Papa Murphy's Holdings, Inc.
Form 10-Q
May 06, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended March 30, 2015
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-36432

Papa Murphy’s Holdings, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 27-2349094<br>(IRS Employer<br>Identification No.) |
| 8000 NE Parkway Drive, Suite 350<br>Vancouver, WA<br>(Address of principal executive offices) | 98662<br>(Zip Code) |

(360) 260-7272
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X]. No [ ].
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X]. No [ ].
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer [ ] | Accelerated filer [ ] |
| Non-accelerated filer [X] | Smaller reporting company [ ] |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ]. No [X].
At May 1, 2015, there were 16,943,654 shares of the Registrant's common stock, $0.01 par value, outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
Papa Murphy’s Holdings, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations

| | Three Months Ended | |
|---|---|---|
| (In thousands, except share and per share data) | March 30, 2015 | March 31, 2014 |
| Revenues | | |
| Franchise royalties | $10,679 | $10,069 |
| Franchise and development fees | 1,140 | 1,169 |
| Company-owned store sales | 17,167 | 12,018 |
| Lease and other | 182 | 1,861 |
| Total revenues | 29,168 | 25,117 |
| Costs and Expenses | | |
| Store operating costs: | | |
| Cost of food and packaging | 6,089 | 4,590 |
| Compensation and benefits | 4,354 | 3,030 |
| Advertising | 1,669 | 1,122 |
| Occupancy | 1,003 | 660 |
| Other store operating costs | 1,445 | 1,069 |
| Selling, general and administrative | 6,882 | 8,199 |
| Depreciation and amortization | 2,319 | 1,841 |
| Loss on disposal of property and equipment | 59 | 6 |
| Total costs and expenses | 23,820 | 20,517 |
| Operating Income | 5,348 | 4,600 |
| Interest expense | 1,143 | 3,112 |
| Interest income | (13) | (34) |
| Other expense, net | 2 | 12 |
| Income Before Income Taxes | 4,216 | 1,510 |
| Provision for income taxes | 1,620 | 691 |
| Net Income | 2,596 | 819 |
| Earnings (loss) per share of common stock | | |
| Basic | $0.16 | $(0.20) |
| Diluted | $0.15 | $(0.20) |
| Weighted average common stock outstanding | | |
| Basic | 16,604,206 | 3,851,741 |
| Diluted | 16,791,684 | 3,851,741 |

See accompanying notes.

Table of Contents

Papa Murphy’s Holdings, Inc. and Subsidiaries
Unaudited Condensed Consolidated Balance Sheets

| (In thousands, except par value and share data) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | $1,045 | $5,056 |
| Accounts receivable, net of allowance for doubtful accounts of $71 and $60, respectively | 5,551 | 5,661 |
| Notes receivable, net (including related party notes of $250 and zero, respectively) | 317 | 62 |
| Inventories | 737 | 640 |
| Prepaid expenses and other current assets | 3,422 | 3,423 |
| Advertising cooperative assets, restricted | 251 | 149 |
| Current deferred tax asset | 1,366 | 1,338 |
| Total current assets | 12,689 | 16,329 |
| Property and equipment, net | 13,814 | 12,120 |
| Notes receivable, net of current portion | 203 | 225 |
| Goodwill | 105,875 | 101,082 |
| Trade name and trademarks | 87,002 | 87,002 |
| Definite-life intangibles, net | 44,837 | 44,515 |
| Deferred finance charges, net | 1,405 | 1,485 |
| Other assets | 4,758 | 4,191 |
| Total assets | $270,583 | $266,949 |
| | | |
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | $4,423 | $3,057 |
| Accrued and other liabilities | 8,030 | 9,600 |
| Advertising cooperative liabilities | 373 | 253 |
| Current portion of unearned franchise and development fees | 2,570 | 2,848 |
| Current portion of long-term debt | 3,500 | 2,800 |
| Total current liabilities | 18,896 | 18,558 |
| Long-term debt, net of current portion | 111,500 | 112,200 |
| Unearned franchise and development fees, net of current portion | 657 | 640 |
| Deferred tax liability | 42,957 | 42,069 |
| Other long-term liabilities | 1,973 | 1,740 |
| Total liabilities | 175,983 | 175,207 |
| Commitments and contingencies (Note 15) | | |
| | | |
| Equity | | |
| Papa Murphy’s Holdings Inc. Shareholders’ Equity | | |
| Preferred stock ($0.01 par value; 15,000,000 shares authorized; no shares issued) | — | — |
| Common stock ($0.01 par value; 200,000,000 shares authorized; 16,943,654 and 16,944,308 shares issued, respectively) | 169 | 169 |
| Additional paid-in capital | 117,560 | 117,354 |
| Stock subscriptions receivable | (100) | (100) |
| Accumulated deficit | (23,529) | (26,125) |
| Total Papa Murphy’s Holdings Inc. shareholders’ equity | 94,100 | 91,298 |
| Noncontrolling interests | 500 | 444 |
| Total equity | 94,600 | 91,742 |

| | | |
|---|---|---|
| Total liabilities and equity | $270,583 | $266,949 |

See accompanying notes.

4

Table of Contents

Papa Murphy’s Holdings, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows

| | Three Months Ended March 30, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Operating Activities | | |
| Net income | $2,596 | $819 |
| Adjustments to reconcile to cash from operating activities | | |
| Depreciation and amortization | 2,319 | 1,841 |
| Loss on disposal of property and equipment | 59 | 6 |
| Non-cash employee equity compensation | 156 | 550 |
| Amortization of deferred finance charges | 80 | 207 |
| Change in operating assets and liabilities | | |
| Accounts receivable | 110 | (1,728) |
| Prepaid expenses and other current assets | 632 | (530) |
| Unearned franchise and development fees | (261) | 111 |
| Accounts payable | 1,178 | (1,514) |
| Accrued expenses | (2,189) | (2,361) |
| Deferred taxes | 860 | 453 |
| Other assets and liabilities | (53) | 6 |
| Cash from operating activities | 5,487 | (2,140) |
| Investing Activities | | |
| Acquisition of property and equipment | (1,201) | (538) |
| Acquisition of stores, less cash acquired | (7,671) | (130) |
| Proceeds from sale of stores | — | 21 |
| Issuance of notes receivable | (250) | — |
| Payments received on notes receivable | 18 | 824 |
| Investment in cost-method investee | (500) | (500) |
| Cash from investing activities | (9,604) | (323) |
| Financing Activities | | |
| Advances on revolver | — | 1,000 |
| Repurchases of common stock | (1) | (1,108) |
| Debt issuance and modification costs, including prepayment penalties | — | (6) |
| Payments received on subscription receivables | — | 1,057 |
| Proceeds from exercise of stock options | 51 | — |
| Investment by noncontrolling interest holders | 56 | 56 |
| Cash from financing activities | 106 | 999 |
| Net change in cash and cash equivalents | (4,011) | (1,464) |
| Cash and Cash Equivalents, beginning of year | 5,056 | 3,705 |
| Cash and Cash Equivalents, end of period | $1,045 | $2,241 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the period for interest | $1,080 | $3,110 |
| Cash paid during the period for income taxes | $3 | $5 |
| Noncash Supplemental Disclosures of Investing and Financing Activities | | |
| Acquisition of property and equipment in accounts payable | $295 | $53 |

See accompanying notes.

Table of Contents

Papa Murphy’s Holdings, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents

Note 1 — Description of Business and Basis of Presentation

Description of business

Papa Murphy’s Holdings, Inc. (“Papa Murphy’s” or the “Company”), together with its subsidiaries, is a franchisor and operator of a Take ‘N’ Bake pizza chain. The Company franchises the right to operate Take ‘N’ Bake pizza franchises and operates Take ‘N’ Bake pizza stores owned by the Company. As of March 30, 2015, the Company had 1,476 stores consisting of 1,446 domestic stores (1,338 franchised stores and 108 Company-owned stores) across 38 states, plus 30 franchised stores in Canada and the United Arab Emirates.

Substantially all of the Company's revenues are derived from retail sales of pizza and other food and beverage products to the general public by Company-owned stores and the collection of franchise royalties and fees associated with franchise and development rights.

Public offering and stock split

On May 7, 2014, the Company completed an initial public offering (the “IPO”) of 5,833,333 shares of common stock at a price to the public of $11.00 per share. The Company received net proceeds from the offering of approximately $54.6 million after offering fees and expenses. The net proceeds, along with additional cash on hand, were used to repay $55.5 million of the Company's loans outstanding under the Company's then existing senior secured credit facility, after which the Company had $112.1 million outstanding under the facility with the revolver undrawn. Immediately prior to the IPO, the Company amended and restated its certificate of incorporation to reflect the conversion of all outstanding Series A Preferred Stock and Series B Preferred Stock (together, the “Preferred Shares”) to 3,054,318 shares of common stock. In connection with the IPO, on May 1, 2014, the Company amended its certificate of incorporation to effect a 2.2630 for 1 stock split of its common stock. As a result of the stock split, all previously reported share and option amounts in these interim unaudited condensed consolidated financial statements and accompanying notes have been retrospectively restated to reflect the stock split. After the conversion of the Preferred Shares and the stock split, but before the shares were sold in the IPO, the Company had 11,134,070 common shares outstanding.

Basis of presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all information and footnotes required by generally accepted accounting principles in the United States (“GAAP”) for complete financial statements. In the Company’s opinion, all necessary adjustments, consisting of only normal recurring adjustments, have been made for the fair presentation of the results of the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year. The accompanying interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and the related notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 29, 2014.

Principles of consolidation

The interim unaudited condensed consolidated financial statements include the accounts of Papa Murphy’s Holdings, Inc., its subsidiaries and certain entities which the Company consolidates as variable interest entities (“VIEs”). The Company reports noncontrolling interests in consolidated entities as a component of equity separate from shareholders’ equity. All significant intercompany transactions and balances have been eliminated.

Throughout the interim unaudited condensed consolidated financial statements and the related notes thereto, “Papa Murphy’s” and “the Company” refer to Papa Murphy’s Holdings, Inc. and its consolidated subsidiaries.

Fiscal year

The Company uses a 52- or 53-week fiscal year, ending on the Monday nearest to December 31. Fiscal years 2015 and 2014 are 52-week years. All three month periods presented herein contain 13 weeks. All references to years and quarters relate to fiscal periods rather than calendar periods. References to 2015 and 2014 are references to fiscal years ending December 28, 2015, and ended December 29, 2014, respectively.

Table of Contents

Note 2 — Acquisitions

Investments

The Company, through its non-wholly owned subsidiary, Project Pie Holdings, LLC (“PPH”), has made investments in Project Pie, LLC (“Project Pie”) in the form of Series A Convertible Preferred Units (the “Preferred Units”). Project Pie is a fast casual custom-pizza restaurant chain with 17 stores, 13 of which are franchised, located throughout the United States, the Philippines and Scotland as of March 30, 2015. The amount invested in Project Pie and the percentage of all issued and outstanding common units on a fully converted basis are as follows:

| (in thousands) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| Investment in Project Pie | $4,500 | $4,000 |
| Fully converted common unit ownership | 45.0 % | 42.1 % |

The Company determined during the three months ended March 30, 2015, that Project Pie is a variable interest entity as a result of Project Pie having insufficient equity at risk, but that the Company does not have a variable interest in Project Pie and does not have control. The Company does not account for its investment in Project Pie as an equity method investment as the Company’s investment is in preferred units which contain subordination characteristics substantially different from the common units and were determined to not be in-substance common stock. The Company’s investment is classified as a cost method investment in Other assets. In addition to the above, the Company has a $250,000 note receivable from Project Pie (see Note 7 — Notes Receivable).

Acquisitions in 2015

M2AD Acquisition

On March 9, 2015, Papa Murphy's Company Stores, Inc. (“PMCSI”), a wholly-owned subsidiary of the Company, acquired certain assets used in the operation of six Papa Murphy's stores in the Seattle, Washington area from M2AD Management, Inc., the previous operator of the six Papa Murphy's stores (the "M2AD Acquisition"). Transaction costs of $5,000 associated with the M2AD Acquisition were recognized as Other store operating costs in the Condensed Consolidated Statements of Operations. The total purchase price was $4.1 million, which included a post-close holdback of $6,000. As of March 30, 2015, PMCSI retained the full holdback amount. The M2AD Acquisition was funded through existing cash and was accounted for using the acquisition method of accounting whereby operating results subsequent to the acquisition date are included in the interim unaudited condensed consolidated financial statements.

The fair values of the assets acquired are summarized below (in thousands):

| | |
|---|---|
| Cash and cash equivalents | $5 |
| Inventories | 39 |
| Prepaid expenses and other current assets | 38 |
| Property and equipment | 406 |
| Reacquired franchise rights | 1,139 |
| Asset retirement obligation | (75 ) |
| Total identifiable net assets acquired | 1,552 |
| Goodwill | 2,554 |
| Total consideration | $4,106 |

Reacquired franchise rights have weighted average useful lives of 6.6 years. Goodwill represents the excess of the purchase price over the net tangible and intangible assets acquired and is expected to be fully deductible for income tax purposes. This goodwill is primarily attributable to the acquired customer bases and, to a lesser extent, economies of scale expected from combining the operations of the acquired entities with the operations of the Company.

Table of Contents

Unaudited pro forma information—The following unaudited pro forma consolidated revenues and net income of the Company give effect to the M2AD Acquisition as if it had occurred as of the beginning of 2014:

| (in thousands) | Three Months Ended March 30, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Pro forma revenues | $30,312 | $26,486 |
| Pro forma net income | $2,629 | $877 |

The pro forma information presented in this note includes adjustments for amortization of acquired intangible assets, depreciation of acquired property and equipment and income tax expense. The pro forma information is presented for informational purposes and may not be indicative of the results that would have been obtained had the M2AD Acquisition actually occurred at the beginning of 2014, nor is it intended to be indicative of future operating performance.

Revenues and net income from the acquired stores from the closing date of the acquisition included in the Company’s Condensed Consolidated Statements of Operations for the three months ended March 30, 2015, are as follows:

| (in thousands) | Three Months Ended March 30, 2015 |
|---|---|
| Revenues | $285 |
| Net income | 15 |

Other Acquisitions

PMCSI also acquired all of the assets of eleven stores through four individually immaterial acquisitions during the three months ended March 30, 2015: eight stores in Tennessee, one in Idaho, one in Oregon and one in Texas. The Tennessee stores were acquired on January 26, 2015, the Idaho store on January 12, 2015, the Oregon store on March 2, 2015, and the Texas store on March 9, 2015 (collectively, the "Other Acquisitions"). The Company incurred transaction costs of $27,000 associated with the Other Acquisitions that were recognized as Other store operating costs in the Condensed Consolidated Statements of Operations. The aggregate purchase price for the Other Acquisitions was approximately $3.6 million, which included holdbacks totaling $72,000. As of March 30, 2015, PMCSI retained $17,000 of the holdback amount. The Other Acquisitions were funded through existing cash and were accounted for using the acquisition method of accounting whereby operating results subsequent to the acquisition date are included in the interim unaudited condensed consolidated financial statements.

The fair values of the assets acquired are summarized below (in thousands):

| | |
|---|---|
| Cash and cash equivalents | $6 |
| Inventories | 56 |
| Prepaid expenses and other current assets | 49 |
| Property and equipment | 863 |
| Reacquired franchise rights | 498 |
| Asset retirement obligation | (136) |
| Total identifiable net assets acquired | 1,336 |
| Goodwill | 2,239 |
| Total consideration | $3,575 |

Reacquired franchise rights have weighted average useful lives of 3.5 years. Goodwill represents the excess of the purchase price over the net tangible and intangible assets acquired and is expected to be fully deductible for income tax purposes. This goodwill is primarily attributable to the acquired customer bases and, to a lesser extent, economies of scale expected from combining the operations of the acquired entities with the operations of the Company.

Table of Contents

Unaudited pro forma information—The following unaudited pro forma consolidated revenues and net income of the Company give effect to the Other Acquisitions as if they had occurred as of the beginning of 2014:

| | Three Months Ended | |
|---|---|---|
| (in thousands) | March 30, 2015 | March 31, 2014 |
| Pro forma revenues | $29,725 | $26,377 |
| Pro forma net income | $2,573 | $830 |

The pro forma information presented in this note includes adjustments for amortization of acquired intangible assets, depreciation of acquired property and equipment and income tax expense. The pro forma information is presented for informational purposes and may not be indicative of the results that would have been obtained had the Other Acquisitions actually occurred at the beginning of 2014, nor is it intended to be indicative of future operating performance.

Revenues and net loss from the acquired stores from the closing date of the Other Acquisitions included in the Company's Condensed Consolidated Statements of Operations for the three months ended March 30, 2015, are as follows:

| (in thousands) | Three Months Ended March 30, 2015 |
|---|---|
| Revenues | $741 |
| Net loss | (35) |

Note 3 — Prepaid Expenses and Other Current Assets

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

| (in thousands) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| Prepaid media development costs | $418 | $ 593 |
| Prepaid rents and insurance | 558 | 620 |
| POS software licenses for resale | 1,548 | 1,800 |
| Other | 898 | 410 |
| Total prepaid expenses and other current assets | $3,422 | $ 3,423 |

Prepaid media development costs represent costs incurred for advertisements that have not aired. During the three months ended March 30, 2015, and March 31, 2014, the Company recognized $0.2 million and $1.8 million, respectively, in software license revenue upon the resale of Point of Sale ("POS") software licenses to franchise owners at cost. The income from the sale is included in Lease and other revenues and the related expense is recorded in Selling, general and administrative costs on the Condensed Consolidated Statements of Operations.

Note 4 — Property and Equipment

Property and equipment are net of accumulated depreciation of $10.2 million and $9.3 million at March 30, 2015, and December 29, 2014, respectively. Depreciation expense for the three months ended March 30, 2015, and March 31, 2014, was $1.0 million and $0.6 million, respectively.

Table of Contents

Note 5 — Goodwill

The following summarizes changes to the Company's goodwill, by reportable segment:

| (in thousands) | DOMESTIC COMPANY STORES | DOMESTIC FRANCHISE | TOTAL |
|---|---|---|---|
| Balance at December 29, 2014 | $ 19,536 | $ 81,546 | $ 101,082 |
| Acquisitions | 4,793 | — | 4,793 |
| Balance at March 30, 2015 | $ 24,329 | $ 81,546 | $ 105,875 |

There is no goodwill associated with the International Segment. During the three months ended March 30, 2015, the Company has determined that there have not been any triggering events that would require an updated impairment review.

Note 6 — Intangible Assets

Intangible assets are net of accumulated amortization of $20.6 million and $19.3 million as of March 30, 2015, and December 29, 2014, respectively. Amortization expense during the periods reported was as follows:

| | Three Months Ended | |
|---|---|---|
| (in thousands) | March 30, 2015 | March 31, 2014 |
| Amortization expense | $ 1,315 | $ 1,232 |

Note 7 — Notes Receivable

Notes receivable consist of the following:

| (in thousands) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| Note issued by Project Pie maturing in June 2015 bearing interest at 13.0% (see Note 16 - Related Party Transactions). | $ 250 | $ — |
| Total related party notes receivable | 250 | — |
| Note maturing in 2020 bearing interest at 9.0% and collateralized by store assets. | 270 | 287 |
| Total notes receivable | 520 | 287 |
| Less current portion | (317 ) | (62 ) |
| Notes receivable, net of current portion | $ 203 | $ 225 |

Table of Contents

Note 8 — Financing Arrangements
Long-term debt consists of the following:

| (in thousands) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| 2014 Credit Facility | | |
| Term loan | $ 112,000 | $ 112,000 |
| Notes payable | 3,000 | 3,000 |
| Total long-term debt | 115,000 | 115,000 |
| Less current portion | (3,500 ) | (2,800 ) |
| Total long-term debt, net of current portion | $ 111,500 | $ 112,200 |

2014 senior secured credit facility
On August 28, 2014, PMI Holdings, Inc., a wholly-owned subsidiary of the Company, entered into a $132.0 million senior secured credit facility (the “2014 Credit Facility”) consisting of a $112.0 million term loan and a $20.0 million revolving credit facility, which includes a $2.5 million letter of credit subfacility and a $1.0 million swing-line loan subfacility. The term loan and any loans made under the revolving credit facility mature in August 2019. As of March 30, 2015, the 2014 Credit Facility bore interest under the LIBOR rate option at 3.42%.
With a maturity date of over one year from March 30, 2015, balances outstanding under the 2014 Credit Facility are classified as non-current on the Condensed Consolidated Balance Sheets, except for mandatory, minimum term loan amortization payments of $0.7 million due on March 31, 2015, and thereafter on the last day of each fiscal quarter commencing on June 29, 2015.
The weighted average interest rate for all borrowings under our 2014 Credit Facility for the first quarter of 2015 was 3.43%.
2013 senior secured credit facility
In August 2014, the borrowings under the 2014 Credit Facility refinanced the $177.0 million senior secured credit facility entered into in October 2013 (the “2013 Credit Facility”), which included a $167.0 million senior secured term loan and a $10.0 million revolving credit facility, including a $2.5 million letter of credit subfacility.
On May 7, 2014, the Company prepaid $55.5 million of its long-term debt under the 2013 Credit Facility in connection with the IPO. A proportionate share of deferred financing costs of $1.2 million were expensed as a Loss on early retirement of debt on the Company's Condensed Consolidated Statements of Operations at the time of this debt prepayment.
Notes payable
PMCSI has a $3.0 million note payable which bears interest at 5% and matures in December 2018. This note is subordinated to the 2014 Credit Facility.
Note 9 — Fair Value Measurement
The Company determines the fair value of assets and liabilities based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. GAAP defines a fair value hierarchy that prioritizes the assumptions used to measure fair value. The three levels of the fair value hierarchy are defined as follows:
Level 1 — Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
Level 2 — Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data
Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

Table of Contents

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis:

| (in thousands) | March 30, 2015 CARRYING VALUE | March 30, 2015 FAIR VALUE | December 29, 2014 CARRYING VALUE | December 29, 2014 FAIR VALUE | FAIR VALUE MEASUREMENTS |
|---|---|---|---|---|---|
| Financial assets | | | | | |
| Notes receivable [1] | 520 | 524 | 287 | 302 | Level 3 |
| Cost-method investments [2] | 4,500 | 5,373 | 4,000 | 5,055 | Level 3 |
| Financial liabilities | | | | | |
| Long-term debt, including current portion thereof [3] | 115,000 | 115,000 | 115,000 | 113,880 | Level 3 |

(1) The fair value of the notes receivable was estimated primarily using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

(2) The fair value of cost-method investments was estimated primarily using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

(3) The fair value of long-term debt was estimated using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

Financial instruments not included in the table above consist of cash and cash equivalents, accounts receivable and accounts payable. The fair value of cash and cash equivalents, accounts receivable and accounts payable approximates carrying value because of the short-term nature of the accounts.

Note 10 — Accrued and Other Liabilities

Accrued and other liabilities consist of the following:

| (in thousands) | March 30, 2015 | December 29, 2014 |
|---|---|---|
| Accrued compensation and related costs | 2,377 | 3,670 |
| Gift cards and certificates payable | 2,418 | 2,912 |
| Accrued interest and non-income taxes payable | 635 | 745 |
| Convention fund balance | 533 | 271 |
| Advertising and development fund | 469 | 507 |
| Unearned product rebates | 269 | 791 |
| Income taxes payable | 602 | — |
| Other | 727 | 704 |
| | $8,030 | $9,600 |

Note 11 — Income Taxes

Information on the Company's income taxes for the periods reported are as follows:

| (in thousands) | Three Months Ended March 30, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Provision for income taxes | $1,620 | $691 |
| Income before income taxes | 4,216 | 1,510 |
| Effective income tax rate | 38.4 % | 45.8 % |

The effective income tax rate for the first three months of 2015 approximates what is believed to be a normalized effective income tax rate for the Company. The effective income tax rate for the three months ended March 31, 2014, includes the effect of a discrete adjustment for accelerated vesting of restricted stock.

Table of Contents

Note 12 — Shareholders’ Equity

Preferred stock

Prior to the IPO, the Company’s preferred stock consisted of Series A Preferred Shares and Series B Preferred Shares. The Preferred Shares had a cumulative preferred dividend of 6.00% per year based on an original liquidation value of $36.68 per share. Upon liquidation of the Company, the holders of the Preferred Shares were entitled to receive the unpaid liquidation value plus accreted dividends before any distribution could be made to the holders of common stock. In addition, the Preferred Shares participated in 20% of all remaining earnings if distributed to common stockholders. The unpaid liquidation value of the Series A and Series B Preferred Shares was $21.14 and $26.80 per share, respectively, as of the IPO. At the IPO, the Preferred Shares were converted into 3,054,318 shares of common stock.

Noncontrolling interests

The Company received the following additional investments by noncontrolling interest holders in PPH during the periods reported:

| | Three Months Ended | |
|---|---|---|
| (in thousands) | March 30, 2015 | March 31, 2014 |
| Additional investment by noncontrolling interest holders in PPH | $56 | $56 |

Note 13 — Share-based Compensation

In May 2010, the Company’s Board of Directors approved the 2010 Amended Management Incentive Plan (the “2010 Plan”). In May 2014, the Company's Board of Directors adopted the 2014 Equity Incentive Plan (the “2014 Plan,” and together with the 2010 Plan, the “Incentive Plans”). With the adoption of the 2014 Plan, the Company has discontinued selling stock and issuing awards under the 2010 Plan, but stock previously purchased and awards previously granted under the 2010 Plan remain outstanding.

The Incentive Plans reserve 2,116,747 common shares for equity incentive awards which can be awarded as incentive stock options, non-qualified stock options, restricted stock awards, and unrestricted stock awards. Under the Incentive Plans, the Company has awarded 781,311 and 610,084 shares of restricted common stock to eligible employees as of March 30, 2015, and December 29, 2014, respectively. In addition, the Company has issued 953,094 and 945,149 stock options under the Incentive Plans to eligible employees as of March 30, 2015, and December 29, 2014, respectively.

Restricted common shares

Information with respect to restricted stock activity is as follows:

| | Number of Shares of Restricted Common Stock | | |
|---|---|---|---|
| | Time Vesting | Performance Vesting | Weighted Average Sale/Grant Date Fair Value Per Share |
| Unvested, December 29, 2014 | 127,650 | 215,556 | $2.27 |
| Vested | (3,018) | — | 5.48 |
| Repurchased | (1,508) | (3,772) | 0.19 |
| Unvested, March 30, 2015 | 123,124 | 211,784 | $2.28 |

The weighted average fair value of share-based compensation awards vested during the period were as follows:

| | Three Months Ended | |
|---|---|---|
| (in thousands, except per share amounts) | March 30, 2015 | March 31, 2014 |
| Total fair value of shares vested | 17 | 386 |

Table of Contents

Stock options

Information with respect to stock option activity is as follows:

| | Number of Shares Subject to Options | | | | |
|---|---|---|---|---|---|
| | Time Vesting | Performance Vesting | Weighted Average Exercise Price Per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
| Outstanding, December 29, 2014 | 722,307 | 222,842 | $11.16 | | |
| Granted | 192,000 | — | 13.43 | | |
| Exercised | (4,626 ) | — | 11.00 | | |
| Forfeited | (4,657 ) | (2,891 ) | 11.32 | | |
| Outstanding, March 30, 2015 | 905,024 | 219,951 | $11.55 | 9.2 years | $7,458 |
| Exercisable, March 30, 2015 | 365,384 | — | $11.22 | 9.1 years | $2,544 |
| Vested and expected to vest at March 30, 2015 | 824,078 | 186,958 | $11.53 | 9.2 years | $6,721 |

Fair value information for options granted and vested and the intrinsic value of options exercised during the periods reported are as follows:

| | Three Months Ended | |
|---|---|---|
| (in thousands, except per share amounts) | March 30, 2015 | March 31, 2014 |
| Weighted average grant date fair value per share | $5.41 | $4.28 |
| Total fair value of awards granted | 1,039 | 784 |
| Total fair value of awards vested | 10 | 285 |
| Total intrinsic value of options exercised | 32 | — |

Compensation cost and valuation

Total compensation costs recognized in connection with the Incentive Plans during the periods reported were as follows:

| | Three Months Ended | |
|---|---|---|
| (in thousands) | March 30, 2015 | March 31, 2014 |
| Stock compensation expense | $156 | $550 |
| Income tax benefits associated with stock compensation expense | 52 | 116 |

As of March 30, 2015, the total unrecognized stock-based compensation expense, net of estimated forfeitures, was $3.7 million with $2.4 million associated with time vesting awards and $1.3 million associated with performance vesting awards. The remaining weighted average contractual life for unrecognized stock-based compensation expense was 3.7 years as of March 30, 2015.

Prior to the IPO, the valuation of the Company’s common stock and Preferred Shares was based on the principles of option-pricing theory. This approach is based on modeling the value of the various components of an entity’s capital structure as a series of call options on the proceeds expected from the sale of the entity or the liquidation of its assets at some future date. Specifically, each of the preferred and common equity is modeled as a call option on the aggregate value of the Company with an exercise price equal to the liquidation preferences of the more senior securities. In estimating the fair value of the aggregate value of the Company, the Company considered both the income approach and the market approach.

The Company's valuation was performed under both an IPO and non-IPO scenario with each value weighted based on an estimated probability of occurrence. The key inputs required to calculate the value of the common stock using the option-pricing model included the risk free rate, the volatility of the underlying assets, and the estimated time until a liquidation event. The Company applied a marketability discount to the value of common stock based on facts and circumstances at each valuation date.

Table of Contents

During the reported periods prior to the IPO, the Company assumed the following:

| | Three Months Ended March 31, 2014 (1) | |
|---|---|---|
| | IPO Scenario | Non-IPO Scenario |
| Risk free rate | 0.36% | 0.36% |
| Volatility of the underlying assets | 45% | 45% |
| Estimated time until a liquidation event | 0.58 years | 1.75 years |
| Marketability discount—common stock | 10% | 25% |
| Marketability discount—preferred stock | 8% | 15% |
| Weight applied to scenario | 95% | 5% |

(1) The last valuation of the Company was performed as of March 31, 2014.

The fair value of the stock option awards granted during the periods reported was estimated with the following weighted-average assumptions.

| | Three Months Ended | |
|---|---|---|
| | March 30, 2015 | March 31, 2014 |
| Risk free rate | 1.9% | 1.9% |
| Expected volatility | 37.9% | 35.3% |
| Expected term | 6.3 years | 5.6 years |
| Expected dividend yield | 0.0% | 0.0% |

Note 14 — Earnings per Share (EPS)

The number of shares and earnings per share (“EPS”) data for all periods presented are based on the historical weighted-average shares of common stock outstanding. Prior to the IPO, the Company’s cumulative preferred stockholders were entitled to participate in 20% of all remaining earnings or dividends if distributed to common stockholders. As such, the Company calculated EPS using the two-class method. The two-class method determines EPS for common stock and participating securities according to dividends and dividend equivalents and their respective participation rights in undistributed earnings.

Basic EPS is calculated by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding during each period. Diluted EPS is calculated using income available to common stockholders divided by diluted weighted-average shares of common stock outstanding during each period, which includes unvested restricted common stock and outstanding stock options. Diluted EPS considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential common shares would have an anti-dilutive effect.

Table of Contents

The following table sets forth the computations of basic and dilutive EPS:

Three M