

PAPA JOHNS INTERNATIONAL INC

Form 10-Q

August 04, 2015

[Table of Contents](#)

**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 June 28, 2015

OR

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number: 0-21660

## PAPA JOHN S INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**61-1203323**

(I.R.S. Employer Identification  
number)

**2002 Papa Johns Boulevard**

**Louisville, Kentucky 40299-2367**

(Address of principal executive offices)

**(502) 261-7272**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  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 (Section 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  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

Accelerated filer

Non-accelerated filer

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

At July 28, 2015, there were outstanding 39,457,802 shares of the registrant's common stock, par value \$0.01 per share.



Table of Contents

INDEX

	<b>Page No.</b>
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>
<u>Item 1.</u>	<u>Financial Statements</u>
	<u>Condensed Consolidated Balance Sheets – June 28, 2015 and December 28, 2014</u>
	2
	<u>Condensed Consolidated Statements of Income – Three and Six Months Ended June 28, 2015 and June 29, 2014</u>
	3
	<u>Consolidated Statements of Comprehensive Income – Three and Six Months Ended June 28, 2015 and June 29, 2014</u>
	4
	<u>Consolidated Statements of Cash Flows – Six Months Ended June 28, 2015 and June 29, 2014</u>
	5
	<u>Notes to Condensed Consolidated Financial Statements</u>
	6
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>
	14
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	25
<u>Item 4.</u>	<u>Controls and Procedures</u>
	26
<u>PART II.</u>	<u>OTHER INFORMATION</u>
<u>Item 1.</u>	<u>Legal Proceedings</u>
	26
<u>Item 1A.</u>	<u>Risk Factors</u>
	27
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	27
<u>Item 6.</u>	<u>Exhibits</u>
	28

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****Papa John's International, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets**

(In thousands, except per share amounts)	June 28, 2015 (Unaudited)	December 28, 2014
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 22,447	\$ 20,122
Accounts receivable, net	53,083	56,047
Notes receivable, net	6,422	6,106
Income taxes receivable	10,808	9,527
Inventories	23,848	27,394
Deferred income taxes	9,312	8,248
Prepaid expenses	17,737	18,736
Other current assets	9,535	9,828
<b>Total current assets</b>	<b>153,192</b>	<b>156,008</b>
Property and equipment, net	215,208	219,457
Notes receivable, less current portion, net	12,009	12,801
Goodwill	82,291	82,007
Deferred income taxes	3,537	3,914
Other assets	36,805	38,616
<b>Total assets</b>	<b>\$ 503,042</b>	<b>\$ 512,803</b>
<b>Liabilities and stockholders' equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 35,029	\$ 38,832
Income and other taxes payable	9,709	9,637
Accrued expenses and other current liabilities	73,161	58,293
<b>Total current liabilities</b>	<b>117,899</b>	<b>106,762</b>
Deferred revenue	3,926	4,257
Long-term debt	234,000	230,451
Deferred income taxes	19,792	22,188
Other long-term liabilities	42,262	41,875
<b>Total liabilities</b>	<b>417,879</b>	<b>405,533</b>
<b>Redeemable noncontrolling interests</b>	<b>7,741</b>	<b>8,555</b>
<b>Stockholders' equity:</b>		
Preferred stock (\$0.01 par value per share; no shares issued)		
Common stock (\$0.01 par value per share; issued 43,684 at June 28, 2015 and 43,331 at December 28, 2014)	437	433
Additional paid-in capital	152,569	147,912
Accumulated other comprehensive income	639	671

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Retained earnings	114,908	92,876
Treasury stock (4,290 shares at June 28, 2015 and 3,549 shares at December 28, 2014, at cost)	(204,309)	(155,659)
Total stockholders' equity, net of noncontrolling interests	64,244	86,233
Noncontrolling interests in subsidiaries	13,178	12,482
<b>Total stockholders' equity</b>	<b>77,422</b>	<b>98,715</b>
<b>Total liabilities, redeemable noncontrolling interests and stockholders' equity</b>	<b>\$ 503,042</b>	<b>\$ 512,803</b>

See accompanying notes.

Table of Contents**Papa John's International, Inc. and Subsidiaries****Condensed Consolidated Statements of Income****(Unaudited)**

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
<b>North America revenues:</b>				
Domestic Company-owned restaurant sales	\$ 185,962	\$ 170,000	\$ 383,249	\$ 348,193
Franchise royalties	23,081	20,983	48,440	43,597
Franchise and development fees	195	132	460	276
Domestic commissary sales	149,007	150,581	311,340	314,628
Other sales	14,420	13,595	36,034	26,345
<b>International revenues:</b>				
Royalties and franchise and development fees	6,641	6,317	13,139	12,096
Restaurant and commissary sales	19,685	19,256	38,613	37,106
<b>Total revenues</b>	<b>398,991</b>	<b>380,864</b>	<b>831,275</b>	<b>782,241</b>
<b>Costs and expenses:</b>				
<b>Domestic Company-owned restaurant expenses:</b>				
Cost of sales	43,289	42,030	90,793	87,186
Salaries and benefits	51,502	45,805	105,160	93,388
Advertising and related costs	16,492	15,354	33,262	31,610
Occupancy costs and other restaurant operating expenses	36,073	34,666	73,173	69,264
Total domestic Company-owned restaurant expenses	147,356	137,855	302,388	281,448
<b>Domestic commissary expenses:</b>				
Cost of sales	113,777	118,470	238,903	247,394
Salaries and benefits and other commissary operating expenses	23,781	23,062	48,391	45,941
Total domestic commissary expenses	137,558	141,532	287,294	293,335
Other operating expenses	13,648	13,221	34,251	24,652
International restaurant and commissary expenses	16,250	15,876	31,728	30,761
General and administrative expenses	42,043	33,562	83,976	70,528
Other general expenses	1,004	1,964	2,820	3,497
Depreciation and amortization	10,136	9,855	20,177	19,019
<b>Total costs and expenses</b>	<b>367,995</b>	<b>353,865</b>	<b>762,634</b>	<b>723,240</b>
<b>Operating income</b>	<b>30,996</b>	<b>26,999</b>	<b>68,641</b>	<b>59,001</b>
Legal settlement expense	(12,278)		(12,278)	
Net interest (expense) income	(1,187)	(763)	(2,396)	(1,355)
<b>Income before income taxes</b>	<b>17,531</b>	<b>26,236</b>	<b>53,967</b>	<b>57,646</b>
Income tax expense	5,063	8,397	17,260	19,266
<b>Net income before attribution to noncontrolling interests</b>	<b>12,468</b>	<b>17,839</b>	<b>36,707</b>	<b>38,380</b>
Income attributable to noncontrolling interests	(1,688)	(1,091)	(3,691)	(2,321)
<b>Net income attributable to the Company</b>	<b>\$ 10,780</b>	<b>\$ 16,748</b>	<b>\$ 33,016</b>	<b>\$ 36,059</b>
<b>Calculation of income for earnings per share:</b>				
Net income attributable to the Company	\$ 10,780	\$ 16,748	\$ 33,016	\$ 36,059
Decrease (increase) in noncontrolling interest redemption value	73	(31)	143	(39)
Net income attributable to participating securities	(50)	(81)	(150)	(218)
<b>Net income attributable to common shareholders</b>	<b>\$ 10,803</b>	<b>\$ 16,636</b>	<b>\$ 33,009</b>	<b>\$ 35,802</b>

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Basic earnings per common share	\$	0.27	\$	0.40	\$	0.83	\$	0.86
Diluted earnings per common share	\$	0.27	\$	0.40	\$	0.82	\$	0.85
Basic weighted average common shares outstanding		39,692		41,225		39,764		41,501
Diluted weighted average common shares outstanding		40,217		41,970		40,368		42,332
Dividends declared per common share	\$	0.14	\$	0.125	\$	0.28	\$	0.25

*See accompanying notes.*



Table of Contents**Papa John's International, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income****(Unaudited)**

(In thousands)	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Net income before attribution to noncontrolling interests	\$ 12,468	\$ 17,839	\$ 36,707	\$ 38,380
Other comprehensive income (loss), before tax:				
Foreign currency translation adjustments	2,116	959	575	926
Interest rate swaps (1)	459	(404)	(625)	(447)
Other comprehensive income (loss), before tax	2,575	555	(50)	479
Income tax effect:				
Foreign currency translation adjustments	(783)	(355)	(213)	(343)
Interest rate swaps (2)	(170)	149	231	165
Income tax effect	(953)	(206)	18	(178)
Other comprehensive income (loss), net of tax	1,622	349	(32)	301
Comprehensive income before attribution to noncontrolling interests	14,090	18,188	36,675	38,681
Comprehensive loss, redeemable noncontrolling interests	(1,015)	(1,086)	(2,328)	(2,341)
Comprehensive (loss) income, nonredeemable noncontrolling interests	(673)	(5)	(1,363)	20
Comprehensive income attributable to the Company	\$ 12,402	\$ 17,097	\$ 32,984	\$ 36,360

(1) Amounts reclassified out of accumulated other comprehensive income ( AOCI ) into net interest (expense) income included \$393 and \$787 for the three and six months ended June 28, 2015, respectively and \$250 and \$499 for the three and six months ended June 29, 2014, respectively.

(2) The income tax effects of amounts reclassified out of AOCI into net interest (expense) income were \$145 and \$291 for the three and six months ended June 28, 2015, respectively and \$93 and \$185 for the three and six months ended June 29, 2014, respectively.

See accompanying notes.

Table of Contents**Papa John's International, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(Unaudited)**

(In thousands)	Six Months Ended	
	June 28, 2015	June 29, 2014
<b>Operating activities</b>		
Net income before attribution to noncontrolling interests	\$ 36,707	\$ 38,380
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible accounts and notes receivable	631	936
Depreciation and amortization	20,177	19,019
Deferred income taxes	6,424	6,298
Stock-based compensation expense	4,985	3,612
Excess tax benefit on equity awards	(9,488)	(7,890)
Other	2,239	2,270
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,682	3,400
Income taxes receivable	(1,281)	
Inventories	3,474	(7,295)
Prepaid expenses	999	180
Other current assets	293	(152)
Other assets and liabilities	(773)	(17)
Accounts payable	(3,877)	(1,934)
Income and other taxes payable	72	1,423
Accrued expenses and other current liabilities	15,495	(3,970)
Deferred revenue	223	305
Net cash provided by operating activities	77,982	54,565
<b>Investing activities</b>		
Purchases of property and equipment	(16,501)	(26,239)
Loans issued	(1,571)	(2,642)
Repayments of loans issued	2,787	1,880
Acquisitions, net of cash acquired	(491)	(3,179)
Other	348	3
Net cash used in investing activities	(15,428)	(30,177)
<b>Financing activities</b>		
Net proceeds on line of credit facility	3,549	52,100
Cash dividends paid	(11,083)	(10,404)
Excess tax benefit on equity awards	9,488	7,890
Tax payments for equity award issuances	(10,654)	(7,498)
Proceeds from exercise of stock options	3,915	3,361
Acquisition of Company common stock	(52,083)	(63,304)
Contributions from noncontrolling interest holders	683	100
Distributions to noncontrolling interest holders	(4,350)	(600)
Other	319	293
Net cash used in financing activities	(60,216)	(18,062)
Effect of exchange rate changes on cash and cash equivalents	(13)	(25)
Change in cash and cash equivalents	2,325	6,301
Cash and cash equivalents at beginning of period	20,122	13,670
Cash and cash equivalents at end of period	\$ 22,447	\$ 19,971

*See accompanying notes.*

Table of Contents**Papa John's International, Inc. and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Unaudited)**

June 28, 2015

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the six months ended June 28, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ended December 27, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for Papa John's International, Inc. (referred to as the Company, Papa John's or in the first person notations of we, and our ) for the year ended December 28, 2014.

**2. Significant Accounting Policies**Noncontrolling Interests

Papa John's has joint ventures in which there are noncontrolling interests, including the following as of June 28, 2015 and June 29, 2014:

	Number of Restaurants	Restaurant Locations	Papa John's Ownership	Noncontrolling Interest Ownership
<b>June 28, 2015</b>				
Star Papa, LP	84	Texas	51%	49%
Colonel's Limited, LLC	61	Maryland and Virginia	70%	30%
PJ Minnesota, LLC	35	Minnesota	70%	30%
PJ Denver, LLC	26	Colorado	60%	40%
<b>June 29, 2014</b>				
Star Papa, LP	81	Texas	51%	49%
Colonel's Limited, LLC	52	Maryland and Virginia	70%	30%
PJ Minnesota, LLC	34	Minnesota	80%	20%

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PJ Denver, LLC	25	Colorado	60%	40%
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We are required to report consolidated net income at amounts attributable to the Company and the noncontrolling interests. Additionally, disclosures are required to clearly identify and distinguish between the interests of the Company and the interests of the noncontrolling owners, including a disclosure on the face of the condensed consolidated statements of income attributable to the noncontrolling interest holder.

Table of Contents

The income before income taxes attributable to these joint ventures for the three and six months ended June 28, 2015 and June 29, 2014 was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Papa John's International, Inc.	\$ 2,660	\$ 1,744	\$ 5,670	\$ 3,592
Noncontrolling interests	1,688	1,091	3,691	2,321
Total income before income taxes	\$ 4,348	\$ 2,835	\$ 9,361	\$ 5,913

The following summarizes the redemption feature, location within the condensed consolidated balance sheets and the value at which the noncontrolling interests are recorded for each joint venture as of June 28, 2015:

Joint Venture	Redemption Feature	Location within the Condensed Consolidated Balance Sheets	Recorded Value
Star Papa, LP	Redeemable	Temporary equity	Carrying value
PJ Denver, LLC	Redeemable	Temporary equity	Redemption value
Colonel's Limited, LLC	No redemption feature	Permanent equity	Carrying value
PJ Minnesota, LLC	No redemption feature	Permanent equity	Carrying value

The noncontrolling interest holders of two joint ventures have the option to require the Company to purchase their interests. Since redemption of the noncontrolling interests is outside of the Company's control, the noncontrolling interests are presented in the caption "Redeemable noncontrolling interests" in the condensed consolidated balance sheets and include the following joint ventures:

- The Star Papa, LP agreement contains a redemption feature that is not currently redeemable, but it is probable to become redeemable in the future. Due to specific valuation provisions contained in the agreement, this noncontrolling interest has been recorded at its carrying value.
- The PJ Denver, LLC agreement contains a redemption feature that is currently redeemable and, therefore, this noncontrolling interest has been recorded at its current redemption value. The change in redemption value is recorded as an adjustment to "Redeemable noncontrolling interests" and "Retained earnings" in the condensed consolidated balance sheets.

The following summarizes changes in these redeemable noncontrolling interests (in thousands):

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Balance at December 28, 2014	\$	8,555
Net income		2,329
Distributions		(3,000)
Change in redemption value		(143)
Balance at June 28, 2015	\$	7,741

The noncontrolling interests of our Colonel's Limited, LLC and PJ Minnesota, LLC joint ventures are recorded at carrying value in Stockholders equity in the condensed consolidated balance sheets at both June 28, 2015 and December 28, 2014, as the noncontrolling interest holders agreements had no redemption features.

### Deferred Income Tax Accounts and Tax Reserves

We are subject to income taxes in the United States and several foreign jurisdictions. Significant judgment is required in determining our provision for income taxes and the related assets and liabilities. The provision for

Table of Contents

income taxes includes income taxes paid, currently payable or receivable and those deferred. We use an estimated annual effective rate based on expected annual income to determine our quarterly provision for income taxes. Discrete items are recorded in the quarter in which they occur.

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax loss carryforwards. The effect on deferred taxes of changes in tax rates is recognized in the period in which the new tax rate is enacted. As a result, our effective tax rate may fluctuate. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize. As of June 28, 2015, we had a net deferred tax liability of approximately \$6.9 million.

Tax authorities periodically audit the Company. We record reserves and related interest and penalties for identified exposures as income tax expense. We evaluate these issues on a quarterly basis to adjust for events, such as statute of limitations expirations, court rulings or audit settlements, which may impact our ultimate payment for such exposures.

Fair Value Measurements and Disclosures

The Company is required to determine the fair value of financial assets and liabilities based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. Fair value is a market-based measurement, not an entity specific measurement. The fair value of certain assets and liabilities approximates carrying value because of the short-term nature of the accounts, including cash, accounts receivable and accounts payable. The fair value of our notes receivable net of allowances also approximates carrying value. The fair value of the amount outstanding under our revolving credit facility approximates its carrying value due to its variable market-based interest rate. These assets and liabilities are categorized as Level 1 as defined below.

Certain assets and liabilities are measured at fair value on a recurring basis and are required to be classified and disclosed in one of the following categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are not corroborated by market data.

Our financial assets and liabilities that were measured at fair value on a recurring basis as of June 28, 2015 and December 28, 2014 are as follows (in thousands):

**Carrying**

**Fair Value Measurements**



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	Value	Level 1	Level 2	Level 3
<b>June 28, 2015</b>				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 18,758	\$ 18,758	\$	\$
Financial liabilities:				
Interest rate swaps (b)	1,021		1,021	
<b>December 28, 2014</b>				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 18,238	\$ 18,238	\$	\$
Financial liabilities:				
Interest rate swaps (b)	376		376	

Table of Contents

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- (a) Represents life insurance policies held in our non-qualified deferred compensation plan.
- (b) The fair values of our interest rate swaps are based on the sum of all future net present value cash flows. The future cash flows are derived based on the terms of our interest rate swaps, as well as considering published discount factors, and projected London Interbank Offered Rates ( LIBOR ).

There were no transfers among levels within the fair value hierarchy during the six months ended June 28, 2015.

Variable Interest Entities

Papa John's domestic restaurants, both Company-owned and franchised, participate in Papa John's Marketing Fund, Inc. ( PJMF ), a nonstock corporation designed to operate at break-even for the purpose of designing and administering advertising and promotional programs for all participating domestic restaurants. PJMF is a variable interest entity as it does not have sufficient equity to fund its operations without ongoing financial support and contributions from its members. Based on the ownership and governance structure and operating procedures of PJMF, we have determined that we do not have the power to direct the most significant activities of PJMF and therefore are not the primary beneficiary. Accordingly, we determined that consolidation of PJMF is not appropriate.

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Revenue from Contracts with Customers (Accounting Standards Update 2014-09), a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP. This update requires companies to recognize revenue at amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services at the time of transfer. In doing so, companies will need to use more judgment and make more estimates than under today's guidance. Such estimates may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Companies can either apply a full retrospective adoption or a modified retrospective adoption.

We are required to adopt the new requirements in the first quarter of 2018 based on the FASB's decision to defer the effective date by one year. We are evaluating the method of adoption and its impact of the new requirements on our consolidated financial statements. We currently do not believe the impact will be significant.

### **3. Calculation of Earnings Per Share**

We compute earnings per share using the two-class method. The two-class method requires an earnings allocation formula that determines earnings per share for common shareholders and participating security holders according to dividends declared and participating rights in

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undistributed earnings. We consider time-based restricted stock awards to be participating securities because holders of such shares have non-forfeitable dividend rights. Under the two-class method, undistributed earnings allocated to participating securities are subtracted from net income attributable to the Company in determining net income attributable to common shareholders.

Additionally, in accordance with Accounting Standards Codification ( ASC ) 480, *Distinguishing Liabilities from Equity*, the change in the redemption value for the noncontrolling interest of PJ Denver, LLC increases or decreases income attributable to common shareholders.

Table of Contents

The calculations of basic and diluted earnings per common share are as follows (in thousands, except per-share data):

	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
<b>Basic earnings per common share:</b>				
Net income attributable to the Company	\$ 10,780	\$ 16,748	\$ 33,016	\$ 36,059
Decrease (increase) in noncontrolling interest redemption value	73	(31)	143	(39)
Net income attributable to participating securities	(50)	(81)	(150)	