to medium-sized, publicly traded U.S. companies.

The Company's Series B Preferred Shares are listed on the OTC Markets using the OTCQX premium listing service under the symbol "MHGUP".

Item 9 The nature of products or services offered.

Quick-Service Operations

The Company operates Wendy's quick-service restaurants in Arkansas, Connecticut, Florida, Georgia, Indiana, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas, and Virginia.

Menu

Each Wendy's restaurant offers a diverse menu of food items featuring hamburgers and chicken sandwiches, all of which are prepared to order with the customer's choice of condiments. The Wendy's menu additionally includes chili, baked and french-fried potatoes, chicken nuggets, freshly prepared salads, soft drinks, "Frosty" desserts and children's meals. Wendy's breakfast menu was launched in the first quarter of 2020 and features a variety of breakfast sandwiches and specialty coffees, including the Frosty-ccino. Each Wendy's restaurant features soft drink products supplied by the Coca Cola Company and its respective affiliates. The franchisor maintains significant discretion over the menu items offered in the Company's restaurants.

Restaurant Layout and Operation

The Company's Wendy's restaurants typically range from 2,200 to 3,600 square feet with seating capacity for approximately 30 to 130 people. Restaurants are generally open from 6:30 a.m. until midnight, with the exception of restaurants that do not offer Wendy's breakfast and therefore open at 10:00 a.m. Restaurants feature a pick-up drive-through window. Sales to drive-through customers account for approximately 84% of total 2021 restaurant sales.

Marketing and Promotion

The franchisor requires at least 4.0% of the Company's restaurant sales be contributed to an advertising and marketing fund, 3.5% of which is used to benefit all Wendy's restaurants in national advertising programs. The Wendy's National Advertising Program uses these funds to develop advertising and sales promotion materials and concepts to be implemented nationally. The remaining 0.5% is used on local advertising. The Company typically spends local advertising dollars in support of radio advertising, print media, social media, local promotions and community goodwill projects. In addition, digital marketing discounts provided through in-app purchases further represent the Company's overall investment in marketing.

Raw Materials and Energy

The Company's restaurants comply with uniform recipe and ingredient specifications provided by the franchisor. Food and beverage inventories and restaurant supplies are purchased from independent vendors that are approved by the franchisor. The Company has not experienced any significant shortages of food, equipment, fixtures or other products that are necessary to restaurant operations. While no such shortages are anticipated at this time, the Company believes that alternate suppliers are available if any shortage were to occur.

The Company's principal sources of energy for its Wendy's operations are electricity and natural gas. The supply of energy available to the Company has been sufficient to maintain normal operations.

Seasonality

The Company's business is subject to various seasonal fluctuations. Midwest and East Coast traffic typically increases during the summer, resulting in increased revenues during those months. Traffic in the southern states typically increases during the early spring, resulting in increased revenues during those months.

Relationship with Franchisor

Meritage operates its Wendy's restaurants pursuant to various agreements (including one franchise agreement for each restaurant) with its franchisor, The Wendy's Company. These agreements grant privileges to the Company such as the right to utilize trademarks, service marks, designs and other proprietary rights in connection with the operation of its Wendy's restaurants. These agreements also impose requirements on the Company regarding the preparation and quality of food products, the level of service, capital improvements, and general operating procedures. The remaining terms of the Company's franchise agreements (including options to renew) range from one to 35 years.

The franchise agreements provide, among other things, that a change in the operational control of the Wendy's operating entity, or the removal of a guarantor of the franchise agreements, cannot occur without the prior consent of the franchisor. In addition, any proposed sale of a Wendy's restaurant, ownership interests or franchise rights therein is subject to the consent of, and a right of first refusal by, the franchisor.

These agreements also grant the franchisor wide discretion over many aspects of the restaurant operations, and often require the consent of the franchisor to carry out certain operational transactions pertaining to the Wendy's restaurants. If Meritage needs the consent of its franchisor to proceed with its business plans and such consent is not obtained, Meritage will not be able to proceed with its plans which, in turn, could adversely affect Meritage's growth strategy. If Meritage were to proceed without the franchisor's consent when required, the franchisor could terminate the franchise agreements or exercise its right to purchase the Wendy's restaurants.

In addition to monthly fees, Meritage is required to pay the franchisor a technical assistance fee upon the opening of a new Wendy's restaurant. Meritage is permitted to develop new Wendy's restaurants subject to the expandability criteria and site standards of the franchisor. While the franchise agreements are in place, Meritage is prohibited from acquiring or developing any "Competing Business" as defined in the Wendy's Franchise Agreement within its designated market area ("DMA"), or outside of them if the restaurant sells hamburgers, chicken sandwiches or products similar to the franchisor, and is located within a three-mile radius of another Wendy's restaurant. For two years after the expiration or termination of the franchise agreements, Meritage is prohibited from participating in any quick-service restaurant business that sells hamburgers, chicken sandwiches or products similar to the franchisor, and is located within its DMA.

The reputation of Meritage's restaurants is largely dependent on the reputation of the entire Wendy's restaurant chain, which in turn is dependent upon the management and financial condition of The Wendy's Company and the performance of Wendy's restaurants operated by other Wendy's franchisees. Should the Wendy's Company be unable to compete effectively with similar restaurant chains in the future, Meritage would be materially and adversely affected. Furthermore, many of the attributes which lead to the success of Wendy's operations are factors over which Meritage has no control, such as national marketing, introduction of new products, quality assurance and other operational systems. Meritage cannot conduct its Wendy's operations without its affiliation with its franchisor. Any termination of the franchise agreements would have a material adverse effect on Meritage's financial condition and results of operations.

Independent Concept Operations

The Company owns eight independent restaurants currently operating under four concepts throughout Michigan which include two Morning Belle restaurants, three Stan's Tacos, one Freighters Eatery & Taproom, and two Twisted Roosters. In an effort to refine the Company's brands and establish future development opportunity, the Company is actively focused on consolidating its independent concepts into two primary brands: Morning Belle and Stan's Tacos.

Morning Belle restaurants are both located in Grand Rapids, Michigan, and are the Company's newest concept. The restaurants feature a relaxing, garden themed environment tailored to family and friends and includes breakfast options using the best ingredients for the freshest taste. The restaurants' vibrant decor is designed to make days brighter with any one of the restaurants' crafted morning cocktails, or signature breakfast, brunch or lunch dishes.

Stan's Tacos restaurants are located in Standale, Grand Rapids, and Grand Haven, Michigan. The restaurants' upbeat décor aims to reflect a summer patio and features a unique, tailored menu which includes a variety of made-to-order tacos and specialty margaritas.

Freighters Eatery & Taproom in Port Huron, Michigan is connected to a Hilton DoubleTree hotel and is situated on the St. Clair River providing a unique waterfront dining experience for guests. Freighter's extensive dine-in, banquet, and room service menus feature locally sourced menu options, as well as a wide variety of Michigan-sourced libations.

The two Twisted Rooster restaurants located in Belleville and Chesterfield, Michigan are family centric and feature dynamic recipes which include local ingredients, and a wide variety of local craft beer, wine and liquors.

Restaurant Menu, Layout and Operation

Morning Belle is a bright, garden-themed breakfast restaurant that ranges from 2,400 to 5,500 square feet and features between 90 and 140 dining seats. The restaurants' décor includes white brick and shiplap walls, warm cedar accents, vibrant fabrics and fresh plants. Morning Belle's menu features breakfast, brunch and lunch options which include traditional breakfast entrees, scratch-made pancakes, a kids menus, lighter options such as salads with fresh cut vegetables and grain bowls, and its own glazed donut waffle for the more indulgent palate. The concept's extensive specialty beverage menu includes, among other items, a variety of mimosas, spiked cold brews, and pomegranate lemonade.

Stan's Tacos' Standale location is a 4,700 square foot site on the end cap space of a shopping center. The restaurant features a large cabana bar as well as a 14-foot garage door to welcome the outside in. Located in the heart of downtown, Stan's Tacos' Grand Rapids location is 6,000 square feet and includes both full-service dining, and a newly added grab-and-go station. Stan's Tacos Grand Haven is 2,100 square foot facility with a 48-seat patio tailored to the outdoor environment. All three locations accommodate approximately 115-140 guests and exhibit a come-as-you-are atmosphere for guests of every age. The restaurants feature specialty margaritas and made-to-order tacos using only the freshest ingredients.

Freighters Eatery & Taproom is a unique facility with large windows and an outdoor patio with a stunning waterfront view. The 11,105 square foot restaurant is connected to a DoubleTree Hilton hotel as well as the Blue Water Convention Center. The restaurant features a generously sized bar, fireplace lounge and outdoor patio. The menu at Freighters Eatery & Taproom features an imaginative flare on what might otherwise be considered "typical" American favorites. Its seasonally changing menus offer a selection of appetizers and specialty entrees and desserts. The full-service bar is stocked with locally sourced libations, craft beers, wines and small-batch liquors, which are used as a base for various specialty cocktails. It also has a full-service breakfast buffet which available daily. The restaurant serves as a caterer for the adjoining hotel, including room service, and features a variety of corporate and private event catering packages.

Twisted Rooster's buildings are freestanding brick structures with 5,400 to 7,200 square feet. The restaurants accommodate between 200 and 245 guests, including an extensive bar area. The interior is designed to be fun and energetic, featuring contemporary pieces by local artists. The Twisted Rooster menu features classic American fare with dynamic twists at a reasonable price. It includes steaks, signature sandwiches, fresh fish, pasta plates, signature macaroni and cheese, and fresh-cut salads with signature dressings and homemade desserts. Also offered are a wide variety of alcoholic beverages including beer, wine and cocktails. The restaurants serve lunch, dinner, special menu items including seasonal promotions, daily special selections, a kid's menu, and curbside takeout.

Marketing and Promotion

The advertising and promotional efforts for the Company's independent concepts are aimed at building brand loyalty and emphasizing the distinctiveness of each location's food, service, atmosphere and commitment to supporting the local economy. Their "grassroots" campaigns include community involvement, participation in local events and support of local media outlets among other initiatives. Social media, digital and mobile marketing also play a large role in their advertising strategy, as the online conversation and consumer review systems grow larger.

Raw Materials and Energy

The Company's independent concepts comply with internal recipe and ingredient specifications. Food and beverage inventories and restaurant supplies are purchased from third party suppliers. The Company has not experienced any significant shortages of food or other products that are necessary to restaurant operations. While no such shortages are anticipated at this time, the Company believes that alternate suppliers are available if any shortage were to occur.

The Company's principal sources of energy for its independent concept restaurants are electricity and natural gas. The supply of energy available to the Company has been sufficient to maintain normal operations.

Competition and Industry Conditions

Meritage operates restaurants within the quick-service restaurant ("QSR") industry and the casual dining restaurant industry.

Quick-Service Restaurant Industry

Meritage operates its Wendy's restaurants within the quick-service restaurant ("QSR") industry. The QSR industry is characterized by customers who are looking for quick, convenient and value-oriented meals that are ordered, paid for and picked up at a cash register. Within the quick-service industry, the hamburger segment comprises approximately half of the market and is dominated by Wendy's, McDonald's, and Burger King. Pizza, chicken, breakfast, Mexican, Asian and other sandwich market segments comprise a significant portion of the remainder of the QSR industry.

Most of the Company's Wendy's restaurants are located in close proximity to their principal QSR competitors which are highly competitive on the basis of price and value perception, service, location, food quality, menu variety, speed of service, attractiveness of facilities, and effectiveness of marketing and new product development. The Company also competes within the food service industry and the QSR restaurant sector not only for customers, but also for personnel and suitable real estate sites. The Company believes the competitive position of a Wendy's restaurant is ultimately enhanced by its unique qualities such as the use of fresh ground beef, a diverse menu, its promotional products, food prepared to order with an emphasis on quality, nutrition and taste, pleasant and speedy service and atmosphere. Wendy's continues to implement its reimaging program, which includes innovative exterior and interior restaurant designs, with plans for significantly more new and reimaged restaurants which began in 2015 and continuing beyond. The program also differentiates the Company from its competitors by its emphasis on restaurant employees who provide friendly and engaged customer service.

Casual Dining Restaurant Industry

The Company operates its Morning Belle, Stan's Tacos, Freighters and Twisted Rooster restaurants within the casual dining industry. The casual dining restaurant industry services customers interested in high-quality, value-oriented, full-service meals with wait staff taking orders and available throughout the meal.

As with its Wendy's restaurants, the Company's independent concept restaurants are located in close proximity to their principal casual dining restaurant competitors who are highly competitive on the basis of price and value perception, service, location, food quality, menu variety, quality and speed of service, attractiveness of facilities, effectiveness of marketing and new product development.

Item 10 The nature and extent of the issuer's facilities.

Each Wendy's restaurant is built to the franchisor's specifications for exterior style and interior decor. Typical freestanding restaurants are one-story brick buildings with parking for 15 to 70 vehicles. The restaurants have a food preparation area, a dining room with seating capacity for 30 to 130 guests, and a pick-up window for drive-through service.

The Company remains focused on reimaging its Wendy's. Reimaging costs inclusive of deferred maintenance items range from $450,000 to $700,000 per restaurant. Currently, 60% of the Company's Wendy's restaurant portfolio has been reimaged.

Of the 337 Wendy's restaurants it operates, the Company (i) owns the land and buildings comprising 15 restaurants, (ii) leases the land and buildings comprising 315 restaurants, and (iii) owns the building and leases the land comprising seven restaurants. The remaining lease terms (including options to renew) range from one to 50 years. The structures are between one and 47 years old. Meritage has performed major remodels on a number of its older Wendy's restaurants in the last several years. The land and buildings owned by the Company are held as collateral for financing.

Of the eight independent restaurants it operates, the Company (i) owns the land and building of one restaurant, (ii) leases the land and buildings comprising six restaurants, and (iii) owns the building and leases the land for one restaurant. The remaining term of the building and land leases (including options to renew) are between 17 and 39 years. The remaining term of the land lease (including options to renew) is 17 years. The building owned by the Company is held as collateral for financing.

The Company leases office space at 45 Ottawa SW Suite 600, Grand Rapids, Michigan, which serves as the registered office and principal place of business of the Company. The lease term runs through July 2026 with three 5-year renewal options.

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Part D Management Structure and Financial Information

Item 11 The name of the Chief Executive Officer, members of the Board of Directors, as well as control persons.

Board of Director and Officers beneficial ownership percentages as of January 2, 2022 represented per Exchange Act Rule 13d-3(d)(1)(i) are as follows:

Name and Age	Position	Total Shares Beneficially Owned Amount (1)	Percentage
Robert E. Schermer, Jr., 63	Chief Executive Officer	2,398,487	32.5%
Gary A. Rose, 59	President, Chief Operating Officer, and Corporate Secretary	947,842	13.3%
Tracey A. Smith, 47	Vice President, Chief Financial Officer, and Treasurer	155,342	2.3%
Robert E. Schermer, Sr., 86	Chairman of the Board of Directors	1,360,984	19.4%
Duane F. Kluting, 72	Director	136,231	2.1%
Joseph L. Maggini, Sr., 82	Director	549,600	8.1%
Peter D. Wierenga, 67	Director	602,418	8.9%
Dirk J. Pruis, 61	Director	30,328	0.5%
Chris A. Armbruster, 60	Director	4,337	0.1%
All Current Executive Officers and Directors as a Group (9 persons)		6,185,569	67.8%

(1) Represents beneficial ownership of Company common stock including options presently exercisable or exercisable within 60 days, as well as shares of common stock underlying Series B Convertible Preferred Shares, Series C Convertible Preferred Shares, Series D Convertible Preferred Shares, and Series E Convertible Preferred Shares.

Robert E. Schermer, Jr. has been a Director of the Company since 1996. He has been Chief Executive Officer of the Company since 1998. Mr. Schermer served as President of the Company from October 1998 through May 2016. Mr. Schermer’s business address is 45 Ottawa SW, Suite 600, Grand Rapids, MI 49503.

Gary A. Rose has been President since May 2016 and Chief Operating Officer since 2006. He was Vice President, Chief Financial Officer and Treasurer of the Company from 2005 through May 2016. He was Secretary from 2008 through May 2017. Mr. Rose is a CPA and spent six years with Deloitte & Touche in Grand Rapids, MI. Mr. Rose’s business address is 45 Ottawa SW, Suite 600, Grand Rapids, MI 49503.

Tracey A. Smith has been Vice President, Chief Financial Officer and Treasurer since May 2016. She has been Secretary since May 2017. She was Director of Finance from 2012 through May 2016 and Controller from 2008 through 2011. Mrs. Smith’s business address is 45 Ottawa SW, Suite 600, Grand Rapids, MI 49503.

Robert E. Schermer, Sr. has been Chairman of the Board of Directors since 1996. Mr. Schermer is currently retired. From 1990 through 2005, he was Senior Vice President and a Managing Director of Robert W. Baird & Co. Incorporated, an investment banking and securities brokerage firm headquartered in Milwaukee, WI. Mr. Schermer’s business address is 45 Ottawa SW, Suite 600, Grand Rapids, MI 49503.

Duane F. Kluting has been a Director of the Company since 2005. Mr. Kluting is currently retired. From 1992 through 2003, Mr. Kluting served as Vice President, Chief Financial Officer and Corporate

Secretary of X-Rite, Incorporated, a developer and manufacturer of color measurement instrumentation and software used in graphic arts, retail and industrial applications. Mr. Kluting's business address is 2525 Keyton Ct NW, Grand Rapids, MI 49504.

Joseph L. Maggini, Sr. has been a Director of the Company since 1996. Mr. Maggini was the President and Chairman of the Board of Magic Steel Corporation, a steel service center located in Grand Rapids, Michigan that he founded in 1974. After 40 years, Mr. Maggini sold his company in June of 2019 and is no longer affiliated with Magic Steel Sales. Mr. Maggini's business address is 3326 Vine Street SW, Grandville, MI 49418.

Peter D. Wierenga has been a Director of the Company since 2010. He is currently retired. He was the Vice President and Director of Godwin Plumbing, Inc., a plumbing and mechanical contractor, from 1987 through 2015. Concurrently, Mr. Wierenga was the President and director of Godwin Hardware Stores, a retail hardware company, since 1988. Mr. Wierenga's business address is 3319 Antigua Drive, Punta Gorda, FL 33950.

Dirk J. Pruis has served as a Director of the Company since 2018. Mr. Pruis began his career as a CPA at Touche Ross. Between 1993 and 2014 he held various leadership positions at Goldman Sachs and its subsidiaries, most recently a Managing Director and Chief of Staff in the Operations Division. Mr. Pruis is currently an Associate Professor of Finance and Accounting and Director of the Financial Planning Program at Calvin University. Professor Pruis' business address is 3201 Burton Street SE, Grand Rapids, MI 49546.

Chris A. Armbruster has served as Director of the Company since 2020. Mr. Armbruster worked for Taco Bell Corporation from 1991 through 2013 where he held several leadership positions in finance involving acquisitions and divestitures, financial planning and development. He spent the last six years at Taco Bell as Vice President of Development and Franchise Finance. Between 2015 and 2018 he served as Vice President of Development for the Wendy's Company. Currently, Mr. Armbruster is Chief Development Officer for Guzman y Gomez's North America division. Mr. Armbruster's business address is 6969 Red Bank Road, Galena, OH 43021.

The non-employee directors are compensated in accordance with the compensatory plans outlined in Item 17 below. In fiscal 2021, each of the non-employee directors received an option grant of 10,000 common shares priced at $21.75 per share (the closing price on the date of the grant). In fiscal 2021, the non-employee directors received compensation for attendance at Board and Committee meetings as follows: Mr. Kluting: $33,971 (paid in 1,569 common shares); Mr. Pruis: $33,971 (paid in 1,569 common shares); Mr. Maggini: $11,302 (paid in 522 common shares); Mr. Schermer, Sr.: $11,302 (paid in 552 common shares); Mr. Wierenga: $11,302 (paid in 522 common shares); and Mr. Armbruster: $11,302 (paid in 522 common shares).

The Board of Directors establishes and oversees the Company's executive officer compensation policies and incentive awards. Mr. Schermer, Jr. earned a base salary of $315,810 plus an annual car allowance of $10,500. Mr. Rose earned a base salary of $279,510 plus an annual car allowance of $8,400. Mrs. Smith earned a base salary of $220,220. In fiscal 2021, Mr. Schermer, Jr. and Mr. Rose each also received 30,000 stock option grants priced at $20.00 per share (the closing price on the date of the grant). Mrs. Smith received 15,000 and grants priced at $20.00 per share (the closing price on the date of the grant). The Company also has a deferred compensation program and a bonus program in place for executive officers. Deferred compensation earned and accrued in fiscal 2021 was $795,000 each for Mr. Schermer, Jr. and Mr. Rose. Deferred compensation earned and accrued in fiscal 2021 for Mrs. Smith was $188,000. Bonuses earned and accrued in fiscal 2021 were $1,472,000 for Mr. Schermer, Jr. and Mr. Rose. Bonus earned and accrued in fiscal 2021 for Mrs. Smith was $589,000.

Legal/Disciplinary History

None.

Disclosure of Family Relationships

Robert E. Schermer, Sr. is the father of Robert E. Schermer, Jr. In addition, Mr. Schermer, Jr. is the sole owner of Terra Libre, LLC, a Michigan limited liability company that owns 521,921 shares of MHGU common stock.

Related Party Transactions

Robert E. Schermer, Jr. has provided personal guarantees to The Wendy's Company for the Wendy's franchise agreements, as well as personal guarantees to certain vendors.

Robert E. Schermer, Jr., Gary A. Rose, Joseph L. Maggini Sr. and Peter D. Wierenga are each 22.5% owners in the Company's variable interest entity, Restaurant Holdings, for which the Company is a primary beneficiary.

Robert E. Schermer, Jr. and Gary A. Rose are each 50.0% owners of a company that leased real property to one of the Company's independent concept restaurants. Subsequent to fiscal 2021, the real property was sold to a third party and the related party relationship terminated.

During the year the Company repurchased 159,523 shares of Company common stock from certain Board members at market price.

Conflicts of Interest

None.

Item 12 Financial information for the issuer's most recent fiscal period.

See audited consolidated financial statements for fiscal year ended January 2, 2022, separately posted on the OTC Markets website (www.otcmarkets.com/otcqx/home) for Meritage and incorporated by reference in this Annual Report. The audited consolidated financial statements include the following reports:

(1) balance sheet;
(2) statements of operations;
(3) statements of equity;
(4) statements of cash flows;
(5) notes to financial statements; and
(6) report of independent auditor

Item 13 Similar financial information for such part of the preceding two fiscal years as the issuer or its predecessor has been in existence.

See audited financial statements for the Company's preceding two fiscal years separately posted on the OTC Markets website (www.otcmarkets.com/otcqx/home) for Meritage and incorporated by reference in this Annual Report. Each year's audited consolidated financial statements include the following comparative reports:

(1) balance sheets;
(2) statements of operations;
(3) statements of equity;
(4) statements of cash flows;
(5) notes to financial statements; and
(6) report of independent auditor

Item 14 Beneficial Owners.

Other than certain Meritage directors and officers as identified in Item 11 above, no other shareholders are believed by the Company to beneficially own 5% or more of the Company's outstanding common shares.

Item 15 The name, address, telephone number, and email address of each of the following outside providers that advise the issuer on matters relating to the operations, business development and disclosure:

Legal Counsel:
Keating Muething & Klekamp PLL
c/o F. Mark Reuter, Esq.
One East Fourth Street, Suite 1400
Cincinnati, OH 45202-3752
(513) 579-6400
mreuter@kmklaw.com

Auditors:
BDO USA LLP
License #: 1102003448 (State of Michigan)
c/o Tony Lawrence
200 Ottawa Avenue NW, Suite 300
Grand Rapids, MI 49503
(616) 774-7000
ALawrence@bdo.com

BDO USA LLP conducted an audit of the consolidated financial statements of Meritage in accordance with generally accepted auditing standards.

Item 16 Management's Discussion and Analysis or Plan of Operations.

Refer to Forward-Looking Statements following Item 21 of this annual disclosure statement.

Overview

Meritage operates in the quick-service and casual dining restaurant industries. The Company has experienced significant growth through acquisitions, newly built locations, reimaging campaigns, and investment in independent concept restaurants. The Company has committed significant capital resources to the Wendy's brand initiatives, including a commitment to build 50 new restaurants by November 30, 2025 under a development agreement with Wendy's, as well as the launch of a new Wendy's breakfast menu in March 2020. As of the date of this report, the Company has completed approximately 20 of the new restaurant commitments. Additionally, since 2009, the Company has acquired 264 Wendy's restaurants through 26 separate transactions making it one of the largest franchisees in the Wendy's system. As part of its long-term growth strategy, the Company continues to evaluate acquisition opportunities in the Wendy's system, as well as other growth opportunities in the restaurant industry.

In connection with the Company's continued growth initiatives, the Company entered into an Area Development Agreement effective August 18, 2021 with its newest quick-service franchisor, Taco John's. Subject to certain terms and conditions, the Company committed to build 50 new Taco John's restaurants by March 31, 2026, with options to develop an additional 150 restaurants thereafter. The Company estimates it will invest approximately $100 million in the initial 50 store roll-out and anticipates it will be eligible to receive significant economic incentives subject to fulfilling its development schedule under the Area Development Agreement.

As of January 2, 2022, the Company operated 337 Wendy's quick-service restaurants under franchise agreements with The Wendy's Company and eight independent restaurants operating under four concepts. Of the Wendy's quick-service restaurants, nine restaurants in Arkansas, 32 in Connecticut, 55 in Florida, 48 in Georgia, 12 in Indiana, 13 in Massachusetts, 55 in Michigan, seven in Mississippi, three in Missouri, two in North Carolina, 15 in Ohio, 28 in Oklahoma, one in South Carolina, 32 in Tennessee, 12 in Texas and 13 in Virginia. All eight independent concept restaurants are located in Michigan.

A schedule of Company restaurants follows:

	Wendy's	Independent Concepts	Total Restaurants
Restaurants as of December 29, 2019	331	6	337
Acquired restaurants	-	-	-
Newly opened restaurants	8	1	9
Closed restaurants	(6)	-	(6)
Restaurants as of January 3, 2021	333	7	340
Acquired restaurants	-	-	-
Newly opened restaurants	9	1	10
Closed restaurants	(5)	-	(5)
Restaurants as of January 2, 2022	337	8	345

Results of Operations

Results of operations are summarized below:

	Fiscal 2021 (in thousands)		Fiscal 2020 (in thousands)	
Food and Beverage Revenue	$ 577,127	100.0%	$ 516,178	100.0%
Expenses				
Food and beverage	150,774	26.1%	134,420	26.0%
Labor and related	183,396	31.8%	153,110	29.7%
Occupancy	76,467	13.2%	69,943	13.6%
Advertising	22,295	3.9%	18,164	3.5%
Franchise fees	21,841	3.8%	19,518	3.8%
Other operating	51,761	9.0%	42,652	8.3%
Total Operating Expenses	506,534	87.8%	437,807	84.8%
General and administrative	32,225	5.6%	27,824	5.4%
Preopening, acquisition and closing	3,989	0.7%	8,464	1.6%
Depreciation and amortization	16,306	2.8%	16,307	3.2%
Total Expenses	559,054	96.9%	490,402	95.0%
Income from Operations	18,073	3.1%	25,776	5.0%
Other (Income) Expense				
Interest	6,709	1.2%	10,784	2.1%
Other	(11,934)	(2.1%)	(3,164)	-0.6%
Total Other (Income) Expense	(5,225)	(0.9%)	7,620	1.5%
Income Before Income Taxes	23,298	4.0%	18,156	3.5%
Income Tax Expense	5,096	0.9%	2,401	0.5%
Consolidated Net Income	$ 18,202	3.1%	$ 15,755	3.1%
Less Consolidated Net Income Attributable to Noncontrolling Interest in Variable Interest Entity	757	0.1%	845	0.2%
Consolidated Comprehensive Net Income Attributable to Controlling Interest	$ 17,445	3.0%	$ 14,910	2.9%
Other Comprehensive Income - Net of Tax				
Change in interest rate swap valuation	1,402	0.2%	-	0.0%
Consolidated Comprehensive Net Income	$ 18,847	3.2%	$ 14,910	2.9%

Food and Beverage Revenue

The Company reported revenues of $577.1 million in fiscal 2021, an increase of 11.8% over prior year's revenues of $516.2 million. Total Company "same store sales" (i.e., food and beverage revenue for stores in full operation on a per period basis for both fiscal years) increased by 9.6% in 2021 over prior year's sales.

The Company's Wendy's restaurants reported sales of $567.8 million in fiscal 2021, an increase of 11.3% over the prior year's sales of $510.0 million. The Company's Wendy's restaurants experienced a "same store sales" increase of 9.1% over prior year's sales. The sales increase is the result of reduced sales in 2020 resulting from the COVID-19 pandemic, a net addition of restaurants through new build efforts, incremental sales provided from the launch of Wendy's Breakfast menu in March 2020, and the impact of significant price increased deployed throughout the year, primarily concentrated in the second half of the fiscal 2021.

The Company's independent concept restaurants reported sales of $9.3 million, an increase of 49.8% from prior year sales of $6.2 million. Independent concept restaurants experienced a "same store sales" increase of 53.3% from prior year's sales. The increases reflect the impact of both closed and limited operations in 2020 due to state and local ordinances implemented in response to the COVID-19 pandemic.

Cost of Food and Beverages

The cost of food and beverage as a percent of revenue remained consistent when compared to the prior year. Neutral costs as a percent of revenue are the result of a balance in dynamic swings in commodity costs throughout the year, ranging from 25.1% in the first quarter, to 28.5% in the fourth quarter. Such fluctuations represent the impact of favorable commodity costs in the first half of the year, coupled with significant, inflationary increases exclusive to the second half of the year, including a 34% increase in the average cost of beef. In addition to commodity costs, the Company has responded to evolving market conditions by deploying significant and strategic price increases throughout the year, primarily concentrated in the third and fourth quarter of 2021.

Labor and Related Expenses

Labor and related expenses increased to 31.8% of revenue for fiscal 2021 from 29.7% of revenue in fiscal 2020. Similar to cost of food and beverages, the significant increase in overall labor costs primarily reflects the inflationary impact of market wage competition and increased hourly wage rates concentrated in the latter half of the year. Further contributing to the increase were additional over-time wages resulting from reduced available staff.

Occupancy Expenses

Occupancy expenses decreased to 13.2% of revenue for fiscal 2021 from 13.6% of revenue for fiscal 2020. The decrease represents the dilutive impact of fixed costs from increased sales over the prior year, slightly offset by increased repair and maintenance costs.

General and Administrative Expenses

General and administrative expenses increased to 5.6% of revenue for fiscal 2021 from 5.4% of revenue for fiscal 2020. The increase is primarily due to variable incentive compensation.

Preopening, Acquisition and Closing Expenses

Preopening and acquisition expenses generally represent costs associated with opening new locations, concepts, or product lines in addition to numerous reimaging efforts and acquisitions. Such costs were offset by a reduction in expenses due to construction during the COVID-19 pandemic.

Closing expenses generally represent actual and estimated costs related to the closure of under-performing restaurants. Closing and disposition expenses are expected to be an ongoing cost due to continuing efforts to improve the Company's overall restaurant portfolio.

Preopening, acquisition and closing expenses in 2020 included one-time costs related to preparing for the launch of Wendy's Breakfast, as well as non-recurring costs related to the COVID-19 pandemic which include, but are not limited to, safety supplies, legal and bank fees, business interruption income replacement and other expenses.

Depreciation and Amortization

The decrease in depreciation and amortization as a percent of revenue compared to prior year is primarily the result of increased sales in fiscal 2021 combined with reduced real estate construction throughout 2020 due to the COVID-19 pandemic.

Interest Expense

The decrease in the amount of interest expense is primarily due to a decline in the effective interest rate on variable debt over the prior year, as well as favorable interest rates obtained in the Company's August 5, 2021 refinancing. Further contributing to the decline is the change in fair value of the Company's interest rate swap agreements which was recognized as interest expense through the second quarter of 2021. Effective with the recent refinancing, the Company implemented a change in accounting principle to recognize the change in fair value of its swap agreements through other comprehensive income, a component of equity.

Interest expense is summarized below:

	Fiscal 2021 (in thousands)	Fiscal 2020 (in thousands)
Interest expense - swap	$ (1,036)	$ 408
Interest expense	7,745	10,376
Total interest expense	$ 6,709	$ 10,784

Other (Income) Expense

Other (Income) Expense generally represents gains on real estate transactions completed throughout the year, which are partially offset by stock option expense. The increase in income is primarily due to the quantity and profitability of sale and leaseback transactions for the year ended January 2, 2022, when compared to sale and leaseback transactions for the same period in the prior year.

Income Tax Expense (Benefit)

Income tax expense is summarized as follows:

	Fiscal 2021 (in thousands)	Fiscal 2020 (in thousands)
Federal income tax expense (benefit)	$ (51)	$ (321)
State and local income tax expense	1,087	1,403
Change in deferred income taxes	4,060	1,319
Total Income tax expense	$ 5,096	$ 2,401

The Company had net deferred tax liabilities totaling approximately $13,720 and $9,660 at January 2, 2022 and January 3, 2021, respectively.

The Company's federal income tax expense was reduced by tax credits of $1,705 and $1,539 in 2021 and 2020, respectively.

Financial Condition

Management monitors short and long-term cash needs and currently believes that with its ongoing operations and current cash balances, the Company has sufficient capital to meet its ongoing obligations. Loan covenants of the Company's various loan agreements include requirements for the maintenance of certain financial ratios. At January 2, 2022 and January 3, 2021, the Company was in compliance with these covenants.

Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements as of January 2, 2022.

Part E Issuance History

Item 17 List of securities offerings and shares issued for services in the past two years.

Common Shares Issued: Fiscal Years 2020 and 2021:

Transaction	Date	Shares Issued
Director Comp – 1st Quarter 2020	03/29/2020	1,685
Director Comp – 2nd Quarter 2020	06/28/2020	2,322
Director Comp – 3rd Quarter 2020	09/27/2020	1,732
Director Comp – 4th Quarter 2020	01/03/2021	1,428
Director Comp – 1st Quarter 2021	04/04/2021	1,292
Director Comp – 2nd Quarter 2021	07/04/2021	1,212
Director Comp – 3rd Quarter 2021	10/03/2021	1,342
Director Comp – 4th Quarter 2021	01/02/2022	1,380

Management Compensation Plans

2017 Directors' Compensation Plan ("2017 Plan"). The 2017 Plan was adopted by the Board of Directors in May 2017. Pursuant to the Plan, all non-employee directors currently receive a fee of $3,000 for attendance at meetings of the Board of Directors and $6,000 for attendance at meetings of the audit committee of the Board. Compensation is paid quarterly in arrears in the form of cash or Company common shares which are priced at the average fair market value during the five trading days prior to the end of the fiscal quarter. A director who is also an employee of Meritage is not separately compensated for serving as a director. This Plan will terminate pursuant to its terms on January 1, 2027.

2008 Directors' Share Equity Plan ("2008 Directors' Plan"), and 2018 Directors' Share Equity Plan ("2018 Directors' Plan"). The 2008 Directors' Plan was adopted by the Board of Directors in March 2008. The 2018 Directors' Plan was adopted by the Board of Directors in March 2018. Under the terms of the 2018 Directors' Plan, non-employee directors are granted an option to purchase 10,000 common shares upon initial election to the Board, and another option to purchase 10,000 common shares upon each subsequent election. The Plan allows for discretionary issuance of additional shares, pending Board approval. The 2008 Incentive Plan will terminate pursuant to its terms in May 2024. The 2018 Incentive Plan will terminate pursuant to its terms in May 2028.

2002 Management Equity Incentive Plan ("2002 Incentive Plan"), 2008 Management Equity Incentive Plan ("2008 Incentive Plan") and 2017 Management Equity Incentive Plan ("2017 Incentive Plan"). The 2002 Incentive Plan authorized up to 1,000,000 common shares for use in the 2002 Incentive Plan. The 2008 Incentive Plan authorized up to 750,000 common shares for use in the 2008 Incentive Plan. The 2017 Incentive Plan was adopted by the Board of Directors in May 2017 and authorized up to 1,000,000 common shares for use in the 2017 Incentive Plan. The purpose of these Plans is to (i) further the long-term growth of Meritage by offering competitive incentive compensation related to long-term performance goals to employees who are largely responsible for planning and directing such growth, (ii) reinforce the commonality of interest between Meritage's shareholders and its employees and (iii) aid in attracting and retaining employees of outstanding abilities and specialized skills. These Plans allow for the award of (i) incentive and non-qualified stock options, (ii) stock appreciation rights which may be issued in tandem with stock options or as freestanding rights, (iii) restricted and unrestricted stock, (iv) performance shares conditioned upon meeting performance criteria, and (v) other awards based in whole or in part by reference to, or otherwise based on, securities of Meritage. The 2002 Incentive Plan terminated pursuant to its terms in May 2012. The 2008 Incentive Plan terminated in May 2018 pursuant to its terms. The 2017 Incentive Plan will terminate pursuant to its terms in May 2027.

Part F Exhibits

Item 18 Material Contracts.

Material contracts are separately posted on the OTC Markets website for Meritage and can be accessed at www.otcmarkets.com/otcqx/home or can be found in previous Forms 10-K and other SEC EDGAR filings which can be accessed on the SEC website at www.sec.gov. In addition, the following material contracts are included with this Annual Report:

None.

Item 19 Articles of Incorporation and Bylaws.

The Articles of Incorporation and Bylaws of the Company are separately posted on the OTC Markets website and can be accessed at www.otcmarkets.com/otcqx/home.

Item 20 Purchases of Equity Securities by the Issuer and Affiliated Purchasers.

The following table summarizes Meritage's purchases of its common shares, par value $0.01 per share, for the fiscal year ended January 2, 2022:

Company's Purchase of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Shares Purchased as Part of Publicly Announced Programs	Shares That May Yet Be Purchased Under the Program (1)
Month #1 01/04/21-01/31/21	---	---	---	270,716
Month #2 02/01/21-03/07/21	---	---	---	270,716
Month #3 03/08/21-04/04/21	2,722	$19.65	---	267,994
Month #4 04/05/21-05/02/21	---	---	---	270,716
Month #5 05/03/21-06/06/21	---	---	---	270,716
Month #6 06/07/21-07/04/21	9,523	$21.98	---	258,471
Month #7 07/05/21-08/01/21	---	---	---	270,716
Month #8 08/02/21-09/05/21	10,784	$20.76	---	247,687
Month #9 09/06/21-10/03/21	7,216	$22.00	---	240,471
Month #10 10/04/21-10/31/21	---	---	---	260,716
Month #11 11/01/21-12/05/21	22,727	$22.00	---	217,744
Month #12 12/06/21-01/02/22	150,000	$22.00	---	67,744

(1) The Board of Directors authorized the Company to repurchase from time to time, subject to capital availability, up to 550,000 shares of Meritage's common stock through open market transactions or otherwise. There is no expiration date relating to this program, and the Board is permitted to rescind the program at any time. Additionally, in February 2010, the Board authorized the repurchase, subject to capital availability, of up to 100,000 preferred shares of Meritage.

Item 21 Issuer's Certifications.

I, Robert E. Schermer, Jr., Chief Executive Officer, certify that:

1. I have reviewed this annual disclosure statement of Meritage Hospitality Group Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

March 9, 2022

Robert E. Schermer, Jr.
Chief Executive Officer

I, Tracey A. Smith, Chief Financial Officer, certify that:

1. I have reviewed this annual disclosure statement of Meritage Hospitality Group Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

March 9, 2022

Tracey A. Smith
Chief Financial Officer

FORWARD-LOOKING STATEMENTS

Certain statements contained in this report that are not historical facts constitute forward-looking statements. These may be identified by words such as "estimates," "anticipates," "hopes," "projects," "plans," "expects," "believes," "should," "would," and similar expressions (including the negative versions), and by the context in which they are used. Such statements are based only upon current expectations of the Company. Any forward-looking statement speaks only as of the date made. Reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors which may cause actual results, performance, or achievements to differ materially from those expressed or implied. Meritage undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which they are made.

Statements concerning expected financial performance, business strategies and actions which Meritage intends to pursue to achieve its strategic objectives, constitute forward-looking information. Implementation of these strategies and achievement of such financial performance are subject to numerous conditions, uncertainties and risk factors, which could cause actual performance to differ materially from the forward-looking statements. These include, without limitation: competition; changes in the national or local economy; changes in consumer preferences, tastes and eating habits; concerns about the nutritional quality of our restaurant menu items; concerns about consumption of beef or other menu items due to diseases or other food safety issues; promotions and price discounting by competitors; severe weather; changes in travel patterns; road construction; demographic trends; failure to manage social media trends; inflation, including related increases in the cost of food, labor and energy; supply chain interruptions; the availability and cost of suitable restaurant sites; the ability to finance expansion; interest rates; insurance costs; the availability of adequate managers and hourly-paid employees; risks associated with leasing real property; directives issued by the franchisor regarding operations and menu pricing; the general reputation of Meritage's and its franchisors' restaurants; the relationship between Meritage and its franchisors; legal claims; security, including cyber security and information technology security; credit card fraud; Meritage's ability to consummate acquisitions or, if consummated, to successfully integrate acquired businesses into Meritage's operations; Meritage's execution of growth initiatives; and the recurring need for restaurant renovation and capital improvements. Meritage is also subject to extensive government regulations relating to, among other things, zoning, public health, sanitation, alcoholic beverage control, environment, food preparation, minimum and overtime wages and tips, employment of minors, citizenship requirements, working conditions, other labor and employment matters, and the operation of its restaurants. Meritage is also subject to risks and uncertainties related to disruptions to or reductions in business operations, liquidity, prospects or supply chains due to pandemics, epidemics, widespread health emergencies, or outbreaks of infectious diseases such as the coronavirus disease COVID-19, its potential variants and developments related to these types of events. Because Meritage's operations are concentrated in certain areas of Arkansas, Connecticut, Florida, Georgia, Indiana, Massachusetts, Michigan, Mississippi, Missouri, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas and Virginia, significant economic changes in these states, or in the local economies where our restaurants are located, could adversely affect our operations. Additionally, with Meritage's expansion, the Company could be adversely affected by tropical storms, hurricanes, or tornadoes. The Company's news releases and public reports are not intended to constitute an offer to sell or a solicitation of an offer to buy any securities of the Company or otherwise engage in a transaction with the Company.