WEIGHT WATCHERS INTERNATIONAL INC
Form 10-Q
November 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 29, 2018

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: 001-16769

WEIGHT WATCHERS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Virginia	11-6040273
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

675 Avenue of the Americas, 6th Floor, New York, New York 10010

(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (212) 589-2700

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

The number of shares of common stock outstanding as of October 26, 2018 was 66,837,077.

WEIGHT WATCHERS INTERNATIONAL, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS AT

(IN THOUSANDS)

	September 29, 2018	December 30, 2017
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 219,770	$ 83,054
Receivables (net of allowances: September 29, 2018 - $1,786 and December 30, 2017 - $2,001)	28,871	23,913
Inventories	14,270	31,728
Prepaid income taxes	39,950	43,488
Prepaid expenses and other current assets	33,259	26,805
TOTAL CURRENT ASSETS	336,120	208,988
Property and equipment, net	49,811	47,978
Franchise rights acquired	750,730	754,040
Goodwill	154,697	156,281
Other intangible assets, net	56,605	46,536
Deferred income taxes	14,170	12,447
Other noncurrent assets	19,370	19,730
TOTAL ASSETS	$ 1,381,503	$ 1,246,000
LIABILITIES AND TOTAL DEFICIT		
CURRENT LIABILITIES		
Portion of long-term debt due within one year	$ 57,750	$ 82,750
Accounts payable	22,960	24,356
Salaries and wages payable	58,119	62,179
Accrued marketing and advertising	16,058	18,154
Accrued interest	31,932	10,834
Other accrued liabilities	66,843	58,251
Derivative payable	0	12,171
Deferred revenue	58,367	74,332
TOTAL CURRENT LIABILITIES	312,029	343,027
Long-term debt, net	1,687,464	1,740,612
Deferred income taxes	206,070	143,591
Other	17,213	30,289
TOTAL LIABILITIES	2,222,776	2,257,519
Redeemable noncontrolling interest	3,939	4,467
TOTAL DEFICIT		
Common stock, $0 par value; 1,000,000 shares authorized; 120,353 shares issued	0	0

at September 29, 2018 and 118,947 shares issued at December 30, 2017		
Treasury stock, at cost, 53,517 shares at September 29, 2018 and 54,258 shares at December 30, 2017	(3,180,015)	(3,208,836)
Retained earnings	2,340,255	2,203,317
Accumulated other comprehensive loss	(5,452)	(10,467)
TOTAL DEFICIT	(845,212)	(1,015,986)
TOTAL LIABILITIES AND TOTAL DEFICIT	$ 1,381,503	$ 1,246,000

The accompanying notes are an integral part of the consolidated financial statements.

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF NET INCOME

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Service revenues, net	$311,963	$ 273,219	$984,362	$ 817,696
Product sales and other, net	53,802	50,468	199,373	176,726
Revenues, net	365,765	323,687	1,183,735	994,422
Cost of services	122,357	118,073	390,296	363,284
Cost of product sales and other	28,014	28,526	112,250	100,943
Cost of revenues	150,371	146,599	502,546	464,227
Gross profit	215,394	177,088	681,189	530,195
Marketing expenses	35,515	30,310	189,855	158,707
Selling, general and administrative expenses	61,019	55,400	182,696	153,671
Operating income	118,860	91,378	308,638	217,817
Interest expense	35,506	26,993	107,238	82,227
Other expense, net	881	125	1,978	278
Gain on early extinguishment of debt	0	0	0	(1,554)
Income before income taxes	82,473	64,260	199,422	136,866
Provision for income taxes	12,374	19,593	19,580	36,457
Net income	70,099	44,667	179,842	100,409
Net loss attributable to the noncontrolling interest	33	52	122	135
Net income attributable to Weight Watchers International, Inc.	$70,132	$ 44,719	$179,964	$ 100,544
Earnings Per Share attributable to Weight Watchers International, Inc.				
Basic	$1.05	$ 0.69	$2.72	$ 1.57
Diluted	$1.00	$ 0.65	$2.57	$ 1.48
Weighted average common shares outstanding				
Basic	66,701	64,463	66,074	64,237
Diluted	70,331	68,686	70,117	67,939

The accompanying notes are an integral part of the consolidated financial statements.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Net income	$70,099	$ 44,667	$179,842	$ 100,409
Other comprehensive gain:				
Foreign currency translation gain (loss)	1,534	5,673	(5,695)	11,704
Income tax (expense) benefit on foreign currency translation gain (loss)	(390)	(2,206)	1,443	(4,559)
Foreign currency translation gain (loss), net of taxes	1,144	3,467	(4,252)	7,145
Gain on derivatives	2,904	4,105	15,201	8,482
Income tax expense on gain on derivatives	(736)	(1,601)	(3,855)	(3,308)
Gain on derivatives, net of taxes	2,168	2,504	11,346	5,174
Total other comprehensive gain	3,312	5,971	7,094	12,319
Comprehensive income	73,411	50,638	186,936	112,728
Net loss attributable to the noncontrolling interest	33	52	122	135
Foreign currency translation loss (gain), net of taxes attributable to the noncontrolling interest	33	(113)	406	(72)
Comprehensive loss (income) attributable to the noncontrolling interest	66	(61)	528	63
Comprehensive income attributable to Weight Watchers International, Inc.	$73,477	$ 50,577	$187,464	$ 112,791

The accompanying notes are an integral part of the consolidated financial statements.

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Nine Months Ended	
	September 29, 2018	September 30, 2017
Operating activities:		
Net income	$ 179,842	$ 100,409
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	32,594	38,331
Amortization of deferred financing costs and debt discount	6,330	4,292
Impairment of intangible and long-lived assets	3	670
Write-off of net assets due to cessation of Spain operations	0	70
Share-based compensation expense	15,346	9,372
Deferred tax provision	1,322	6,393
Allowance for doubtful accounts	(68)	(775)
Reserve for inventory obsolescence	6,146	6,280
Foreign currency exchange rate loss	1,480	158
Gain on early extinguishment of debt	0	(1,840)
Changes in cash due to:		
Receivables	(12,763)	6,768
Inventories	11,888	4,821
Prepaid expenses	2,535	9,711
Accounts payable	(2,024)	(19,622)
Accrued liabilities	16,634	(21,459)
Deferred revenue	(12,465)	16,692
Other long term assets and liabilities, net	(12,819)	5,907
Income taxes	20,658	18,627
Cash provided by operating activities	254,639	184,805
Investing activities:		
Capital expenditures	(11,932)	(10,755)
Capitalized software expenditures	(20,115)	(20,242)
Cash paid for acquisitions	(3,063)	0
Other items, net	(9,843)	(130)
Cash used for investing activities	(44,953)	(31,127)
Financing activities:		
Net borrowings (payments) on revolver	(25,000)	0
Payments on long-term debt	(57,750)	(88,387)
Taxes paid related to net share settlement of equity awards	(20,564)	(4,894)
Proceeds from stock options exercised	32,610	4,925
Cash used for financing activities	(70,704)	(88,356)
Effect of exchange rate changes on cash and cash equivalents	(2,266)	4,269
Net increase in cash and cash equivalents	136,716	69,591
Cash and cash equivalents, beginning of period	83,054	108,656

Cash and cash equivalents, end of period	$219,770	$ 178,247

The accompanying notes are an integral part of the consolidated financial statements.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AND PER UNIT AMOUNTS)

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts of Weight Watchers International, Inc. and all of its subsidiaries. The terms "Company" and "WW" as used throughout these notes are used to indicate Weight Watchers International, Inc. and all of its operations consolidated for purposes of its financial statements. The Company's "Digital" business refers to providing subscriptions to the Company's digital offerings, including the Personal Coaching product. The Company's "Digital + Studio" business refers to providing access to the Company's weekly in-person workshops combined with the Company's digital subscription product offerings to commitment plan subscribers. The "Digital + Studio" business also includes the provision of access to workshops for the Company's "pay-as-you-go" members and other studio members.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and include amounts that are based on management's best estimates and judgments. While all available information has been considered, actual amounts could differ from those estimates. The consolidated financial statements include all of the Company's majority-owned subsidiaries. All entities acquired, and any entity of which a majority interest was acquired, are included in the consolidated financial statements from the date of acquisition. All intercompany accounts and transactions have been eliminated in consolidation. The Company's operating results for any interim period are not necessarily indicative of future or annual results. The consolidated financial statements are unaudited and, accordingly, they do not include all of the information necessary for a comprehensive presentation of results of operations, financial position and cash flow activity required by GAAP for complete financial statements but, in the opinion of management, reflect all adjustments including those of a normal recurring nature necessary for a fair statement of the interim results presented.

These statements should be read in conjunction with the Company's Annual Report on Form 10-K for fiscal 2017 filed on February 28, 2018, which includes additional information about the Company, its results of operations, its financial position and its cash flows.

2. Recently Issued Accounting Standards

In February 2016, the Financial Accounting Standards Board (the "FASB") issued updated guidance regarding leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but will be updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The effective date of the new guidance for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. In July 2018, the FASB issued updated guidance by providing an entity with an additional and optional transition method to adopt the new lease guidance. The modified retrospective transition approach requires application of the new guidance at the beginning of the earliest comparative period presented and the optional transition method permits an entity to apply the guidance at the adoption date. The updated guidance is effective for the Company beginning in the first quarter of fiscal 2019. While the Company is still evaluating the impact that the adoption of this guidance will have on the consolidated financial statements and related disclosures of the Company, the Company currently expects that most of its operating leases will be subject to the updated guidance and that this guidance will have a material impact on its consolidated balance sheet.

For a discussion of the Company's other significant accounting policies, see "Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements of the Company's Annual Report on Form 10-K for fiscal 2017. For a discussion of accounting standards adopted in the current period, see Note 3.

3. Accounting Standards Adopted in Current Year

In March 2016, the FASB issued updated guidance on revenue from contracts with customers, which is intended to clarify the implementation guidance on principal versus agent considerations. The amendments in this update do not change the core principle of the guidance, but are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations by including indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customer. In April 2016, the FASB issued updated guidance on revenue from contracts with customers, which is intended to clarify guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. In May 2016, the FASB issued updated guidance on revenue from contracts with customers, which is intended to provide narrow scope guidance and practical expedients contained in the new revenue standard. In December 2016, the FASB issued updated guidance on revenue from contracts with customers for technical corrections and improvements on narrow

aspects within the original and amended guidance. The amendments in these updates are effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years, with early adoption permitted. On the first day of the first quarter of fiscal 2018, the Company adopted the updated guidance on revenue from contracts with customers on a modified retrospective basis. See Note 4 for further details.

In October 2016, the FASB issued updated guidance on intra-equity transfers of assets other than inventory which is intended to improve the accounting for income tax consequences by eliminating the deferral of tax effects of intra-entity asset transfers other than inventory within the consolidated entity. The current guidance to defer the recognition of any tax impact on the transfer of inventory within the consolidated entity until it is sold to a third party remains unaffected. The updated guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those fiscal years, with early adoption permitted. The updated guidance must be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company adopted this guidance the first day of the first quarter of 2018, and as a result, recorded a net deferred tax liability with a corresponding cumulative adjustment to decrease retained earnings of $48,624 associated with an intra-entity transfer of certain intellectual property rights related to the Company’s non-U.S. business to its Canadian entity. Before the 2017 Tax Act was passed, the Company’s position was that this transaction was net neutral from a tax perspective and therefore a cumulative effect entry might not be required. However, after further analysis of the new tax law during the first quarter of 2018, the Company concluded an entry to retained earnings was necessary.

In February 2018, the FASB issued updated guidance on tax effects of items within accumulated other comprehensive income resulting from Tax Cuts and Jobs Act of 2017 (the “2017 Tax Act”). This update eliminates the stranded tax effects from the Act and permits a company to make an accounting policy election to reclassify those effects from accumulated other comprehensive income (“AOCI”) to retained earnings. The updated guidance is effective for the Company beginning in the first quarter of fiscal 2019 and early adoption is permitted. The Company adopted this guidance the first day of the first quarter of fiscal 2018, and the election was made to reclassify the income tax effects of the 2017 Tax Act from accumulated other comprehensive loss to retained earnings, resulting in a $2,485 increase to retained earnings in the consolidated balance sheet. There were no other income tax effects related to the application of the 2017 Tax Act with the adoption of this updated guidance.

In March 2018, the FASB issued guidance pursuant to the amendments issued by the staff of the U.S. Securities and Exchange Commission. The amendments provide guidance on when to record and disclose provisional amounts for certain income tax effects of the 2017 Tax Act. The amendments also require any provisional amounts or subsequent adjustments to be included in net income from continuing operations. Additionally, this guidance discusses required disclosures that an entity must make with regard to the 2017 Tax Act. This guidance is effective immediately as new information is available to adjust provisional amounts that were previously recorded. The Company adopted this guidance the first day of the first quarter of fiscal 2018 and will continue to evaluate indicators that may give rise to a change in our tax provision as a result of the 2017 Tax Act. See Note 10 for additional information on the 2017 Tax Act.

In June 2018, the FASB issued updated guidance regarding share-based payment transactions for acquiring goods and services from nonemployees. The updated guidance applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The effective date of the new guidance for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted, but no earlier than an entity's adoption date of the revenue guidance. The updated guidance is effective for the Company beginning in the first quarter of fiscal 2019. The Company early adopted this guidance during the third quarter of 2018. The adoption of this guidance had no impact on the consolidated financial statements.

4. Revenue

Adoption of Revenue from Contracts with Customers

On December 31, 2017, the Company adopted the updated guidance on revenue from contracts with customers using the modified retrospective method applied to those contracts which were not completed as of December 31, 2017. Results for reporting periods beginning after December 31, 2017 are presented under the updated guidance, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historical revenue accounting.

The Company recorded a net increase to opening retained earnings of $2,145 as of December 31, 2017 due to the cumulative impact of adopting the updated guidance, inclusive of a $3,501 decrease to deferred revenue, a decrease of $568 to prepaid expenses and other current assets and an increase to the deferred income tax liability of $788.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AND PER UNIT AMOUNTS)

Revenue Recognition

Revenues are recognized when control of the promised services or goods is transferred to the Company’s customers, in an amount that reflects the consideration it expects to be entitled to in exchange for those services or goods.

WW earns revenue from subscriptions for the Company’s digital products and by conducting workshops, for which it charges a fee, predominantly through commitment plans, prepayment plans or the “pay-as-you-go” arrangement. WW also earns revenue by selling consumer products (including publications) in its workshops, online and to its franchisees, collecting commissions from franchisees, collecting royalties related to licensing agreements, selling magazine subscriptions, publishing, selling advertising space on its websites and in copies of its publications and By Mail product sales.

Commitment plans, prepaid workshop fees and magazine subscription revenue is recorded to deferred revenue and amortized into revenue as control is transferred over the period earned since these performance obligations are satisfied over time. Digital subscription revenues, consisting of the fees associated with subscriptions for the Company’s Digital subscription products, including its Personal Coaching product, are deferred and recognized on a straight-line basis as control is transferred over the subscription period. One-time Digital sign-up fees are considered immaterial in the context of the contract and the related revenue is recorded to deferred revenue and amortized into revenue over the commitment period. In the Digital + Studio business, WW generally charges non-refundable registration and starter fees in exchange for access to the Company’s digital subscription products, an introductory information session and materials it provides to new members. Revenue from these registration and starter fees is considered immaterial in the context of the contract and are recorded to deferred revenue and amortized into revenue over the commitment period. Revenue from “pay-as-you-go” workshop fees, consumer product sales, By Mail, commissions and royalties is recognized at the point in time control is transferred, when services are rendered, products are shipped to customers and title and risk of loss passes to the customers, and commissions and royalties are earned, respectively. Revenue from advertising in magazines is recognized when advertisements are published. Revenue from magazine sales is recognized when the magazine is sent to the customer. For revenue transactions that involve multiple performance obligations, the amount of revenue recognized is determined using the relative fair value approach, which is generally based on each performance obligation’s stand-alone selling price. Discounts to customers, including free registration offers, are recorded as a deduction from gross revenue in the period such revenue was recognized. Revenue from advertising on its websites is recognized when the advertisement is viewed by the user.

The Company grants refunds in aggregate amounts that historically have not been material. Because the period of payment of the refund generally approximates the period revenue was originally recognized, refunds are recorded as a reduction of revenue over the same period.

The following table presents the Company’s revenues disaggregated by revenue source:

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Digital Subscription Revenues	$143,299	$ 107,587	$432,863	$ 312,710
Digital + Studio Fees	168,664	165,632	551,499	504,986
Service revenues, net	$311,963	$ 273,219	$984,362	$ 817,696
Product sales and other, net	53,802	50,468	199,373	176,726
Revenues, net	$365,765	$ 323,687	$1,183,735	$ 994,422

The following tables present the Company’s revenues disaggregated by segment:

	Three Months Ended September 29, 2018				
	North America	Continental Europe	United Kingdom	Other	Total
Digital Subscription Revenues	$95,664	$ 37,928	$ 6,282	$3,425	$143,299
Digital + Studio Fees	125,282	25,441	12,619	5,322	168,664
Service revenues, net	$220,946	$ 63,369	$ 18,901	$8,747	$311,963
Product sales and other, net	34,335	9,025	6,455	3,987	53,802
Revenues, net	$255,281	$ 72,394	$ 25,356	$12,734	$365,765

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AND PER UNIT AMOUNTS)

	Three Months Ended September 30, 2017				
	North America	Continental Europe	United Kingdom	Other	Total
Digital Subscription Revenues	$71,294	$ 27,746	$ 5,687	$2,860	$107,587
Digital + Studio Fees	122,441	23,412	13,306	6,473	165,632
Service revenues, net	$193,735	$ 51,158	$ 18,993	$9,333	$273,219
Product sales and other, net	29,942	9,507	6,480	4,539	50,468
Revenues, net	$223,677	$ 60,665	$ 25,473	$13,872	$323,687

	Nine Months Ended September 29, 2018				
	North America	Continental Europe	United Kingdom	Other	Total
Digital Subscription Revenues	$289,002	$ 113,431	$ 19,800	$10,630	$432,863
Digital + Studio Fees	408,200	83,923	41,552	17,824	551,499
Service revenues, net	$697,202	$ 197,354	$ 61,352	$28,454	$984,362
Product sales and other, net	121,805	39,164	23,498	14,906	199,373
Revenues, net	$819,007	$ 236,518	$ 84,850	$43,360	$1,183,735

	Nine Months Ended September 30, 2017				
	North America	Continental Europe	United Kingdom	Other	Total
Digital Subscription Revenues	$212,976	$ 74,989	$ 15,887	$8,858	$312,710
Digital + Studio Fees	376,106	70,176	39,448	19,256	504,986
Service revenues, net	$589,082	$ 145,165	$ 55,335	$28,114	$817,696
Product sales and other, net	106,315	34,415	20,572	15,424	176,726
Revenues, net	$695,397	$ 179,580	$ 75,907	$43,538	$994,422

Information about Contract Balances

For Service Revenues, the Company typically collects payment in advance of providing services. Any amounts collected in advance of services being provided are recorded in deferred revenue. In the case where amounts are not collected, but the service has been provided and the revenue has been recognized, the amounts are recorded in accounts receivable. The opening and ending balances of the Company's deferred revenues are as follows:

	Deferred Revenue	Deferred Revenue-Long Term

Balance as of December 30, 2017	$74,332	$ 2,049
Net increase (decrease) during the period	(15,965)	(815)
Balance as of September 29, 2018	$58,367	$ 1,234

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AND PER UNIT AMOUNTS)

Revenue recognized from amounts included in current deferred revenue as of December 30, 2017 was $71,930 for the nine months ended September 29, 2018. The Company's long-term deferred revenue, which is included in other liabilities on the Company's consolidated balance sheet, had a balance of $1,234 at September 29, 2018 related to upfront payments received as an inducement for entering into certain sales-based royalty agreements with third party licensees. This revenue is amortized on a straight-line basis over the term of the agreements.

Practical Expedients and Exemptions

The Company elected to apply the updated guidance only to contracts that were not completed as of December 31, 2017, the date of adoption. The Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. The Company expenses sales commissions when incurred (amortization period would have been one year or less) and these expenses are recorded within selling, general and administrative expenses. The Company treats shipping and handling fees as fulfillment costs and not as a separate performance obligation, and as a result, any fees received from customers are included in the transaction price allocated to the performance obligation of providing goods with a corresponding amount accrued within cost of product sales and other for amounts paid to applicable carriers. Sales tax, value-added tax, and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue.

5. Acquisition of Kurbo Health, Inc.

On August 10, 2018, the Company acquired substantially all of the assets of Kurbo Health, Inc. ("Kurbo"), a family-based healthy lifestyle coaching program, for a net purchase price of $3,063. Payment was in the form of cash. The total purchase price of Kurbo has been allocated to goodwill ($1,101), website development ($1,916), prepaid expenses ($78) and other assets ($32) partially offset by deferred revenue ($57) and other liabilities ($7). The acquisition of Kurbo has been accounted for under the purchase method of accounting and, accordingly, earnings of Kurbo have been included in the consolidated operating results of the Company since the date of acquisition. The goodwill will be deductible annually for tax purposes.

6. Franchise Rights Acquired, Goodwill and Other Intangible Assets

Franchise rights acquired are due to acquisitions of the Company's franchised territories as well as the acquisition of franchise promotion agreements and other factors associated with the acquired franchise territories. For the nine months ended September 29, 2018, the change in the carrying value of franchise rights acquired is due to the effect of exchange rate changes.

Goodwill primarily relates to the acquisition of the Company by H.J. Heinz Company in 1978, the acquisition of WeightWatchers.com, Inc. in 2005, the acquisitions of the Company's franchised territories, the acquisitions of the majority interest in Vigilantes do Peso Marketing Ltda. and of Knowplicity, Inc., d/b/a Wello, in fiscal 2014 and the acquisition of Weilos, Inc. in fiscal 2015. For the nine months ended September 29, 2018, the change in the carrying amount of goodwill is due to the Kurbo acquisition (see Note 5 for further information) and the effect of exchange rate changes as follows:

	North America	Continental Europe	United Kingdom	Other	Total
Balance as of December 30, 2017	$140,389	$ 7,759	$ 1,253	$6,880	$156,281
Goodwill acquired during the period	1,101	0	0	0	1,101
Effect of exchange rate changes	(1,115)	(433)	(45)	(1,092)	(2,685)
Balance as of September 29, 2018	$140,375	$ 7,326	$ 1,208	$5,788	$154,697

Goodwill and Franchise Rights Acquired:

The Company reviews goodwill and other indefinite-lived intangible assets, including franchise rights acquired with indefinite lives, for potential impairment on at least an annual basis or more often if events so require. The Company performed fair value impairment testing as of May 6, 2018 and May 7, 2017, each the first day of fiscal May, on its goodwill and other indefinite-lived intangible assets. In addition, for the Company's Brazil reporting unit only, given the ongoing challenging economic environment, the negative performance trends and the Company's reduced expectations regarding the future impact of its business growth strategies in the country, the Company performed an interim goodwill impairment analysis at December 30, 2017.

In performing its annual impairment analysis as of May 6, 2018 and May 7, 2017, the Company determined that the carrying amounts of its goodwill reporting units and franchise rights acquired with indefinite lives units of account did not exceed their

respective fair values and therefore, no impairment existed. In performing the interim goodwill impairment analysis for its Brazil reporting unit, the Company recorded a $13,323 impairment charge at December 30, 2017.

For all reporting units, except for Brazil, there was significant headroom in the impairment analysis. Based on the results of the Company's annual impairment test performed for all of its reporting units except for Brazil, as of the September 29, 2018 balance sheet date, the Company estimated that for reporting units that hold approximately 97.2% of the Company's goodwill, those units had a fair value at least 50% higher than the respective reporting unit's carrying amount. Based on the results of the Company's annual impairment test performed for its Brazil reporting unit, the fair value of this reporting unit exceeded its carrying value by approximately 10%, and accordingly a relatively small change in the underlying assumptions would likely cause a change in the results of the impairment assessment and, as such, could result in an impairment of the goodwill related to Brazil, for which the carrying amount is $4,806.

When determining fair value, the Company utilizes various assumptions, including projections of future cash flows, growth rates and discount rates. A change in these underlying assumptions would cause a change in the results of the tests and, as such, could cause fair value to be less than the carrying amounts and result in an impairment of those assets. In the event such a result occurred, the Company would be required to record a corresponding charge, which would impact earnings. The Company would also be required to reduce the carrying amounts of the related assets on its balance sheet. The Company continues to evaluate these assumptions and believes that these assumptions are appropriate.

The following is a discussion of the goodwill and franchise rights acquired impairment analysis.

Goodwill

In performing the impairment analysis for goodwill, the fair value for the Company's reporting units is estimated using a discounted cash flow approach. This approach involves projecting future cash flows attributable to the reporting unit and discounting those estimated cash flows using an appropriate discount rate. The estimated fair value is then compared to the carrying value of the reporting units. The Company has determined the appropriate reporting unit for purposes of assessing annual impairment to be the country for all reporting units. For all of the Company's reporting units except for Brazil (see below), the Company estimated future cash flows by utilizing the historical debt-free cash flows (cash flows provided by operating activities less capital expenditures) attributable to that country and then applied expected future operating income growth rates for such country. The Company utilized operating income as the basis for measuring its potential growth because it believes it is the best indicator of the performance of its business. The Company then discounted the estimated future cash flows utilizing a discount rate which was calculated using the average cost of capital, which included the cost of equity and the cost of debt. The cost of equity was determined by combining a risk-free rate of return and a market risk premium for the Company's peer group. The risk-free rate of return was determined based on the average rate of long-term U.S. Treasury securities. The market risk premium was determined by reviewing external market data. The cost of debt was determined by estimating the Company's current borrowing rate.

As it relates to the impairment analysis for Brazil, the Company estimated future debt free cash flows in contemplation of its growth strategies for that market. In developing these projections, the Company considered the historical impact of similar growth strategies in other markets as well as the current market conditions in Brazil. The Company then discounted the estimated future cash flows utilizing a discount rate which was calculated using the average cost of capital, which included the cost of equity and the cost of debt. The cost of equity was determined by combining a risk-free rate of return and a market risk premium for the Company's peer group. The risk-free rate of return was determined based on the average rate of long-term U.S. Treasury securities. The market risk premium was determined by reviewing external market data including the current economic conditions in Brazil and the country specific risk thereon. A further risk premium was included to reflect the risk associated with the significantly higher growth rates projected in the May 6, 2017 annual impairment test. The cost of debt was determined by estimating the Company's current borrowing rate.

Franchise Rights Acquired

Finite-lived franchise rights acquired are amortized over the remaining contractual period, which is generally less than one year.

In performing the impairment analysis for indefinite-lived franchise rights acquired, the fair value for franchise rights acquired is estimated using a discounted cash flow approach referred to as the hypothetical start-up approach for franchise rights related to the Company's Digital + Studio business and a relief from royalty methodology for franchise rights related to the Company's Digital business. The aggregate estimated fair value for these rights is then compared to the carrying value of the unit of account for those franchise rights. The Company has determined the appropriate unit of account for purposes of assessing impairment to be the combination of the rights in both the Digital + Studio business and the Digital business in the country in which the acquisitions have occurred. In its hypothetical start-up approach analysis for fiscal 2018, the Company assumed that the year of maturity was reached

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after 7 years. Subsequent to the year of maturity, the Company estimated future cash flows for the Digital + Studio business in each country based on assumptions regarding revenue growth and operating income margins. The cash flows associated with the Digital business were based on the expected Digital revenue for such country and the application of a market-based royalty rate. The cash flows for the Digital + Studio and Digital businesses were discounted utilizing rates consistent with those utilized in the goodwill impairment analysis.

Finite-lived Intangible Assets

The carrying values of finite-lived intangible assets as of September 29, 2018 and December 30, 2017 were as follows:

	September 29, 2018		December 30, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Capitalized software costs	$117,975	$ 100,104	$111,617	$ 94,697
Website development costs	101,740	73,322	90,096	61,125
Trademarks	11,487	10,962	11,231	10,833
Other	13,890	4,099	3,793	3,546
Trademarks and other intangible assets	$245,092	$ 188,487	$216,737	$ 170,201
Franchise rights acquired	4,269	4,269	4,526	4,526
Total finite-lived intangible assets	$249,361	$ 192,756	$221,263	$ 174,727

Aggregate amortization expense for finite-lived intangible assets was recorded in the amounts of $7,213 and $21,453 for the three and nine months ended September 29, 2018, respectively. Aggregate amortization expense for finite-lived intangible assets was recorded in the amounts of $9,120 and $27,310 for the three and nine months ended September 30, 2017, respectively.

Estimated amortization expense of existing finite-lived intangible assets for the next five fiscal years and thereafter is as follows:

Remainder of fiscal 2018	$7,129
Fiscal 2019	$21,733
Fiscal 2020	$13,503
Fiscal 2021	$5,401
Fiscal 2022 and thereafter	$8,839

7. Long-Term Debt

The components of the Company's long-term debt were as follows:

	September 29, 2018				December 30, 2017			
	Principal Balance	Unamortized Deferred Financing Costs	Unamortized Debt Discount	Effective Rate [1]	Principal Balance	Unamortized Deferred Financing Costs	Unamortized Debt Discount	Effective Rate [1]
New Revolving Credit Facility due November 29, 2022	$ 0	$ 0	$ 0	4.34 %	$ 25,000	$ 0	$ 0	4.15 %
Former Tranche B-2 Term Facility due April 2, 2020	0	0	0	0.00 %	0	0	0	4.76 %
New Term Loan Facility due November 29, 2024	1,482,250	8,658	27,133	7.36 %	1,540,000	9,783	30,433	6.84 %
Notes due December 1, 2025	300,000	1,245	0	8.59 %	300,000	1,422	0	8.82 %
Total	1,782,250	$ 9,903	$ 27,133	7.55 %	1,865,000	$ 11,205	$ 30,433	4.96 %
Less: Current Portion	57,750				82,750			
Unamortized Deferred Financing Costs	9,903				11,205			
Unamortized Debt Discount	27,133				30,433			
Total Long-Term Debt	$ 1,687,464				$ 1,740,612			

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(1) Includes amortization of deferred financing costs and debt discount. For fiscal 2017, the effective interest rate for the tranche B-2 term facility of the Company's then-existing term loan facility was computed based on interest expense incurred over the period for which borrowings were outstanding.

On November 29, 2017, the Company refinanced its then-existing credit facilities (hereinafter referred to as "the November 2017 debt refinancing") consisting of $1,930,386 of borrowings under a term loan facility and an undrawn $50,000 revolving credit facility with $1,565,000 of borrowings under its new credit facilities, consisting of a $1,540,000 term loan facility, and a $150,000 revolving credit facility (of which $25,000 was drawn upon at the time of the November 2017 debt refinancing) (collectively, the "New Credit Facilities"), and $300,000 in aggregate principal amount of 8.625% Senior Notes due 2025 (the "Notes"). During the fourth quarter of fiscal 2017, the Company incurred fees of $53,832 (which included $30,800 of a debt discount) in connection with the November 2017 debt refinancing. In addition, the Company recorded a loss on early extinguishment of debt of $10,524 in connection thereto. This early extinguishment of debt write-off was comprised of $5,716 of deferred financing fees paid in connection with the November 2017 debt refinancing and $4,808 of pre-existing deferred financing fees.

Senior Secured Credit Facilities

The New Credit Facilities were issued under a new credit agreement, dated November 29, 2017 (the "Credit Agreement"), among the Company, as borrower, the lenders party thereto, JPMorgan Chase Bank, N.A. ("JPMorgan Chase"), as administrative agent and an issuing bank, Bank of America, N.A., as an issuing bank, and Citibank, N.A., as an issuing bank. The New Credit Facilities consist of (1) $1,540,000 in aggregate principal amount of senior secured tranche B term loans due in 2024 (the "New Term Loan Facility") and (2) a $150,000 senior secured revolving credit facility (which includes borrowing capacity available for letters of credit) due in 2022 (the "New Revolving Credit Facility").

As of September 29, 2018, the Company had $1,482,250 of debt outstanding under the New Credit Facilities, with $148,735 of availability and $1,265 in issued but undrawn letters of credit outstanding under the New Revolving Credit Facility. Outstanding balances under the New Revolving Credit Facility are included in the current portion of long-term debt on the accompanying consolidated balance sheet as of December 30, 2017 included in these consolidated financial statements.

All obligations under the Credit Agreement are guaranteed by, subject to certain exceptions, each of the Company's current and future wholly-owned material domestic restricted subsidiaries. All obligations under the Credit Agreement, and the guarantees of those obligations, are secured by substantially all of the assets of the Company and

each guarantor, subject to customary exceptions, including:

- a pledge of 100% of the equity interests directly held by the Company and each guarantor in any wholly-owned domestic material subsidiary of the Company or any guarantor (which pledge, in the case of any non-U.S. subsidiary of a U.S. subsidiary, will not include more than 65% of the voting stock of such first-tier non-U.S. subsidiary), subject to certain exceptions; and
- a security interest in substantially all other tangible and intangible assets of the Company and each guarantor, subject to certain exceptions.

Under the terms of the Credit Agreement, depending on the Company’s Consolidated Leverage Ratio (as defined in the Credit Agreement), on an annual basis on or about the time the Company is required to deliver its financial statements for any fiscal year, the Company is obligated to offer to prepay a portion of the outstanding principal amount of the New Term Loan Facility in an aggregate amount determined by a percentage of its annual excess cash flow (as defined in the Credit Agreement) (said payment, a “Cash Flow Sweep”).

Borrowings under the New Term Loan Facility bear interest at a rate per annum equal to, at the Company's option, either (1) an applicable margin plus a base rate determined by reference to the highest of (a) 0.50% per annum plus the higher of (i) the Federal Funds Effective Rate and (ii) the Overnight Bank Funding Rate as determined by the Federal Reserve Bank of New York, (b) the prime rate of JPMorgan Chase and (c) the LIBOR rate determined by reference to the cost of funds for U.S. dollar deposits for an interest period of one month adjusted for certain additional costs, plus 1.00%; provided that such rate is not lower than a floor of 1.75% or (2) an applicable margin plus a LIBOR rate determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, provided that LIBOR is not lower than a floor of 0.75%. Borrowings under the New Revolving Credit Facility bear interest at a rate per annum equal to an applicable margin based upon a leverage-based pricing grid, plus, at the Company's option, either (1) a base rate determined by reference to the highest of (a) 0.50% per annum plus the higher of (i) the Federal Funds Effective Rate and (ii) the Overnight Bank Funding Rate as determined by the Federal Reserve Bank of New York, (b) the prime rate of JPMorgan Chase and (c) the LIBOR rate determined by reference to the cost of funds for U.S. dollar deposits for an interest period of one month adjusted for certain additional costs, plus 1.00% or (2) a LIBOR rate determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs. As of September 29, 2018, the applicable margins for the LIBOR rate borrowings under the New Term Loan Facility and the New Revolving Credit Facility were 4.75% and 2.50%, respectively.

On a quarterly basis, the Company pays a commitment fee to the lenders under the New Revolving Credit Facility in respect of unutilized commitments thereunder, which commitment fee fluctuates depending upon the Company's Consolidated Leverage Ratio. Based on the Company's Consolidated Leverage Ratio as of September 29, 2018, the commitment fee was 0.40% per annum.

The Credit Agreement contains other customary terms, including (1) representations, warranties and affirmative covenants, (2) negative covenants, including limitations on indebtedness, liens, mergers, acquisitions, asset sales, investments, distributions, prepayments of subordinated debt, amendments of material agreements governing subordinated indebtedness, changes to lines of business and transactions with affiliates, in each case subject to baskets, thresholds and other exceptions, and (3) customary events of default.

The availability of certain baskets and the ability to enter into certain transactions are also subject to compliance with certain financial ratios. In addition, the New Revolving Credit Facility includes a maintenance covenant that will require, in certain circumstances, compliance with certain first lien secured net leverage ratios.

As of September 29, 2018, the Company was in compliance with all financial covenants in the Credit Agreement governing the New Credit Facilities.

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Senior Notes

The Notes were issued pursuant to an Indenture, dated as of November 29, 2017 (the “Indenture”), among the Company, the guarantors named therein and The Bank of New York Mellon, as trustee. The Indenture contains customary covenants, events of default and other provisions for an issuer of non-investment grade debt securities. These covenants include limitations on indebtedness, liens, mergers, acquisitions, asset sales, investments, distributions, prepayments of subordinated debt and transactions with affiliates, in each case subject to baskets, thresholds and other exceptions.

The Notes accrue interest at a rate per annum equal to 8.625% and are due on December 1, 2025. Interest on the Notes is payable semi-annually on June 1 and December 1 of each year, beginning on June 1, 2018. On or after December 1, 2020, the Company may on any one or more occasions redeem some or all of the Notes at a purchase price equal to 104.313% of the principal amount of the Notes, plus accrued and unpaid interest, if any, to, but not including, the redemption date, such optional redemption price decreasing to 102.156% on or after December 1, 2021 and to 100.000% on or after December 1, 2022. Prior to December 1, 2020, the Company may on any one or more occasions redeem up to 40% of the aggregate principal amount of the Notes with an amount not to exceed the net proceeds of certain equity offerings at 108.625% of the aggregate principal amount thereof, plus accrued and unpaid int