WEIGHT WATCHERS INTERNATIONAL INC
Form 10-Q
November 05, 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 27, 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: 001-16769

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 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 (§232.405 of this chapter) 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 large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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

The number of shares of common stock outstanding as of October 29, 2014 was 56,685,659.

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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 27, 2014	December 28, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 327,381	$ 174,557
Receivables (net of allowances: September 27, 2014 - $3,721 and December 28, 2013 - $3,477)	32,050	36,248
Inventories	23,460	40,939
Deferred income taxes	22,924	24,457
Prepaid expenses and other current assets	33,172	39,524
TOTAL CURRENT ASSETS	438,987	315,725
Property and equipment, net	76,814	87,052
Franchise rights acquired	833,148	836,835
Goodwill	110,696	79,294
Trademarks and other intangible assets, net	58,220	45,297
Deferred financing costs, net	34,587	42,046
Other noncurrent assets	5,878	2,682
TOTAL ASSETS	$ 1,558,330	$ 1,408,931
LIABILITIES AND TOTAL DEFICIT		
CURRENT LIABILITIES		
Portion of long-term debt due within one year	$ 30,000	$ 30,000
Accounts payable	36,582	45,496
Derivative payable	28,899	7,578
Other accrued liabilities	179,311	175,639
Income taxes payable	22,437	10,777
Deferred revenue	81,129	76,330
TOTAL CURRENT LIABILITIES	378,358	345,820
Long-term debt	2,340,000	2,358,000
Deferred income taxes	182,161	164,064
Other	15,489	15,669
TOTAL LIABILITIES	2,916,008	2,883,553
Redeemable noncontrolling interest	5,990	0
TOTAL DEFICIT		

Common stock, $0 par value; 1,000,000 shares authorized; 112,195 shares issued	0	0
Treasury stock, at cost, 55,513 shares at September 27, 2014 and 55,562 shares at December 28, 2013	(3,254,459)	(3,256,406)
Retained earnings	1,895,470	1,773,267
Accumulated other comprehensive (loss) income	(4,679)	8,517
TOTAL DEFICIT	(1,363,668)	(1,474,622)
TOTAL LIABILITIES AND TOTAL DEFICIT	$ 1,558,330	1,408,931

The accompanying notes are an integral part of these 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 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Service revenues, net	$ 281,863	$ 321,954	$ 917,217	$ 1,065,862
Product sales and other, net	63,321	74,380	234,872	292,150
Revenues, net	345,184	396,334	1,152,089	1,358,012
Cost of services	122,079	130,284	402,033	427,585
Cost of product sales and other	35,538	34,070	113,775	131,095
Cost of revenues	157,617	164,354	515,808	558,680
Gross profit	187,567	231,980	636,281	799,332
Marketing expenses	36,811	48,157	198,377	241,108
Selling, general and administrative expenses	59,362	59,303	180,893	176,609
Operating income	91,394	124,520	257,011	381,615
Interest expense	32,958	26,892	89,411	76,298
Other expense (income), net	1,520	(352)	2,679	802
Gain on Brazil acquisition	0	0	(10,540)	0
Early extinguishment of debt	0	0	0	21,685
Income before income taxes	56,916	97,980	175,461	282,830
Provision for income taxes	19,123	37,722	62,045	108,903
Net income	37,793	60,258	113,416	173,927
Net loss attributable to the noncontrolling interest	99	0	9	0
Net income attributable to Weight Watchers International, Inc.	$ 37,892	$ 60,258	$ 113,425	$ 173,927
Earnings per share				
Basic	$ 0.67	$ 1.07	$ 2.00	$ 3.10
Diluted	$ 0.67	$ 1.07	$ 2.00	$ 3.09
Weighted average common shares outstanding				
Basic	56,675	56,321	56,575	56,056
Diluted	56,769	56,504	56,646	56,348

Dividends declared per common share	$	0.00	$	0.18	$	0.00	$	0.53

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

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(IN THOUSANDS)

	Three Months Ended		Nine Months Ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Net income	$ 37,793	$ 60,258	$ 113,416	$ 173,927
Other comprehensive loss:				
Foreign currency translation adjustments	(10,639)	3,486	(6,579)	(4,727)
Income tax effect on foreign currency translation adjustments	4,153	(1,360)	2,566	1,824
Foreign currency translation adjustments, net of taxes	(6,486)	2,126	(4,013)	(2,903)
Changes in gain (loss) on derivatives	10,404	(12,132)	(15,235)	(7,049)
Income tax effect on changes in gain (loss) on derivatives	(4,058)	4,732	5,941	2,749
Changes in gain (loss) on derivatives, net of taxes	6,346	(7,400)	(9,294)	(4,300)
Total other comprehensive loss	(140)	(5,274)	(13,307)	(7,203)
Comprehensive income	37,653	54,984	100,109	166,724
Less: Net loss attributable to the noncontrolling interest	99	0	9	0
Less: Foreign currency translation adjustments, net of taxes attributable to the noncontrolling interest	336	0	111	0
Comprehensive loss attributable to the noncontrolling interest	435	0	120	0
Comprehensive income attributable to Weight Watchers International, Inc.	$ 38,088	$ 54,984	$ 100,229	$ 166,724

The accompanying notes are an integral part of these 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 27, 2014	September 28, 2013
Operating activities:		
Net income	$ 113,416	$ 173,927
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	36,288	33,115
Amortization of deferred financing costs	7,459	5,715
Share-based compensation expense	7,235	2,515
Deferred tax provision	25,908	21,516
Allowance for doubtful accounts	608	(64)
Reserve for inventory obsolescence	11,773	7,358
Foreign currency exchange rate loss	2,631	837
Loss on disposal of assets	121	1,390
Gain on Brazil acquisition	(10,540)	0
Early extinguishment of debt	0	21,685
Other items, net	(184)	0
Changes in cash due to:		
Receivables	4,077	2,841
Inventories	6,395	7,240
Prepaid expenses	4,883	7,243
Accounts payable	(8,698)	(8,105)
UK self-employment liability	0	(7,272)
Accrued liabilities	8,144	5,520
Deferred revenue	5,627	5,280
Income taxes	6,148	20,696
Cash provided by operating activities	221,291	301,437
Investing activities:		
Capital expenditures	(5,960)	(37,656)
Capitalized software expenditures	(21,318)	(15,686)
Cash paid for acquisitions	(16,678)	(78,354)
Other items, net	(3,421)	270
Cash used for investing activities	(47,377)	(131,426)
Financing activities:		
Proceeds from new term loans	0	2,400,000
Payments on long-term debt	(18,000)	(2,412,364)
Payment of dividends	(80)	(19,701)
Deferred financing costs	0	(44,817)
Proceeds from stock options exercised	297	15,655
Tax benefit of restricted stock units vested and stock options exercised	1	2,128

Cash used for financing activities	(17,782)	(59,099)
Effect of exchange rate changes on cash and cash equivalents and other	(3,308)	128
Net increase in cash and cash equivalents	152,824	111,040
Cash and cash equivalents, beginning of period	174,557	70,215
Cash and cash equivalents, end of period	$ 327,381	$ 181,255

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

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE 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 WWI as used throughout these notes is used to indicate Weight Watchers International, Inc. and all of its operations consolidated for purposes of its financial statements.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America 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 are unaudited 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 2013, which includes additional information about the Company, its results of operations, its financial position and its cash flows.

Revisions:

The classification of certain brand marketing funds received from licensees has been revised to reflect them as revenue as opposed to being recorded as an offset to expense, increasing the three and nine months ended September 28, 2013 Product sales and other, net, Cost of product sales and other, Gross profit, Marketing expenses and Selling, general and administrative expenses as follows:

	September 28, 2013	
	Three Months Ended	**Nine Months Ended**
Product sales and other, net	$ 2,436	$ 12,057
Cost of product sales and other	$ 415	$ 1,078
Gross profit	$ 2,021	$ 10,979
Marketing expenses	$ 1,798	$ 10,278
Selling, general and administrative expenses	$ 223	$ 701

These adjustments were not considered to be material, individually or in the aggregate, to previously issued financial statements. However, because of the significance of these adjustments, the Company revised its three and nine months ended September 28, 2013 consolidated statements of net income. These revisions had no impact on the consolidated balance sheets, consolidated statements of comprehensive income or consolidated statements of cash flows included in these financial statements.

2. Summary of Significant Accounting Policies

Recently Issued Accounting Pronouncements:

In May 2014, the Financial Accounting Standards Board (the FASB) issued updated guidance on accounting for revenue from contracts with customers. The objective of this guidance is to provide a single, comprehensive revenue recognition model, to remove existing industry specific guidance and to expand qualitative and quantitative disclosures. The core principle of the new standard is for revenue recognition to depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. This guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption not permitted. The Company is currently evaluating the impact that the adoption of this guidance will have on the consolidated financial position, results of operations or cash flows of the Company.

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

In April 2014, the FASB issued updated guidance on reporting discontinued operations and disclosures of disposals of components of an entity. This guidance raises the threshold for disposal transactions to qualify as discontinued operations and focuses on disposal transactions that represent strategic shifts having a major effect on operations and financial results, requiring additional disclosures and revising balance sheet presentation. This guidance is effective for fiscal years beginning after December 15, 2014, and interim periods within those fiscal years and is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Reclassification:

Certain prior year amounts have been reclassified to conform to the current period presentation. With respect to the Company s previously announced change in segment reporting, segment data for the three and nine months ended September 28, 2013 has been revised to reflect the new reportable segment structure. See Note 13 for disclosures related to segments.

In addition, the components of Revenues and Cost of revenues as presented in the Consolidated Statements of Net Income have been reclassified to reflect the integration of the Company s Internet-based business with its meetings and other businesses. Revenues are comprised of service revenues, which are comprised of meetings fees, Online subscription revenue and eTools subscription revenue, and revenues from product sales and other. Cost of revenues is comprised of cost of services and cost of product sales and other.

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 2013.

3. Acquisitions of Franchisees, Additional Equity Interest in Brazil and Wello

Franchisee Acquisitions

The acquisitions of franchisees have been accounted for under the purchase method of accounting and, accordingly, earnings of acquired franchisees have been included in the consolidated operating results of the Company since the applicable date of acquisition. Details of these franchise acquisitions are outlined below.

The acquisitions resulted in goodwill related to, among other things, expected synergies in operations. The Company expects that the majority of goodwill recorded in connection with the below acquisitions will be deductible for tax purposes. The effect of these franchise acquisitions was not material to the Company s consolidated financial position, results of operations, or operating cash flows in the periods presented.

On March 4, 2013, the Company acquired substantially all of the assets of its Alberta and Saskatchewan, Canada franchisees, Weight Watchers of Alberta Ltd. and Weight Watchers of Saskatchewan Ltd., for an aggregate purchase price of $35,000. The total purchase price has been allocated to franchise rights acquired ($30,633), goodwill ($4,626), customer relationship value ($473), inventory ($218), fixed assets ($182) and prepaid expenses ($3) offset by deferred revenue of $1,135.

On July 15, 2013, the Company acquired substantially all of the assets of its West Virginia franchisee, Weight Watchers of West Virginia, Inc., for a net purchase price of $16,028 less assumed assets, plus assumed liabilities, net of $28. The total purchase price has been allocated to franchise rights acquired ($10,131), goodwill ($5,212), customer relationship value ($448) and fixed assets ($209).

On July 22, 2013, the Company acquired substantially all of the assets of its Columbus, Ohio franchisee, Weight Watchers of Columbus, Inc., for a net purchase price of $23,357 plus assumed liabilities of $143 and its Reno, Nevada franchisee, Weight Watchers of Northern Nevada, Inc., for a net purchase price of $3,969 plus assumed liabilities of $31. The aggregate total purchase price has been allocated to franchise rights acquired ($19,643), goodwill ($7,220), customer relationship value ($494), fixed assets ($116) and inventory ($27).

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

On October 28, 2013, the Company acquired substantially all of the assets of its Manitoba, Canada franchisee, Weight Watchers of Manitoba Ltd., for a net purchase price of $5,197 plus assumed liabilities of $28 and its Franklin and St. Lawrence Counties, New York franchisee, Weight Watchers of Franklin and St. Lawrence Counties Inc., for a net purchase price of $274 plus assumed liabilities of $1. The total purchase price of the Manitoba, Canada franchisee has been allocated to franchise rights acquired ($4,525), goodwill ($449), customer relationship value ($249), inventory ($1) and prepaid expenses ($1). The total purchase price of the Franklin and St. Lawrence Counties, New York franchisee has been allocated to franchise rights acquired ($238), goodwill ($23), customer relationship value ($13) and prepaid expenses ($1).

Acquisition of Additional Equity Interest in Brazil

Prior to March 12, 2014, the Company had owned 35% of Vigilantes do Peso Marketing Ltda. (VPM), a Brazilian limited liability partnership. On March 12, 2014, the Company acquired an additional 45% equity interest in VPM for a net purchase price of $14,181 less cash acquired of $2,262. VPM was converted into a joint-stock corporation prior to closing and subsequently operates as a subsidiary of the Company with rights to conduct typical business lines. As a result of the acquisition, the Company gained a direct controlling financial interest in VPM and has therefore begun consolidating this entity since the date of acquisition.

The equity interest held immediately before the acquisition was $12. An implied fair value technique was used to measure acquisition date fair value of the equity interest to be $11,029. As a result of this transaction, the Company adjusted its previously held equity interest to fair value of $11,017 and recorded a charge of $477 associated with the settlement of the royalty-free arrangement of the Brazilian partnership. The net effect of these items resulted in the Company recognizing a gain of $10,540 ($6,429 after-tax or $0.11 per fully diluted share) in the first quarter of fiscal 2014.

The fair value of the redeemable noncontrolling interest has been valued at $6,157. In connection with the acquisition, a call option and a put option were granted related to the 20% interest in VPM not owned by the Company.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

The net purchase price of the Brazil acquisition has been allocated as follows:

Fair value of consideration transferred:	
Net purchase price	$ 14,181
Less cash acquired	2,262
Total	11,919
Gain on acquisition	10,540
Redeemable noncontrolling interest	6,157
	28,616
Identifiable assets acquired and liabilities assumed:	
Franchise rights acquired	2,000
Receivables	1,139
Fixed assets	575
Prepaid expenses	421
Inventory	287
Customer relationship value	275
Other assets	199
Accrued liabilities	(1,063)
Deferred tax on acquired intangibles	(680)
Deferred revenue	(445)
Income taxes payable	(258)
Accounts payable	(91)
Total identifiable net assets	2,359
Goodwill	$ 26,257

The acquisition resulted in goodwill related to, among other things, expected synergies in operations and the ability of the Company to provide VPM with various intellectual property and technology innovations which will afford additional future opportunities in the meetings and Online businesses within the growing market where VPM operates. The Company does not expect goodwill to be deductible for tax purposes.

Acquisition of Wello

On April 16, 2014, the Company acquired Knowplicity, Inc., d/b/a Wello, an online fitness and personal training company for a net purchase price of $8,977 less cash acquired of $11. Payment was in the form of stock issued $4,207 and cash $4,770. The total purchase price of Wello has been allocated to goodwill ($6,204), website development ($4,516), prepaid expenses ($4) and fixed assets ($1) offset by deferred tax liabilities ($1,759). As a result of the acquisition, Wello became a wholly owned subsidiary of the Company and the Company began to consolidate the entity as of the date of acquisition. The acquisition resulted in goodwill related to, among other things, expected synergies in operations. The Company does not expect goodwill to be deductible for tax purposes.

4. 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 27, 2014, the change in the carrying value of franchise rights acquired is due to the VPM acquisition, as described in Note 3, and the effect of exchange rate changes as follows:

Balance as of December 28, 2013	$ 836,835
Franchise rights acquired during the period	2,000
Amortization of Brazil franchise rights acquired	(544)
Effect of exchange rate changes	(5,143)
Balance as of September 27, 2014	$ 833,148

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

The franchise rights acquired related to the VPM acquisition are being amortized ratably over a 2 year period.

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 acquisition of the majority interest in VPM in the first quarter of fiscal 2014 and the acquisition of Wello in the second quarter of fiscal 2014. See Note 3 for further information on certain acquisitions. For the nine months ended September 27, 2014, the change in the carrying amount of goodwill is due to the VPM and Wello acquisitions and the effect of exchange rate changes as follows:

	North America	UK	CE	Other	Total
Balance as of December 28, 2013	$ 67,699	$ 1,530	$ 8,345	$ 1,720	$ 79,294
Goodwill acquired during the period	6,204	0	0	26,257	32,461
Effect of exchange rate changes	(467)	0	0	(592)	(1,059)
Balance as of September 27, 2014	$ 73,436	$ 1,530	$ 8,345	$ 27,385	$ 110,696

The carrying amount of finite-lived intangible assets as of September 27, 2014 and December 28, 2013 was as follows:

	September 27, 2014		December 28, 2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Capitalized software costs	$ 99,711	$ 70,496	$ 85,095	$ 62,418
Website development costs	82,332	58,017	69,660	48,060
Trademarks	10,802	10,154	10,691	9,955
Other	11,531	7,489	7,021	6,737
	$ 204,376	$ 146,156	$ 172,467	$ 127,170

Aggregate amortization expense for finite-lived intangible assets was recorded in the amounts of $7,518 and $20,697 for the three and nine months ended September 27, 2014, respectively. Aggregate amortization expense for finite-lived intangible assets was recorded in the amounts of $6,413 and $18,076 for the three and nine months ended September 28, 2013, respectively.

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

Remainder of fiscal 2014	$ 6,926
Fiscal 2015	$ 24,881
Fiscal 2016	$ 16,401
Fiscal 2017	$ 9,185

Fiscal 2018 and thereafter	$	827

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

5. Long-Term Debt

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

	September 27, 2014		December 28, 2013	
	Balance	Effective Rate	Balance	Effective Rate
Revolving Facility due April 2, 2018	$ 0	0.00%	$ 0	0.00%
Tranche B-1 Term Facility due April 2, 2016	296,250	3.11%	298,500	2.97%
Tranche B-2 Term Facility due April 2, 2020	2,073,750	3.95%	2,089,500	3.75%
Total Debt	2,370,000	3.85%	2,388,000	3.49%
Less Current Portion	30,000		30,000	
Total Long-Term Debt	$ 2,340,000		$ 2,358,000	

The Company s credit facilities at the end of the first quarter of fiscal 2013 consisted of the following term loan facilities and revolving credit facilities: a tranche B loan (Term B Loan), a tranche C loan (Term C Loan), a tranche D loan (Term D Loan), a tranche E loan (Term E Loan), tranche F loan (Term F Loan), revolving credit facility A-1 (Revolver A-1) and revolving credit facility A-2 (Revolver A-2).

On April 2, 2013, the Company refinanced its credit facilities pursuant to a Credit Agreement (as amended, supplemented or otherwise modified, the New Credit Agreement) among the Company, the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent and an issuing bank, The Bank of Nova Scotia, as revolving agent, swingline lender and an issuing bank, and the other parties thereto. The New Credit Agreement provides for (a) a revolving credit facility (including swing line loans and letters of credit) in an initial aggregate principal amount of $250,000 that will mature on April 2, 2018 (the Revolving Facility), (b) an initial term B-1 loan credit facility in an aggregate principal amount of $300,000 that will mature on April 2, 2016 (the Tranche B-1 Term Facility) and (c) an initial term B-2 loan credit facility in an aggregate principal amount of $2,100,000 that will mature on April 2, 2020 (the Tranche B-2 Term Facility , and together with the Tranche B-1 Term Facility, the Term Facilities ; the Term Facilities and Revolving Facility collectively, the WWI Credit Facility). In connection with this refinancing, the Company used the proceeds from borrowings under the Term Facilities to pay off a total of $2,399,904 of outstanding loans, consisting of $128,759 of Term B Loans, $110,602 of Term C Loans, $117,612 of Term D Loans, $1,125,044 of Term E Loans, $817,887 of Term F Loans, $21,247 of loans under the Revolver A-1 and $78,753 of loans under the Revolver A-2. Following the refinancing of a total of $2,399,904 of loans, at April 2, 2013, the Company had $2,400,000 debt outstanding under the Term Facilities and $248,848 of availability under the Revolving Facility. The Company incurred fees of $44,817 during the second quarter of fiscal 2013 in connection with this refinancing. In the second quarter of fiscal 2013, the Company wrote-off fees associated with this refinancing which resulted in the Company recording a charge of $21,685 in early extinguishment of debt.

On September 26, 2014, the Company and certain lenders entered into an agreement amending the New Credit Agreement that, among other things, eliminated the Financial Covenant (as defined in the New Credit Agreement) with respect to the Revolving Facility. In connection with this amendment, the Company wrote-off deferred financing fees of approximately $1,583 in the third quarter of fiscal 2014. Concurrently with and in order to effect this amendment, the Company reduced the amount of the Revolving Facility from $250,000 to $50,000.

At September 27, 2014, the Company had $2,370,000 outstanding under the WWI Credit Facility, consisting entirely of term loans and there were no loans outstanding under the Revolving Facility. In addition, at September 27, 2014, the Revolving Facility had $1,302 in issued but undrawn letters of credit outstanding thereunder and $48,698 in available unused commitments thereunder. The proceeds from borrowings under the Revolving Facility (including swing line loans and letters of credit) are available to be used for working capital and general corporate purposes.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Borrowings under the New Credit Agreement bear interest at a rate equal to, at the Company s option, LIBOR plus an applicable margin or a base rate plus an applicable margin. LIBOR under the Tranche B-2 Term Facility is subject to a minimum interest rate of 0.75% and the base rate under the Tranche B-2 Term Facility is subject to a minimum interest rate of 1.75%. The applicable margin relating to both of the Term Facilities will increase by 25 basis points in the event that the Company receives a corporate rating of BB- (or lower) from S&P and a corporate rating of Ba3 (or lower) from Moody s. On February 21, 2014, both S&P and Moody s issued revised corporate ratings of the Company of B+ and B1, respectively. As a result, effective February 21, 2014, the applicable margin on borrowings under the Tranche B-1 Term Facility went from 2.75% to 3.00% and on borrowings under the Tranche B-2 Term Facility went from 3.00% to 3.25%. The applicable margin relating to the Revolving Facility will fluctuate depending upon the Company s Consolidated Leverage Ratio (as defined in the New Credit Agreement). At September 27, 2014, borrowings under the Tranche B-1 Term Facility bore interest at LIBOR plus an applicable margin of 3.00% and borrowings under the Tranche B-2 Term Facility bore interest at LIBOR plus an applicable margin of 3.25%. Based on the Company s Consolidated Leverage Ratio as of September 27, 2014, had there been any borrowings under the Revolving Facility, it would have borne interest at LIBOR plus an applicable margin of 2.25% or base rate plus an applicable margin of 1.25%. On a quarterly basis, the Company will pay a commitment fee to the lenders under the Revolving Facility in respect of unutilized commitments thereunder, which commitment fee will fluctuate depending upon the Company s Consolidated Leverage Ratio. Based on the Company s Consolidated Leverage Ratio as of September 27, 2014, the commitment fee was 0.40% per annum. The Company also will pay customary letter of credit fees and fronting fees under the Revolving Facility.

The New Credit Agreement contains customary covenants including covenants that, in certain circumstances, restrict the Company s ability to incur additional indebtedness, pay dividends on and redeem capital stock, make other payments, including investments, sell its assets and enter into consolidations, mergers and transfers of all or substantially all of its assets. The WWI Credit Facility does not require the Company to maintain any financial ratios and is guaranteed by certain of the Company s existing and future subsidiaries. Substantially all of the Company s assets secure the WWI Credit Facility.

At September 27, 2014 and December 28, 2013, the Company s debt consisted entirely of variable-rate instruments. Interest rate swaps were entered into to hedge a portion of the cash flow exposure associated with the Company s variable-rate borrowings. The average interest rate on the Company s debt, exclusive of the impact of swaps, was approximately 3.90% and 3.65% per annum at September 27, 2014 and December 28, 2013, respectively. The average interest rate on the Company s debt, including the impact of swaps, was approximately 4.93% and 4.08% per annum at September 27, 2014 and December 28, 2013, respectively.

6. Earnings Per Share

Basic earnings per share (EPS) are calculated utilizing the weighted average number of common shares outstanding during the periods presented. Diluted EPS is calculated utilizing the weighted average number of common shares outstanding during the periods presented adjusted for the effect of dilutive common stock equivalents.

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The following table sets forth the computation of basic and diluted EPS:

	Three Months Ended		Nine Months Ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Numerator:				
Net income	$ 37,892	$ 60,258	$ 113,425	$ 173,927
Denominator:				
Weighted average shares of common stock outstanding	56,675	56,321	56,575	56,056
Effect of dilutive common stock equivalents	94	183	71	292
Weighted average diluted common shares outstanding	56,769	56,504	56,646	56,348
Earnings per share				
Basic	$ 0.67	$ 1.07	$ 2.00	$ 3.10
Diluted	$ 0.67	$ 1.07	$ 2.00	$ 3.09

The number of anti-dilutive common stock equivalents excluded from the calculation of the weighted average number of common shares for diluted EPS was 3,365 and 1,355 for the three months ended September 27, 2014 and September 28, 2013, respectively, and 2,979 and 1,294 for the nine months ended September 27, 2014 and September 28, 2013, respectively.

7. Stock Plans

On May 6, 2008 and May 12, 2004, respectively, the Company s shareholders approved the 2008 Stock Incentive Plan (the 2008 Plan) and the 2004 Stock Incentive Plan (the 2004 Plan). On May 6, 2014, the Company s shareholders approved the 2014 Stock Incentive Plan (the 2014 Plan), which replaces the 2008 Plan and 2004 Plan for all equity-based awards granted on or after May 6, 2014. The 2014 Plan is designed to promote the long-term financial interests and growth of the Company by attracting, motivating and retaining employees with the ability to contribute to the success of the business and to align compensation for the Company s employees over a multi-year period directly with the interests of the shareholders of the Company. The Company s Board of Directors or a committee thereof administers the 2014 Plan.

8. Income Taxes

The effective tax rates for the three and nine months ended September 27, 2014 were 33.6% and 35.4%, respectively. The effective tax rate for both the three and nine months ended September 28, 2013 was 38.5%. For the three months ended September 27, 2014, the primary differences between the US federal statutory tax rate and the Company s consolidated effective tax rate were state income taxes and increases in the Company s valuation allowances offset by lower rates in certain foreign jurisdictions. For the nine months ended September 27, 2014, the primary differences between the US federal statutory tax rate and the Company s consolidated effective tax rate were state income taxes and increases in the Company s valuation allowances offset by a net tax benefit associated with the closure of the Company s China business and lower rates in certain foreign jurisdictions. For both the three and nine months ended September 28, 2013, the primary differences between the US federal statutory tax rate and the Company s consolidated effective tax rate were state income taxes and increases in the Company s valuation allowances, offset by lower rates in certain foreign jurisdictions. During the three months ended June 28, 2014, the Company recorded a $1,500 increase to its valuation allowance related to tax benefits for foreign losses that are not expected to be realized. The recognition of this valuation allowance should have occurred in prior periods as the losses were incurred. However, the impact is not material to any previously issued period or the expected full year 2014 financial statements. As a result, the Company corrected this error in the second quarter of fiscal 2014.

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9. Legal

Jeri Connolly et al. v. Weight Watchers North America, Inc.

In August 2013, the Company was contacted by plaintiffs counsel in the previously filed and settled *Sabatino v. Weight Watchers North America, Inc.* case (*Sabatino*), threatening to file a new class action on behalf of the Company s current and former service providers in California asserting various wage and hour claims, including but not limited to claims for unpaid overtime and minimum wage violations, which allegedly accrued after the effective date of the *Sabatino* settlement. On March 17, 2014, the parties came to an agreement in principle to settle the matter on a class-wide basis for $1,688. On April 29, 2014, the parties executed a Memorandum of Understanding to document the terms and conditions of settlement and, the following day, plaintiffs filed a complaint regarding the claims at issue in the Northern District of California. On June 11, 2014, the parties filed a formal settlement agreement and other required documents for the Court s preliminary approval. On July 21, 2014, the parties received the Court s preliminary approval of the settlement agreement. On August 11, 2014, notices of settlement were sent out to the class members advising them of the settlement and their right to object or opt-out of the settlement; no class members did so by the deadline of September 22, 2014. A hearing seeking the Court s final approval of the settlement is scheduled for December 2014, and on October 15, 2014 the parties filed a joint motion for the Court s final approval in anticipation of that hearing. The Company believes that its previously recorded reserve is adequate with respect to this matter.

In re Weight Watchers International, Inc. Securities Litigation

In March 2014, two substantially identical putative class action complaints alleging violation of the federal securities laws were filed by individual shareholders against the Company, certain of the Company s current and former officers and directors, and the Company s controlling shareholder, in the United States District Court for the Southern District of New York. The complaints were purportedly filed on behalf of all purchasers of the Company s common stock, no par value per share, between February 14, 2012 and October 30, 2013, inclusive (the Class Period). The complaints allege that, during the Class Period, the defendants disseminated materially false and misleading statements and/or concealed material adverse facts. The complaints allege claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5. The plaintiffs seek to recover unspecified damages on behalf of the class members. In June 2014, the Court consolidated the cases and appointed lead plaintiffs and lead counsel. On August 12, 2014, the plaintiffs filed an amended complaint that, among other things, reduced the Class Period to between February 14, 2012 and February 13, 2013 and dropped all current officers and certain directors previously named as defendants. On October 14, 2014, the defendants filed a motion to dismiss. The Company continues to believe that the suits are without merit and intends to defend them vigorously.

On May 29, 2014 and June 23, 2014, the Company received shareholder litigation demand letters alleging breaches of fiduciary duties and unjust enrichment by Company officers and directors and Artal Group, S.A., to the alleged injury of the Company. The allegations in the letters relate to those contained in the ongoing securities class action litigation. In response to the letter, pursuant to Virginia law, the Board of Directors has created a special committee to review and evaluate the facts and circumstances surrounding the claims made in the demand letters.

New York State Department of Taxation and Finance Matter

In 2010, the New York State Department of Taxation and Finance (NYSDTF) initiated an audit of the Online products (Online memberships and eTools) being sold by WeightWatchers.com to determine whether such products should be subject to New York state sales tax. On August 26, 2011, the NYSDTF issued a letter to the Company setting forth its position as to why the Online products sold by its Online subsidiary should be taxable. After discussions, the parties entered into a settlement agreement which included the following material terms:

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(1) the NYSDTF would not initiate any legal proceedings against the Company for any alleged unpaid sales taxes for its Online products; (2) the Company agreed to pay the NYSDTF $1,748 in lieu of claims of unpaid sales taxes; (3) the Company agreed to impose a sales tax for its Online products sold to New York-based customers going forward; and (4) the NYSDTF agreed that the Company could challenge the taxability of future versions of the Company s Online products. On April 28, 2014, the Company sent the NYSDTF a signed copy of the settlement agreement, and the corresponding settlement payment. The Company updated its systems to begin charging sales tax to Online customers in New York effective June 1, 2014.

Other Litigation Matters

Due to the nature of the Company s activities, it is also, at times, subject to pending and threatened legal actions that arise out of the ordinary course of business. In the opinion of management, based in part upon advice of legal counsel, the disposition of any such matters is not expected to have a material effect on the Company s results of operations, financial condition or cash flows.

10. Derivative Instruments and Hedging

As of September 27, 2014 and September 28, 2013, the Company had in effect interest rate swaps with notional amounts totaling $1,500,000 and $467,500, respectively. In January 2009, the Company entered into a forward-starting interest rate swap with an effective date of January 4, 2010 and a termination date of January 27, 2014. Effective April 2, 2013, due to the Company s debt refinancing, the Company ceased the application of hedge accounting for this swap. Accordingly, changes in the fair value of this swap were recorded in earnings subsequent to April 2, 2013 and were immaterial for the nine months ended September 27, 2014.

On July 26, 2013, in order to hedge an additional portion of its variable rate debt, the Company entered into a forward-starting interest rate swap with an effective date of March 31, 2014 and a termination date of April 2, 2020. The initial notional amount of this swap was $1,500,000. During the term of this swap, the notional amount will decrease from $1,500,000 effective March 31, 2014 to $1,250,000 on April 3, 2017 with a further reduction to $1,000,000 on April 1, 2019. This interest rate swap effectively fixes the variable interest rate on the notional amount of this swap at 2.38%. This swap qualifies for hedge accounting and, therefore, changes in the fair value of this swap have been recorded in accumulated other comprehensive income (loss).

As of September 27, 2014 and December 28, 2013, cumulative unrealized losses for qualifying hedges were reported as a component of accumulated other comprehensive income (loss) in the amounts of $13,897 ($22,782 before taxes) and $4,603 ($7,546 before taxes), respectively.

The Company is hedging forecasted transactions for periods not exceeding the next seven years. The Company expects approximately $11,581 ($18,985 before taxes) of derivative losses included in accumulated other comprehensive income (loss) at September 27, 2014, based on current market rates, will be reclassified into earnings within the next 12 months.

11. Fair Value Measurements

Accounting guidance on fair value measurements for certain financial assets and liabilities requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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When measuring fair value, the Company is required to maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value of Financial Instruments

The Company s significant financial instruments include long-term debt and interest rate swap agreements.

The fair value of the Company s long-term debt is determined by utilizing average bid prices on or near the end of each fiscal quarter (Level 2 input). As of September 27, 2014 and September 28, 2013, the fair value of the Company s long-term debt was approximately $1,896,918 and $2,355,846, respectively.

Derivative Financial Instruments

The fair values for the Company s derivative financial instruments are determined using observable current market information such as the prevailing LIBOR interest rate and LIBOR yield curve rates and include consideration of credit risk. See Note 10 for disclosures related to derivative financial instruments.

The following table presents the aggregate fair value of the Company s derivative financial instruments:

	Total Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap liability at September 27, 2014	$ 28,899	$ 0	$ 28,899	$ 0
Interest rate swap liability at December 28, 2013	$ 7,578	$ 0	$ 7,578	$ 0

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12. Accumulated Other Comprehensive Income

Amounts reclassified out of accumulated other comprehensive income are as follows:

Changes in Accumulated Other Comprehensive Income by Component [(a)]

	Nine Months Ended September 27, 2014		
	Loss on Qualifying Hedges	Foreign Currency Translation Adjustments	Total
Beginning Balance at December 28, 2013	$ (4,603)	$ 13,120	$ 8,517
Other comprehensive loss before reclassifications, net of tax	(13,526)	(4,013)	(17,539)
Amounts reclassified from accumulated other comprehensive income, net of tax [(b)]	4,232	0	4,232
Net current period other comprehensive loss including noncontrolling interest	(9,294)	(4,013)	(13,307)
Less: net current period other comprehensive loss attributable to the noncontrolling interest	0	111	111
Ending Balance at September 27, 2014	$ (13,897)	$ 9,218	$ (4,679)

(a) Amounts in parentheses indicate debits

(b) See separate table below for details about these reclassifications

	Nine Months Ended September 28, 2013		
	Loss on Qualifying Hedges	Foreign Currency Translation Adjustments	Total
Beginning Balance at December 29, 2012	$ (6,602)	$ 19,461	$ 12,859
Other comprehensive loss before reclassifications, net of tax	(8,922)	(2,903)	(11,825)
Amounts reclassified from accumulated other comprehensive income, net of tax [(b)]	4,622	0	4,622

Net current period other comprehensive loss	(4,300)	(2,903)	(7,203)
Ending Balance at September 28, 2013	$ (10,902)	$ 16,558	$ 5,656

(a) Amounts in parentheses indicate debits

(b) See separate table below for details about these reclassifications

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Reclassifications out of Accumulated Other Comprehensive Income [(a)]

Details about Other Comprehensive Income Components	Three Months Ended September 27, 2014	Three Months Ended September 28, 2013	Nine Months Ended September 27, 2014	Nine Months Ended September 28, 2013	Affected Line Item in the Statement Where Net Income is Presented
	Amounts Reclassified from Accumulated Other Comprehensive Income		Amounts Reclassified from Accumulated Other Comprehensive Income		
Loss on Qualifying Hedges					
Interest rate contracts	$ 0	$ (2,460)	$ (6,937)	$ (7,577)	Interest expense
	0	(2,460)	(6,937)	(7,577)	Income before income taxes
	0	960	2,705	2,955	Provision for income taxes
	$ 0	$ (1,500)	$ (4,232)	$ (4,622)	Net income

(a) Amounts in parentheses indicate debits to profit / loss

13. Segment Data

Effective December 29, 2013, the Company realigned its organizational structure to improve the leverage of its significant assets and the alignment of its innovation efforts by integrating its Internet-based business with its meetings and other businesses and assigning responsibility for those integrated businesses on a geographical basis. This resulted in the Company changing the determination of its reportable segments such that the Company now has four reportable segments: North America, United Kingdom, Continental Europe and Other. Other consists of Asia Pacific and emerging markets operations and franchise revenues and related costs, all of which have been grouped together as if they were a single reportable segment because they do not meet any of the quantitative thresholds and are immaterial for separate disclosure. To be consistent with the information that is presented to the chief operating decision maker, the Company does not include intercompany activity in the segment results. Segment information for the three and nine months ended September 28, 2013 presented below has been revised to reflect the new reportable segment structure.

	Total Revenue			
	Three Months Ended		Nine Months Ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
North America	$ 221,157	$ 268,431	$ 734,053	$ 918,869
United Kingdom	37,778	40,510	123,405	136,699
Continental Europe	67,068	67,813	235,549	232,444
Other	19,181	19,580	59,082	70,000

Total revenue	$ 345,184	$ 396,334	$ 1,152,089	$ 1,358,012

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