Papa Murphy's Holdings, Inc.
Form 10-Q
November 13, 2014
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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 September 29, 2014
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 (State or Other Jurisdiction of Incorporation or Organization)	27-2349094 (IRS Employer Identification No.)
8000 NE Parkway Drive, Suite 350 Vancouver, WA (Address of principal executive offices)	98662 (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 November 7, 2014, there were 16,941,265 shares of the Registrant's common stock, $0.01 par value, outstanding.

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
PAPA MURPHY'S HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)
(In thousands of dollars, except share and per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2014	September 30, 2013	September 29, 2014	September 30, 2013
Revenues				
Franchise royalties	$8,965	$ 8,404	$28,349	$ 26,877
Franchise and development fees	1,088	1,359	3,119	3,064
Company-owned store sales	11,626	9,345	35,121	27,807
Lease and other	490	21	2,543	95
Total revenues	22,169	19,129	69,132	57,843
Costs and Expenses				
Store operating costs (exclusive of depreciation and amortization shown separately below):				
Cost of food and packaging	4,667	3,469	13,756	10,436
Compensation and benefits	3,000	2,582	8,935	7,812
Advertising	1,286	936	3,531	2,744
Occupancy	715	607	2,049	1,743
Other store operating costs	1,069	943	3,145	2,790
Selling, general, and administrative	5,915	6,238	22,938	17,484
Depreciation and amortization	2,007	1,797	5,815	5,240
(Gain) loss on disposal or impairment of property and equipment	(15)	648	27	749
Total costs and expenses	18,644	17,220	60,196	48,998
Operating Income	3,525	1,909	8,936	8,845
Interest expense	1,539	2,475	6,966	7,589
Interest income	(14)	(21)	(67)	(65)
Loss on early retirement of debt	3,428	—	4,619	—
Other expense, net	63	18	118	34
(Loss) Income Before Income Taxes	(1,491)	(563)	(2,700)	1,287
(Benefit from) provision for income taxes	(703)	(168)	(1,124)	977
Net (Loss) Income	(788)	(395)	(1,576)	310
Other Comprehensive (Loss) Income				
Foreign currency translation adjustment	—	—	—	—
Total Comprehensive (Loss) Income	$(788)	$ (395)	$(1,576)	$ 310
Loss per share of common stock				
Basic	$(0.05)	$ (0.52)	$(0.35)	$ (1.21)
Diluted	$(0.05)	$ (0.52)	$(0.35)	$ (1.21)
Weighted average common stock outstanding				
Basic	16,584,724	3,881,199	10,603,339	3,749,972

Diluted	16,584,724	3,881,199	10,603,339	3,749,972

See accompanying notes.

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PAPA MURPHY'S HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(In thousands of dollars, except par value and share data)
(Unaudited)

	September 29, 2014	December 30, 2013
Assets		
Current Assets		
Cash and cash equivalents	$ 597	$ 3,705
Accounts receivable, net of allowance for doubtful accounts of $52 and $37, respectively	5,195	2,430
Notes receivable, net (including related party notes of zero and $39, respectively)	58	837
Inventories	588	495
Prepaid expenses and other current assets	4,815	7,054
Current deferred tax asset	1,853	1,856
Total current assets	13,106	16,377
Property and equipment, net	11,097	9,660
Notes receivable (including related party notes of zero and $444, respectively), net of current portion	239	444
Goodwill	98,449	96,089
Trade name and trademarks	87,002	87,002
Definite-life intangibles, net	45,523	48,744
Deferred finance charges, net	1,559	3,934
Other assets	3,663	2,252
Total assets	$ 260,638	$ 264,502
Liabilities and Equity		
Current Liabilities		
Accounts payable	$ 3,725	$ 3,673
Accrued and other liabilities	7,450	9,741
Current portion of unearned franchise and development fees	2,744	2,881
Current portion of long-term debt	2,100	1,670
Total current liabilities	16,019	17,965
Long-term debt, net of current portion	112,900	168,330
Unearned franchise and development fees, net of current portion	1,174	1,113
Deferred tax liability	40,245	41,465
Other long-term liabilities	1,596	1,482
Total liabilities	171,934	230,355
Commitments and contingencies (Note 15)		
Equity		
Papa Murphy's Holdings Inc. Shareholders' Equity		
Series A preferred stock ($0.01 par value; zero and 3,000,000 shares authorized, respectively; zero and 2,853,809 shares issued and outstanding, respectively (aggregate liquidation preference zero and $61,476, respectively))	—	60,156
Series B preferred stock ($0.01 par value; zero and 1,000,000 shares authorized, respectively; zero and 26,551 shares issued and outstanding, respectively (aggregate liquidation preference zero and $722, respectively))	—	741
	—	—

Preferred stock ($0.01 par value; 15,000,000 shares authorized; no shares issued or outstanding)		
Common stock ($0.01 par value; 200,000,000 shares authorized; 16,941,265 and 4,347,882 shares issued and outstanding, respectively)	169	43
Additional paid-in capital	117,195	1,555
Stock subscription receivable	(100)	(1,197)
Accumulated deficit	(28,949)	(27,373)
Total Papa Murphy’s Holdings Inc. shareholders’ equity	88,315	33,925
Noncontrolling interests	389	222
Total equity	88,704	34,147
Total liabilities and equity	$ 260,638	$ 264,502

See accompanying notes.

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PAPA MURPHY’S HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Shareholders' Equity
(In thousands)
(Unaudited)

	CUMULATIVE SERIES A PREFERRED STOCK		CUMULATIVE SERIES B PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	STOCK SUBSCRIP-TION RECEIVABLE	ACCUMU-LATED DEFICIT	TOTAL PAPA MURPHY'S HOLDINGS INC. SHARE-HOLDERS' EQUITY	NON-CONTROLLING INTERESTS	TOTAL EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOUNT						
BALANCE, December 30, 2013	2,854	$60,156	27	$741	4,348	$43	$1,555	$(1,197)	$(27,373)	$33,925	$222	$34,147
Common stock issued, net of transaction costs	—	—	—	—	5,833	58	54,590	—	—	54,648	—	54,648
Common stock repurchases	—	—	—	—	(152)	(1)	(1,517)	—	—	(1,518)	—	(1,518)
Conversion of preferred stock to common stock	(2,854)	(60,156)	(27)	(741)	6,912	69	60,828	—	—	—	—	—
Repayment of note receivable issued to fund the purchase of stock	—	—	—	—	—	—	—	1,097	—	1,097	—	1,097
Stock based compensation expense	—	—	—	—	—	—	1,739	—	—	1,739	—	1,739
Investment by noncontrolling interest	—	—	—	—	—	—	—	—	—	—	167	167
Net loss	—	—	—	—	—	—	—	—	(1,576)	(1,576)	—	(1,576)
BALANCE, September 29, 2014	—	$—	—	$—	16,941	$169	$117,195	$(100)	$(28,949)	$88,315	$389	$88,704

See accompanying notes.

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PAPA MURPHY’S HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(In thousands of dollars)
(Unaudited)

	Nine Months Ended	
	September 29, 2014	September 30, 2013
Operating Activities		
Net (loss) income	$(1,576)	$310
Adjustments to reconcile net (loss) income to net cash from operating activities		
Depreciation and amortization	5,815	5,240
Loss on disposal or impairment of property and equipment	27	749
Loss on early retirement of debt	4,619	—
Bad debt expense	12	434
Non-cash employee equity compensation	1,739	389
Amortization of deferred finance charges	470	641
Change in operating assets and liabilities		
Trade and other receivables	(2,778)	(5)
Inventories	(48)	23
Prepaid expenses and other current assets	915	(5,110)
Unearned franchise and development fees	(76)	153
Accounts payable	(21)	1,281
Accrued expenses	(2,385)	(1,122)
Deferred taxes	(1,217)	857
Other assets and liabilities	61	5,256
Net cash from operating activities	5,557	9,096
Investing Activities		
Acquisition of property and equipment	(3,036)	(2,221)
Acquisition of stores, less cash acquired	(647)	(3,600)
Proceeds from sale of stores	153	4
Payments received on notes receivable	960	23
Investment in cost-method investee	(1,500)	—
Net cash from investing activities	(4,070)	(5,794)
Financing Activities		
Proceeds from issuance of long-term debt	112,000	—
Payments on long-term debt	(169,900)	(660)
Advances on revolver	1,800	500
Payments on revolver	(1,800)	(4,500)
Issuance of common stock, net of underwriting fees	59,675	57
Repurchases of common stock	(1,518)	(27)
Debt issuance and modification costs, including prepayment penalties	(2,626)	(288)
Payments received on subscription receivables	1,097	—
Costs associated with initial public offering	(3,490)	—
Investment by noncontrolling interest holders	167	—
Net cash from financing activities	(4,595)	(4,918)
Effect of exchange rate fluctuations on cash	—	(2)
Net change in cash and cash equivalents	(3,108)	(1,618)
Cash and Cash Equivalents, beginning of year	3,705	2,428

Cash and Cash Equivalents, end of period	$597	$810
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for interest	$6,667	$7,029
Cash paid during the period for income taxes	$110	$105
Deferred offering costs paid in 2013 reclassified to equity	$1,537	$—
Noncash Supplemental Disclosures of Investing and Financing Activities		
Issuance of note receivable for preferred and common stock	$—	$113
Issuance of note payable for acquisition of stores	$2,900	$—
Acquisition of property and equipment in accounts payable	$310	$—

See accompanying notes.

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PAPA MURPHY’S HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)
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 September 29, 2014, the Company had 1,437 stores consisting of 1,409 domestic stores (1,333 franchised stores and 76 company-owned stores) across 38 states, plus 28 franchised stores in Canada and the United Arab Emirates.

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 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. The total liquidation preference on the Preferred Shares at the time of conversion was $64.3 million. As part of the IPO, the Company increased its authorized shares from 3,000,000 shares of common stock, $0.01 par value per share, to 200,000,000 shares of common stock, $0.01 par value per share. The Company also authorized the issuance of 15,000,000 shares of preferred stock, $0.01 par value per share, with no shares outstanding.

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. Concurrent with the stock split, the Company adjusted the number of shares subject to, and the exercise price of, its outstanding stock option awards under the Company's 2010 Amended Management Incentive Plan (the "2010 Plan") such that the holders of the options were in the same economic position both before and after the stock split. As a result of the stock split, all previously reported share amounts, including options in these 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 for the year ended December 30, 2013 included in the Company’s Registration Statement (Registration No. 333-194488) which was declared effective by the SEC on May 1, 2014 (as amended, the "Registration Statement").

Principles of consolidation—The interim unaudited condensed consolidated financial statements include the accounts of Papa Murphy’s Holdings, Inc. and its subsidiaries. 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 2014 and 2013 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 2014 and 2013 are references to fiscal years ending December 29, 2014 and ended December 30, 2013, respectively.

Internal use software—Expenditures for major software purchases and software developed for internal use are capitalized and amortized over the useful life of the software (three to five years) on a straight-line basis. The Company’s policy provides for the capitalization of external direct costs of materials and services associated with developing or obtaining

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internal-use computer software. Costs associated with preliminary project stage activities, training, maintenance and all other post-implementation stage activities are expensed as incurred.

Software revenue recognition—The Company recognizes revenues for the resale of software licenses upon delivery to franchise owners to the extent collectability is probable. In an effort to obtain more favorable pricing and expedite the roll-out of point-of-sale ("POS") systems, the Company acquired $4.5 million of POS software licenses in a lump sum purchase in 2013 and intends to resell them to franchise owners at cost.

Recent accounting pronouncements—In July 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which prescribes that an unrecognized tax benefit or a portion of an unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar loss, or a tax credit carryforward, except in certain cases where the unrecognized tax benefit should be presented as a liability and should not be combined with deferred tax assets. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. This update should be applied prospectively to all unrecognized tax benefits that exist at the effective date, with retrospective application permitted. The Company adopted ASU No. 2013-11 effective December 30, 2013. The adoption concerns presentation and disclosure only and did not have an effect on the Company's consolidated financial position or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, a new standard to achieve a consistent application of revenue recognition within the U.S., resulting in a single revenue model to be applied by reporting companies under U.S. generally accepted accounting principles. Under the new model, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. This new standard is effective for fiscal years beginning after December 15, 2016; early adoption is prohibited. This new standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. The Company has not yet selected a transition method nor has it determined the effects of the new standard on its condensed consolidated financial statements.

Note 2—Acquisitions

On August 18, 2014, Papa Murphy's Company Stores, Inc. ("PMCSI"), a wholly-owned subsidiary of the Company, acquired certain assets used in the operation of nine Papa Murphy's stores in the Minneapolis, MN area (the "Drake acquisition") from Drake Enterprises, the previous operator of the nine Papa Murphy's stores. Transaction costs of $59,000 associated with the acquisition were recognized as Other store operating costs in the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss). The total purchase price was $3.5 million, which included a post-close holdback of $54,000. The Drake acquisition was funded through cash and the issuance of a $2.9 million note payable to the seller (see Note 8—Financing Arrangements). The transaction was accounted for using the acquisition method of accounting whereby operating results subsequent to the acquisition date are included in the condensed consolidated financial statements.

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

Cash and cash equivalents	$4	
Inventories	46	
Prepaid expenses and other current assets	33	
Property and equipment	546	
Reacquired franchise rights	516	
Asset retirement obligation	(61	)
Total identifiable net assets acquired	1,084	
Goodwill	2,369	
Total consideration	$3,453	

Reacquired franchise rights have weighted average useful lives of 3.3 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 that of the Company.

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Unaudited pro forma information—The unaudited pro forma consolidated revenues and net loss of the Company as though the acquisition date had been as of the beginning of 2013 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2014	September 30, 2013	September 29, 2014	September 30, 2013
Pro forma revenues	$22,723	$20,115	$72,040	$61,216
Pro forma net income (loss)	$(829)	$(493)	$(1,625)	$181

The pro forma information presented in this note includes adjustments for amortization of acquired intangible assets, depreciation of acquired property and equipment, interest expense on borrowings used to fund the consideration paid 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 acquisitions actually occurred at the beginning of 2013, nor is it intended to be indicative of future operating performance.

Revenues earned from the acquired stores of $0.5 million and net loss of $35,000 from the closing date of the acquisition are included in the Company's Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and nine months ended September 29, 2014.

Note 3—Prepaid Expenses and Other Current Assets

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

	September 29, 2014	December 30, 2013
Prepaid media development costs	$202	$16
Prepaid rents and insurance	869	458
Equity issuance costs	—	1,537
POS software licenses for resale	2,177	4,548
Convention deposits	1,110	—
Other	457	495
Total prepaid expenses and other current assets	$4,815	$7,054

Prepaid media development costs represent costs incurred for advertisements that have not aired. During the three and nine months ended September 29, 2014, the Company recognized $0.4 million and $2.4 million in software license revenue upon the resale of 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 and Comprehensive Income (Loss).

Note 4—Property and Equipment

Property and equipment are net of accumulated depreciation of $8.4 million and $6.5 million at September 29, 2014 and December 30, 2013, respectively. Depreciation expense for the three months ended September 29, 2014 and September 30, 2013 was $0.7 million and $0.6 million, respectively. Depreciation expense for the nine months ended September 29, 2014 and September 30, 2013 was $2.1 million and $1.8 million, respectively.

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 30, 2013	$ 14,543	$81,546	$96,089
Acquisitions	2,369	—	2,369
Disposition	(9)	—	(9)
Balance at September 29, 2014	$ 16,903	$81,546	$98,449

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There is no goodwill associated with the International Segment. During the three months ended September 29, 2014, 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 $18.0 million and $14.3 million as of September 29, 2014 and December 30, 2013, respectively. Amortization expense for the three months ended September 29, 2014 and September 30, 2013 was $1.3 million and $1.2 million, respectively. Amortization expense for the nine months ended September 29, 2014 and September 30, 2013 was $3.7 million and $3.4 million, respectively.

Note 7—Notes Receivable

Notes receivable consists of the following (in thousands):

	September 29, 2014	December 30, 2013
Note issued on sale of company-owned stores maturing in 2020, bearing interest at 9.0%. Monthly payments of principal and interest of $7 are due through July 2015. Monthly payment amounts increase annually pursuant to an agreed schedule until they reach a monthly maximum of $9 in August 2018. Collateralized by store assets. Note was reclassified from related party notes receivable to third party notes receivable in 2014 (see Note 16—Related Party Transactions).	$—	$443
Uncollateralized note issued to an employee, maturing in 2017, bearing interest at 0.88%. Note was paid in full in 2014.	—	40
Total related party notes receivable	—	483
Notes issued to finance franchise owners’ purchase of point of sale systems, three year term, maturing during 2014 and bearing interest at 10.5%. Monthly payments of principal and interest due through 2014. Collateralized by POS systems. Notes were paid in full in 2014.	—	23
Note issued on the sale of company-owned stores maturing during 2015, denominated in Canadian dollars, bearing interest at 4%. Monthly payment terms of interest only through 2015. Collateralized by store assets.	792	825
Note issued on sale of company-owned stores maturing in 2020, bearing interest at 9.0%. Monthly payments of principal and interest of $7 are due through July 2015. Monthly payment amounts increase annually pursuant to an agreed schedule until they reach a monthly maximum of $9 in August 2018. Collateralized by store assets.	297	—
Note issued on the sale of company-owned stores maturing during 2014, bearing interest at 8%. Note was paid in full in 2014.	—	775
Total notes receivable	1,089	2,106
Less allowance for doubtful notes receivable, current portion	(792)	(825)
Notes receivable, net of allowance for doubtful notes receivable	297	1,281
Less current portion	(58)	(837)
Notes receivable, net of current portion	$239	$444

Note 8—Financing Arrangements

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

	September 29, 2014	December 30, 2013
Senior secured credit facility		
Term loan	$112,000	$167,000
Notes payable	3,000	3,000
Total long-term debt	115,000	170,000
Less current portion	(2,100)	(1,670)
Total long-term debt, net of current portion	$112,900	$168,330

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Senior secured credit facility—On August 28, 2014, PMI Holdings, Inc., a wholly-owned subsidiary of the Company, entered into a new $132.0 million senior secured credit facility (the "2014 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. Closing and structuring fees of $1.6 million were incurred as a result of this transaction which will be amortized over the duration of the new loan. The new term loan and any loans made under the revolving credit facility mature in August 2019.

Borrowings under the 2014 facility bear interest at a rate per annum equal to an applicable margin based on the Company's consolidated leverage ratio, plus, at the Company's option, either (a) a base rate determined by reference to the highest of (i) the "Prime Rate" publicly quoted by The Wall Street Journal, (ii) the federal funds rate plus 50 basis points, or (iii) the LIBOR rate with a one-month interest period plus 100 basis points, or (b) a LIBOR rate determined for the specified interest period. The applicable margin for borrowings under the 2014 facility ranges from 150 to 225 basis points for base rate borrowings and 250 to 325 basis points for LIBOR rate borrowings. The 2014 facility includes customary fees for loan facilities of this type, including a commitment fee on the revolving credit facility. As of September 29, 2014, the 2014 facility bore interest under the LIBOR rate option at 3.41%.

The obligations under the 2014 facility are guaranteed by certain domestic subsidiaries of the Company (the "subsidiary guarantors") and are secured by substantially all of the assets of the Company and the subsidiary guarantors. The 2014 facility also contains customary affirmative and negative covenants that are typical for loan facilities of this type, including covenants that, among other things, restrict our ability and the ability of our subsidiaries to incur indebtedness, issue certain types of equity, incur liens, enter into fundamental changes, including mergers and consolidations, sell assets, make dividends, distributions and investments, and prepay subordinated indebtedness, subject to customary exceptions. The 2014 facility also includes certain financial covenants with respect to a maximum consolidated leverage ratio and a minimum interest coverage ratio.

With a maturity date of over one year from September 29, 2014, balances outstanding under the 2014 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 the last day of each fiscal quarter commencing on March 29, 2015.

The weighted average interest rate across all senior secured credit facilities for the third quarter of 2014 was 4.74%.

2013 senior secured credit facility—In August 2014, the borrowings under the 2014 facility refinanced the $177.0 million senior secured credit facility entered into in October 2013 (the "2013 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. In connection with the refinancing, unamortized deferred financing costs of $2.3 million from the 2013 facility and a prepayment penalty of $1.1 million were expensed as a Loss on early retirement of debt on the Company's Condensed Consolidated Statements of Operations and Comprehensive Income (Loss).

On May 7, 2014, the Company prepaid $55.5 million of its long-term debt under the 2013 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 and Comprehensive Income (Loss) at the time of this debt prepayment.

Notes payable—PMCSI has a note payable for $3.0 million which bears interest at 5% and matures in December 2018. This note is subordinated to the senior secured credit facility.

As part of the Drake acquisition, PMCSI issued a note payable for $2.9 million to Drake Enterprises in August 2014. The note bore interest at 7% and was scheduled to mature in April 2019 with an acceleration clause in the event of a refinancing of the 2013 facility. The note was paid in full during September 2014.

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 cooroborated with observable market data

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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.

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

	September 29, 2014		December 30, 2013		
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE	FAIR VALUE MEASUREMENTS
Financial assets					
Notes receivable [a]	297	302	1,281	1,287	Level 3
Financial liabilities					
Long-term debt, including current portion thereof [b]	115,000	113,880	170,000	168,882	Level 3

(a) 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.

(b) 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 and long-term debt. 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. The fair value of the equity interests of Project Pie, LLC ("Project Pie"), a cost-method investee, which equity interests are owned by the Company's majority-owned subsidiary, Project Pie Holdings, LLC ("PPH"), approximates book value due to the recent nature of the investment and subsequent investments.

Note 10—Accrued and Other Liabilities

Accrued and other liabilities consist of the following (in thousands):

	September 29, 2014	December 30, 2013
Accrued payable for POS software licenses	$—	$2,729
Accrued compensation and related costs	2,202	2,232
Gift cards and certificates payable	2,075	2,829
Accrued interest and non-income taxes payable	281	384
Convention fund balance	1,018	576
Unearned product rebates	1,317	—
Other	557	991
	$7,450	$9,741

Note 11—Income Taxes

The Company recognized an income tax benefit of $0.7 million on loss before income taxes of $1.5 million, or an effective tax rate of 47.1%, for the three months ended September 29, 2014, compared to an income tax benefit of $0.2 million on loss before income taxes of $0.6 million, or an effective tax rate of 29.8%, for the three months ended September 30, 2013. The effective tax rate for the three months ended September 30, 2013 includes the effect of certain permanent differences between tax reporting purposes and financial reporting purposes and the relative impact of those differences on a small quarterly loss.

The Company recognized an income tax benefit of $1.1 million on loss before income taxes of $2.7 million, or an effective tax rate of 41.6%, for the nine months ended September 29, 2014, compared to an income tax expense of $1.0 million on income before income taxes of $1.3 million, or an effective tax rate of 75.9%, for the nine months ended September 30, 2013. The effective tax rate for the nine months of 2014 includes the effect of discrete adjustments for the accelerated vesting of restricted stock. The effective tax rate for the first nine months ended

September 30, 2013 includes the effect of a discrete adjustment for a change in the blended state tax rate.

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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—During the three and nine months ended September 29, 2014 the Company received an additional investment of zero and $0.2 million, respectively, by noncontrolling interest holders in PPH.
Note 13—Share-based Compensation
Restricted common shares and stock options—In May 2010, the Company's Board of Directors approved 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 consisting of incentive stock options, non-qualified stock options, restricted stock awards, and unrestricted stock awards. Under the Incentive Plans, the Company has awarded 608,576 and 753,783 shares of restricted common stock to eligible employees as of September 29, 2014 and December 30, 2013, respectively. In addition, the Company has issued 951,153 and zero stock options under the Incentive Plans to eligible employees as of September 29, 2014 and December 30, 2013, respectively.
Information with respect to restricted stock sales is as follows:

	NUMBER OF SHARES OF RESTRICTED COMMON STOCK		
	TIME VESTING	MARKET CONDITION VESTING	WEIGHTED AVERAGE SALE/GRANT DATE FAIR VALUE PER SHARE
Unvested, December 30, 2013	243,475	236,707	$ 2.49
Sold/Granted	6,815	—	8.80
Vested	(97,300)	(4,555)	4.50
Forfeited/Repurchased	(14,780)	(16,596)	2.39
Unvested, September 29, 2014	138,210	215,556	$ 2.31

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Information with respect to stock option activity is as follows:

	NUMBER OF SHARES SUBJECT TO OPTIONS				
	TIME VESTING	MARKET VESTING	WEIGHTED AVERAGE EXERCISE PRICE PER SHARE	WEIGHTED AVERAGE REMAINING CONTRACTUAL TERM	AGGREGATE INTRINSIC VALUE (in thousands)
Outstanding, December 30, 2013	—	—	$—		
Granted	740,932	231,655	11.16		
Exercised	—	—	—		
Forfeited	(12,621)	(8,813)	11.00		
Outstanding, September 29, 2014	728,311	222,842	$11.16	9.6 years	$ —
Exercisable, September 29, 2014	352,751	—	$11.21	9.6 years	$ —
Vested and expected to vest at September 29, 2014	671,977	189,416	$11.17	9.6 years	$ —

The weighted average fair value of share-based compensation awards granted and vested, and the intrinsic value of options exercised during the period were (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2014	September 30, 2013	September 29, 2014	September 30, 2013
Restricted Stock Sales/Grants:				
Weighted average sale/grant date fair value per share	$8.80	$ —	$8.80	$ 6.77
Total fair value of shares sold/granted	$60	$ —	$60	$ 230
Total fair value of shares vested	$26	$ —	$458	$ 50
Stock Option Awards:				
Weighted average grant date fair value per share	$—	$ —	$4.27	$ —
Total fair value of awards granted	$—	$ —	$4,151	$ —
Total fair value of awards vested	$87	$ —	$1,519	$ —
Total intrinsic value of options exercised	$—	$ —	$—	$ —

Compensation cost and valuation—Total compensation costs recognized in connection with the Incentive Plans for the three months ended September 29, 2014 and September 30, 2013 were $0.2 million and $0.2 million, respectively. Total compensation costs recognized in connection with the Incentive Plans for the nine months ended September 29, 2014 and September 30, 2013 were $1.7 million and $0.4 million, respectively. Income tax benefits associated with the Incentive Plans recognized for the three months ended September 29, 2014 and September 30, 2013 were $0.1 million and zero, respectively. Income tax benefits recognized for the nine months ended September 29, 2014 and September 30, 2013 were $0.6 million and zero, respectively.

As of September 29, 2014, the total unrecognized stock-based compensation expense, net of estimated forfeitures, was $1.7 million and the remaining weighted average contractual life was 2.4 years.

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 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.

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

	Three Months Ended	Nine Months Ended	
	September 30, 2013	September 29, 2014 (A)	September 30, 2013
Risk free rate	0.41%	0.36%	0.28~0.50%
Volatility of the underlying assets	35%	45%	35~40%
Estimated time until a liquidation event	(B)	(C)	(D)
Marketability discount—common stock	(B)	(C)	(D)
Marketability discount—preferred stock	(B)	(C)	(D)

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

(B) On July 1, 2013, the Company began to apply a probability weighted expected return method, where equity values were calculated using an option pricing model under an IPO and non-IPO scenarios and each value was weighted based on estimated probability of occurrence. During the period, 0.50~2.25 years were used as estimated time until a liquidation event and 15~30% and 10-15% of marketability discount were used for common and preferred stock, respectively, depending on an IPO or non-IPO scenarios, respectively. As of September 30, 2013, a 50% weight was given to the IPO scenario.

(C) During the period, 0.58~1.75 years were used as estimated time until a liquidation event and 10~25% and 8~15% of marketability discount were used for common and preferred stock, respectively, depending on an IPO or non-IPO scenarios. As of March 31, 2014, the date of the last valuation performed by the Company, a 95% weight was given to the IPO scenario.

(D) During the period, 0.50~2.5 years were used as estimated time until a liquidation event and 15~30% and 10-15% of marketability discount were used for common and preferred stock, respectively, depending on an IPO or non-IPO scenarios, respectively. As of September 30, 2013, a 50% weight was given to the IPO scenario.

The fair value of the stock option awards granted in the three and nine months ended September 29, 2014 was estimated with the following weighted-average assumptions.

	Three Months Ended		Nine Months Ended	
	September 29, 2014	September 30, 2013	September 29, 2014	September 30, 2013
Risk free rate	—	—	2.0%	—
Expected volatility	—	—	35.0%	—
Expected term	—	—	6.3 years	—
Expected dividend yield	—	—	0.0%	—

Preferred and common stock subject to put options—In July 2011, the Company entered into a share repurchase and put option agreement with an executive officer, pursuant to which the executive officer had the right and option to have the Company repurchase 74,491 shares of unrestricted preferred stock and 92,951 shares (41,075 pre-stock split) of unrestricted common stock ("Put Option").

The change in the fair value of the Put Option during the three and nine months ended September 30, 2013 resulted in additional compensation expense of $0.2 million and $0.3 million. In December 2013, the share repurchase and put option agreement was canceled.

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 has 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.

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 earnings per share (“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 restricted common stock. 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.

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The following table sets forth the computations of basic and dilutive earnings per share (in thousands, except per share data):

	Three Months Ended September 29, 2014	Nine Months Ended