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

FORM 8-K/A
(Amendment No. 1)

CURRENT REPORT
Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): October 23, 2019

FRANCHISE GROUP, INC.
(Exact name of registrant as specified in charter)

Delaware	001-35588	27-3561876
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification Number)

1716 Corporate Landing Parkway, Virginia Beach, Virginia 23454
(Address of Principal Executive Offices) (Zip Code)

(757) 493-8855
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.01 par value	**FRG**	**NASDAQ Global Market**

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

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. ☐

Explanatory Note

This Current Report on Form 8-K/A amends each of (i) the Form 8-K previously filed by Franchise Group, Inc. (the "Company") on October 23, 2019 and (ii) the Form 8-K previously filed by the Company on December 17, 2019. This report includes the financial statements that had been omitted from each of the previously filed Current Reports on Form 8-K as permitted by Item 9.01(a)(4) of Form 8-K.

On October 23, 2019, the Company completed its acquisition (which was previously announced in the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on August 28, 2019) of the Sears Outlet segment and Buddy's Home Furnishing Stores businesses of Sears Hometown and Outlet Stores, Inc., a Delaware corporation ("SHOS"), each as described in SHOS's annual report on Form 10-K for the fiscal year ended February 2, 2019 (collectively, the "Business") of SHOS, pursuant to the terms of the Equity and Asset Purchase Agreement (the "Purchase Agreement"), dated as of August 27, 2019, by and among SHOS, Franchise Group Newco S, LLC ("Newco S") and the Company (solely for the purposes of Section 10.17 thereto, pursuant to which the Company guaranteed, among other things, the performance of Newco S's obligations and the payment of amounts due to SHOS under the Purchase Agreement up to and including the closing of the Acquisition (the "Closing"), in addition to agreeing to fund a certain equity contribution to Newco S in order to consummate the Acquisition). At the Closing, pursuant to the Purchase Agreement, Newco S acquired the Business from SHOS (the "Acquisition") through the purchase of certain assets and the assumption of certain liabilities, as well as the acquisition of the equity interests of certain subsidiaries of SHOS, in each case primarily used in or related to the Business, and the Company's guarantee obligations under the Purchase Agreement terminated.

On December 16, 2019, pursuant to the terms of the Agreement and Plan of Merger, dated August 7, 2019 (as amended from time to time, the "Merger Agreement"), by and among Vitamin Shoppe, Inc., a Delaware corporation ("Vitamin Shoppe"), the Company, and Valor Acquisition, LLC, a Delaware limited liability company and an indirect subsidiary of the Company ("Merger Sub"), the Company and Vitamin Shoppe completed the merger of Vitamin Shoppe and Merger Sub, with Merger Sub surviving the merger as an indirect subsidiary of the Company (the "Merger").

The Company is filing this Current Report on Form 8-K/A to provide certain financial statements of Sears Outlet Stores (a carve-out business of SHOS) ("Sears Outlet Stores") and Vitamin Shoppe and unaudited pro forma financial information of Sears Outlet Stores, Vitamin Shoppe and the Company required by Item 9.01 of Form 8-K and should be read in conjunction with the Company's Current Reports on Form 8-K previously filed on October 23, 2019 and December 17, 2019.

Item 9.01. Financial Statements and Exhibits

(a) Financial Statements of Business Acquired

The audited combined financial statements of Sears Outlet Stores as of and for the years ended February 2, 2019 and February 3, 2018, including the notes to such financial statements and the report of BDO USA, LLP are filed with this Current Report on Form 8-K/A as Exhibit 99.1 and are incorporated by reference herein.

The unaudited combined financial statements of Sears Outlet Stores as of and for the six months ended August 3, 2019 and August 4, 2018, are filed with this Current Report on Form 8-K/A as Exhibit 99.2 and are incorporated by reference herein.

The audited consolidated financial statements of Vitamin Shoppe as of and for the years ended December 29, 2018, December 30, 2017 and December 31, 2016, including the notes to such financial statements and the report of Deloitte & Touche LLP are filed with this Current Report on Form 8-K/A as Exhibit 99.3 and are incorporated by reference herein.

The unaudited consolidated financial statements of Vitamin Shoppe as of and for the nine months ended September 28, 2019 and September 29, 2018, are filed with this Current Report on Form 8-K/A as Exhibit 99.4 and are incorporated by reference herein.

(b) Pro forma Financial Information

The unaudited pro forma financial information included with this Current Report on Form8-K/A has been prepared to illustrate the pro forma effects of the Acquisition, the Merger, the Company's previously announced merger with Buddy's Newco, LLC and the Company's previously announced tender offer to purchase certain of its outstanding shares of common stock and the related debt and equity financings (collectively, the "Transactions"). The unaudited pro forma combined balance sheet as of October 31, 2019 and the unaudited pro forma combined statement of operations for the six months ended October 31, 2019 and year ended April 30, 2019 are filed with this Current Report on Form 8-K/A as Exhibit 99.5 and are incorporated by reference herein. The unaudited pro forma combined balance sheet as of October 31, 2019 gives effect to the Transactions as if they had occurred as of October 31, 2019. The unaudited pro forma combined statements of operations for the six months ended October 31, 2019 and year ended April 30, 2019 gives effect to the Transactions as if they had occurred as of May 1, 2018. All pro forma information in this Current Report on Form 8-K/A has been prepared for informational purposes only and is not necessarily indicative of the past or future results of operations or financial position of Sears Outlet Stores, Vitamin Shoppe or the Company.

(d) Exhibits

The following exhibits are filed herewith:

Exhibit No.	Description of Exhibits
23.1	Consent of BDO USA, LLP
23.2	Consent of Deloitte & Touche LLP
99.1	Combined Financial Statements for Sears Outlet Stores as of and for the years ended February 2, 2019 and February 3, 2018
99.2	Combined Financial Statements for Sears Outlet Stores as of and for the six months ended August 3, 2019 and August 4, 2018
99.3	Consolidated Financial Statements for Vitamin Shoppe as of and for the years ended December 29, 2018, December 30, 2017 and December 31, 2016
99.4	Consolidated Financial Statements for Vitamin Shoppe as of and for the nine months ended September 28, 2019 and September 29, 2018
99.5	Unaudited pro forma combined balance sheet as of October 31, 2019 and the unaudited pro forma combined statement of operations for the six months ended October 31, 2019 and year ended April 30, 2019

EXHIBIT INDEX

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99.4	Consolidated Financial Statements for Vitamin Shoppe as of and for the nine months ended September 28, 2019 and September 29, 2018
99.5	Unaudited pro forma combined balance sheet as of October 31, 2019 and the unaudited pro forma combined statement of operations for the six months ended October 31, 2019 and year ended April 30, 2019

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

FRANCHISE GROUP, INC.

Date: January 8, 2020

By: /s/ Eric Seeton
Eric Seeton
Chief Financial Officer

Exhibit 23.1

Consent of Independent Auditor

Franchise Group, Inc.
Virginia Beach, Virginia

We hereby consent to the incorporation by reference in the Registration Statement on FormS-8 (No. 333-182585) of Franchise Group, Inc. of our report dated January 7, 2020, relating to the combined financial statements of Sears Outlet Stores (a carve-out business of Sears Hometown and Outlet Stores, Inc.), which appears in this Form 8-K/A.

/s/ BDO USA, LLP

Chicago, Illinois
January 8, 2020

Exhibit 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-182585 on Form S-8 of Franchise Group, Inc. of our report dated February 26, 2019, relating to the financial statements of Vitamin Shoppe, Inc. appearing in this Current Report on Form 8-K/A dated January 8, 2020.

/s/ Deloitte & Touche LLP

Richmond, Virginia

January 8, 2020

Exhibit 99.1

SEARS OUTLET STORES

(a carve-out business of Sears Hometown and Outlet Stores, Inc.)

Combined Financial Statements

For the Fiscal Years Ended
February 2, 2019 and February 3, 2018

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
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Independent Auditor's Report

To the Stockholders of Sears Outlet Stores, L.L.C., Leasing Operations, LLC and Outlet Merchandise, LLC
Sears Outlet Stores (a carve-out business of Sears Hometown and Outlet Stores, Inc.)
Hoffman Estates, Illinois

We have audited the accompanying combined financial statements of Sears Outlet Stores (a carve-out business of Sears Hometown and Outlet Stores, Inc.), which comprise the combined balance sheets as of February 2, 2019 and February 3, 2018, and the related combined statements of operations, changes in equity, and cash flows for the fiscal years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Sears Outlet Stores (a carve-out business of Sears Hometown and Outlet, Inc.) as of February 2, 2019 and February 3, 2018, and the results of its operations and its cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1, on October 23, 2019, Sears Hometown and Outlet Stores, Inc. completed the sale of Sears Outlet Stores (a carve-out business of Sears Hometown and Outlet, Inc.) including substantially all of the assets and liabilities to Franchise Group Newco S, LLC, an indirect subsidiary of Franchise Group, LLC. Our opinion is not modified with respect to this matter.

BDO USA, LLP

Chicago, Illinois
January 7, 2020

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF OPERATIONS

In thousands	**Year ended February 2, 2019**	Year ended February 3, 2018
NET SALES	**$ 495,274**	$ 543,856
COSTS AND EXPENSES		
Cost of sales and occupancy	**361,413**	440,876
Selling and administrative	**124,876**	143,859
Impairment of property and equipment	**1,082**	—
Depreciation and amortization	**6,171**	7,661
Gain on sale of assets	**(1,358)**	—
Total costs and expenses	492,184	592,396
Operating income (loss)	**3,090**	(48,540)
Interest expense	**(6,054)**	(2,508)
Other income	**163**	704
Loss before income taxes	**(2,801)**	(50,344)
Income tax expense (benefit)	**263**	(108)
NET LOSS	**$ (3,064)**	$ (50,236)

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED BALANCE SHEETS

In thousands	**February 2, 2019**	February 3, 2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	**$ 445**	$ 470
Accounts and franchisee receivables, net	**2,026**	1,282
Merchandise inventories	**98,237**	99,749
Due from Parent	**2,318**	2,533
Prepaid expenses and other current assets	**7,983**	5,773
Total current assets	**111,009**	109,807
PROPERTY AND EQUIPMENT, net	**16,902**	22,409
OTHER ASSETS, net	**458**	3,647
TOTAL ASSETS	**$ 128,369**	$ 135,863
LIABILITIES		
CURRENT LIABILITIES		
Payable to related party	**$ 2,843**	$ 4,217
Accounts payable	**16,437**	11,507
Other current liabilities	**24,417**	18,350
Total current liabilities	**43,697**	34,074
OTHER LONG-TERM LIABILITIES	**1,600**	1,680
TOTAL LIABILITIES	**45,297**	35,754
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Net Parent investment	**83,072**	100,109
TOTAL LIABILITIES AND EQUITY	**$ 128,369**	$ 135,863

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF CHANGES IN EQUITY

In thousands	Net Parent Investment
Balance at January 28, 2017	$113,173
Net loss	(50,236)
Transfers from Parent	37,172
Balance at February 3, 2018	**100,109**
Net loss	(3,064)
Transfers to Parent	(13,469)
Cumulative effect adjustment from adoption of new revenue recognition standard	(504)
Balance at February 2, 2019	**$ 83,072**

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF CASH FLOWS

In thousands	**Year ended February 2, 2019**	Year ended February 3, 2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	**$ (3,064)**	$ (50,236)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	**6,171**	7,661
Gain on the sale of assets	**(1,358)**	—
Impairment of property and equipment	**1,082**	—
Provision for losses on franchisee receivables	**2,839**	7,561
Changes in operating assets and liabilities:		
Accounts and franchisee receivables	**(3,583)**	(4,665)
Merchandise inventories	**1,512**	23,395
Payable to related party	**(1,374)**	(11,285)
Accounts payable	**4,930**	(3,076)
Store closing accrual	**(2,967)**	2,546
Customer deposits	**971**	799
Due from Parent	**215**	1,316
Other operating assets and liabilities, net	**6,383**	(6,186)
Net cash provided by (used in) operating activities	**11,757**	(32,170)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property	**2,837**	—
Purchases of property and equipment	**(1,482)**	(4,750)
Net cash provided by (used in) investing activities	**1,355**	(4,750)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Distributions to) contributions from Parent, net	**(13,469)**	37,172
Net borrowings from capital lease obligations	**332**	—
Net cash (used in) provided by financing activities	**(13,137)**	37,172
NET CHANGE IN CASH AND CASH EQUIVALENTS	**(25)**	252
CASH AND CASH EQUIVALENTS - Beginning of period	**470**	218
CASH AND CASH EQUIVALENTS - End of period	**$ 445**	$ 470

See Notes to Combined Financial Statements.

NOTE 1—BACKGROUND, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background

Sears Outlet Stores, ("SOS," the "Company," "we," "our," or "us") is acarve-out business of Sears Hometown and Outlet Stores, Inc. ("SHO" or "Parent") which combines the accounts of Sears Outlet Stores, L.L.C., Leasing Operations, LLC, and Outlet Merchandise, LLC. On April 23, 2012, SHO was formed as a wholly owned subsidiary of Sears Holdings, and on October 11, 2012, Sears Holdings completed the separation of SHO. On October 23, 2019, SHO completed the sale of the Company, including substantially all of the assets and liabilities to Franchise Group Newco S, LLC (the "Purchaser"), an indirect subsidiary of Franchise Group, LLC (formerly known as Liberty Tax, Inc.), pursuant to the Equity and Asset Purchase Agreement, dated as of August 27, 2019.

The Company is a national retailer primarily focused on providing customers within-store and online access to purchase, at prices that are significantly lower than list prices, new, one-of-a-kind, out-of-carton, discontinued, obsolete, used, reconditioned, overstocked, and scratched and dented products across a broad assortment of merchandise categories, including home appliances, apparel, mattresses, lawn and garden equipment, sporting goods and tools.

As of February 2, 2019, we operated 14 distribution centers and 123 Sears Outlet retail stores in the United States including one distribution center and store in Puerto Rico. Our independent franchisees operated five of our Sears Outlet retail stores. The business model and economic structure of the franchisee operated stores, which are independently owned, are substantially similar to Company-operated stores in many respects. The Company requires all of the stores to operate under specified circumstances according to the Company's standards. Stores must display the required merchandise, offer all required products and services, and use the Company's point of sale system. Also, the Company has the right to approve advertising and promotional and marketing materials and imposes specified advertising requirements on the owners. The Company owns the merchandise, establishes all selling prices for the merchandise, and bears general inventory risk (with specific exceptions) until sale of the merchandise and if the customer returns the merchandise. In addition, because each transaction is recorded in the Company's point of sale system, the Company bears customer credit risk. The Company establishes a commission structure for stores operated by our franchisees and pays commissions when our franchisees sell the merchandise and services. Several of the primary differences between Company-operated stores and franchisee-operated stores are that (1) the Company is responsible for occupancy and payroll costs associated with Company-operated stores while our franchisees are responsible for these costs for their stores, (2) the Company is responsible for all terms and conditions of employment for the employees in the Company-operated stores and our franchisees are responsible for all terms and conditions of employment for the employees in their stores, and (3) we pay commissions to our franchisees.

We also operated eight Buddy's Home Furnishings stores where we are a franchisee, enabling us to benefit from Buddy's expertise and system infrastructure in the rent-to-own business which we own the inventory that we rent to our customers.

Basis of Presentation

Stand-alone financial statements have not been historically prepared for the Company. The accompanying Combined Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). These Combined Financial Statements are presented as carve-out financial statements and reflect the combined historical results of operations, balance sheets and cash flows of the Company. All intercompany balances and transactions within the Company have been eliminated in these Combined Financial Statements. As described in Note 7 Related Party Agreements and Transactions, certain transactions between the Company and our Parent have been included in these Combined Financial Statements.

The Combined Balance Sheets reflect, among other things, all the assets and liabilities of the Company that are specifically identifiable as being directly attributable to the Company, including net Parent investment as a component of equity. Net Parent Investment represents our Parent's historical investment in the Company and includes accumulated net earnings (loss) attributable to our Parent, the net effect of certain transactions with our Parent and our Parent's subsidiaries, and cost allocations from our Parent that were not historically allocated to the Company.

SHO uses a centralized approach to cash management and financing of its operations. These arrangements are not reflective of the manner in which the Company would have financed its operations had it been a stand-alone business separate from SHO during the periods presented. Cash pooling arrangements are excluded from the asset and liability balances in the Combined Balance Sheets. These amounts have instead been reported as Net Parent Investment.

SHO and its subsidiaries provide a variety of services to the Company. The Combined Statements of Operations includes expense allocations for services and certain support functions that are provided on a centralized basis within SHO such as legal, information technology, human resources, corporate audit, treasury and various other SHO corporate functions that are allocated to the Company and reflected in the Combined Statements of Operations within total costs and expenses. Where allocations of amounts were necessary, the Company believes the allocation of these amounts were determined on a reasonable basis, reflecting all of the costs of the Company, and consistently applied in the periods presented. These allocated amounts, however, are not necessarily indicative of the actual amounts that might have been incurred or realized had the Company operated as a separate stand-alone entity during the periods presented. Consequently, these Combined Financial Statements do not necessarily represent the results the Company would have achieved if the Company had operated as a separate stand-alone entity from SHO during the periods presented.

As noted above, the Company depends on SHO to provide all key products and services to the Company and SHO depends on Transform Holdco (Sears Holdings prior to Transform Holdco acquiring most of the operating assets and assuming the related operative agreements and obligations of Sears Holdings from bankruptcy in mid-February 2019) for most of its key products and services. Consequently, if Transform Holdco is unwilling, unable, or otherwise fails to provide these key products and services or if Transform Holdco's brands are impaired, the Company could be materially and adversely affected. These key products and services include:

- inventory procurement, including KCD (KENMORE®, CRAFTSMAN®, and DIEHARD®) products and other products, which collectively account for a majority of SHO's revenue. For the fiscal year ended February 2, 2019, products which SHO acquired through Transform Holdco (Sears Holdings prior to mid-February 2019) accounted for approximately 78% of SHO's merchandise purchases,
- logistical, supply chain, and inventory support services,
- online, computer and information technology infrastructure (including the point-of-sale system used by the Company and dealers and franchisees), and support,
- use of the Sears brand name and other intellectual property owned by Transform Holdco.

The Company has evaluated for subsequent events through to the date the Combined Financial Statements were available to be issued as at January 7, 2020.

Variable Interest Entities

On an ongoing basis the Company evaluates its business relationships, such as those with its franchisees, to identify potential variable interest entities. Generally, these businesses qualify for a scope exception under the consolidation guidance, or, where a variable interest exists, the Company does not possess the power to direct the activities that most significantly impact the economic performance of these businesses. The Company has not consolidated any of such entities in the periods presented.

SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year

Our fiscal years end on the Saturday closest to January 31. Unless otherwise stated, references to specific years in these notes are to fiscal years. The following fiscal periods are presented herein.

Fiscal Year	Ended	Weeks
2018	February 2, 2019	52
2017	February 3, 2018	53

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events. The estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances. Adjustments to estimates and assumptions are made when facts and circumstances dictate. As future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying financial statements. Significant estimates and assumptions are required as part of determining inventory and accounts and franchisee receivables valuation, estimating depreciation and recoverability of long-lived assets, establishing insurance, warranty, legal and other reserves, performing long-lived asset impairment analysis, and establishing valuation allowances on deferred income tax assets and reserves for tax examination exposures.

Cash and Cash Equivalents

Cash equivalents include deposits in-transit from banks for payments related to third-party credit card and debit card transactions.

Under SHO's cash management system, the Company utilizes available borrowings from the Parent, on an as-needed basis, to fund the clearing of checks as they are presented for payment. As of February 2, 2019 and February 3, 2018, outstanding deposits totaling $2.3 million and $2.5 million, respectively, were included in Due from Parent in the Combined Balance Sheets.

Allowance for Doubtful Accounts

We provide an allowance for doubtful accounts based on both historical experience and a specific identification basis. Allowances for doubtful accounts on accounts and franchisee receivable balances were $1.3 million and $3.1 million at February 2, 2019 and February 3, 2018, respectively. Our accounts receivable balance is comprised of various vendor-related and customer-related accounts receivable. Our franchisee receivable balance is comprised of promissory notes that relate primarily to the sale of assets for our franchised locations.

The Company provides an allowance for losses on franchisee receivables (which consist primarily of franchisee promissory notes) in an amount equal to estimated probable losses net of recoveries. The allowance is based on an analysis of expected future write-offs, existing economic conditions, and an assessment of specific identifiable franchisee promissory notes and other franchisee receivables considered at risk or uncollectible. The expense associated with the allowance for losses on franchisee receivables is recognized as selling and administrative expense. As of February 2, 2019, all franchisee receivables have been fully reserved.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market. Merchandise inventories are valued under the retail inventory method, or "RIM," using primarily a last-in, first-out, or "LIFO," cost-flow assumption.

Inherent in RIM calculations are certain significant management judgments and estimates including, among others, merchandise markons, markups, markdowns, and shrinkage, which significantly impact the ending inventory valuation at cost and resulting gross margins. The methodologies utilized by us in our application of RIM are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogeneous classes of merchandise, the development of shrinkage and obsolescence reserves, the accounting for price changes, and the computations inherent in the LIFO adjustment (where applicable). Management believes that RIM provides an inventory valuation that reasonably approximates cost and results in carrying inventory at the lower of cost or market.

In connection with our LIFO calculation, we estimate the effects of inflation on inventories by utilizing external price indices determined by the U.S. Bureau of Labor Statistics. If we had used the first-in, first-out, or "FIFO" method of inventory valuation instead of the LIFO method, merchandise inventories would have been insignificantly higher at February 2, 2019 and February 3, 2018.

Vendor Rebates and Allowances

We receive rebates and allowances from vendors through a variety of programs and arrangements intended to offset the costs of promoting and selling the vendors' products. In addition, Transform Holdco (Sears Holdings prior to February 11, 2019) allocates a portion of the rebates and allowances it receives from vendors based on shipments to or sales of the related products to the Company. Vendor payments are recognized and recorded as a reduction to the cost of merchandise inventories when earned and, thereafter, as a reduction of cost of sales and occupancy as the merchandise is sold. Up-front consideration received from vendors linked to purchases or other commitments is initially deferred and amortized ratably to cost of sales and occupancy over the life of the contract or as performance of the activities specified by the vendor to earn the fee is completed.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Additions and substantial improvements are capitalized and include expenditures that materially extend the useful lives of existing facilities and equipment. Maintenance and repairs that do not materially improve or extend the lives of the respective assets are expensed as incurred.

Property and equipment consist of the following:

In thousands	February 2, 2019	February 3, 2018
Land	$ 409	$ 512
Buildings and improvements	30,517	33,329
Furniture, fixtures and equipment	16,438	20,014
Construction in progress	1,056	1,016
Capitalized leases	436	—
Total property and equipment	48,856	54,871
Less: accumulated depreciation	(31,954)	(32,462)
Total property and equipment, net	$ 16,902	$ 22,409

Depreciation expense is recorded over the estimated useful lives of the respective assets using the straight-line method for financial statement purposes and accelerated methods for tax purposes. The range of lives are generally 15 to 25 years for buildings, 3 to 10 years for furniture, fixtures, and equipment, and 3 to 5 years for computer systems and equipment. Leasehold improvements are depreciated over the shorter of the associated lease term or the estimated useful life of the asset. Total depreciation expense was $6.0 million and $6.4 million, for fiscal years 2018 and 2017, respectively.

Impairment of Long-Lived Assets and Costs Associated with Exit Activities

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment, is evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses, current cash flows that may be insufficient to recover the investment in the property over the remaining useful life, or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets, or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques. We recorded impairment charges with respect to long-lived assets of $1.1 million in fiscal year 2018, included in Impairment of property and equipment in the accompanying Combined Statements of Operations. No impairment charges were recorded in fiscal 2017.

We account for costs associated with location closings in accordance with accounting standards pertaining to accounting for costs associated with exit or disposal activities and compensation. When management makes a decision to close a location, we record a reserve as of that date for the expected inventory markdowns associated with the closing. We also record a liability for future lease costs (net of estimated sublease income) when we cease to use the location. As of February 2, 2019 and February 3, 2018, this liability was approximately $0.2 million and $3.2 million, respectively. See Note 8.

Leases

We lease certain stores, office facilities, computers and transportation equipment. The determination of operating and capital lease obligations is based on the expected durations of the leases and contractual minimum lease payments specified in the lease agreements. For certain stores, amounts in excess of these minimum lease payments are payable based upon a specified percentage of sales. Contingent rent is accrued during the period it becomes probable that a particular store will achieve a specified sales level thereby triggering a contingent rental obligation. Certain leases also include an escalation clause or clauses and renewal option clauses calling for increased rents. Where the lease contains an escalation clause or concession such as a rent holiday, rent expense is recognized using the straight-line method over the term of the lease. We recorded rent expense for operating leases in fiscal years 2018 and 2017 of $36.3 million and $46.8 million, respectively, included in Cost of sales and occupancy in the accompanying Combined Statements of Operations.

We have subleases with Transform Holdco (as assignee) for three locations. We had rent expense paid to Sears Holdings (Transform Holdco after February 11, 2019) of $0.6 million and $1.1 million in fiscal years 2018 and 2017, respectively.

Minimum lease obligations excluding taxes, insurance and other expenses under the operating lease in effect as of February 2, 2019 are as follows:

Fiscal Year *(in thousands)*	**Operating Leases**
2019	$ 35,591
2020	31,369
2021	25,169
2022	18,262
2023	9,351
Thereafter	4,374
Total Minimum Lease Payments	124,116
Less - Sublease Income on Leased Properties	(2,979)
Net Minimum Lease Payments	$121,137

Insurance Programs

Our Parent maintains its own insurance arrangements with third-party insurance companies for exposures incurred for a number of risks including worker's compensation and general liability claims. In fiscal years 2018 and 2017, the Company recorded insurance expense of $0.6 million and $0.3 million, respectively, which was allocated to the Company consistent with the allocations discussed in Notes 1 and 7.

Loss Contingencies

We account for contingent losses in accordance with accounting standards pertaining to loss contingencies. Under accounting standards, loss contingency provisions are recorded for probable losses at management's best estimate of a loss; or when a best estimate cannot be made, a minimum loss contingency amount is recorded. These estimates are often initially developed substantially earlier than the ultimate loss is known, and the estimates are refined each accounting period as additional information is known.

Revenue Recognition

Revenues from contracts with customers include sales of merchandise, commissions on merchandise sales made through www.sears.com, Company websites, services and extended-service plans, financing programs, and delivery and handling revenues related to merchandise sold. Revenue is measured based on the amount of fixed consideration that we expect to receive, reduced by estimates for variable consideration such as returns. Revenue also excludes any amounts collected from customers and remitted or payable to governmental authorities. In arrangements where we have multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price.

We recognize revenues from retail operations upon the transfer of control of goods to the customer. We satisfy our performance obligations at the point of sale for retail store transactions and upon delivery for online transactions. We defer revenue for retail store and online transactions including commissions on extended-service plans, where we have received consideration but have not transferred control of the goods to the customer at the end of the period. The performance obligation is generally satisfied in the following reporting period. The balance of deferred revenue was $2.2 million and $1.2 million at February 2, 2019 and February 3, 2018, respectively. The change in deferred revenue represents revenue recognized during fiscal year 2018.

We recognize revenues from commissions on services, and delivery and handling revenues related to merchandise sold, at the point of sale as we are not the primary obligor with respect to such services and have no future obligations for future performance. Commissions earned on services, and delivery and handling revenues, are presented net of related costs because we are acting as an agent in arranging the services for the customer and do not control the services being rendered.

The Company accepts Transform Holdco (Sears Holdings prior to February 11, 2019) gift cards as tender for purchases and is reimbursed weekly by Transform Holdco for gift cards tendered.

Refund Liability and Right of Return Asset

Fiscal 2018. Revenues from merchandise sales and services are reported net of estimated returns and allowances and exclude sales taxes. The typical return period is 30 days. The refund liability for returns is calculated as a percentage of sales based on historical return percentages and recognized at the transaction price as a reduction of revenues. The refund liability was $1.5 million at February 2, 2019. We also recognize a return asset, and corresponding adjustment to cost of sales, for our right to recover the goods returned by the customer, measured at the former carrying amount of the goods, less any expected recovery cost. The right of return asset was $0.6 million at February 2, 2019.

At each financial reporting date, we assess our estimates of expected returns, refund liabilities, and return assets.

Reserve for Sales Returns and Allowances

Fiscal 2017. Revenues from merchandise sales and services are reported net of estimated returns and allowances and exclude sales taxes. The refund liability for returns and allowances, including the impact to gross profit, is calculated as a percentage of sales based on historical return percentages. Estimated returns are recorded as a reduction of sales and cost of sales. The reserve for returns and allowances was $0.5 million at February 3, 2018.

Cost of Sales and Occupancy

Cost of sales and occupancy is comprised principally of merchandise costs, warehousing and distribution (including receiving and store delivery) costs, retail store occupancy costs, home services and installation costs, warranty cost, royalties payable to Transform Holdco related to our sale of products branded with one of the KENMORE®, CRAFTSMAN®, and DIEHARD® marks (the “KCD Marks”), customer shipping and handling costs, vendor allowances, markdowns, and physical inventory losses. The KCD Marks are owned by, or licensed to, subsidiaries of Transform Holdco.

Selling and Administrative Expenses

Selling and administrative expenses are comprised principally of franchisee commissions, payroll and benefits costs for retail and support employees, advertising, pre-opening costs, and other administrative expenses.

Franchisee Commissions

In accordance with our agreements with our franchisees, we pay commissions to our franchisees on the net sales of merchandise and extended-service plans. In addition, each franchisee can earn marketing support, home improvement referrals, rent support, and other items. Commission costs are expensed as incurred and reflected within selling and administrative expenses. Commission costs were $6.4 million and $22.2 million in fiscal years 2018 and 2017, respectively. Commission costs vary based on factors including store count, number of dealer and franchise locations, sales mix, sales volume, and commission rates.

Pre-Opening Costs

Pre-opening and start-up activity costs are expensed in the period in which they occur.

Advertising Costs

Advertising costs are expensed as incurred, generally the first time the advertising occurs, and were $14.6 million and $17.0 million for 2018 and 2017, respectively. These costs are included within selling and administrative expenses in the accompanying Combined Statements of Operations.

Income Taxes

We provide deferred income tax assets and liabilities based on the estimated future tax effects of differences between the financial and tax basis of assets and liabilities based on currently enacted tax laws. The tax balances and income tax expense recognized by us are based on management's interpretation of the tax laws of multiple jurisdictions. Income tax expense also reflects our best estimates and assumptions regarding, among other things, the level of future taxable income, tax planning, and any valuation allowance. For the year ended February 2, 2019, a valuation allowance of $37.0 million has been recorded for the full amount of the net deferred tax assets. In the future, we may record additional net deferred tax assets; and if future utilization of deferred tax assets is uncertain, we may record additional valuation allowance against such deferred tax assets. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results and incorporate assumptions including the amount of future federal, state and foreign pre-tax operating income (loss), the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income.

Tax benefits are recognized when they aremore-likely-than-not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is more-likely-than-not of being recognized upon settlement. We will be subject to periodic audits by the Internal Revenue Service ("IRS") and other state local and foreign taxing authorities. Theses audits may challenge certain of the Company's tax positions such as the timing and amount of income and deductions and the allocation of taxable income to various tax jurisdictions. We evaluate our tax positions and establish liabilities in accordance with the applicable guidance on uncertainty in income taxes. These tax uncertainties are reviewed as facts and circumstances change and are adjusted accordingly. This requires significant management judgment in estimating final outcomes. Actual results could materially differ from these estimates and could significantly affect the effective tax rate and cash flows in future years. Interest and penalties are classified as income tax expense in the Combined Statements of Operations.

Prior to the 2012 Separation, our taxable income was included in the consolidated federal, state and foreign income tax returns of Sears Holdings or its affiliates. Income taxes in these combined financial statements have been recognized on a separate return basis. Under a Tax Sharing Agreement between the Company and Transform Holdco (the "Tax Sharing Agreement"), Transform Holdco is responsible for any federal, state or foreign income tax liability relating to tax periods ending on or before the 2012 Separation; and the Company is responsible for any federal, state or foreign tax liability relating to tax periods ending after the 2012 Separation.

Fair Value of Financial Instruments

We determine the fair value of financial instruments in accordance with standards pertaining to fair value measurements. Such standards define fair value and establish a framework for measuring fair value under U.S. GAAP. Under fair value measurement accounting standards, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. We report the fair value of financial assets and liabilities based on the fair value hierarchy prescribed by accounting standards for fair value measurements, which prioritizes the inputs to valuation techniques used to measure fair value into three levels, as follows:

Level 1 inputs—unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs—inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risks, and default rates.

Level 3 inputs—unobservable inputs for the asset or liability.

Cash and cash equivalents, accounts payable, accrued expenses (Level 1), and accounts and franchisee notes receivable are reflected in the balance sheets at cost, which approximates fair value due to the short-term nature of these instruments. The carrying value of long-term notes receivable approximates fair value.

We may be required, on a nonrecurring basis, to adjust the carrying value of the Company's long-lived assets. When necessary, these valuations are determined by the Company using Level 3 inputs. These assets are subject to fair value adjustments in certain circumstances as when there is evidence that impairment may exist. As disclosed in Note 1, the Company recorded impairment charges of $1.1 million and $0.0 million on its property and equipment in fiscal years 2018 and 2017, respectively. The Company utilized Level 3 inputs to measure the fair value of property and equipment, and intangible assets.

Recently Issued Accounting Pronouncements

ASU 2016-02 "Leases (Topic 842)"

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU")2016-02, *"Leases (Topic 842)",* which establishes a right-of-use model and requires an entity that is a lessee to recognize theright-of-use assets and liabilities arising from leases on the balance sheet. ASU No. 2016-02 also requires disclosures about the amount, timing, and uncertainty of cash flows arising from leases. Leases will be classified as finance or operating, with classification affecting both the pattern and classification of expense recognition in the statements of earnings. This guidance was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASUNo. 2018-10, Codification Improvements to Topic 842; and ASU No. 2018-11, Targeted Improvements. ASU No. 2016-02 and subsequent updates require a modified retrospective transition, with the cumulative effect of transition, including initial recognition of lease assets and liabilities for existing operating leases, as of (i) the effective date or (ii) the beginning of the earliest comparative period presented. These updates also provide a number of practical expedients for implementation which we are applying, as discussed below.

Our leases primarily consist of retail space and distribution centers. We completed our initial assessment of the standard as well as implementation of our leasing software, including data upload, and are continuing to finalize our calculations, including validation procedures. We continue establishing new processes and internal controls required to comply with the new lease accounting and disclosure requirements set by the new standard.

On February 3, 2019, we adopted ASU 2016-02. We are using the package of practical expedients that allows companies to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any expired or existing leases. We have made accounting policy elections to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition. Consequently, short-term leases are expensed over the lease term. We did not elect to adopt the hindsight practical expedient and, therefore, will maintain the lease terms previously determined under ASC 840.

The most significant and material impact of adoption was the recognition of right-of-use ("ROU") assets and lease liabilities on our balance sheet for operating leases. As a result of adopting Topic 842 in our 2019 fiscal year, we recognized an operating ROU asset and lease liability of $116.0 million and $116.4 million, respectively. Existing prepaid rent, accrued rent, and deferred rent were recorded as an offset to our gross operating lease right of use assets. The standard did not have a material impact on our results of operations or cash flows.

Recently Adopted Accounting Pronouncements

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)"

In May 2014, the FASB issued ASU 2014-09, *"Revenue from Contracts with Customers (Topic 606)",* which supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, "*Revenue Recognition"*. Several additional ASUs have subsequently been issued amending and clarifying the standard. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle and to determine when and how revenue is recognized. The updates may be applied retrospectively for each period presented or as a cumulative-effect adjustment at the date of adoption.

We adopted this standard on February 4, 2018, using the modified retrospective approach. The impact of the adoption of ASU 2014-09 on our combined financial statements is as follows:

- Our revenue is primarily generated from the sales of merchandise to customers through the retail, e-commerce or wholesale channels. Our performance obligations underlying such sales, and the timing of revenue recognition related thereto, remain substantially unchanged following the adoption of this ASU.
- The adoption of ASU No. 2014-09 requires that we recognize our sales return allowance on a gross basis rather than as a net liability. As such, we now recognize (i) a return asset for the right to recover the goods returned by the customer, measured at the former carrying amount of the goods, less any expected recovery costs (recorded as an increase to prepaid expenses and other current assets), (ii) a return liability for the amount of expected returns (recorded as an increase to other current liabilities), and (iii) deferred revenue for commissions earned on extended protection agreements (recorded as an increase to other current liabilities).

We have made accounting policy elections to (1) exclude from the measurement of transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by us from a customer (sales tax, value added tax, etc.) and (2) account for shipping and handling activities performed after a customer obtains control of the good as activities to fulfill the promise to transfer the good.

We applied ASU No. 2014-09 only to contracts that were not completed prior to fiscal year 2018. The cumulative effect of applying ASU No. 2014-09 was immaterial. The comparative prior period information continues to be reported under the accounting standards in effect during those periods.

NOTE 2—NET SALES

During fiscal year 2018, approximately 98% of our net sales were generated in the United States.

Net sales of merchandise and services were as follows:

	Fiscal years ended	
In thousands	February 2, 2019	February 3, 2018
Merchandise	$ 453,217	$ 497,143
Services	35,424	40,197
Other	6,633	6,516
Net sales	$ 495,274	$ 543,856

NOTE 3—ACCOUNTS AND FRANCHISEE RECEIVABLES AND OTHER ASSETS

Accounts and franchisee receivables and other assets consist of the following:

In thousands	February 2, 2019	February 3, 2018
Short-term franchisee receivables	$ 393	$ 698
Miscellaneous receivables	2,027	1,117
Long-term franchisee receivables	930	5,786
Other assets	458	420
Allowance for losses on short-term franchisee receivables	(394)	(340)
Allowance for losses on long-term franchisee receivables	(930)	(2,752)
Net accounts and franchisee receivables and other assets	$ 2,484	$ 4,929

NOTE 4—ALLOWANCE FOR LOSSES ON FRANCHISEE RECEIVABLES

The allowance for losses on franchisee receivables consists of the following:

	Fiscal Years Ended	
In thousands	February 2, 2019	February 3, 2018
Allowance for losses on franchisee receivables, beginning of period	$ 3,092	$ 4,299
Provisions during the period	2,839	7,561
Write off of franchisee receivables	(4,607)	(8,768)
Allowance for losses on franchisee receivables, end of period	$ 1,324	$ 3,092

On November 2, 2018, the Company and a franchisee entered into a transaction consisting of agreements that terminated all of the franchisee's franchise agreements and sublease arrangements for 5 franchised locations. The agreements provided that the franchisee transferred ownership of all assets, management of stores, and certain rights to property leases. The assets the Company purchased included all store furniture, fixtures, and equipment. As of the transaction date, the franchisee was the obligor on promissory notes to the Company with a total carrying value, net of reserves, of $2.7 million. As part of the transaction, the Company waived the remaining unpaid principal on these promissory notes. During fiscal year 2018, the Company recognized a loss of $2.7 million on the transaction.

On June 7, 2017, the Company and a franchisee entered into a transaction consisting of agreements that terminated all of the franchisee's franchise agreements and sublease arrangements for 14 franchised locations (except with respect to one location as to which the Company would either assume the lease or enter into a lease directly with the landlord). The agreements provided that the franchisee transferred ownership of all assets, management of stores, and certain rights to property leases (in one instance

pursuant to an occupancy agreement). The assets the Company purchased included all store furniture, fixtures, and equipment. As of the transaction date, the franchisee was the obligor on promissory notes to the Company with a total carrying value, net of reserves, of $5.5 million. As part of the transaction, the Company waived the remaining unpaid principal on these promissory notes and received a new promissory note from the franchisee in the amount of $1.5 million, which is payable in installments through December 11, 2022. During fiscal year 2017, the Company recognized a loss of $5.5 million on the transaction.

NOTE 5—OTHER CURRENT AND LONG-TERM LIABILITIES

Other current and long-term liabilities consist of the following:

In thousands	February 2, 2019	February 3, 2018
Customer deposits	$ 1,533	$ 1,226
Sales and other taxes	4,927	5,338
Accrued expenses	11,751	4,701
Payroll and related items	7,593	5,585
Store closing and severance costs	213	3,180
Total other current and long-term liabilities	$ 26,017	$ 20,030

NOTE 6—INCOME TAXES

The Company is included in the Parent's federal, state and local income tax returns and in its own Puerto Rico partnership return with its corresponding pass through taxable income included in the Parent's Puerto Rico corporate income tax return. For purposes of these carve-out financial statements, income taxes related to the Company have been presented as if it were a separate taxpayer. Under this approach, the Company determines its current tax liability, deferred tax assets and liabilities and related tax expense as if it were filing separate tax returns in each tax jurisdiction.

Income tax expense in the carve-out statement of operations represents the sum of current tax and deferred tax. Income taxes are presented on a separate tax return basis as if the Company were a standalone entity. The financial statement presentation assumes that in the event a tax attribute was utilized on a combined return of the Parent, the Company has not realized the benefits of the tax attribute unless it could realize the benefit as a standalone taxpayer. Likewise, in the event the Company could utilize a tax attribute on a standalone basis, the Company has realized the benefits of the tax attribute even though it may not have been utilized on the Parent's combined return.

Tax attributes such as net operating loss carryovers have been recognized by the Parent and by the Company. Because the Company is part of the same legal entity that generated many of these tax attributes, the Parent has estimated the amount of certain attributes attributable to the Company. These attributes, although disclosed herein, may not be transferred in certain transactions.

The provisions for income tax expense for fiscal years 2018 and 2017 consist of the following:

In thousands	Fiscal Years Ended February 2, 2019	Fiscal Years Ended February 3, 2018
Loss before income taxes:		
U.S.	$ (267)	$ (49,727)
Foreign	(2,534)	(617)
Total	$ (2,801)	$ (50,344)
Income tax expense (benefit):		
Current:		
Federal	$ —	$ —
State	98	84
Foreign	165	(47)
Total	263	37
Deferred:		
Federal	—	(145)
Total	—	(145)
Income tax expense (benefit)	$ 263	$ (108)

The provisions for income taxes for financial reporting purposes is different from the tax provision computed by applying the statutory federal tax rate. The reconciliation of the tax rate follows:

	Fiscal Years Ended February 2, 2019	Fiscal Years Ended February 3, 2018
Federal tax rate	21.0%	33.7%
State income tax (net of federal benefit)	(2.8)%	(0.1)%
Federal tax rate change	—%	(23.8)%
Valuation allowance	(21.2)%	(9.6)%
Foreign taxes	(6.0)%	0.1%
Other	(0.5)%	(0.1)%
Effective tax rate	(9.5)%	0.2%

The major components of the deferred tax assets and liabilities as of February 2, 2019 and February 3, 2018 are as follows:

	Fiscal Year Ended	
In thousands	**February 2, 2019**	**February 3, 2018**
Deferred tax assets		
Bad debts	$ 355	$ 785
Inventory	4,081	2,556
Deferred compensation	1,201	442
Net operating loss	21,950	21,187
Property	1,763	2,201
Royalty-free license	5,168	5,796
Other	3,028	3,771
Subtotal deferred tax assets	37,546	36,738
Valuation allowance	(37,023)	(36,291)
Total deferred tax assets	523	447
Deferred tax liabilities		
Other	(523)	(447)
Total deferred tax liabilities	(523)	(447)
Net deferred tax assets	$ —	$ —

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act made broad and complex changes to the U.S. tax code that affected our fiscal year ended February 3, 2018, including, but not limited to, (1) reducing the U.S. federal corporate tax rate, (2) eliminating the corporate alternative minimum tax (AMT) and changing how existing AMT credits can be realized, and (3) various other miscellaneous changes that were effective in fiscal 2017. The Tax Act reduced the federal corporate tax rate to 21% in the fiscal year ended February 3, 2018. Based on Section 15 of the Internal Revenue Code, our fiscal year ended February 3, 2018 had a blended corporate tax rate of 33.7%, which is based on the applicable tax rates before and after the Tax Act and the number of days in the year.

The Tax Act also established new tax rules that affect fiscal 2018, including, but not limited to, (1) reduction of the U.S. federal corporate tax rate; (2) the elimination of corporate AMT; (3) a new limitation on deductible interest expense; (4) limitations on the deductibility of certain executive compensation; (5) limitations on the use of foreign tax credits to reduce the U.S. income tax liability; and (6) limitations on net operating losses ("NOL"s) generated in tax years beginning after December 31, 2017, to 80% of taxable income.

The SEC staff issued Staff Accounting Bulletin ("SAB") No. 118 ("SAB 118"), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, *"Income Taxes"*. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act.

In connection with our initial analysis of the impact of the Tax Act, we have recorded a discrete net tax benefit of $0.1 million in the period ended February 3, 2018. This net tax benefit consisted of a reduction in the valuation allowance by $0.1 million as a result of the elimination of the AMT credit as a deferred tax asset and corresponding establishment of a long-term receivable.

All accounting for the Tax Act is complete.

The Tax Act reduces the corporate rate to 21%, effective January 1, 2018. Our net deferred tax assets (“DTA”) and deferred tax liabilities (“DTL”) decreased by $12.0 million with a corresponding net adjustment to the valuation allowance for the year ended February 3, 2018. A deferred tax benefit of $0.1 million was recorded in the period ended February 3, 2018 as a result of a reduction in the valuation allowance due to the elimination of the AMT credit as a deferred tax asset and corresponding establishment of a long-term receivable. During fiscal 2018, the balance of the receivable was increased $0.1million due to an IRS adjustment and related payment of additional AMT associated with a recently completed IRS exam and $0.1 million of the receivable was reclassed to a current asset reflecting the portion expected to be received within 12 months.

We account for income taxes in accordance with accounting standards for such taxes, which require that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the financial reporting and tax bases of recorded assets and liabilities. Accounting standards also require that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. In performing the assessment for 2017 and 2018, a significant piece of negative evidence evaluated was the cumulative loss incurred over each of the three-year periods ended February 3, 2018 and February 2, 2019. The loss was evaluated as book loss adjusted for non-deductible and non-recurring items such as sale of property, store closing costs, franchise income/expense and software expenses. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.

On the basis of this analysis and significant negative objective evidence, management has determined a full valuation allowance is still necessary for each of the years ended February 3, 2018 and February 2, 2019. The valuation allowance increased by $0.7 million for the current year which was offset by the corresponding increase in net DTA. As of February 2, 2019, a valuation allowance of $37.0 million is recorded for the full amount of the net deferred tax assets. Changes in the valuation allowance are recorded as a non-cash charge for increases or credit for decreases to income tax expense or benefit. A valuation allowance release resulted in a tax benefit of $0.1 million in the year ended February 3, 2018 due to the elimination of the AMT DTA and corresponding establishment of a long-term receivable.

At the end of 2018 and 2017, we had federal NOL carryforwards of $86.8 million and $83.4 million, respectively, which will expire between 2036 and 2038 though the 2018 NOL has an indefinite life. At the end of 2018 and 2017, we had state NOL carryforwards of $4.7 million and $4.6 million, respectively, which will expire between 2019 and 2039 though some of the 2018 state NOLs have an indefinite life. We have credit carryforwards of $0.2 million which will expire between 2023 and 2039.

The operations of the Company are included in the SHO’s federal, state and city income tax returns in the United States and foreign tax returns in Puerto Rico as well as its own partnership return in Puerto Rico. SHO was also a part of the Sears Holdings combined state returns for the years ended February 2, 2013 and February 1, 2014. SHO has completed its federal audit for the tax return ended January 30, 2016 and all matters have been resolved. Currently, SHO is under audit for one separate state returns for fiscal years 2013 through 2016.

NOTE 7—RELATED PARTY AGREEMENTS AND TRANSACTIONS

As the Company is a carve-out business of SHO, SHO and its subsidiaries would be considered related parties to the Company. As discussed in Note 1, SHO provides certain buying, distribution and administrative services to the Company on a centralized basis including finance, legal, information technology, human resources, corporate services and other overhead functions. If not billed directly to the Company, these costs are allocated to the Company to approximate the Company’s proportionate share of such costs and expenses. Allocated costs and expenses include shared occupancy space, interest expense, corporate payroll, business process outsourcing, and liability insurance. The Company is charged for purchases of merchandise made from SHO.

Employees of the Company participate in benefit plans that are sponsored by SHO. See Note 10 – Defined Contribution Plan for more information. SHO also provides stock-based compensation for management of the Company.

Transactions with Parent for the years ended February 3, 2019 and February 2, 2018 consist of the following:

In thousands	February 2, 2019	February 3, 2018
Net Commissions from Transform Holdco	$ 18,629	$ 22,562
Purchases from Transform Holdco related to cost of sales and occupancy	83,039	106,169
Services from Transform Holdco included in selling and administrative	13,812	19,890
Cost of sales and occupancy cost allocations from Parent	27	(32)
Selling and administrative cost allocations from Parent	14,815	7,812
Interest expense allocation from Parent	6,054	2,508

The Company depends on SHO to provide key products and services to the Company and SHO depends on Transform Holdco (Sears Holdings prior to Transform Holdco acquiring most of the operating assets and assuming the related operative agreements and obligations of Sears Holdings from bankruptcy in mid-February 2019) for most of its key products and services. As of February 2, 2019 and February 3, 2018, the Company recorded $2.8 million and $4.2 million of payable to related party representing an allocation of the Company's portion of the amount owed by SHO to Transform Holdco (Sears Holdings from bankruptcy in mid-February 2019).

NOTE 8—STORE CLOSING CHARGES

Accelerated Closed Store Charges

Our Parent completed steps to reduce costs, make the best use of capital, and improve our profitability by closing, or seeking the closure of under-performing stores.

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which we no longer expect to receive any economic benefit are accrued when we cease to use the leased space and have been reduced for estimated sublease income.

Accelerated (prior to lease expiration) store closure costs for the fiscal years ended February 2, 2019 and February 3, 2018, respectively, were as follows:

In thousands	Lease Termination Costs (1)	Inventory Related (1)	Impairment and Accelerated Depreciation (2)	Other Charges (3)	Total Store Closing Costs
Fiscal years ended February 2, 2019	$ (406)	$ —	$ 83	$ 45	$ (278)
Fiscal years ended February 3, 2018	7,148	409	979	168	8,704

(1) Recorded within cost of sales and occupancy in the Combined Statements of Operations. Lease termination costs are net of estimated sublease income, and include the reversal of closed store reserves when a lease agreement is terminated for an amount less than the remaining reserve established for the store.
(2) Recorded within depreciation and amortization in the Combined Statements of Operations.
(3) Recorded within selling and administrative in the Combined Statements of Operations.

Closed Store Reserves

The store closing reserves included within other current liabilities in the Balance Sheets, consists of the following:

In thousands	February 2, 2019	February 3, 2018
Store closing and severance costs reserve, beginning of period	$ 3,180	$ 634
Store closing (recovery) costs	(361)	7,725
Payments/utilization	(2,606)	(5,179)
Store closing and severance costs reserve, end of period	$ 213	$ 3,180

NOTE 9—SALE OF ASSETS

On August 10, 2018, we completed the sale of a property in Newington, Connecticut. The sale price of the property was $2.8 million net of closing costs, and we recorded a gain on the sale of approximately $1.4 million when the sale was completed in accordance with the terms and conditions of the Purchase and Sale Agreement. We did not sell any owned property in fiscal year 2017.

NOTE 10 — DEFINED CONTRIBUTION PLAN

Our Parent sponsors a Sears Hometown and Outlet Stores, Inc, 401(k) savings plan for employees meeting service eligibility requirements which offers a discretionary matching contribution. In fiscal years ended February 2, 2019 and February 3, 2018, the Company incurred expenses for the retirement savings plan in the amount of $0.6 million and $0.5 million, respectively. The expense was allocated to the Company consistent with the allocations discussed in Note 7—Related Party Agreements and Transactions.

NOTE 11—COMMITMENTS AND CONTINGENCIES

We are subject to various legal and governmental proceedings arising out of the ordinary course of business, the outcome of which, individually and in the aggregate, in the opinion of management, would not have a material adverse effect on our business, financial position, or results of operations, or cash flows.

NOTE 12 — SUBSEQUENT EVENTS

On October 23, 2019, SHO completed the sale of the Company, including substantially all of the assets and liabilities comprising SOS, to Franchise Group Newco S, LLC (the "Purchaser"), an indirect subsidiary of Franchise Group, LLC (formerly known as Liberty Tax, Inc.), pursuant to an Equity and Asset Purchase Agreement, dated as of August 27, 2019. Pursuant to the terms of the Purchase Agreement, the Purchaser paid SHO an aggregate purchase price, after giving effect to a customary working capital adjustment, of $119,960,000 in cash, and in addition reimbursed SHO for certain costs it incurred in connection with the sale of the Company and certain employee payments and insurance costs incurred by SHO in connection with the Merger.

Exhibit 99.2

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)

Combined Financial Statements

For the Twenty Six Weeks Ended
August 3, 2019 and August 4, 2018

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
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SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF OPERATIONS

In thousands	26 Weeks Ended August 3, 2019	26 Weeks Ended August 4, 2018
NET SALES	$ 234,185	$ 257,210
COST and EXPENSES		
Cost of sales and occupancy	169,325	189,098
Selling and administrative	51,582	59,321
Impairment of property and equipment	—	56
Depreciation and amortization	2,113	2,733
Gain on sale of assets	(2,877)	—
Total costs and expenses	220,143	251,208
Operating income	14,042	6,002
Interest expense	(1,786)	(2,038)
Other income	6	106
Income before taxes	12,262	4,070
Income tax expense (benefit)	290	386
NET INCOME	$ 12,552	$ 4,456

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED BALANCE SHEETS

In thousands	August 3, 2019	August 4, 2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,413	$ 248
Accounts and franchisee receivables, net	1,131	7,112
Merchandise inventories	97,027	89,420
Due from parent	2,485	3,277
Prepaid expenses and other current assets	2,247	6,893
Total current assets	104,303	106,950
PROPERTY AND EQUIPMENT, net	15,484	20,132
OPERATING LEASE RIGHT OF USE ASSET	108,427	
OTHER ASSETS, net	798	3,117
TOTAL ASSETS	$ 229,012	$ 130,199
LIABILITIES		
CURRENT LIABILITIES		
Payable to related party	$ 1,339	$ 3,660
Accounts payable	20,018	11,154
Current operating lease liabilities	29,274	—
Other current liablities	8,640	20,797
Total current liabilities	59,271	35,611
LONG TERM OPERATING LEASE LIABILITIES	79,676	
OTHER LONG-TERM LIABILITIES	837	1,705
TOTAL LIABILITIES	139,784	37,316
EQUITY		
Net Parent investment	89,228	92,883
TOTAL LIABILITIES AND EQUITY	$ 229,012	$ 130,199

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF CHANGES IN EQUITY

In thousands	August 3, 2019	August 4, 2018
Net Parent Investment Balance at February 2, 2019 and February 3, 2018	$ 83,072	$ 100,109
Net income	12,552	4,456
Transfers (to)/from parent	(5,876)	(11,178)
Cumulative effect of adjustment from adoption of new revenue recognition standard	(520)	(504)
Net Parent Investment Balance at August 3, 2019 and August 4, 2018	$ 89,228	$ 92,883

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
COMBINED STATEMENTS OF CASH FLOWS

In thousands	August 3, 2019	August 4, 2018
CASH FLOW FROM OPERATING ACTIVITIES		
Net loss	$ 12,552	$ 4,456
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,368	2,988
Gain on the sale of assets	(2,877)	—
Impairment of property and equipment	—	56
Provision for lossess on franchisee receivables	19	99
Changes in operating assets and liabilitiels:		
Accounts and franchisee receivables	876	(5,929)
Merchandise inventories	1,210	10,329
Payable to related party	(1,504)	(557)
Accounts payable	3,581	(353)
Store closing accrual	(2,967)	(2,967)
Customer deposits	971	971
Due from parent	(167)	(744)
Other Operating assets	(105,423)	(5,676)
Other Operating liabilities	(14,544)	4,469
	(105,905)	7,142
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property and investments	2,837	2,837
Purchase of property and equipment	1,482	1,482
	4,319	4,319
CASH FLOWS FROM FINANCING ACTIVITIES		
(Distributions to) contributions from Parent, net	(6,395)	(11,683)
Net borrowings from capital lease obligations	108,949	—
	102,554	(11,683)
NET CHANGE IN CASH AND CASH EQUIVALENTS	968	(222)
CASH AND CASH EQUIVALENTS - Beginning of Period	445	470
CASH AND CASH EQUIVALENTS - End of Period	$ 1,413	$ 248

See Notes to Combined Financial Statements.

SEARS OUTLET STORES
(a carve-out business of Sears Hometown and Outlet Stores, Inc.)
NOTES TO COMBINED FINANCIAL STATEMENTS
(Amounts in thousands)

NOTE 1—BACKGROUND, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background

Sears Outlet Stores, ("SOS," the "Company," the "Business", "we," "our," or "us") is acarve-out business of Sears Hometown and Outlet Stores, Inc. ("SHO" or "Parent") which combines the accounts of Sears Outlet Stores, L.L.C., Leasing Operations, LLC, Outlet Merchandise, LLC, and the operations of eight Buddy's Home Furnishings stores where we are a franchisee. On April 23, 2012, SHO was formed as a wholly owned subsidiary of Sears Holdings, and on October 11, 2012, Sears Holdings completed the separation of SHO. On October 23, 2019, SHO completed the sale of the Company, including substantially all of the assets and liabilities to Franchise Group Newco S, LLC (the "Purchaser"), an indirect subsidiary of Franchise Group, LLC (formerly known as Liberty Tax, LLC), pursuant to the Equity and Asset Purchase Agreement, dated as of August 27, 2019.

The Company is a national retailer primarily focused on providing customers within-store and online access to purchase, at prices that are significantly lower than list prices, new, one-of-a-kind, out-of-carton, discontinued, obsolete, used, reconditioned, overstocked, and scratched and dented products across a broad assortment of merchandise categories, including home appliances, apparel, mattresses, lawn and garden equipment, sporting goods and tools.

As of August 3, 2019, we operated [14] distribution centers and [123] Sears Outlet retail stores in the United States including one distribution center and store in Puerto Rico. Our independent franchisees operated [five] of our Sears Outlet retail stores. The business model and economic structure of the franchisee operated stores, which are independently owned, are substantially similar to Company-operated stores in many respects. The Company requires all of the stores to operate under specified circumstances according to the Company's standards. Stores must display the required merchandise, offer all required products and services, and use the Company's point of sale system. Also, the Company has the right to approve advertising and promotional and marketing materials and imposes specified advertising requirements on the owners. The Company owns the merchandise, establishes all selling prices for the merchandise, and bears general inventory risk (with specific exceptions) until sale of the merchandise and if the customer returns the merchandise. In addition, because each transaction is recorded in the Company's point of sale system, the Company bears customer credit risk. The Company establishes a commission structure for stores operated by our franchisees and pays commissions when our franchisees sell the merchandise and services. Several of the primary differences between Company-operated stores and franchisee-operated stores are that (1) the Company is responsible for occupancy and payroll costs associated with Company-operated stores while our franchisees are responsible for these costs for their stores, (2) the Company is responsible for all terms and conditions of employment for the employees in the Company-operated stores and our franchisees are responsible for all terms and conditions of employment for the employees in their stores, and (3) we pay commissions to our franchisees.

We also operated [eight] Buddy's Home Furnishings stores where we are a franchisee, enabling us to benefit from Buddy's expertise and system infrastructure in the rent-to-own business which we own the inventory that we rent to our customers.

Basis of Presentation

Stand-alone financial statements have not been historically prepared for the business. The accompanying Combined Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America. These Combined Financial Statements are presented as carve-out financial statements and reflect the combined historical results of operations, balance sheets and cash flows of the Company. All intercompany balances and transactions within the Company have been eliminated in these Combined Financial Statements. As described in Note 7 Related Party Agreements and Transactions, certain transactions between the Company and our Parent have been included in these Combined Financial Statements.

The Combined Balance Sheets reflect, among other things, all the assets and liabilities of the Company that are specifically identifiable as being directly attributable to the Company, including net Parent investment as a component of equity. Net Parent Investment represents our Parent's historical investment in the Company and includes accumulated net earnings (loss) attributable to our Parent, the net effect of certain transactions with our Parent and our Parent's subsidiaries, and cost allocations from our Parent that were not historically allocated to the Company.

SHO uses a centralized approach to cash management and financing of its operations. These arrangements are not reflective of the manner in which the Company would have financed its operations had it been a stand-alone business separate from SHO
during the periods presented. Cash pooling arrangements are excluded from the asset and liability balances in the Combined Balance Sheets. These amounts have instead been reported as Net Parent Investment.

SHO and its subsidiaries provide a variety of services to the Company. The Combined Statements of Operations includes expense allocations for services and certain support functions that are provided on a centralized basis within SHO such as legal, information technology, human resources, corporate audit, treasury and various other SHO corporate functions that are allocated to the Company and reflected in the Combined Statements of Operations within total costs and expenses. Where allocations of amounts were necessary, the Company believes the allocation of these amounts were determined on a reasonable basis, reflecting all of the costs of the Company, and consistently applied in the periods presented. These allocated amounts, however, are not necessarily indicative of the actual amounts that might have been incurred or realized had the Company operated as a separate stand-alone entity during the periods presented. Consequently, these Combined Financial Statements do not necessarily represent the results the Company would have achieved if the Company had operated as a separate stand-alone entity from SHO during the periods presented.

As noted above, the Company depends on SHO to provide all key products and services to the Company and SHO depends on Transform Holdco (Sears Holdings prior to Transform Holdco acquiring most of the operating assets and assuming the related operative agreements and obligations of Sears Holdings from bankruptcy in mid-February 2019) for most of its key products and services. Consequently, if Transform Holdco is unwilling, unable, or otherwise fails to provide these key products and services or if Transform Holdco's brands are impaired, the Company could be materially and adversely affected. These key products and services include:

- inventory procurement, including KCD (KENMORE®, CRAFTSMAN®, and DIEHARD®) products and other products, which collectively account for a majority of SHO's revenue. For the twenty-six weeks ended August 3, 2019, products which SHO acquired through Transform Holdco (Sears Holdings prior to mid-February 2019) accounted for approximately 78% of SHO's merchandise purchases,
- logistical, supply chain, and inventory support services,
- online, computer and information technology infrastructure (including the point-of-sale system used by the Company and dealers and franchisees), and support,
- use of the Sears brand name and other intellectual property owned by Transform Holdco.

The Company has evaluated for subsequent events through to the date the Combined Financial Statements were available to be issued as at January 7, 2020.

Variable Interest Entities

On an ongoing basis the Company evaluates its business relationships, such as those with its franchisees, to identify potential variable interest entities. Generally, these businesses qualify for a scope exception under the consolidation guidance, or, where a variable interest exists, the Company does not possess the power to direct the activities that most significantly impact the economic performance of these businesses. The Company has not consolidated any of such entities in the periods presented.

SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year

Our second fiscal quarter ends on the Saturday closest to July 31. For 2019 and 2018, our second fiscal quarter ended as follows: The following fiscal periods are presented herein.

Fiscal Year	Ended	Weeks
2019	August 3, 2019	52
2018	August 4, 2018	53

Our fiscal years end on the Saturday closest to January 31. Unless otherwise stated, references to specific years and quarters in these notes are to fiscal years and fiscal quarters.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events. The estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances. Adjustments to estimates and assumptions are made when facts and circumstances dictate. As future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying financial statements. Significant estimates and assumptions are required as part of determining inventory and accounts and franchisee receivables valuation, estimating depreciation and recoverability of long-lived assets, establishing insurance, warranty, legal and other reserves, performing long-lived asset impairment analysis, and establishing valuation allowances on deferred income tax assets and reserves for tax examination exposures.

Cash and Cash Equivalents

Cash equivalents include deposits in-transit from banks for payments related to third-party credit card and debit card transactions.

Under SHO’s cash management system, the Company utilizes available borrowings from the Parent, on an as-needed basis, to fund the clearing of checks as they are presented for payment. As of August 3, 2019 and August 4, 2018, outstanding deposits totaling $2.5 million and $3.3 million, respectively, were included in Due from Parent in the Combined Balance Sheets.

Allowance for Doubtful Accounts

We provide an allowance for doubtful accounts based on both historical experience and a specific identification basis. Allowances for doubtful accounts on accounts and franchisee receivable balances were $1.3 million and $1.3 million at August 3, 2019 and August 4, 2018, respectively. Our accounts receivable balance is comprised of various vendor-related and customer-related accounts receivable. Our franchisee receivable balance is comprised of promissory notes that relate primarily to the sale of assets for our franchised locations.

The Company provides an allowance for losses on franchisee receivables (which consist primarily of franchisee promissory notes) in an amount equal to estimated probable losses net of recoveries. The allowance is based on an analysis of expected future write-offs, existing economic conditions, and an assessment of specific identifiable franchisee promissory notes and other franchisee receivables considered at risk or uncollectible. The expense associated with the allowance for losses on franchisee receivables is recognized as selling and administrative expense. As of August 3, 2019 and August 4, 2018, all franchisee receivables have been fully reserved.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market. Merchandise inventories are valued under the retail inventory method, or “RIM,” using primarily a last-in, first-out, or “LIFO,” cost-flow assumption.

Inherent in RIM calculations are certain significant management judgments and estimates including, among others, merchandise markons, markups, markdowns, and shrinkage, which significantly impact the ending inventory valuation at cost and resulting gross margins. The methodologies utilized by us in our application of RIM are consistent for all periods presented. Such methodologies include the development of the cost-to-retail ratios, the groupings of homogeneous classes of merchandise, the development of shrinkage and obsolescence reserves, the accounting for price changes, and the computations inherent in the LIFO adjustment (where applicable). Management believes that RIM provides an inventory valuation that reasonably approximates cost and results in carrying inventory at the lower of cost or market.

In connection with our LIFO calculation, we estimate the effects of inflation on inventories by utilizing external price indices determined by the U.S. Bureau of Labor Statistics. If we had used the first-in, first-out, or “FIFO” method of inventory valuation instead of the LIFO method, merchandise inventories would have been insignificantly higher at August 3, 2019 and August 4, 2018.

Vendor Rebates and Allowances

We receive rebates and allowances from vendors through a variety of programs and arrangements intended to offset the costs of promoting and selling the vendors' products. In addition, Transform Holdco (Sears Holdings prior to February 11, 2019) allocates a portion of the rebates and allowances it receives from vendors based on shipments to or sales of the related products to the Company. Vendor payments are recognized and recorded as a reduction to the cost of merchandise inventories when earned and, thereafter, as a reduction of cost of sales and occupancy as the merchandise is sold. Up-front consideration received from vendors linked to purchases or other commitments is initially deferred and amortized ratably to cost of sales and occupancy over the life of the contract or as performance of the activities specified by the vendor to earn the fee is completed.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Additions and substantial improvements are capitalized and include expenditures that materially extend the useful lives of existing facilities and equipment. Maintenance and repairs that do not materially improve or extend the lives of the respective assets are expensed as incurred.

Property and equipment consist of the following:

In thousands	August 3, 2019	August 4, 2018
Land	$ 409	$ 512
Buildings and improvements	28,424	33,919
Furniture, fixtures and equipment	16,966	16,107
Construction in progress	450	913
Capitalized leases	436	150
Total property and equipment	46,685	51,600
Less: accumulated depreciation	(31,201)	(31,468)
Total property and equipment, net	$ 15,484	$ 20,132

Depreciation expense is recorded over the estimated useful lives of the respective assets using the straight-line method for financial statement purposes and accelerated methods for tax purposes. The range of lives are generally 15 to 25 years for buildings, 3 to 10 years for furniture, fixtures, and equipment, and 3 to 5 years for computer systems and equipment. Leasehold improvements are depreciated over the shorter of the associated lease term or the estimated useful life of the asset. Total depreciation expense was $2.1 million and $2.7 million, for twenty six weeks ended August 3, 2019 and August 4, 2018, respectively.

Impairment of Long-Lived Assets and Costs Associated with Exit Activities

In accordance with accounting standards governing the impairment or disposal of long-lived assets, the carrying value of long-lived assets, including property and equipment, is evaluated whenever events or changes in circumstances indicate that a potential impairment has occurred. Factors that could result in an impairment review include, but are not limited to, a current period cash flow loss combined with a history of cash flow losses, current cash flows that may be insufficient to recover the investment in the property over the remaining useful life, or a projection that demonstrates continuing losses associated with the use of a long-lived asset, significant changes in the manner of use of the assets, or significant changes in business strategies. An impairment loss is recognized when the estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value as determined based on quoted market prices or through the use of other valuation techniques.

We account for costs associated with location closings in accordance with accounting standards pertaining to accounting for costs associated with exit or disposal activities and compensation. When management makes a decision to close a location, we record a reserve as of that date for the expected inventory markdowns associated with the closing. We also record a liability for future lease costs (net of estimated sublease income) when we cease to use the location. As of August 3, 2019 and August 4, 2018, this liability was approximately $0.2 million and $0.2 million, respectively. See Note 8.

Leases

We lease certain stores, office facilities, computers and transportation equipment. The determination of operating and capital lease obligations is based on the expected durations of the leases and contractual minimum lease payments specified in the lease agreements. For certain stores, amounts in excess of these minimum lease payments are payable based upon a specified percentage of sales. Contingent rent is accrued during the period it becomes probable that a particular store will achieve a specified sales level thereby triggering a contingent rental obligation. Certain leases also include an escalation clause or clauses and renewal option clauses calling for increased rents. Where the lease contains an escalation clause or concession such as a rent holiday, rent expense is recognized using the straight-line method over the term of the lease.

Insurance Programs

Our Parent maintains its own insurance arrangements with third-party insurance companies for exposures incurred for a number of risks including worker's compensation and general liability claims. In the twenty six weeks ended August 3, 2019 and August 4, 2018, the Company recorded insurance expense of $1.5 million and $0.7 million, respectively, which was allocated to the Company consistent with the allocations discussed in Notes 1 and 7.

Loss Contingencies

We account for contingent losses in accordance with accounting standards pertaining to loss contingencies. Under accounting standards, loss contingency provisions are recorded for probable losses at management's best estimate of a loss; or when a best estimate cannot be made, a minimum loss contingency amount is recorded. These estimates are often initially developed substantially earlier than the ultimate loss is known, and the estimates are refined each accounting period as additional information is known.

Revenue Recognition

Revenues from contracts with customers include sales of merchandise, commissions on merchandise sales made through www.sears.com, Company websites, services and extended-service plans, financing programs, and delivery and handling revenues related to merchandise sold. Revenue is measured based on the amount of fixed consideration that we expect to receive, reduced by estimates for variable consideration such as returns. Revenue also excludes any amounts collected from customers and remitted or payable to governmental authorities. In arrangements where we have multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price.

We recognize revenues from retail operations upon the transfer of control of goods to the customer. We satisfy our performance obligations at the point of sale for retail store transactions and upon delivery for online transactions. We defer revenue for retail store and online transactions including commissions on extended-service plans, where we have received consideration but have not transferred control of the goods to the customer at the end of the period. The performance obligation is generally satisfied in the following reporting period. The balance of deferred revenue was $2.8 million and $1.9 million at August 3, 2019 and August 4, 2018, respectively. The change in deferred revenue represents revenue recognized during the twenty six weeks ended August 3, 2019.

We recognize revenues from commissions on services, and delivery and handling revenues related to merchandise sold, at the point of sale as we are not the primary obligor with respect to such services and have no future obligations for future performance. Commissions earned on services, and delivery and handling revenues, are presented net of related costs because we are acting as an agent in arranging the services for the customer and do not control the services being rendered.

The Company accepts Transform Holdco (Sears Holdings prior to February 11, 2019) gift cards as tender for purchases and is reimbursed weekly by Transform Holdco for gift cards tendered.

Refund Liability and Right of Return Asset

Revenues from merchandise sales and services are reported net of estimated returns and allowances and exclude sales taxes. The typical return period is 30 days. The refund liability for returns is calculated as a percentage of sales based on historical return percentages and recognized at the transaction price as a reduction of revenues. The refund liability was $1.3 million and $1.9 million at August 3, 2019 and August 4, 2018, respectively. We also recognize a return asset, and corresponding adjustment to cost of sales, for our right to recover the goods returned by the customer, measured at the former carrying amount of the goods, less any expected recovery cost. The right of return asset was $0.5 million and $0.7 million at August 3, 2019 and August 4, 2018, respectively.

At each financial reporting date, we assess our estimates of expected returns, refund liabilities, and return assets.

Cost of Sales and Occupancy

Cost of sales and occupancy is comprised principally of merchandise costs, warehousing and distribution (including receiving and store delivery) costs, retail store occupancy costs, home services and installation costs, warranty cost, royalties payable to Transform Holdco related to our sale of products branded with one of the KENMORE®, CRAFTSMAN®, and DIEHARD® marks (the “KCD Marks”), customer shipping and handling costs, vendor allowances, markdowns, and physical inventory losses. The KCD Marks are owned by, or licensed to, subsidiaries of Transform Holdco.

Selling and Administrative Expenses

Selling and administrative expenses are comprised principally of franchisee commissions, payroll and benefits costs for retail and support employees, advertising, pre-opening costs, and other administrative expenses.

Franchisee Commissions

In accordance with our agreements with our franchisees, we pay commissions to our franchisees on the net sales of merchandise and extended-service plans. In addition, each franchisee can earn marketing support, home improvement referrals, rent support, and other items. Commission costs are expensed as incurred and reflected within selling and administrative expenses. Commission costs were $1.3 million and $4.0 million in the twenty six weeks ended August 3, 2019 and August 4, 2018, respectively. Commission costs vary based on factors including store count, number of dealer and franchise locations, sales mix, sales volume, and commission rates.

Pre-Opening Costs

Pre-opening and start-up activity costs are expensed in the period in which they occur.

Advertising Costs

Advertising costs are expensed as incurred, generally the first time the advertising occurs, and were $7.5 million and $6.0 million for twenty six weeks ended August 3, 2019 and August 4, 2018, respectively. These costs are included within selling and administrative expenses in the accompanying Combined Statements of Operations.

Income Taxes

We provide deferred income tax assets and liabilities based on the estimated future tax effects of differences between the financial and tax basis of assets and liabilities based on currently enacted tax laws. The tax balances and income tax expense recognized by us are based on management’s interpretation of the tax laws of multiple jurisdictions. Income tax expense also reflects our best estimates and assumptions regarding, among other things, the level of future taxable income, tax planning, and any valuation allowance. As of August 3, 2019, a valuation allowance has been recorded for the full amount of the net deferred tax assets. In the future, we may record additional net deferred tax assets; and if future utilization of deferred tax assets is uncertain, we may

record additional valuation allowance against such deferred tax assets. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results and incorporate assumptions including the amount of future federal, state and foreign pre-tax operating income (loss), the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income.

Tax benefits are recognized when they are more likely than not to be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is more likely than not of being recognized upon settlement. We will be subject to periodic audits by the Internal Revenue Service and other state local and foreign taxing authorities. Theses audits may challenge certain of the Company’s tax positions such as the timing and amount of income and deductions and the allocation of taxable income to various tax jurisdictions. We evaluate our tax positions and establish liabilities in accordance with the applicable guidance on uncertainty in income taxes. These tax uncertainties are reviewed as facts and circumstances change and are adjusted accordingly. This requires significant management judgment in estimating final outcomes. Actual results could materially differ from these estimates and could significantly affect the effective tax rate and cash flows in future years. Interest and penalties are classified as income tax expense in the Combined Statements of Operations.

Prior to the 2012 Separation, our taxable income was included in the consolidated federal, state and foreign income tax returns of Sears Holdings or its affiliates. Income taxes in these consolidated financial statements have been recognized on a separate return basis. Under a Tax Sharing Agreement between the Company and Transform Holdco (the “Tax Sharing Agreement”), Transform Holdco is responsible for any federal, state or foreign income tax liability relating to tax periods ending on or before the 2012 Separation; and the Company is responsible for any federal, state or foreign tax liability relating to tax periods ending after the 2012 Separation.

Fair Value of Financial Instruments

We determine the fair value of financial instruments in accordance with standards pertaining to fair value measurements. Such standards define fair value and establish a framework for measuring fair value under GAAP. Under fair value measurement accounting standards, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. We report the fair value of financial assets and liabilities based on the fair value hierarchy prescribed by accounting standards for fair value measurements, which prioritizes the inputs to valuation techniques used to measure fair value into three levels, as follows:

Level 1 inputs—unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide ongoing pricing information.

Level 2 inputs—inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable for the asset or liability, such as interest-rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risks, and default rates.

Level 3 inputs—unobservable inputs for the asset or liability.

Cash and cash equivalents, accounts payable, accrued expenses (Level 1), and accounts and franchisee notes receivable are reflected in the balance sheets at cost, which approximates fair value due to the short-term nature of these instruments. The carrying value of long-term notes receivable approximates fair value.

We may be required, on a nonrecurring basis, to adjust the carrying value of the Company's long-lived assets. When necessary, these valuations are determined by the Company using Level 3 inputs. These assets are subject to fair value adjustments in certain circumstances as when there is evidence that impairment may exist. As disclosed in Note 1, the Company recorded impairment charges of $0.0 million and $0.1 million on its property and equipment in the twenty six weeks ended August 3, 2019 and August 4, 2018, respectively. The Company utilized Level 3 inputs to measure the fair value of property and equipment, and intangible assets.

Recently Issued Accounting Pronouncements

ASU 2016-02 "Leases (Topic 842)"

In February 2016, the FASB issued Accounting Standards Update ("ASU")2016-02, "Leases (Topic 842)", which establishes a right-of-use model and requires an entity that is a lessee to recognize the right-of-use assets and liabilities arising from leases on the balance sheet. ASUNo. 2016-02 also requires disclosures about the amount, timing, and uncertainty of cash flows arising from leases. Leases will be classified as finance or operating, with classification affecting both the pattern and classification of expense recognition in the statements of earnings. This guidance was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASUNo. 2018-10, Codification Improvements to Topic 842; and ASU No. 2018-11, Targeted Improvements. ASU No. 2016-02 and subsequent updates require a modified retrospective transition, with the cumulative effect of transition, including initial recognition of lease assets and liabilities for existing operating leases, as of (i) the effective date or (ii) the beginning of the earliest comparative period presented. These updates also provide a number of practical expedients for implementation which we are applying, as discussed below.

Our leases primarily consist of retail space and distribution centers. We completed our initial assessment of the standard as well as implementation of our leasing software, including data upload, and are continuing to finalize our calculations, including validation procedures. We continue establishing new processes and internal controls required to comply with the new lease accounting and disclosure requirements set by the new standard.

On February 3, 2019, we adopted ASU 2016-02. We are using the package of practical expedients that allows companies to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases, and (3) initial direct costs for any expired or existing leases. We have made accounting policy elections to treat the lease and non-lease components of leases as a single lease component and to exempt leases with an initial term of twelve months or less from balance sheet recognition. Consequently, short-term leases are expensed over the lease term. We did not elect to adopt the hindsight practical expedient and, therefore, will maintain the lease terms previously determined under ASC 840.

The most significant and material impact of adoption was the recognition ofright-of-use ("ROU") assets and lease liabilities on our balance sheet for operating leases. As a result of adopting Topic 842 in our 2019 fiscal year, we recognized an operating ROU asset and lease liability of $116.0 million and $116.4 million, respectively. Existing prepaid rent, accrued rent, and deferred rent were recorded as an offset to our gross operating lease right of use assets. The standard did not have a material impact on our results of operations or cash flows.

Recently Adopted Accounting Pronouncements

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)"

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)", which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) 605, Revenue Recognition. Several additional ASUs have subsequently been issued amending and clarifying the standard. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle and to determine when and how revenue is recognized. The updates may be applied retrospectively for each period presented or as a cumulative effect adjustment at the date of adoption.

We adopted this standard on February 4, 2018, using the modified retrospective approach. The impact of the adoption of ASU 2014-09 on our consolidated financial statements is as follows:

- Our revenue is primarily generated from the sales of merchandise to customers through the retail, e-commerce or wholesale channels. Our performance obligations underlying such sales, and the timing of revenue recognition related thereto, remain substantially unchanged following the adoption of this ASU.
- The adoption of ASU No. 2014-09 requires that we recognize our sales return allowance on a gross basis rather than as a net liability. As such, we now recognize (i) a return asset for the right to recover the goods returned by the customer, measured at the former carrying amount of the goods, less any expected recovery costs (recorded as an increase to prepaid expenses and other current assets), (ii) a return liability for the amount of expected returns (recorded as an increase to other current liabilities), and (iii) deferred revenue for commissions earned on extended protection agreements (recorded as an increase to other current liabilities).

We have made accounting policy elections to (1) exclude from the measurement of transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by us from a customer (sales tax, value added tax, etc.) and (2) account for shipping and handling activities performed after a customer obtains control of the good as activities to fulfill the promise to transfer the good.

We applied ASU No. 2014-09 only to contracts that were not completed prior to fiscal year 2018. The cumulative effect of applying ASU No. 2014-09 was immaterial. The comparative prior period information continues to be reported under the accounting standards in effect during those periods.

NOTE 2—NET SALES

During the twenty six weeks ended August 4, 2019, approximately 98% of our net sales were generated in the United States.

Net sales of merchandise and services were as follows:

	26 Weeks Ended	
In thousands	**August 3, 2019**	**August 4, 2018**
Merchandise	$ 217,187	$ 235,104
Services	12,295	19,141
Other	3,703	2,965
Net sales	$ 234,185	$ 257,210

NOTE 3—ACCOUNTS AND FRANCHISEE RECEIVABLES AND OTHER ASSETS

Accounts and franchisee receivables and other assets consist of the following:

In thousands	**August 3, 2019**	**August 4, 2018**
Short-term franchisee receivables	$ 379	$ 640
Miscellaneous receivables	601	6,423
Long-term franchisee receivables	813	5,203
Other assets	798	3,141
Allowance for losses on short-term franchisee receivables	(379)	(330)
Allowance for losses on long-term franchisee receivables	(819)	(2,503)
Net accounts and franchisee receivables and other assets	$ 1,393	$ 12,574

NOTE 4—ALLOWANCE FOR LOSSES ON FRANCHISEE RECEIVABLES

The allowance for losses on franchisee receivables consists of the following:

	26 Weeks Ended	
In thousands	**August 3, 2019**	**August 4, 2018**
Allowance for losses on franchisee receivables, beginning of period	$ 1,324	$ 3,092
Provisions during the period		100
Write off of franchisee receivables	(126)	(259)
Allowance for losses on franchisee receivables, end of period	$ 1,198	$ 2,833

On November 2, 2018, the Company and a franchisee entered into a transaction consisting of agreements that terminated all of the franchisee's franchise agreements and sublease arrangements for 21 franchised locations. The agreements provided that the franchisee transferred ownership of all assets, management of stores, and certain rights to property leases. The assets the Company purchased included all store furniture, fixtures, and equipment. As of the transaction date, the franchisee was the obligor on promissory notes to the Company with a total carrying value, net of reserves, of $2.7 million. As part of the transaction, the Company waived the remaining unpaid principal on these promissory notes. During the second half of fiscal year 2018, the Company recognized a loss of $2.7 million on the transaction.

NOTE 5—OTHER CURRENT AND LONG-TERM LIABILITIES

Other current and long-term liabilities consist of the following:

In thousands	**August 3, 2019**	**August 4, 2018**
Customer deposits	$ 2,139	$ 1,246
Sales and other taxes	1,672	5,676
Accrued expenses	8,486	(7,223)
Payroll and related items	670	603
Store closing and severance costs	0	1309
Total other current and long-term liabilities	$ 12,964	$ 1,611

NOTE 6—INCOME TAXES

The Business is included in the Parent's federal, state and local income tax returns and in its own Puerto Rico partnership return with its corresponding pass through taxable income included in the Parent's Puerto Rico corporate income tax return. For purposes of these carve-out financial statements, income taxes related to the Business have been presented as if it were a separate taxpayer. Under this approach, the Business determines its current tax liability, deferred tax assets and liabilities and related tax expense as if it were filing separate tax returns in each tax jurisdiction. Current income taxes payable for any federal, state, or foreign income taxes are reported in the period incurred.

Tax in the carve-out statement of operations represents the sum of current tax and deferred tax. Income taxes are presented on a separate tax return basis as if the Business were a standalone entity. The financial statement presentation assumes that in the event a tax attribute was utilized on a combined return of the Parent, the Business has not realized the benefits of the tax attribute unless it could realize the benefit as a standalone taxpayer. Likewise, in the event the Business could utilize a tax attribute on a standalone basis, the Business has realized the benefits of the tax attribute even though it may not have been utilized on the Parent's combined return.

Tax attributes such as net operating loss carryovers have been recognized by the Parent and by the Business. Because the Business is part of the same legal entity that generated many of these tax attributes, the Parent has estimated the amount of certain attributes attributable to the Business. These attributes may not be transferred in certain transactions.

We account for uncertainties in income taxes according to accounting standards for uncertain tax positions. The Company is present in a large number of taxable jurisdictions and, at any point in time, can have tax audits underway at various stages of completion in one or more of these jurisdictions. We evaluate our tax positions and establish liabilities for uncertain tax positions that may be challenged by local authorities and may not be fully sustained, despite our belief that the underlying tax positions are fully supportable. Unrecognized tax benefits are reviewed on an ongoing basis and are adjusted in light of changing facts and circumstances, including progress of tax audits, developments in case law, and closings of statutes of limitation. Such adjustments are reflected in the tax provision as appropriate. For the twenty-six weeks ended August 3, 2019 and August 4, 2018, no unrecognized tax benefits have been identified and reflected in the Condensed Consolidated Financial Statements.

We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. As no unrecognized tax benefits have been identified and reflected in the Condensed Consolidated Financial Statements, no interest or penalties related to unrecognized tax benefits are reflected in the Condensed Consolidated Balance Sheets or Statements of Operations.

We account for income taxes in accordance with accounting standards for such taxes, which require that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the financial reporting and tax bases of recorded assets and liabilities. Accounting standards also require that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion of or all of the deferred tax assets will not be realized.

Management assesses the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to realize the benefit of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss for the three years ended February 2, 2019. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future income. On the basis of this analysis, management has established a full valuation allowance to offset the net deferred tax assets that are not expected to be realized. Management will continue to evaluate objective and subjective evidence for changes in circumstances that cause a change in judgment about the realizability of the deferred tax assets.

The operations of the Business are included in the SHO’s federal, state and city income tax returns in the United States and foreign tax returns in Puerto Rico as well as its own partnership return in Puerto Rico. SHO was also a part of the Sears Holdings combined state returns for the years ended February 2, 2013 and February 1, 2014. SHO has completed its federal audit for the tax return ended January 30, 2016 and all matters have been resolved. Currently, SHO is under audit for one separate state returns for fiscal years 2013 through 2016.

NOTE 7—RELATED PARTY AGREEMENTS AND TRANSACTIONS

As the Company is a carve-out business of SHO, SHO and its subsidiaries would be considered related parties to the Company. As discussed in Note 1, SHO provides certain buying, distribution and administrative services to the Company on a centralized basis including finance, legal, information technology, human resources, corporate services and other overhead functions. If not billed directly to the Company, these costs are allocated to the Company to approximate the Company’s proportionate share of such costs and expenses. Allocated costs and expenses include shared occupancy space, interest expense, corporate payroll, business process outsourcing, and liability insurance. The Company is charged for purchases of merchandise made from SHO.

Employees of the Company participate in benefit plans that are sponsored by SHO. See Note 10 – Defined Contribution Plan for more information. SHO also provides stock-based compensation for management of the Company.

The Company depends on SHO to provide key products and services to the Company and SHO depends on Transform Holdco (Sears Holdings prior to Transform Holdco acquiring most of the operating assets and assuming the related operative agreements and obligations of Sears Holdings from bankruptcy in mid-February 2019) for most of its key products and services. As of August 3, 2019 and August 4, 2018, the Company recorded $1.3 million and $3.7 million of payable to related party representing an allocation of the Company's portion of the amount owed by SHO to Transform Holdco (Sears Holdings from bankruptcy in mid-February 2019).

NOTE 8—LEASES

We lease retail locations, office space, and vehicles. While most of these leases are operating leases, some of our vehicles are leased under finance leases. We consider various factors such as market conditions and the terms of any renewal options that may exist to determine whether we will renew or replace the lease. A majority of our leases have remaining lease terms of one to ten years, typically with the option to extend the leases for up to five years. Some of our leases may include the option to terminate in less than five years. If we are reasonably certain to exercise the option to extend a lease, we will include the extended terms in the operating lease right-of-use asset and operating lease liability. Real estate taxes, insurance, maintenance, and operating expenses applicable to the leased property are our obligations under the lease agreements.

Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

The gross amounts of assets and liabilities related to both operating and finance leases are as follows:

Thousands	**Balance Sheet Caption**	**August 3, 2019**
Assets:		
Operating lease assets	Operating lease right-of-use assets	$ 108,426
Finance lease assets	Net property and equipment	273
Total lease assets		$ 108,699
Liabilities:		
Current:		
Operating lease liabilities	Current operating lease liabilities	$ 29,274
Finance lease liabilities	Other current liabilities	95
Long-term:		
Operating lease liabilities	Long-term operating lease liabilities	79,676
Finance lease liabilities	Other long-term liabilities	179
Total lease liabilities		$ 109,224

The components of lease costs are as follows:

Thousands	**Statement of Operations Caption**	**26 Weeks Ended August 3, 2019**
Operating lease cost	Cost of sales and occupancy	$ 18,631
Finance lease cost:		
Amortization of leased assets	Depreciation and amortization	56
Interest on lease liabilities	Interest expense	12
Net lease cost		$ 3,755

ASU 2016-02 requires that public companies use a secured incremental borrowing rate as the discount rate for present value of lease payments. Lease terms and discount rates are as follows:

	August 3, 2019
Weighted Average Remaining Lease Term (Years)	
Operating leases	3.1
Finance leases	2.3
Weighted Average Discount Rate:	
Operating leases	11.2%
Finance leases	7.1%

The approximate future minimum lease payments under finance and operating leases at August 3, 2019 are as follows:

Fiscal Year *(thousands)*	**Finance Leases**	**Operating Leases**
Remainder of 2019	$ 154	$ 1,192
2020	399	2,543
2021	106	1,482
2022	42	949
2023	19	229
Thereafter	3	—
Total lease payments	723	6,395
Less imputed interest	52	280
Net Minimum Lease Payments	$ 671	$ 6,115
Finance lease obligations	671	
Less Current Portion of Finance Lease Obligations	(319)	
Long-term Finance Lease Obligations	$ 352	

Note: Amounts presented do not include payments relating to immaterial leases excluded from the balance sheets as part of transition elections adopted upon implementation of Topic 842.

The approximate future minimum lease payments under capital and operating leases at August 3, 2019 were as follows:

Fiscal Year *(thousands)*	**Capital Leases**	**Operating Leases**
2019	$ 259	$ 3,041
2020	359	2,037
2021	21	1,214
2022	14	775
2023	5	135
Thereafter	—	—
Net Minimum Lease Payments	$ 658	$ 7,202
Capital lease obligations	658	
Less Current Portion of Capital Lease Obligations	(259)	
Long-term Capital Lease Obligations	$ 399	

Other lease information as follows:

Thousands	**26 Weeks Ended August 3, 2019**
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows - operating leases	$ 976
Operating cash flows - finance leases	10
Financing cash flows - finance leases	62

NOTE 9—STORE CLOSING CHARGES

Accelerated Closed Store Charges

Our Parent completed steps to reduce costs, make the best use of capital, and improve our profitability by closing, or seeking the closure of under-performing stores.

In accordance with accounting standards governing costs associated with exit or disposal activities, expenses related to future rent payments for which we no longer expect to receive any economic benefit are accrued when we cease to use the leased space and have been reduced for estimated sublease income.

Accelerated (prior to lease expiration) store closure costs for the twenty six weeks ended August 3, 2019 and August 4, 2018, respectively, were as follows:

In thousands	Lease Termination Costs (1)	Inventory Related (1)	Impairment and Accelerated Depreciation (2)	Other Charges (3)	Total Store Closing Costs
26 weeks ended August 3, 2019 $	0	0	0	0	0
26 weeks ended August 4, 2018	$ 1,309	$ 0	$ 0	$ 0	$ 1,309

(1) Recorded within cost of sales and occupancy in the Combined Statements of Operations. Lease termination costs are net of estimated sublease income, and include the reversal of closed store reserves when a lease agreement is terminated for an amount less than the remaining reserve established for the store.
(2) Recorded within depreciation and amortization in the Combined Statements of Operations.
(3) Recorded within selling and administrative in the Combined Statements of Operations.

Closed Store Reserves

The store closing reserves included within other current liabilities in the Balance Sheets, consists of the following:

In thousands	August 3, 2019	August 4, 2018
Store closing and severance costs reserve, beginning of period	$ 0	$ 3,180
Store closing (recovery) costs	0	0
Payments/utilization	0	(1,871)
Store closing and severance costs reserve, end of period	$ 0	$ 1,309

NOTE 10—SALE OF ASSETS

On August 10, 2018, we completed the sale of a property in Newington, Connecticut. The sale price of the property was $2.8 million net of closing costs, and we recorded a gain on the sale of approximately $1.4 million when the sale was completed in accordance with the terms and conditions of the Purchase and Sale Agreement. This gain was recognized subsequent to the end of the twenty six weeks ended August 4, 2018. We did not sell any owned property in fiscal year 2017.

NOTE 11 — DEFINED CONTRIBUTION PLAN

Our Parent sponsors a Sears Hometown and Outlet Stores, 401(k) savings plan for employees meeting service eligibility requirements which offers a discretionary matching contribution. In the twenty-six weeks ended August 3, 2019 and August 4, 2018, the Company incurred expenses for the retirement savings plan in the amount of $0.9 million and $0.5 million, respectively. The expense was allocated to the Company consistent with the allocations discussed in Note 7- Related Party Agreements and Transactions.

NOTE 12—COMMITMENTS AND CONTINGENCIES

We are subject to various legal and governmental proceedings arising out of the ordinary course of business, the outcome of which, individually and in the aggregate, in the opinion of management, would not have a material adverse effect on our business, financial position, or results of operations, or cash flows.

NOTE 13 — SUBSEQUENT EVENTS

On October 23, 2019, SHO completed the sale of the Company, including substantially all of the assets and liabilities comprising SOS, to Franchise Group Newco S, LLC (the "Purchaser"), an indirect subsidiary of (formerly known as Liberty Tax, Inc.) pursuant to an Equity and Asset Purchase Agreement, dated as of August 27, 2019. Pursuant to the terms of the Purchase Agreement, the Purchaser paid SHO an aggregate purchase price, after giving effect to a customary working capital adjustment, of $119,960,000 in cash, and in addition reimbursed SHO for certain costs it incurred in connection with the Outlet Sale and certain employee payments and insurance costs incurred by SHO in connection with the Merger.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Vitamin Shoppe, Inc.
Secaucus, New Jersey

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Vitamin Shoppe, Inc. and Subsidiary (the "Company") as of December 29, 2018 and December 30, 2017, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the three fiscal years in the period ended December 29, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 29, 2018 and December 30, 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 29, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte & Touche LLP

Parsippany, New Jersey
February 26, 2019

We have served as the Company's auditor since 1997.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 29, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,668	$ 1,947
Inventories	189,273	218,087
Prepaid expenses and other current assets	27,921	39,473
Current assets held for sale	—	22,625
Total current assets	219,862	282,132
Property and equipment, net	123,002	141,520
Intangibles, net	11,088	11,040
Deferred taxes	31,659	37,278
Other long-term assets	2,468	2,572
Noncurrent assets held for sale	—	16,891
Total assets	$ 388,079	$ 491,433
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Revolving credit facility	$ —	$ 12,000
Accounts payable	39,789	46,921
Deferred sales	5,455	5,710
Accrued expenses and other current liabilities	60,553	56,935
Current liabilities held for sale	—	5,337
Total current liabilities	105,797	126,903
Convertible notes, net	55,570	126,415
Deferred rent	37,034	40,832
Other long-term liabilities	1,337	1,916
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 250,000,000 shares authorized and no shares issued and outstanding at December 29, 2018 and December 30, 2017	—	—
Common stock, $0.01 par value; 400,000,000 shares authorized, 24,234,651 shares issued and 23,974,031 shares outstanding at December 29, 2018, and 24,220,509 shares issued and 24,021,948 shares outstanding at December 30, 2017	242	242
Additional paid-in capital	85,853	88,823
Treasury stock, at cost; 260,620 shares at December 29, 2018 and 198,561 shares at December 30, 2017	(7,314)	(7,010)
Retained earnings	109,560	113,312
Total stockholders' equity	188,341	195,367
Total liabilities and stockholders' equity	$ 388,079	$ 491,433

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Net sales	$ 1,114,160	$ 1,146,499	$ 1,239,226
Cost of goods sold	759,367	783,932	819,690
Gross profit	354,793	362,567	419,536
Selling, general and administrative expenses	344,947	332,199	328,939
Goodwill, tradename and store fixed-assets impairment charges	3,017	274,876	797
Income (loss) from operations	6,829	(244,508)	89,800
Gain on extinguishment of debt	16,902	—	—
Interest expense, net	6,602	9,701	9,523
Income (loss) before provision (benefit) for income taxes	17,129	(254,209)	80,277
Provision (benefit) for income taxes	3,588	(18,882)	29,065
Net income (loss) from continuing operations	13,541	(235,327)	51,212
Net loss from discontinued operations, net of tax	(17,293)	(16,824)	(26,248)
Net income (loss)	$ (3,752)	$ (252,151)	$ 24,964
Weighted average common shares outstanding			
Basic	23,496,841	23,137,977	23,875,540
Diluted	23,496,841	23,137,977	24,067,686
Net income (loss) from continuing operations per common share			
Basic	$ 0.58	$ (10.17)	$ 2.14
Diluted	$ 0.58	$ (10.17)	$ 2.13
Net loss from discontinued operations per common share			
Basic	$ (0.74)	$ (0.73)	$ (1.10)
Diluted	$ (0.74)	$ (0.73)	$ (1.09)
Net income (loss) per common share			
Basic	$ (0.16)	$ (10.90)	$ 1.05
Diluted	$ (0.16)	$ (10.90)	$ 1.04

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Net income (loss)	$ (3,752)	$ (252,151)	$ 24,964
Other comprehensive income:			
Foreign currency translation adjustments	—	—	60
Other comprehensive income	—	—	60
Comprehensive income (loss)	$ (3,752)	$ (252,151)	$ 25,024

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)

Figures may not sum due to rounding

	Common Stock		Treasury Stock					
	Shares	Amounts	Shares	Amounts	Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total
Balance at December 26, 2015	25,993,715	$ 260	(120,134)	$ (5,225)	$ 139,827	$ (60)	$ 340,499	$ 475,301
Comprehensive income	—	—	—	—	—	60	24,964	25,024
Equity compensation	—	—	—	—	6,380	—	—	6,380
Issuance of restricted shares	196,777	2	—	—	(2)	—	—	—
Issuance of shares	11,942	—	—	—	333	—	—	333
Purchases of treasury stock	—	—	(41,051)	(1,205)	—	—	—	(1,205)
Purchases of shares under Share Repurchase Programs	(2,552,556)	(26)	—	—	(65,985)	—	—	(66,011)
Cancellation of restricted shares	(103,362)	(1)	—	—	1	—	—	—
Issuance of shares under employee stock purchase plan	33,442	1	—	—	822	—	—	823
Exercises of stock options	5,282	—	—	—	90	—	—	90
Tax benefits on exercise of equity awards	—	—	—	—	(739)	—	—	(739)
Balance at December 31, 2016	23,585,240	236	(161,185)	(6,430)	80,727	—	365,463	439,996
Comprehensive loss	—	—	—	—	—	—	(252,151)	(252,151)
Equity compensation	—	—	—	—	6,122	—	—	6,122
Issuance of restricted shares	607,161	6	—	—	(6)	—	—	—
Purchases of treasury stock	—	—	(37,376)	(580)	—	—	—	(580)
Cancellation of restricted shares	(140,391)	(2)	—	—	2	—	—	—
Issuance of shares under employee stock purchase plan	68,499	1	—	—	468	—	—	469
Exercises of stock options	100,000	1	—	—	1,510	—	—	1,511
Balance at December 30, 2017	24,220,509	242	(198,561)	(7,010)	88,823	—	113,312	195,367
Comprehensive loss	—	—	—	—	—	—	(3,752)	(3,752)
Equity compensation	—	—	—	—	2,663	—	—	2,663
Issuance of restricted shares	375,182	4	—	—	(4)	—	—	—
Purchases of treasury stock	—	—	(62,059)	(304)	—	—	—	(304)
Cancellation of restricted shares	(431,728)	(4)	—	—	4	—	—	—
Issuance of shares under employee stock purchase plan	70,688	1	—	—	289	—	—	290
Repurchases of Convertible Notes	—	—	—	—	(5,922)	—	—	(5,922)
Balance at December 29, 2018	24,234,651	$ 242	(260,620)	$ (7,314)	$ 85,853	$ —	$ 109,560	$ 188,341

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Cash flows from operating activities:			
Net income (loss)	$ (3,752)	$ (252,151)	$ 24,964
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization of fixed and intangible assets	42,114	39,204	38,780
Impairment charges on goodwill	—	210,633	32,636
Impairment charges on intangible assets	8,174	59,405	6,594
Impairment charges on fixed assets	11,057	6,658	797
Loss on sale of FDC Vitamins, LLC	203	—	—
Amortization of deferred financing fees	604	898	957
Gain on extinguishment of debt	(16,902)	—	—
Amortization of debt discount on convertible notes	3,170	4,781	4,690
Deferred income taxes	5,619	(19,834)	(13,683)
Deferred rent	(3,881)	(2,431)	(3,226)
Equity compensation expense	2,663	6,122	6,292
Issuance of shares for services rendered	—	—	333
Tax benefits on exercises of equity awards	792	1,017	739
Changes in operating assets and liabilities:			
Accounts receivable	(1,458)	1,102	70
Inventories	33,052	10,573	(13,078)
Prepaid expenses and other current assets	11,691	(5,916)	(8,521)
Other long-term assets	(16)	(598)	116
Accounts payable	(7,104)	(12,916)	26,522
Deferred sales	(255)	501	(15,277)
Accrued expenses and other current liabilities	4,873	7,047	2,921
Other long-term liabilities	(497)	2,094	747
Net cash provided by operating activities	90,147	56,189	93,373
Cash flows from investing activities:			
Capital expenditures	(28,138)	(55,020)	(40,068)
Net proceeds on sale of FDC Vitamins, LLC	14,847	—	—
Trademarks and other intangible assets	(372)	(428)	(291)
Net cash used in investing activities	(13,663)	(55,448)	(40,359)
Cash flows from financing activities:			
Borrowings under revolving credit facility	163,000	118,000	82,000
Repayments of borrowings under revolving credit facility	(175,000)	(117,000)	(79,000)
Purchases of convertible notes	(63,891)	—	—
Bank overdraft	601	(3,265)	(1,041)
Payments of capital lease obligations	(477)	(451)	(207)
Proceeds from exercises of common stock options	—	1,511	90
Issuance of shares under employee stock purchase plan	290	469	823
Purchases of treasury stock	(304)	(580)	(1,205)
Purchases of shares under Share Repurchase Programs	—	—	(66,011)
Tax benefits on exercises of equity awards	—	—	(739)
Deferred financing fees and other	17	(346)	(14)
Net cash used in financing activities	(75,764)	(1,662)	(65,304)
Effect of exchange rate changes on cash and cash equivalents	1	35	19
Net increase (decrease) in cash and cash equivalents	721	(886)	(12,271)
Cash and cash equivalents beginning of year	1,947	2,833	15,104
Cash and cash equivalents end of year	$ 2,668	$ 1,947	$ 2,833
Supplemental disclosures of cash flow information:			
Interest paid	$ 3,186	$ 3,953	$ 3,715
Income taxes (refunded) paid	$ (14,915)	$ 6,610	$ 33,655
Supplemental disclosures of non-cash investing activities:			
Liability for purchases of property and equipment	$ 1,935	$ 4,457	$ 4,630
Assets acquired under capital leases	$ —	$ 891	$ 1,589
Assets acquired under tenant incentives	$ —	$ 2,986	$ —

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Vitamin Shoppe, Inc. (“VSI”), is incorporated in the State of Delaware, and through its wholly-owned subsidiary, Vitamin Shoppe Industries Inc. (“Subsidiary” or “Industries” together with VSI, the “Company”), is an omni-channel specialty retailer of nutritional products. Sales of both national brands and our own brands of vitamins, minerals, herbs, specialty supplements, sports nutrition and other health and wellness products (“VMS products”) are made through VSI-operated retail stores, the internet and mobile devices to customers located primarily in the United States.

The Company’s fiscal year ends on the last Saturday in December. As used herein, the term “Fiscal Year” or “Fiscal” refers to a52-week or 53-week period, ending on the last Saturday in December. Fiscal 2016 was a 53-week fiscal year.

The consolidated financial statements for the fiscal years ended December 29, 2018, December 30, 2017 and December 31, 2016 include the accounts of VSI and Subsidiary. All intercompany transactions and balances have been eliminated in consolidation. The consolidated financial statements for Fiscal 2017 and Fiscal 2016 have been restated, where appropriate, to reflect discontinued operations. Refer to Note 3., “Discontinued Operations” for additional information. As a result of the discontinued operations, the Company currently operates through one business segment.

2. Summary of Significant Accounting Policies

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents—Cash and cash equivalents include all highly liquid investments with original maturities of ninety days or less. The Company reclassifies cash overdrafts to accounts payable.

Inventories—Inventories are stated at the lower of cost or market value. Cost is determined using the weighted average method. Inventory includes costs of freight on internally transferred merchandise, and costs associated with our buying department and distribution facilities which are capitalized into inventory and then expensed as merchandise is sold. In addition, the cost of inventory is reduced by purchase discounts and other allowances received from certain of our vendors. The Company estimates losses for expiring inventory and the net realizable value of inventory based on when a product is close to expiration and not expected to be sold, when a product has reached its expiration date, or when a product is not expected to be saleable. In determining the reserves for these products, consideration is given to such factors as the amount of inventory on hand, the remaining shelf life, current and expected market conditions, historical trends and the likelihood of recovering the inventory costs based on anticipated demand. The following table details the activity and balances for the Company’s reserve for inventory for the years ended December 29, 2018, December 30, 2017 and December 31, 2016 (in thousands):

	Balance at Beginning of Fiscal Year	Amounts Charged to Cost of Goods Sold	Write-Offs Against Reserves	Balance at End of Fiscal Year
Fiscal Year Ended December 29, 2018	$ 3,667	$ 14,157	$ (14,753)	$ 3,071
Fiscal Year Ended December 30, 2017	$ 5,189	$ 14,274	$ (15,796)	$ 3,667
Fiscal Year Ended December 31, 2016	$ 4,939	$ 8,888	$ (8,638)	$ 5,189

Property and Equipment, Net—Property and equipment, net is stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for on a straight-line basis over the estimated useful lives of the related assets. Furniture, fixtures and equipment are generally depreciated over seven years. Leasehold improvements are amortized generally over the shorter of their useful lives or related lease terms. The direct internal and external costs associated with the development of the features and functionality of the Company’s website, transaction processing systems,

telecommunications infrastructure and network operations, are capitalized and are amortized on a straight line basis over the estimated useful lives of generally five years. Capitalization of costs begins when the preliminary project stage is completed and management authorizes and commits to funding the computer software project and that it is probable that the project will be completed and the software will be used to perform the function intended. Depreciation of the assets commences when they are put into use. Expenditures for repairs and maintenance are expensed as incurred and expenditures for major renovations and improvements are capitalized. Upon retirement or disposition of property and equipment, the applicable cost and accumulated depreciation are removed from the accounts and any resulting gains or losses are included in the results of operations.

Impairment of Long-Lived Assets—The Company reviews its long-lived assets for impairment whenever events or changes in circumstances, including store closures, indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying amount of an asset to undiscounted pre-tax future net cash flows expected to be generated by that asset. If the undiscounted future cash flows are not adequate to recover the carrying value of the asset, an impairment loss is recognized for the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Intangibles—Indefinite-lived intangibles are not amortized. Evaluations for impairment are performed at least annually, in the fourth quarter of each year, or whenever impairment indicators exist. The evaluation of indefinite-lived intangibles may first consider qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value is less than its carrying value. A quantitative evaluation is performed if the qualitative evaluation results in a more likely than not determination or if a qualitative evaluation is not performed. For the Company's indefinite-lived tradename, we utilize the royalty relief method in our quantitative evaluations. Under the royalty relief method, a royalty rate is determined based on comparable licensing arrangements which is applied to the revenue projections for the indefinite-lived tradename and the fair value is calculated using a discounted cash flow analysis. Cash flows are discounted using an internally derived weighted average cost of capital which reflects the costs of borrowing as well as the associated risk. Impairment tests between annual tests may be undertaken if an event occurs or circumstances change that could reduce the fair value of the indefinite-lived tradename below its carrying value. The valuation of indefinite-lived intangible assets is affected by, among other things, the Company's projections for the future and estimated results of future operations. Changes in the business plan or operating results that are different than the estimates used to develop the valuation of the assets may impact these valuations. For those intangible assets which have definite lives, the Company amortizes their cost on a straight-line basis over their estimated useful lives, the periods of which vary based on their particular contractual terms.

During Fiscal 2017, the Company performed quantitative analyses of its retail reporting unit and determined the carrying value of the retail reporting unit exceeded its fair value, resulting in an impairment of the corresponding goodwill of $210.6 million and an impairment charge on the Vitamin Shoppe tradename of $59.4 million. Refer to Note 4. Goodwill and Intangible Assets for additional information.

Rent Expenses, Deferred Rent and Landlord Construction Allowances—Rent expense and rent incentives, including landlord construction allowances, are recognized on a straight-line basis over the lease term. The Company records rent expense for stores and distribution centers as a component of cost of goods sold. The Company accounts for landlord construction allowances as lease incentives and records them as a component of deferred rent, which is recognized in cost of goods sold over the lease term.

Revenue Recognition—The Company recognizes revenue from retail customers when merchandise is sold "at point of sale" in retail stores or upon delivery to a customer. Substantially all revenue from customers represents goods transferred at a point in time. The Company considers control of retail products to have transferred upon delivery, at the retail location or the place of delivery, because the Company has a present right to payment at that time, the customer has legal title to the products, the Company has transferred physical possession of the products, and the customer has significant risks and rewards of ownership of the products. In addition, the Company classifies amounts billed to customers that represent shipping fees as sales. Amount recognized as shipping revenue during Fiscal 2018, Fiscal 2017 and Fiscal 2016, were $2.3 million, $2.1 million and $2.1 million respectively. To arrive at net sales, gross sales are reduced by deferred sales, customer discounts, actual customer returns, and a provision for estimated future customer returns, which is based on management's review of historical information. Sales taxes collected from customers are presented on a net basis and as such are excluded from revenue. During Fiscal 2018, the Company adopted Financial Accounting Standards Board Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). For additional information regarding our adoption of ASU2014-09, refer to Note 8., "Revenue Recognition".

Cost of Goods Sold—The Company includes the cost of inventory sold, costs of warehousing, distribution and store occupancy costs. Warehousing and distribution costs, which are capitalized into inventory and then expensed as merchandise is sold, include freight to transfer merchandise, costs associated with our buying department and distribution facilities. Store occupancy costs include rent, common area maintenance, real estate taxes and utilities.

Vendor Allowances—Vendor allowances include discounts, allowances and rebates received from vendors and are based on various contract terms. Vendor allowances are recognized as either purchase discounts which represent a reduction of product cost, funding which is capitalized into inventory and recognized in the statement of operations as the merchandise is sold, or direct offset which represents funding subject to immediate recognition in the statement of operations, depending on the nature of the allowance.

Frequent Buyer Program—The Company has a frequent buyer program ("Healthy Awards Program"), whereby customers earn points toward free merchandise based on the dollar volume of purchases. Points are earned each calendar quarter and must be redeemed within the subsequent calendar quarter or they expire. Sales are deferred at the time points are earned based on the value of points that are projected to be redeemed, which are based on historical redemption data. The Company records a liability in the period points are earned with a corresponding reduction of sales.

Store Pre-opening Costs—Costs associated with the opening of new retail stores and start up activities are expensed as incurred.

Advertising Costs—The costs of advertising for online marketing arrangements, magazines, direct mail and radio are expensed as incurred, or the first time the advertising takes place. Advertising expense was $24.0 million, $27.3 million and $20.7 million for Fiscal 2018, Fiscal 2017 and Fiscal 2016, respectively.

Online Marketing Arrangements—The Company has entered into online marketing arrangements with various online companies. These agreements are established for periods of 24 months, 12 months or, in some cases, a lesser period and generally provide for compensation based on revenue sharing upon the attainment of stipulated revenue amounts, a percentage of the media expenditure managed by the online partner, or based on the number of visitors that the online company refers to the Company and are expensed as incurred. The Company had no fixed payment commitments during Fiscal 2018, Fiscal 2017 and Fiscal 2016.

Income Taxes—Deferred income tax assets and liabilities are recorded in accordance with the liability method. Deferred income taxes have been provided for temporary differences between the tax bases and financial reporting bases of the Company's assets and liabilities using the tax rates and laws in effect for the periods in which the differences are expected to reverse.

The Tax Cut and Jobs Act of 2017 was enacted on December 22, 2017, reducing the statutory federal income tax rate from 35% to 21%, effective January 1, 2018. As required, the Company determined the effects of tax reform and recorded a provisional amount in Fiscal 2017 and final amount in Fiscal 2018. The Company expects no further impacts resulting from the Tax Cut and Jobs Act of 2017.

The Company accounts for tax positions based on the provisions of the accounting literature related to accounting for uncertainty in income tax positions. Such literature provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. For tax positions that are not more likely than not sustainable upon audit, the Company recognizes the largest amount of the benefit that is more likely than not to be sustained. The Company makes estimates of the potential liability based on our assessment of all potential tax exposures. In addition, the Company uses factors such as applicable tax laws and regulations, current information and past experience with similar issues to make these assessments. The tax positions are analyzed regularly and adjustments are made as events occur that warrant adjustments for those positions. These tax positions were not significant for Fiscal 2018, 2017 and 2016. The Company records interest expense and penalties payable to relevant tax authorities as income tax expense.

Concentrations of Credit Risk—Financial instruments, which potentially subject the Company to concentrations of credit risk, include debit and credit card processors of retail transactions. Accounts receivable from debit and credit card processors, included in prepaid expenses and other current assets on the consolidated balance sheets, totaled $8.1 million at December 29, 2018 and $10.7 million at December 30, 2017.

The Company had two suppliers from whom we purchased at least 5% of our merchandise during Fiscal 2018, two suppliers from whom we purchased at least 5% of our merchandise during Fiscal 2017 and one supplier from whom we purchased at least 5% of our merchandise during Fiscal 2016. We purchased approximately 15% of our total merchandise from these suppliers during Fiscal 2018, approximately 15% during Fiscal 2017 and 11% during Fiscal 2016.

The Company is subject to concentrations of credit risk associated with cash and cash equivalents, and at times holds cash balances in excess of Federal Deposit Insurance Corporation limits.

Stock-Based Compensation—Stock-based compensation cost is measured at the grant date based on the fair value of awards and is recognized as expense on a straight-line basis over the requisite service period for each separately vesting portion of the award, net of anticipated forfeitures. With the exception of restricted shares, performance share units and restricted share units, determining the fair value of stock-based awards at the grant date requires considerable judgment, including estimating expected volatility, expected term and risk-free rate. Compensation expense resulting from the granting of restricted shares, performance share units and restricted share units is based on the grant date fair value of those common shares and is recognized generally over the two to three year vesting period for restricted shares, the approximately three year vesting period for performance share units and over the quarterly to three year vesting periods for restricted share units. For accounting purposes, the expense for performance based stock options, performance based restricted shares and performance share units is calculated and recorded, based on the determination that the achievement of the pre-established performance targets are probable, over the relevant service period.

Expense related to shares purchased under the Company’s Employee Stock Purchase Plan (“ESPP”) is accounted for based on fair value recognition requirements similar to stock options. ESPP participation occurs each calendar quarter (the “Participation Period”) and the expense of which is subject to employee participation in the plan. Under the ESPP, participating employees are allowed to purchase shares at 85% of the lower of the market price of the Company’s common stock at either the first or last trading day of the Participation Period. Compensation expense related to the ESPP is based on the estimated fair value of the discount and purchase price offered on the estimated shares to be purchased under the ESPP. Expense is calculated quarterly, based on the employee contributions made over the applicable three-month Participation Period, using volatility and risk free rates applicable to that three-month period.

Net Income (Loss) Per Share—The Company’s basic net income (loss) per share excludes the dilutive effect of stock options, unvested restricted shares, unvested performance share units, unvested restricted share units and warrants. It is based upon the weighted average number of common shares outstanding during the period divided into net income (loss).

Diluted net income (loss) per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. Stock options, unvested restricted shares, unvested performance share units, warrants and unvested restricted share units are included as potential dilutive securities for the periods applicable, using the treasury stock method to the extent dilutive.

The components of the calculation of basic net income (loss) per common share and diluted net income (loss) per common share are as follows (in thousands except share and per share data):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Numerator:			
Net income (loss) from continuing operations	$ 13,541	$ (235,327)	$ 51,212
Net loss from discontinued operations	(17,293)	(16,824)	(26,248)
Net income (loss)	$ (3,752)	$ (252,151)	$ 24,964
Denominator:			
Basic weighted average common shares outstanding	23,496,841	23,137,977	23,875,540
Effect of dilutive securities (a):			
Stock options	—	—	68,272
Restricted shares	—	—	115,287
Performance share units	—	—	7,173
Restricted share units	—	—	1,414
Diluted weighted average common shares outstanding	23,496,841	23,137,977	24,067,686
Basic net income (loss) from continuing operations per common share	$ 0.58	$ (10.17)	$ 2.14
Diluted net income (loss) from continuing operations per common share	$ 0.58	$ (10.17)	$ 2.13
Basic net loss from discontinued operations per common share	$ (0.74)	$ (0.73)	$ (1.10)
Diluted net loss from discontinued operations per common share	$ (0.74)	$ (0.73)	$ (1.09)
Basic net income (loss) per common share	(0.16)	$ (10.90)	$ 1.05
Diluted net income (loss) per common share	(0.16)	$ (10.90)	$ 1.04

(a) For Fiscal 2018 and 2017, due to a loss for the period, no incremental shares are included because the effect would be anti-dilutive.

Securities for the fiscal years ended December 29, 2018, December 30, 2017 and December 31, 2016 for 560,807, 657,823 and 24,140 shares, respectively, have been excluded from the above calculation as they were anti-dilutive.

The Company has the intent and ability to settle the principal portion of its Convertible Notes in cash, and as such, has applied the treasury stock method, which has resulted in the underlying convertible shares, and related warrants, being anti-dilutive in Fiscal 2018, 2017 and 2016 as the Company's average stock price from the date of issuance of the Convertible Notes through December 29, 2018 was less than the conversion price as well as less than the strike price of the warrant transaction. Refer to Note 7. Credit Arrangements for additional information on the Convertible Notes.

Recent Accounting Pronouncements—Except as noted below, the Company has considered all new accounting pronouncements and has concluded that there are no new pronouncements that may have a material impact on its results of operations, financial condition, or cash flows, based on current information.

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 was issued by the FASB to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and Topic 842 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The Company has elected to adopt ASU 2016-02 in accordance with Accounting Standards Update No. 2018-11, Leases (Topic 842) Targeted Improvements ("ASU 2018-11"). Under the transition method included in ASU 2018-11, the Company will initially apply ASU 2016-02 at the adoption date of December 30, 2018, which is the first day of Fiscal 2019, and will recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company's reporting for the

comparative periods presented in its financial statements will continue to be in accordance with previous GAAP (Topic 840, Leases). Under this transition method, the Company will provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840. The Company is in the process of finalizing its adoption of ASU 2016-02. Generally, the Company expects ASU 2016-02 will not have a material impact on its results of operations, however, the Company expects to recognize a cumulative-effect charge of approximately $4.0 million to $6.0 million to the opening balance of retained earnings in the period of adoption which represents impairment charges to the right-of-use assets. This cumulative-effect charge will result in lower rent expense related to the applicable store locations in subsequent periods. During the period of adoption, the Company expects to recognize a right-of-use assets opening balance of approximately $450.0 million to $470.0 million and a lease liabilities opening balance of approximately $490.0 million to $510.0 million. The adoption of ASU 2016-02 is expected to have no impact on the Company's debt covenants or liquidity. In addition, the Company is making the following modifications to internal controls over financial reporting, beginning in Fiscal 2019, and changes to its accounting policies and procedures, operational processes, and documentation practices:

- Implementing a new information technology system to capture, calculate, and account for leases.
- Enhanced the risk assessment process to take into account risks associated with Topic 842.
- Modified existing controls that address risks associated with accounting for lease assets and liabilities and the related income and expense. This included modifying our contract review controls to consider the new criteria for determining whether a contract is or contains a lease, specifically to clarify the definition of a lease and align with the concept of control.
- Updating our policies and procedures related to accounting for lease assets and liabilities and related income and expense.
- Added controls to address related required disclosures regarding leases, including our significant assumptions and judgments used in applying Topic 842.

3. Discontinued Operations

On May 7, 2018, the Company sold certain assets, including the Betancourt Nutrition® brand, and liabilities of FDC Vitamins, LLC d/b/a Nutri-Force Nutrition ("Nutri-Force") to Arizona Nutritional Supplements, LLC ("ANS"). Proceeds from the sale, net of transaction costs, were approximately $14.8 million. The Company recognized a pre-tax loss on the sale of Nutri-Force of $0.2 million. In addition, the parties executed supply agreements in which the Company has agreed to purchase a total of $53.0 million annually of its private label products and Betancourt Nutrition® brand products from ANS for a term of five years.

The results of operations of Nutri-Force for the fiscal year ended December 29, 2018 are classified as discontinued operations in the consolidated statements of operations. The consolidated balance sheet as of December 30, 2017 and the statements of operations for the fiscal years ended December 30, 2017 and December 31, 2016 have been restated to reflect the discontinued operations.

Reconciliation of the Carrying Amounts of Major Classes of Assets and Liabilities of the Discontinued Operation to Total Assets and Liabilities of the Disposal Group Classified as Held for Sale That Are Presented Separately in the Balance Sheet
(in thousands)

	As of December 30, 2017
Carrying amounts of the major classes of assets included in discontinued operations:	
Accounts receivable	$ 6,265
Inventories	16,200
Prepaid expenses and other current assets	160
Total current assets	22,625
Property and equipment, net	8,513
Intangible assets, net	8,378
Total noncurrent assets	16,891
Total assets of the disposal group classified as held for sale	$ 39,516
Carrying amounts of the major classes of liabilities included in discontinued operations:	
Accounts payable	$ 2,704
Accrued liabilities	2,633
Total current liabilities of the disposal group classified as held for sale	$ 5,337

Reconciliation of the Major Line Items Constituting Loss of Discontinued Operations to theAfter-Tax Loss of Discontinued Operations That Are Presented in the Statements of Operations
(in thousands)

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Major classes of line items constituting net loss on discontinued operations:			
Net sales (1)	$ 11,186	$ 32,195	$ 50,017
Cost of goods sold	10,133	35,385	43,197
Fixed assets impairment charges	7,236	1,820	—
Gross profit (loss)	(6,183)	(5,010)	6,820
Selling, general and administrative expenses	5,090	13,295	11,813
Intangible assets and fixed assets impairment charges	8,978	—	39,230
Discontinued operations loss	203	—	—
Loss before benefit for income taxes	(20,454)	(18,305)	(44,223)
Benefit for income taxes	(3,161)	(1,481)	(17,975)
Net loss	$ (17,293)	$ (16,824)	$ (26,248)

(1) Includes $2.4 million related to a transition services agreement during the fiscal year ended December 29, 2018.

Cash Flow Disclosures for Discontinued Operations
(in thousands)

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Cash flows provided by (used in) operating activities	$ (14,176)	$ 2,240	$ 3,678
Cash flows provided by (used in) investing activities	$ 14,752	$ (1,630)	$ (2,544)
Depreciation and amortization	$ 769	$ 1,126	$ 1,676
Capital expenditures	$ 94	$ 1,630	$ 2,544

4. Goodwill and Intangible Assets

The following table discloses the carrying value of all intangible assets (in thousands):

	December 29, 2018				December 30, 2017			
	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairment Charges (1)	Net	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairment Charges (1)	Net
Intangible assets:								
Goodwill	$210,633	$ —	$ 210,633	$ —	$210,633	$ —	$ 210,633	$ —
Tradenames - Indefinite-lived	68,405	—	59,405	9,000	68,405	—	59,405	9,000
Tradenames - Definite-lived	5,764	3,676	—	2,088	5,392	3,352	—	2,040
	$284,802	$ 3,676	$ 270,038	$11,088	$284,430	$ 3,352	$ 270,038	$11,040

(1) During the second quarter of Fiscal 2017, the Company experienced a significant reduction to its market capitalization. As a result of changed market conditions and the Company's updated initiatives for the second half of Fiscal 2017, the Company revised the outlook for Fiscal 2017 and updated its long-range plan to reflect its operations in this increasingly competitive environment. Based on these factors, the Company concluded that an impairment trigger occurred for the retail reporting unit and therefore interim impairment tests of goodwill and other intangible assets were performed. The results of the interim goodwill impairment test indicated that the carrying value of the retail reporting unit exceeded its fair value, and in accordance with the early adoption of ASU 2017-04, Intangibles—Goodwill and Other—Simplifying the Test for Goodwill Impairment, the Company recorded an impairment charge on the goodwill of its retail segment of $164.3 million, of which $130.9 million was not deductible for income tax purposes.

During the third quarter of Fiscal 2017, the Company experienced another significant reduction to its market capitalization. As a result, the Company concluded that an impairment trigger occurred for the retail reporting unit and therefore interim impairment tests of goodwill and other intangible assets were performed. The Company also had recently updated its long-range plan. The results of the interim goodwill and other intangible assets impairment tests indicated that the carrying value of the Vitamin Shoppe tradename exceeded its fair value and that the carrying value of the retail reporting unit exceeded its fair value. The Company recorded an impairment charge on the Vitamin Shoppe tradename of $59.4 million. The Company also recorded an impairment charge for the remaining goodwill of its retail segment of $46.3 million, which was not deductible for income tax purposes.

Total goodwill impairment charges during Fiscal 2017 were $210.6 million, of which $177.2 million was not deductible for income tax purposes, as reflected in the effective tax rate benefit for the fiscal year ended December 30, 2017. In addition, the tradename impairment charge of $59.4 million and the tax deductible portion of the goodwill impairment charges of $33.4 million resulted in an increase to the Company's net deferred tax assets of $23.7 million for the fiscal year ended December 30, 2017.

Intangible amortization expense for Fiscal 2018, Fiscal 2017 and Fiscal 2016 was $0.3 million in each of these fiscal years.

The useful lives of the Company's definite-lived intangible assets are 10 years. The expected amortization expense on definite-lived intangible assets on the Company's consolidated balance sheet at December 29, 2018, is as follows (in thousands):

Fiscal 2019	$ 334
Fiscal 2020	334
Fiscal 2021	334
Fiscal 2022	331
Fiscal 2023	285
Thereafter	470
	$2,088

5. Property and Equipment

Property and equipment consists of the following (in thousands):

	December 29, 2018	December 30, 2017
Leasehold improvements	$ 166,397	$ 176,025
Furniture, fixtures and equipment	174,878	197,774
Software	88,943	98,128
	430,218	471,927
Less: accumulated depreciation and amortization	(312,977)	(334,082)
Subtotal	117,241	137,845
Construction in progress	5,761	3,675
	$ 123,002	$ 141,520

Depreciation and amortization expense on property and equipment for the fiscal years ended December 29, 2018, December 30, 2017 and December 31, 2016 was approximately $41.0 million, $37.8 million and $36.8 million, respectively. The Company recognized store impairment charges of $3.0 million during Fiscal 2018 on fixed assets related to thirty of its underperforming retail locations still in use in the Company's operations. The Company recognized store impairment charges of $4.8 million during Fiscal 2017 on fixed assets related to thirty-four of its underperforming retail locations, thirty-one of which are still in use in the Company's operations. The Company recognized store impairment charges of $0.8 million during Fiscal 2016 on fixed assets related to five of its underperforming retail locations still in use in the Company's operations. Impairment charges on the fixed assets of retail locations during Fiscal 2018, 2017 and 2016 represented the full net book value of the fixed assets of these retail locations.

6. Accrued Expenses and Other Current Liabilities

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

	December 29, 2018	December 30, 2017
Accrued salaries and related expenses	$ 24,048	$ 18,094
Sales tax payable and related expenses	7,092	7,088
Other accrued expenses	29,413	31,753
	$ 60,553	$ 56,935

7. Credit Arrangements

Convertible Senior Notes due 2020

On December 9, 2015, the Company issued $143.8 million of its 2.25% Convertible Senior Notes due 2020 (the "Convertible Notes"). The Convertible Notes are senior unsecured obligations of VSI. Interest on the Convertible Notes is payable on June 1 and December 1 of each year until their maturity date of December 1, 2020. The Company may not redeem the Convertible Notes prior to the maturity date.

Prior to July 1, 2020, the Convertible Notes will be convertible only under the following circumstances: (1) during any calendar quarter if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the 5 business day period after any 10 consecutive trading day period in which the trading price per $1,000 principal amount of Convertible Notes for such trading day was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. On or after July 1, 2020 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their notes, in multiples of $1,000 principal amount, at the option of the holder regardless of the foregoing circumstances.

The Convertible Notes are convertible at an initial conversion rate of 25.1625 shares of the Company's common stock per $1,000 principal amount of the Convertible Notes, which is equivalent to a conversion price of approximately $39.74. The conversion rate is subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, following certain corporate events that occur prior to the maturity date, the Company is required to increase, in certain circumstances, the conversion rate for a holder who elects to convert its Convertible Notes in connection with such a corporate event including customary conversion rate adjustments in connection with a "make-whole fundamental change" as defined. Upon conversion, the Company may satisfy its conversion obligation by paying or delivering, as applicable, cash, shares of its common stock or a combination of cash and shares of its common stock, at its election.

The Company allocated the principal amount of the Convertible Notes between its liability and equity components (see table below). The carrying amount of the liability component was determined by measuring the fair value of a similar debt instrument of similar credit quality and maturity that did not have the conversion feature. The carrying amount of the equity component, representing the embedded conversion option, was determined by deducting the fair value of the liability component from the principal amount of the Convertible Notes as a whole. The equity component was recorded to additional paid-in capital and is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the Convertible Notes over the carrying amount of the liability component was recorded as a debt discount, and is being amortized to interest expense using an effective interest rate of 3.8% over the term of the Convertible Notes. The Company allocated the total amount of transaction costs incurred to the liability and equity components using the same proportions as the proceeds from the Convertible Notes. Transaction costs attributable to the liability component were recorded as a direct deduction from the liability component of the Convertible Notes, and are being amortized to interest expense using the effective interest method through the maturity date. Transaction costs attributable to the equity component were netted with the equity component of the Convertible Notes in additional paid-in capital.

During Fiscal 2018, the Company repurchased $83.3 million in aggregate principal amount of its Convertible Notes for an aggregate purchase price of $63.9 million, which includes accrued interest of $0.4 million. The gain on extinguishment of the repurchased Convertible Notes was $16.9 million.

The Convertible Notes consist of the following components (in thousands):

	December 29, 2018	December 30, 2017
Liability component:		
Principal	$ 60,439	$ 143,750
Conversion feature	(17,115)	(24,800)
Liability portion of debt issuance costs	(2,675)	(3,802)
Amortization	14,921	11,267
Net carrying amount	$ 55,570	$ 126,415
Equity component:		
Conversion feature	$ 18,862	$ 24,800
Equity portion of debt issuance costs	(793)	(793)
Deferred taxes	941	941
Net carrying amount	$ 19,010	$ 24,948

In connection with the issuance of the Convertible Notes, the Company entered into convertible note hedge transactions for which it paid an aggregate $26.4 million. In addition, the Company sold warrants for which it received aggregate proceeds of $13.0 million. The convertible note hedge transactions are expected generally to reduce potential dilution of the Company's common stock upon any conversion of notes and/or offset any cash payments the Company is required to make in excess of the principal amount of converted notes. However, the warrant transaction could separately have a dilutive effect to the extent that the market value per share of the Company's common stock exceeds the applicable strike price of the warrant transactions, which is approximately $52.99 at inception. As these transactions meet certain accounting criteria, the convertible note hedge and warrant transactions are recorded in stockholders' equity, are not accounted for as derivatives and are not remeasured each reporting period.

The net proceeds from the Convertible Notes and related transactions of $125.7 million, net of commissions and offering costs of $4.6 million, were used to repurchase shares of the Company's common stock under the Company's share repurchase programs. Refer to Note 12. Share Repurchase Programs for additional information.

In connection with the repurchases of Convertible Notes, the convertible note hedge transactions and the warrant transaction noted above were reduced in ratable proportion to the face amount of Convertible Notes that were repurchased. The net proceeds received by the Company from these transactions were de minimis.

Revolving Credit Facility

As of December 29, 2018 and December 30, 2017, the Company had zero and $12.0 million of borrowings outstanding on its Revolving Credit Facility, respectively.

In May 2017, the Company executed an amendment to its Revolving Credit Facility, which provides for an extension of the maturity date to May 9, 2022, provided that the maturity date would be any day on or after September 2, 2020 only if the Company did not on any such day have enough liquidity to retire its Convertible Notes then outstanding, if any. The amendment also provides for a reduction of the interest rate under the Revolving Credit Facility, as noted below.

Subject to the terms of the Revolving Credit Facility, the Company may borrow up to $90.0 million, with a Company option to increase the facility up to a total of $150.0 million. The availability under the Revolving Credit Facility is subject to a borrowing base calculated on the value of certain inventory as well as certain accounts receivable of the Company. The obligations thereunder are secured by a security interest in substantially all of the assets of the Company. Under the Revolving Credit Facility, VSI has guaranteed the Company's obligations, and Industries and its wholly-owned subsidiaries have each

guaranteed the obligations of the other respective entities. The Revolving Credit Facility provides for affirmative and negative covenants affecting the Company. The Revolving Credit Facility restricts, among other things, the Company's ability to incur indebtedness, create or permit liens on the Company's assets, declare or pay dividends and make certain other restricted payments, consolidate, merge or recapitalize, sell assets, make certain investments, loans or other advances, enter into transactions with affiliates, change our line of business, and restricts the types of hedging activities the Company can enter into. The largest amount borrowed during Fiscal 2018 was $44.0 million. The unused available line of credit under the Revolving Credit Facility at December 29, 2018 was $85.9 million.

Borrowings under the Revolving Credit Facility accrue interest, at the Company's option, at the rate per annum based on an "alternative base rate" plus 0.00%, 0.125% or 0.25% or the adjusted Eurodollar rate plus 1.00%, 1.125% or 1.25%, in each case with the highest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is less than 33% of the borrowing base availability under the Revolving Credit Facility, the second highest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is less than 66% and greater than or equal to 33% of the borrowing base availability under the Revolving Credit Facility and the lowest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is greater than or equal to 66% of the borrowing base availability under the Revolving Credit Facility. The weighted average interest rate for the Revolving Credit Facility for Fiscal 2018 was 3.02%. The commitment fee on the undrawn portion of the $90.0 million Revolving Credit Facility was 0.25% as of December 29, 2018 and December 30, 2017.

Interest expense, net for Fiscal 2018, 2017 and 2016 consists of the following (in thousands):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Amortization of debt discount on Convertible Notes	$ 3,170	$ 4,781	$ 4,690
Interest on Convertible Notes	2,054	3,270	3,335
Amortization of deferred financing fees	604	898	957
Interest / fees on the Revolving Credit Facility and other interest	774	752	541
Interest expense, net	$ 6,602	$ 9,701	$ 9,523

8. Revenue Recognition

The Company recognizes revenue from retail customers when merchandise is sold "at point of sale" in retail stores or upon delivery to a customer. Substantially all revenue from customers represents goods transferred at a point in time.

The Company applied the modified retrospective method for the transition to FASB Accounting Standards UpdateNo. 2014-09, Revenue from Contracts with Customers (Topic 606). The modified retrospective method requires application of the revenue standard only to the current year financial statements (i.e., the financial statements for the year in which the revenue standard is first implemented). Under the modified retrospective method, an entity records a cumulative-effect adjustment on the opening balance sheet to retained earnings. The opening adjustment to retained earnings is determined on the basis of the impact of the revenue standard's application on contracts that were not completed as of the date of initial application. The Company did not record an opening adjustment to retained earnings as the impact of the application of the revenue standard was de minimis.

Disaggregation of Revenue

The Company disaggregates revenue from contracts with customers into two categories, sales fulfilled in stores and direct to consumer sales. The Company determines that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.

The following table contains net sales by fulfillment category (in thousands):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016 (a)
Net sales:			
Sales fulfilled in stores	$ 967,258	$ 1,022,954	$ 1,109,202
Direct to consumer sales	146,902	123,545	130,024
Net sales	$ 1,114,160	$ 1,146,499	$ 1,239,226

(a) Fiscal 2016 includes a 53rd week.

The following table represents net sales by major product category (in thousands):

	Fiscal Year Ended		
Product Category	December 29, 2018	December 30, 2017	December 31, 2016 (a)
Vitamins, Minerals, Herbs and Homeopathy	$ 331,017	$ 328,986	$ 339,597
Sports Nutrition	328,826	353,578	408,288
Specialty Supplements	288,939	294,546	308,945
Other	163,043	167,251	180,271
	1,111,825	1,144,361	1,237,101
Delivery Revenue	2,335	2,138	2,125
Total Net sales	$ 1,114,160	$ 1,146,499	$ 1,239,226

(a) Fiscal 2016 includes a 53rd week.

Delivery revenue represents shipping fees billed to customers which are included in net sales in the consolidated statements of operations.

Contract Balances

Receivables primarily consist of amounts due from debit and credit card processors and amounts due from third-partye-commerce marketplaces. These receivables balances are included in prepaid expenses and other current assets in the consolidated balance sheets.

For the periods presented, the Company does not have contract assets. A contract asset would exist when an entity has a contract with a customer for which revenue has been recognized but payment is contingent on a future event other than the passage of time (e.g., unbilled receivables).

Contract liabilities primarily include deferred sales related to the loyalty program, a liability for future gift card redemptions and a liability for sales in transit. These liabilities are included in accrued expenses and other current liabilities in the consolidated balance sheets.

The opening and closing balances of the Company's receivables and contract liabilities are as follows (in thousands):

	Receivables	Contract Liabilities
Balances as of December 30, 2017	$ 10,937	$ 7,511
Increase	1,055	899
Balances as of March 31, 2018	11,992	8,410
Increase / (Decrease)	(560)	1,013
Balances as of June 30, 2018	11,432	9,423
Decrease	(515)	(2,498)
Balances as of September 29, 2018	10,917	6,925
Increase / (Decrease)	(2,706)	362
Balances as of December 29, 2018	$ 8,211	$ 7,287
Balances as of December 31, 2016	$ 11,012	$ 6,901
Increase / (Decrease)	744	(503)
Balances as of April 1, 2017	11,756	6,398
Increase / (Decrease)	(672)	983
Balances as of July 1, 2017	11,084	7,381
Increase / (Decrease)	466	(957)
Balances as of September 30, 2017	11,550	6,424
Increase / (Decrease)	(613)	1,087
Balances as of December 30, 2017	$ 10,937	$ 7,511

The amounts of revenue recognized during the three month periods ended March 31, 2018 and April 1, 2017 that were included in the opening contract liability balances were $6.5 million and $6.0 million, respectively. The amounts of revenue recognized during the three month periods ended June 30, 2018 and July 1, 2017 that were included in the opening contract liability balances were $6.4 million and $5.6 million, respectively. The amounts of revenue recognized during the three month periods ended September 29, 2018 and September 30, 2017 that were included in the opening contract liability balances were $8.4 million and $6.5 million, respectively. The amounts of revenue recognized during the three month periods ended December 29, 2018 and December 30, 2017 that was included in the opening contract liability balances was $5.8 million in both periods. This revenue consists primarily of loyalty point redemptions, the delivery of sales in transit and gift card redemptions.

Performance Obligations

For retail sales, the performance obligation is the transfer of retail merchandise to the customer at the retail store or at the time of delivery to the customer. Variable consideration for retail sales is primarily related to our loyalty program. Under the loyalty program, sales are deferred at the time points are earned based on the value of points that are projected to be redeemed, which are based on historical redemption data and current trends. The Company records a liability in the period points are earned with a corresponding reduction of sales. Under this program, loyalty points are earned each calendar quarter and must be redeemed within the subsequent calendar quarter or they expire. During Fiscal 2018, the Company tested potential changes to the loyalty program, such as extending the redemption period on loyalty points, in order to improve the effectiveness of the program. Enhancements to the loyalty program will be rolled out in Fiscal 2019.

Performance obligations are typically satisfied at the point in time when the Company transfers control of the merchandise to the customer and at such point in time the customer is able to direct the use of and obtains substantially all of the benefits from the merchandise transferred to the customer. For retail sales, payment is due at the time the customer purchases retail merchandise. For retail sales, the Company establishes a provision for estimated returns of retail products, based on historical information.

The Company considers shipping and handling costs as fulfillment costs, and does not consider such activities as a separate performance obligation. When applicable, the Company is responsible for shipment and delivery of the merchandise, even when using a third-party shipping company.

Significant Judgments and Estimates

The Company considers control of retail products to have transferred upon delivery, at the retail location or the place of delivery, because the Company has a present right to payment at that time, the customer has legal title to the products, the Company has transferred physical possession of the products, and the customer has significant risks and rewards of ownership of the products.

Under the loyalty program, the value of points projected to be redeemed is dependent on the estimated redemption rates which are based on both historical information and current trends.

For retail sales in transit, the Company defers the recognition of revenue based on an estimate of the respective anticipated timing of delivery.

Practical Expedients

The Company has elected to use the following practical expedients affecting the measurement and recognition of revenue:

Significant financing component - As substantially all of the Company’s contracts with customers have an original duration of one year or less, the Company uses the practical expedient applicable to such contacts and does not consider the time value of money.

Sales taxes - Consistent with prior periods, sales taxes collected from customers are presented on a net basis and as such are excluded from revenue.

Contract costs - Due to the short term duration of the Company’s contracts with customers, such incremental costs of obtaining or fulfilling a contract are recognized as an expense when incurred since the amortization period of the asset that the Company otherwise would have recognized is one year or less.

Portfolio approach - For its retail contracts with customers, the Company has applied the revenue standard to a portfolio of contracts with similar characteristics since the Company reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts within that portfolio.

Disclosure of remaining performance obligations - Due to the short duration of its contracts with customers of one year or less, the Company has elected not to disclose the information regarding the remaining performance obligations as of the end of each reporting period or when the Company expects to recognize this revenue.

9. Income Taxes

The provision (benefit) for income taxes for Fiscal 2018, Fiscal 2017 and Fiscal 2016 consists of the following (in thousands):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Current:			
Federal	$ (4,925)	$ (501)	$ 20,923
State	(267)	(28)	3,850
Total current	(5,192)	(529)	24,773
Deferred:			
Federal	2,839	(14,461)	(11,655)
State	2,780	(5,373)	(2,028)
Total deferred	5,619	(19,834)	(13,683)
Provision (benefit) for income taxes	$ 427	$ (20,363)	$ 11,090

Provision (benefit) for income taxes is included in the consolidated financial statements as follows (in thousands):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Continuing operations	$ 3,588	$ (18,882)	$ 29,065
Discontinued operations	(3,161)	(1,481)	(17,975)
Provision (benefit) for income taxes	$ 427	$ (20,363)	$ 11,090

A reconciliation of the statutory Federal income tax rate and effective rate for income taxes for continuing operations is as follows:

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Federal statutory rate	21.0%	35.0%	35.0%
State income taxes, net of Federal income tax benefit	9.3%	3.9%	4.5%
Federal tax credit	(8.6)%	— %	— %
Revaluation of deferred tax assets and liabilities	(6.6)%	(3.9)%	— %
Stock compensation	4.6%	(0.4)%	— %
Impairment of goodwill	— %	(27.3)%	— %
Write-off of Canada investment	— %	(0.1)%	(3.7)%
Other	1.2%	0.2%	0.4%
Effective tax rate	20.9%	7.4%	36.2%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying value of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. The temporary differences and carryforwards that give rise to deferred tax assets and liabilities at December 29, 2018 and December 30, 2017 are as follows (in thousands):

	December 29, 2018	December 30, 2017
Deferred tax assets:		
Net operating loss carryforward	$ 12,104	$ 2,820
Deferred rent	6,452	7,012
Tenant allowance	3,268	3,659
General accrued liabilities	4,097	4,660
Deferred wages and compensation	2,494	1,594
Inventory	6,984	8,078
Equity compensation expense	1,979	2,582
Debt	—	583
Trade name and goodwill	3,029	10,850
Other	705	2,830
	41,112	44,668
Valuation allowance	(5,434)	(2,820)
Deferred tax assets	35,678	41,848
Deferred tax liabilities:		
Debt	(1,214)	—
Accumulated depreciation	(1,104)	(3,078)
Prepaid expenses	(1,701)	(1,492)
Deferred tax liabilities	(4,019)	(4,570)
Net deferred tax asset	$ 31,659	$ 37,278

Management periodically assesses whether the Company is more likely than not to realize some or all of its deferred tax assets. As of December 29, 2018, with the exception of $5.4 million of deferred tax assets arising from a foreign and state net operating loss carryforward against which there is a valuation allowance (see above table), management determined that the Company is more likely than not to realize the deferred tax assets detailed above. Realization of deferred tax assets associated with the state net operating loss carryforwards is dependent upon generating sufficient taxable income prior to their expiration by tax jurisdiction.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various state jurisdictions, Puerto Rico and Canada. The Company recognizes interest related to uncertain tax positions in income tax expense. The Company is no longer subject to U.S. federal examinations by tax authorities for years before 2015 and for state examinations before 2012. However, the tax authorities still have the ability to review the relevance of net operating loss carryforwards created in closed years if such tax attributes are utilized in open years (subsequent to 2012).

The Company has domestic federal operating losses of approximately $31.8 million which will be carried forward indefinitely. The Company also has domestic (U.S. state) and foreign net operating losses of approximately $72.3 million and $7.9 million at December 29, 2018, against which a full valuation allowance is recorded. Domestic net operating losses generated will continue to expire annually through Fiscal 2034. The Company's foreign net operating loss was generated through operations in Canada, and will expire in Fiscal 2035.

10. Stock Based Compensation

Equity Incentive Plans - In June 2018, the Company's shareholders approved the 2018 Long-term Incentive Plan (the "2018 Plan") to provide stock based compensation to certain directors, officers, consultants and employees of the Company. The 2018 Plan replaces the two previous plans, the 2006 Stock Option Plan and the Vitamin Shoppe 2009 Equity Incentive

Plan, as amended and restated effective April 6, 2012. Upon adoption of the 2018 Plan, 1,410,928 additional shares were authorized to grant under this plan. As of December 29, 2018, there were 2,995,168 shares available to grant under the 2018 Plan, which includes 240,900 shares currently held by the Company as treasury stock. During Fiscal 2018, the Company granted inducement awards to certain executives, which were granted outside of the 2018 Plan, but generally incorporate the terms and conditions of the 2018 Plan. These inducement awards consisted of 104,510 performance share units and 31,250 restricted share units. Restricted shares, performance share units and restricted share units are issued at a value not less than the fair market value of the common shares on the date of the grant and stock options are exercisable at no less than the fair market value of the underlying shares on the date of grant. Equity awards of restricted shares generally shall become vested between two and three years subsequent to the date on which such equity grants were awarded. Performance share units shall become vested approximately three years subsequent to the date on which such equity grants were awarded. Stock options awarded shall become vested in three equal increments on each of the anniversaries of the date on which such equity grants were awarded and generally have a maximum term of 10 years. However, regarding performance based restricted shares, performance share units and performance based stock options, vesting is dependent not only on the passage of time, but also on the attainment of certain internal performance metrics or market conditions. For accounting purposes, the expense for performance based stock options, performance based restricted shares and performance share units is calculated and recorded, based on the determination that the achievement of the pre-established performance targets or market conditions are probable, over the relevant service period. Restricted share units generally shall become vested quarterly, or up to three years, subsequent to the date on which such equity grants were awarded.

The following table summarizes restricted shares for the 2018 Plan as of December 29, 2018 and changes during Fiscal 2018:

	Number of Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Unvested at December 30, 2017	724,104	$ 18.65
Granted	302,275	$ 4.74
Vested	(158,254)	$ 23.05
Canceled/forfeited	(431,728)	$ 14.32
Unvested at December 29, 2018	436,397	$ 11.70

The total intrinsic value of restricted shares vested during Fiscal 2018, Fiscal 2017 and Fiscal 2016 was $0.8 million, $1.5 million and $2.5 million, respectively.

The following table summarizes stock options for the 2018 Plan as of December 29, 2018 and changes during Fiscal 2018:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 30, 2017	308,888	$ 27.74		
Granted	141,777	$ 4.65		
Exercised	—	$ —		
Canceled/forfeited	(178,665)	$ 25.58		
Outstanding at December 29, 2018	272,000	$ 17.13	7.31	$ —
Vested or expected to vest at December 29, 2018	255,158	$ 17.71	7.22	—
Vested and exercisable at December 29, 2018	103,581	$ 31.44	4.91	$ —

No options were exercised during Fiscal 2018. The total intrinsic value of options exercised during Fiscal 2017 and Fiscal 2016 was $0.7 million and $0.1 million, respectively. The cash received from options exercised during Fiscal 2017 and Fiscal 2016 was $1.5 million and $0.1 million, respectively.

No stock options were granted in Fiscal 2017. The weighted average grant date fair value of stock options was $1.76 for Fiscal 2018 and $7.96 for Fiscal 2016. During Fiscal 2018, the fair value of each option grant was estimated on the date of grant using the Monte Carlo option-pricing model, because these awards contain a market condition based on the achievement of predetermined targets related to the share price of our common stock. During Fiscal 2016, the fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model.

The weighted average grant date fair values of stock options were based on the following assumptions:

	Fiscal Year Ended	
	December 29, 2018	December 31, 2016
Expected dividend yield	— %	— %
Weighted average expected volatility	42.6%	32.4%
Weighted average risk-free interest rate	2.5%	1.2%
Expected holding period	6.02 years	4.00 years

The following table summarizes performance share units for the 2018 Plan, as well as inducement awards, as of December 29, 2018 and changes during Fiscal 2018:

	Number of Unvested Performance Share Units	Weighted Average Grant Date Fair Value
Unvested at December 30, 2017	288,365	$ 22.43
Granted	657,586	$ 6.01
Vested	—	$ —
Canceled/forfeited	(502,082)	$ 11.34
Unvested at December 29, 2018	443,869	$ 10.64

Performance share units granted during Fiscal 2018 shall vest on December 26, 2020 and December 25, 2021 if the performance criteria are achieved. Performance share units granted during Fiscal 2017 shall vest on December 28, 2019 if the performance criteria are achieved. Performance share units can vest at a range of 0% to 150% based on the achievement of pre-established performance targets. Performance share units granted during Fiscal 2016 vested at 11% in February 2019 upon board of directors approval based on the percentage achievement of the performance criteria.

The following table summarizes restricted share units for the 2018 Plan, as well as inducement awards, as of December 29, 2018 and changes during Fiscal 2018:

	Number of Unvested Restricted Share Units	Weighted Average Grant Date Fair Value
Unvested at December 30, 2017	39,708	$ 11.90
Granted	160,560	$ 7.45
Vested	(87,205)	$ 9.25
Canceled/forfeited	(23,723)	$ 6.85
Unvested at December 29, 2018	89,340	$ 7.84

The total intrinsic value of restricted share units vested during Fiscal 2018, Fiscal 2017 and Fiscal 2016 was $0.4 million, $0.1 million and $0.4 million, respectively.

Compensation expense attributable to stock-based compensation for Fiscal 2018 was $2.7 million, for Fiscal 2017 was $6.1 million and for Fiscal 2016 was $6.3 million. As of December 29, 2018, the remaining unrecognized stock based compensation expense for non-vested stock options, restricted shares, performance share units and restricted share units to be expensed in future periods is $4.2 million, and the related weighted average period over which it is expected to be recognized is 1.5 years. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company estimates forfeitures based on its historical forfeiture rate since the inception of granting stock based awards. The estimated value of future forfeitures for stock options, restricted shares, performance share units and restricted share units as of December 29, 2018 is approximately $0.3 million.

Treasury Stock—As part of the Company's equity incentive plans, the Company makes required tax payments on behalf of employees as their restricted shares vest. The Company withholds the number of vested shares having a value on the date of vesting equal to the minimum statutory tax obligation. The shares withheld are recorded as treasury shares. During Fiscal 2018, the Company purchased 62,059 shares in settlement of employees' tax obligations for a total of $0.3 million. The Company accounts for treasury stock using the cost method. 240,900 treasury shares are available to grant under the Company's equity incentive plan.

11. Restructuring Costs

Closing of Distribution Center

In August 2017, the Company announced its intention to close the North Bergen, New Jersey distribution center, which it closed on August 31, 2018, upon lease expiration. The transition of distribution operations to the Company's other distribution centers was substantially completed during Fiscal 2017.

Costs related to this closure, including occupancy, severance and other expenses, for the fiscal year ended December 29, 2018 were $2.7 million, of which approximately $1.6 million is included in cost of goods sold and approximately $1.1 million is included in selling, general and administrative expenses in the consolidated statements of operations. Costs related to this closure, including inventory obsolescence charges, severance and other expenses, for the fiscal year ended December 30, 2017 were $3.1 million, and substantially all of these costs are included in cost of goods sold in the consolidated statements of operations. As of December 29, 2018, the Company had no remaining liabilities related to the closing of the North Bergen, New Jersey distribution center.

12. Share Repurchase Programs

Beginning in August 2014, the Company's board of directors approved share repurchase programs that enable the Company to purchase up to an aggregate of $370 million of its shares of common stock and/or its Convertible Notes, from time to time. As of December 29, 2018, 8,064,325 shares of common stock pursuant to these programs, and 83,311 Convertible Notes, have been repurchased for a total of $333.8 million. There is approximately $36.2 million remaining in this program. On October 31, 2018, the Company's board of directors approved a two year extension of the remaining repurchase program. This repurchase program will expire on November 22, 2020.

The repurchase programs do not obligate the Company to acquire any specific number of securities and may be suspended, terminated or modified at any time for any reason, including market conditions, the cost of repurchasing securities, the availability of alternative investment opportunities, liquidity, restrictions under the Company's credit agreement, applicable law and other factors deemed appropriate.

No shares of the Company were repurchased under these programs during Fiscal 2018. During Fiscal 2018, the Company repurchased $83.3 million in aggregate principal amount of its Convertible Notes for an aggregate purchase price of $63.9 million, which includes accrued interest of $0.4 million.

No shares or other securities of the Company were repurchased under these programs during Fiscal 2017. During Fiscal 2016, the Company repurchased 1,670,837 shares of its common stock in the open market. The shares were retired upon repurchase. Open market share repurchases were $47.0 million in Fiscal 2016 with an average repurchase price per share of $28.13. In Fiscal 2016, the Company also repurchased 646,666 shares of its common stock for $19.0 million, or $29.40 per share, under a 10b5-1 program which the Company entered into to purchase shares under predetermined criteria.

Additionally, the Company has entered into accelerated share repurchase ("ASR") arrangements with financial institutions. In exchange for an up-front payment, the financial institutions initially deliver shares of the Company's common stock. The total number of shares ultimately delivered, and therefore the average repurchase price paid per share, is determined at the end of the purchase period of each ASR based on the volume weighted-average price of the Company's common stock during that period. The shares are retired in the periods they are delivered, and each up-front payment is accounted for as a reduction to stockholders' equity in the Company's Consolidated Balance Sheet in the period the payment was made. The Company reflects each ASR as a repurchase of common stock in the period delivered for purposes of calculating earnings per share and as a forward contract indexed to its own common stock. The ASRs met all of the applicable criteria for equity classification, and therefore, were not accounted for as derivative instruments.

The following table summarizes the Company's ASR arrangements:

Beginning of ASR Period	Up-front Payment (in millions)	Initial Share Deliveries	End of ASR Period	Final Shares Delivered	Average Repurchase Price
December, 2015	$ 50.0	1,391,940	February, 2016	235,053	$ 30.73

13. Benefit Plans

The Company sponsors the Vitamin Shoppe Industries, Inc. 401(k) Plan ("401k Plan"). Employees who have completed one month of service are eligible to participate in the 401k Plan. The 401k Plan provides for participant contributions of 1% to 100% of participant compensation into deferred savings, subject to IRS limitations. The 401k Plan provides for Company contributions upon the participant meeting the eligibility requirements. Participants are 100% vested in the Company matching contribution upon receipt. The Company matching contribution is 100% of the first 3% of participant compensation contributed to the 401k Plan and 50% of the next 2% of participant compensation contributed to the 401k Plan. The Company may make discretionary contributions for each 401k Plan year.

The Company recognized expenses for the 401k Plan of $2.3 million in Fiscal 2018, $2.1 million in Fiscal 2017 and $2.0 million in Fiscal 2016.

14. Lease Commitments

The Company has non-cancelable real estate operating leases, which expire through 2036. These leases generally contain renewal options for periods ranging from 1 to 10 years and require the Company to pay costs such as real estate taxes and common area maintenance. Contingent rentals are paid based on a percentage of gross sales as defined by lease agreements. The following table provides the net rental expense for all real estate operating leases (in thousands):

	Fiscal Year Ended		
	December 29, 2018	December 30, 2017	December 31, 2016
Minimum rentals	$ 126,219	$ 124,150	$ 122,039
Contingent rentals	83	88	88
	126,302	124,238	122,127
Less: Sublease rentals	(1,389)	(360)	(274)
Net rental expense	$ 124,913	$ 123,878	$ 121,853

As of December 29, 2018, the Company's real estate lease commitments are as follows (in thousands):

Fiscal year	Total Operating Leases (1)
2019	$121,227
2020	108,993
2021	95,529
2022	80,274
2023	61,847
Thereafter	115,852
	$583,722

(1) Store operating leases included in the above table do not include contingent rent based upon sales volume. Operating leases do not include common area maintenance costs or real estate taxes that are paid to the landlord during the year, which combined represented approximately 18.5% of our minimum lease obligations for Fiscal 2018.

15. Legal Proceedings

The Company is party to various lawsuits arising from time to time in the normal course of business, some of which are covered by insurance. Although the impact of the final resolution of these matters on the Company's financial condition, results of operations or cash flows is not known, management does not believe that the resolution of these lawsuits will have a material adverse effect on the financial condition, results of operations or liquidity of the Company.

16. Fair Value of Financial Instruments

The fair value hierarchy requires the categorization of assets and liabilities into three levels based upon the assumptions (inputs) used to price the assets or liabilities. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets and liabilities.
- Level 2: Observable inputs other than those included in Level 1. For example, quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.
- Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

The Company's financial instruments include cash, accounts receivable, accounts payable, contract liabilities and its Revolving Credit Facility. The Company believes that the recorded values of these financial instruments approximate their fair values due to their nature and respective durations.

The Company's financial instruments also include its Convertible Notes (in thousands):

	December 29, 2018	December 30, 2017
Fair Value	$ 50,914	$ 91,612
Carrying Value (1)	55,570	126,415

(1) Represents the net carrying amount of the liability component of the Convertible Notes. The Company repurchased a portion of its Convertible Notes during the fiscal year ended December 29, 2018. Refer to Note 7., "Credit Arrangements" for additional information.

The fair value of the Convertible Notes was determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, including the trading price of the Company's Convertible Notes, when available, the Company's stock price and interest rates based on similar debt issued by parties with credit ratings similar to the Company (Level 1 or 2).

Intangible assets and fixed assets are measured at fair value on anon-recurring basis, that is, the assets are subject to fair value adjustments in certain circumstances such as when there is evidence of impairment. These measures of fair value, and related inputs, are considered Level 3 measures under the fair value hierarchy.

17. Selected Quarterly Financial Information (unaudited)

The following table summarizes the Fiscal 2018 and Fiscal 2017 quarterly results from continuing operations (in thousands, except for share data):

	Fiscal Quarter Ended			
	March	June	September (1)	December (2)
Fiscal Year Ended December 29, 2018				
Net sales	$295,964	$ 293,103	$ 276,636	$ 248,457
Gross profit	93,111	94,236	86,691	80,755
Income (loss) from operations	3,811	5,187	3,226	(5,395)
Net income (loss)	9,657	5,283	1,880	(3,279)
Net income (loss) per common share:				
Basic	$ 0.41	$ 0.22	$ 0.08	$ (0.14)
Diluted	$ 0.41	$ 0.22	$ 0.08	$ (0.14)
Fiscal Year Ended December 30, 2017				
Net sales	$305,772	$ 296,420	$ 282,407	$ 261,900
Gross profit	98,982	97,321	86,618	79,646
Income (loss) from operations	18,841	(152,373)	(103,805)	(7,171)
Net income (loss)	9,895	(146,416)	(83,364)	(15,442)
Net income (loss) per common share:				
Basic	$ 0.43	$ (6.30)	$ (3.60)	$ (0.66)
Diluted	$ 0.43	$ (6.30)	$ (3.60)	$ (0.66)

(1) Net income for the fiscal quarter ended September 29, 2018 includes $1.3 million of tax benefit associated with tax accounting method changes and their effect on the revalued deferred tax assets and liabilities under U.S. Tax Reform.

(2) Net loss for the fiscal quarter ended December 29, 2018 includes $1.1 million of tax benefit resulting from a tax credit carryback. Net loss for the fiscal quarter ended December 30, 2017 reflects $15.3 million of tax expense resulting from the change in valuation of deferred tax assets and liabilities under U.S. Tax Reform.

The following table summarizes certain items for Fiscal 2018 and Fiscal 2017 which impacted quarterly results on apre-tax basis (in thousands):

	Fiscal Quarter Ended			
	March	June	September	December
Fiscal Year Ended December 29, 2018				
Gain on extinguishment of debt (a)	$(12,502)	$ (3,727)	$ —	$ (673)
Distribution center closing costs (b)	2,240	450	246	(187)
Store impairment charges (c)	702	131	718	1,466
Inventory obsolescence (d)	—	3,600	—	—
Management realignment (e)	—	1,848	363	622
Shareholder activism (f)	—	662	32	—
Fiscal Year Ended December 30, 2017				
Goodwill impairments (g)	$ —	$164,325	$ 46,308	$ —
Store impairment charges (c)	—	3,765	287	786
Tradename impairment (h)	—	—	59,405	—
Distribution center closing costs (b)	—	—	2,257	846

(a) Gain recognized on the repurchases of a portion of Convertible Notes.
(b) Costs related to the closing of the North Bergen, New Jersey distribution center.
(c) Impairment charges on the fixed assets of retail locations.
(d) Inventory charge resulting from an evaluation to optimize the Company’s product assortment.
(e) Costs related to management turnover, including severance charges, recruitment costs and related professional fees.
(f) Professional fees incurred related to shareholder settlement.
(g) Impairment charges on the goodwill of the retail operations.
(h) Impairment charge on the Vitamin Shoppe tradename.

Exhibit 99.4

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	September 28, 2019	December 29, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,995	$ 2,668
Inventories	181,815	189,273
Prepaid expenses and other current assets	23,601	27,921
Total current assets	221,411	219,862
Right-of-use assets	424,868	—
Property and equipment, net of accumulated depreciation and amortization of $338,044 and $312,977 in 2019 and 2018, respectively	112,755	123,002
Intangibles, net	2,283	11,088
Deferred taxes	35,695	31,659
Other long-term assets	3,250	2,468
Total assets	$ 800,262	$ 388,079
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Revolving credit facility	$ —	$ —
Accounts payable	38,203	39,789
Accrued expenses and other current liabilities	56,337	65,508
Short-term lease liabilities	96,756	500
Total current liabilities	191,296	105,797
Long-term lease liabilities	368,828	934
Convertible notes, net	57,422	55,570
Deferred rent	—	37,034
Other long-term liabilities	308	403
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 250,000,000 shares authorized and no shares issued and outstanding at September 28, 2019 and December 29, 2018	—	—
Common stock, $0.01 par value; 400,000,000 shares authorized, 24,366,706 shares issued and 24,060,705 shares outstanding at September 28, 2019, and 24,234,651 shares issued and 23,974,031 shares outstanding at December 29, 2018	244	242
Additional paid-in capital	86,990	85,853
Treasury stock, at cost; 306,001 shares at September 28, 2019 and 260,620 shares at December 29, 2018	(7,625)	(7,314)
Retained earnings	102,799	109,560
Total stockholders' equity	182,408	188,341
Total liabilities and stockholders' equity	$ 800,262	$ 388,079

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Net sales	$ 253,133	$ 276,636	$ 807,341	$ 865,703
Cost of goods sold	172,565	189,945	541,687	591,665
Gross profit	80,568	86,691	265,654	274,038
Selling, general and administrative expenses	82,493	82,747	254,071	260,263
Impairment charges on fixed, intangible and right-of-use assets	521	718	11,404	1,551
Income (loss) from operations	(2,446)	3,226	179	12,224
Gain on extinguishment of debt	—	—	—	16,229
Interest expense, net	1,080	1,289	3,221	5,429
Income (loss) before provision (benefit) for income taxes	(3,526)	1,937	(3,042)	23,024
Provision (benefit) for income taxes	(117)	57	440	6,204
Net income (loss) from continuing operations	(3,409)	1,880	(3,482)	16,820
Net loss from discontinued operations, net of tax	—	(3,626)	—	(15,245)
Net income (loss)	$ (3,409)	$ (1,746)	$ (3,482)	$ 1,575
Weighted average common shares outstanding				
Basic	23,716,403	23,545,842	23,646,617	23,477,982
Diluted	23,716,403	23,545,842	23,646,617	23,743,856
Net income (loss) from continuing operations per common share				
Basic	$ (0.14)	$ 0.08	$ (0.15)	$ 0.72
Diluted	$ (0.14)	$ 0.08	$ (0.15)	$ 0.71
Net loss from discontinued operations per common share				
Basic	$ —	$ (0.15)	$ —	$ (0.65)
Diluted	$ —	$ (0.15)	$ —	$ (0.64)
Net income (loss) per common share				
Basic	$ (0.14)	$ (0.07)	$ (0.15)	$ 0.07
Diluted	$ (0.14)	$ (0.07)	$ (0.15)	$ 0.07

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)
(Unaudited)

Figures may not sum due to rounding

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Total
	Shares	Amounts	Shares	Amounts			
Balance at December 29, 2018	24,234,651	$ 242	(260,620)	$ (7,314)	$ 85,853	$109,560	$188,341
Adoption of ASU 2016-02	—	—	—	—	—	(3,279)	(3,279)
Net income	—	—	—	—	—	3,497	3,497
Equity compensation	—	—	—	—	632	—	632
Issuance of shares	197,205	2	—	—	(2)	—	—
Purchases of treasury stock	—	—	(41,347)	(287)	—	—	(287)
Cancellation of restricted shares	(63,274)	(1)	—	—	1	—	—
Issuance of shares under employee stock purchase plan	20,844	—	—	—	84	—	84
Balance at March 30, 2019	24,389,426	244	(301,967)	(7,602)	86,568	109,778	188,988
Net loss	—	—	—	—	—	(3,570)	(3,570)
Equity compensation	—	—	—	—	314	—	314
Issuance of shares	60,140	1	—	—	(1)	—	—
Purchases of treasury stock	—	—	(1,105)	(5)	—	—	(5)
Cancellation of restricted shares	(148,073)	(1)	—	—	1	—	—
Issuance of shares under employee stock purchase plan	34,207	—	—	—	150	—	150
Balance at June 29, 2019	24,335,700	243	(303,072)	(7,607)	87,034	106,208	185,878
Net loss	—	—	—	—	—	(3,409)	(3,409)
Equity compensation	—	—	—	—	(110)	—	(110)
Issuance of shares	13,890	—	—	—	—	—	—
Purchases of treasury stock	—	—	(2,929)	(18)	—	—	(18)
Cancellation of restricted shares	(2,793)	—	—	—	—	—	—
Issuance of shares under employee stock purchase plan	19,909	—	—	—	66	—	66
Balance at September 28, 2019	24,366,706	$ 244	(306,001)	$ (7,625)	$ 86,990	$102,799	$182,408

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Total
	Shares	Amounts	Shares	Amounts			
Balance at December 30, 2017	24,220,509	$ 242	(198,561)	$ (7,010)	$ 88,823	$113,312	$195,367
Net loss	—	—	—	—	—	(3,859)	(3,859)
Equity compensation	—	—	—	—	875	—	875
Issuance of restricted shares	288,149	3	—	—	(3)	—	—
Purchases of treasury stock	—	—	(42,339)	(185)	—	—	(185)
Cancellation of restricted shares	(5,492)	—	—	—	—	—	—
Issuance of shares under employee stock purchase plan	29,149	—	—	—	107	—	107
Repurchases of Convertible Notes	—	—	—	—	(5,849)	—	(5,849)
Balance at March 31, 2018	24,532,315	245	(240,900)	(7,195)	83,953	109,453	186,456
Net income	—	—	—	—	—	7,180	7,180
Equity compensation	—	—	—	—	56	—	56
Issuance of restricted shares	17,539	—	—	—	—	—	—
Purchases of treasury stock	—	—	(13,100)	(59)	—	—	(59)
Cancellation of restricted shares	(276,344)	(3)	—	—	3	—	—
Repurchases of Convertible Notes	—	—	—	—	(26)	—	(26)
Balance at June 30, 2018	24,273,510	243	(254,000)	(7,254)	83,985	116,633	193,607
Net loss	—	—	—	—	—	(1,746)	(1,746)
Equity compensation	—	—	—	—	809	—	809
Issuance of restricted shares	40,770	—	—	—	—	—	—
Purchases of treasury stock	—	—	(2,717)	(31)	—	—	(31)
Cancellation of restricted shares	(90,734)	(1)	—	—	1	—	—
Issuance of shares under employee stock purchase plan	25,052	—	—	—	86	—	86
Balance at September 29, 2018	24,248,598	$ 242	(256,717)	$ (7,285)	$ 84,881	$114,887	$192,725

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	September 28, 2019	September 29, 2018
Cash flows from operating activities:		
Net income (loss)	$ (3,482)	$ 1,575
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of fixed assets, intangible assets and finance leases right-of-use assets	30,708	32,002
Impairment charges on intangible assets	9,000	8,174
Impairment charges on fixed assets	994	9,591
Impairment charges on right-of-use assets	1,410	—
Loss on sale of FDC Vitamins, LLC	—	203
Amortization of deferred financing fees	329	485
Gain on extinguishment of debt	—	(16,229)
Amortization of debt discount on convertible notes	1,612	2,570
Deferred income taxes	(2,876)	14,478
Deferred rent	—	(2,835)
Non-cash portion of lease expense for operating leases	69,692	—
Equity compensation expense	837	1,740
Tax benefits on exercises of equity awards	438	743
Changes in operating assets and liabilities:		
Accounts receivable	—	(1,458)
Inventories	7,458	33,925
Prepaid expenses and other current assets	4,483	(1,143)
Other long-term assets	(1,039)	(35)
Accounts payable	(1,428)	(3,994)
Accrued expenses and other current liabilities	(10,032)	(2,147)
Operating lease liabilities	(73,617)	—
Other long-term liabilities	(475)	(46)
Net cash provided by operating activities	34,012	77,599
Cash flows from investing activities:		
Capital expenditures	(19,447)	(24,655)
Net proceeds on sale of FDC Vitamins, LLC	—	14,847
Trademarks and other intangible assets	(469)	(250)
Net cash used in investing activities	(19,916)	(10,058)
Cash flows from financing activities:		
Borrowings under revolving credit facility	10,000	125,000
Repayments of borrowings under revolving credit facility	(10,000)	(137,000)
Purchases of convertible notes	—	(57,158)
Bank overdraft	(386)	1,881
Issuance of shares under employee stock purchase plan	301	194
Purchases of treasury stock	(311)	(275)
Other financing activities	(373)	(339)
Net cash used in financing activities	(769)	(67,697)
Effect of exchange rate changes on cash and cash equivalents	—	1
Net increase (decrease) in cash and cash equivalents	13,327	(155)
Cash and cash equivalents beginning of period	2,668	1,947
Cash and cash equivalents end of period	$ 15,995	$ 1,792
Supplemental disclosures of cash flow information:		
Interest paid	$ 969	$ 2,219
Income taxes paid (refunded)	$ 350	$ (10,729)
Supplemental disclosures of non-cash investing activities:		
Liability for purchases of property and equipment	$ 4,930	$ 1,829

See accompanying notes to consolidated financial statements.

VITAMIN SHOPPE, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

Vitamin Shoppe, Inc. ("VSI"), is incorporated in the State of Delaware, and through its wholly-owned subsidiary, Vitamin Shoppe Industries Inc. ("Subsidiary" or "Industries" together with VSI, the "Company"), is an omni-channel specialty retailer of nutritional products. Sales of both national brands and our own brands of vitamins, minerals, herbs, specialty supplements, sports nutrition and other health and wellness products ("VMS products") are made through VSI-operated retail stores, the internet and mobile devices to customers located primarily in the United States.

The consolidated financial statements as of September 28, 2019 and September 29, 2018 are unaudited. The consolidated balance sheet as of December 29, 2018 was derived from our audited financial statements. The Company currently operates through one business segment, retail, which includes Vitamin Shoppe and Super Supplements retail store formats and our e-commerce formats. In addition, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted pursuant to such rules and regulations. The interim financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair presentation in conformity with GAAP. The interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 29, 2018, as filed with the Securities and Exchange Commission on February 26, 2019 (the "Fiscal 2018 Form 10-K"). The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

The Company's fiscal year ends on the last Saturday in December. As used herein, the term "Fiscal Year" or "Fiscal" refers to a52-week period, ending on the last Saturday in December. The results for the three and nine months ended September 28, 2019 and September 29, 2018 are each based on 13-week and 39-week periods, respectively.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company has reclassified its finance lease liabilities in its consolidated balance sheet as of December 29, 2018 to conform to current year presentation.

Except as noted below, the Company has considered all new accounting pronouncements and has concluded that there are no new pronouncements, issued but not yet effective, that may have a material impact on its results of operations, financial condition, or cash flows, based on current information.

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards UpdateNo. 2016-13 ("ASU 2016-13"), Financial Instruments—Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments. ASU 2016-13 was issued by the FASB to replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to be applied to credit loss estimates. ASU 2016-13 is effective for the Company for fiscal years beginning after December 15, 2019 and will be adopted using a modified-retrospective approach. The Company is evaluating ASU 2016-13 and currently expects this guidance will not have a material impact on its results of operations, financial condition, or cash flows, based on current information.

2. Agreement and Plan of Merger

On August 7, 2019, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Franchise Group, Inc. (formerly known as Liberty Tax, Inc.) ("Franchise Group") and Valor Acquisition, LLC, a wholly owned subsidiary of Franchise Group ("Merger Sub"), pursuant to which Merger Sub will merge with and into the Company, with the Company continuing as the surviving corporation and a wholly owned subsidiary of Franchise Group (the "Merger").

If the Merger is completed, the (i) stockholders of the Company will be entitled to receive $6.50 in cash (the “Per Share Price”), less any applicable withholding taxes, for each share of common stock of the Company owned by them, (ii) common stock of the Company will no longer be publicly traded and will be delisted from the New York Stock Exchange and (iii) common stock of the Company will be deregistered under the Securities Exchange Act of 1934, as amended, and the Company will no longer file periodic or current reports with the United States Securities and Exchange Commission.

The Company expects that the Merger will close during the fourth quarter of 2019, subject to the approval of the Company’s stockholders and other customary closing conditions.

3. Discontinued Operations

On May 7, 2018, the Company sold certain assets, including the Betancourt Nutrition® brand, and liabilities of FDC Vitamins, LLC d/b/a Nutri-Force Nutrition (“Nutri-Force”) to Arizona Nutritional Supplements, LLC (“ANS”). The parties also executed supply agreements in which the Company has agreed to purchase a total of $53.0 million annually of its private label products and Betancourt Nutrition® brand products from ANS through October 2023.

The results of operations of Nutri-Force for the three and nine months ended September 29, 2018 are classified as discontinued operations in the consolidated statements of operations.

Reconciliation of the Major Line Items Constituting Loss of Discontinued Operations to theAfter-Tax Loss of Discontinued Operations That Are Presented in the Statements of Operations (in thousands)

	Three Months Ended September 29, 2018	Nine Months Ended September 29, 2018
Major classes of line items constituting net loss on discontinued operations:		
Net sales (1)	$ 761	$ 11,187
Cost of goods sold	2,417	9,756
Fixed assets impairment charges	—	7,236
Gross loss	(1,656)	(5,805)
Selling, general and administrative expenses	629	2,581
Intangible assets and fixed assets impairment charges	—	8,978
Discontinued operations loss	40	203
Loss before provision (benefit) for income taxes	(2,325)	(17,567)
Provision (benefit) for income taxes	1,301	(2,322)
Net loss	$ (3,626)	$ (15,245)

(1) Revenue related to a transition services agreement during the three and nine months ended September 29, 2018 was $0.8 million and $2.4 million, respectively.

Cash Flow Disclosures for Discontinued Operations
(in thousands)

	Three Months Ended September 29, 2018	Nine Months Ended September 29, 2018
Cash flows provided by (used in) operating activities	$ 936	$ (14,180)
Cash flows provided by (used in) investing activities	$ (882)	$ 14,752
Depreciation and amortization	$ —	$ 769
Capital expenditures	$ —	$ 94

4. Goodwill and Intangible Assets

The following table discloses the carrying value of all intangible assets (in thousands):

	September 28, 2019				December 29, 2018			
	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairment Charges	Net	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairment Charges	Net
Intangible assets								
Goodwill	$210,633	$ —	$ 210,633	$ —	$210,633	$ —	$ 210,633	$ —
Tradenames – Indefinite-lived (1)	68,405	—	68,405	—	68,405	—	59,405	9,000
Tradenames – Definite-lived	6,233	3,950	—	2,283	5,764	3,676	—	2,088
	$285,271	$ 3,950	$ 279,038	$2,283	$284,802	$ 3,676	$ 270,038	$11,088

(1) During the second quarter of Fiscal 2019, the Company experienced a sustained reduction to its market capitalization. In addition, the Company revised its forecast for Fiscal 2019 and updated its long-range plan. Based on these factors, the Company concluded that an impairment trigger occurred and therefore an interim impairment test of the Vitamin Shoppe tradename was performed. The results of the interim impairment test indicated that the carrying value of the Vitamin Shoppe tradename exceeded its fair value. The Company recorded an impairment charge on the Vitamin Shoppe tradename of $9.0 million during the second quarter of Fiscal 2019, which represented the full remaining carrying value of this indefinite-lived tradename.

For indefinite-lived tradenames, the Company utilizes the royalty relief method in its quantitative evaluations. Under the royalty relief method, a royalty rate is determined based on comparable licensing arrangements which is applied to the revenue projections for the applicable indefinite-lived tradename and the fair value is calculated using a discounted cash flow analysis. Cash flows are discounted using an internally derived weighted average cost of capital which reflects the costs of borrowing as well as the associated risk.

These measures of fair value for indefinite-lived tradenames, and related inputs, are considered Level 3 measures under the fair value hierarchy.

The useful lives of the Company's definite-lived intangible assets are 10 years. The expected amortization expense on definite-lived intangible assets on the Company's consolidated balance sheet at September 28, 2019, is as follows (in thousands):

Remainder of Fiscal 2019	$ 91
Fiscal 2020	381
Fiscal 2021	381
Fiscal 2022	378
Fiscal 2023	335
Thereafter	717
	$2,283

5. Accrued Expenses and Other Current Liabilities

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

	September 28, 2019	December 29, 2018
Accrued salaries and related expenses	$ 11,889	$ 24,048
Sales tax payable and related expenses	7,491	7,092
Deferred sales	4,024	5,455
Other accrued expenses	32,933	28,913
	$ 56,337	$ 65,508

6. Credit Arrangements

Convertible Senior Notes due 2020

On December 9, 2015, the Company issued $143.8 million of its 2.25% Convertible Senior Notes due 2020 (the "Convertible Notes"). The Convertible Notes are senior unsecured obligations of VSI. Interest on the Convertible Notes is payable on June 1 and December 1 of each year until their maturity date of December 1, 2020. The Company may not redeem the Convertible Notes prior to the maturity date.

Prior to July 1, 2020, the remaining Convertible Notes will be convertible only under certain circumstances. The Convertible Notes are convertible at an initial conversion rate of 25.1625 shares of the Company's common stock per $1,000 principal amount of the Convertible Notes, which is equivalent to a conversion price of approximately $39.74. The conversion rate is subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, following certain corporate events that occur prior to the maturity date, the Company is required to increase, in certain circumstances, the conversion rate for a holder who elects to convert its Convertible Notes in connection with such a corporate event including customary conversion rate adjustments in connection with a "make-whole fundamental change" as defined. Upon conversion, the Company may satisfy its conversion obligation by paying or delivering, as applicable, cash, shares of its common stock or a combination of cash and shares of its common stock, at its election.

The Company allocated the principal amount of the Convertible Notes between its liability and equity components (see table below). The carrying amount of the liability component was determined by measuring the fair value of a similar debt instrument of similar credit quality and maturity that did not have the conversion feature. The carrying amount of the equity component, representing the embedded conversion option, was determined by deducting the fair value of the liability component from the principal amount of the Convertible Notes as a whole. The equity component was recorded to additional paid-in capital and is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the Convertible Notes over the carrying amount of the liability component was recorded as a debt discount, and is being amortized to interest expense using an effective interest rate of 3.8% over the term of the Convertible Notes. The Company allocated the total amount of transaction costs incurred to the liability and equity components using the same proportions as the proceeds from the Convertible Notes. Transaction costs attributable to the liability component were recorded as a direct deduction from the liability component of the Convertible Notes, and are being amortized to interest expense using the effective interest method through the maturity date. Transaction costs attributable to the equity component were netted with the equity component of the Convertible Notes in additional paid-in capital.

During the nine month period ending September 29, 2018, the Company repurchased $75.3 million in aggregate principal amount of its Convertible Notes for an aggregate purchase price of $57.2 million, which includes accrued interest of $0.3 million. The gain on extinguishment of the repurchased Convertible Notes was $16.2 million.

The Convertible Notes consist of the following components (in thousands):

	September 28, 2019	December 29, 2018
Liability component:		
Principal	$ 60,439	$ 60,439
Conversion feature	(17,115)	(17,115)
Liability portion of debt issuance costs	(2,675)	(2,675)
Amortization	16,773	14,921
Net carrying amount	$ 57,422	$ 55,570
Equity component:		
Conversion feature	$ 18,862	$ 18,862
Equity portion of debt issuance costs	(793)	(793)
Deferred taxes	941	941
Net carrying amount	$ 19,010	$ 19,010

In connection with the issuance of the Convertible Notes, the Company entered into convertible note hedge transactions for which it paid an aggregate $26.4 million. In addition, the Company sold warrants for which it received aggregate proceeds of $13.0 million. The convertible note hedge transactions are expected generally to reduce potential dilution of the Company's common stock upon any conversion of notes and/or offset any cash payments the Company is required to make in excess of the principal amount of converted notes. However, the warrant transaction could separately have a dilutive effect to the extent that the market value per share of the Company's common stock exceeds the applicable strike price of the warrant transactions, which is approximately $52.99 at inception. As these transactions meet certain accounting criteria, the convertible note hedge and warrant transactions are recorded in stockholders' equity, are not accounted for as derivatives and are not remeasured each reporting period.

The net proceeds from the Convertible Notes and related transactions of $125.7 million, net of commissions and offering costs of $4.6 million, were used to repurchase shares of the Company's common stock under the Company's share repurchase programs. Refer to Note 12., "Share Repurchase Programs" for additional information.

In connection with the repurchases of Convertible Notes, the convertible note hedge transactions and the warrant transaction noted above were reduced in ratable proportion to the face amount of Convertible Notes that were repurchased. The net proceeds received by the Company from these transactions were de minimis.

Revolving Credit Facility

As of September 28, 2019 and December 29, 2018, the Company had no borrowings outstanding on its Revolving Credit Facility (the "Revolving Credit Facility").

The Revolving Credit Facility has a maturity date of May 9, 2022, provided that the maturity date would be any day on or after September 2, 2020 only if the Company did not on any such day have enough liquidity to retire its Convertible Notes then outstanding, if any.

Subject to the terms of the Revolving Credit Facility, the Company may borrow up to $90.0 million, with a Company option to increase the facility up to a total of $150.0 million. The availability under the Revolving Credit Facility is subject to a borrowing base calculated on the value of certain inventory as well as certain accounts receivable of the Company. The obligations thereunder are secured by a security interest in substantially all of the assets of the Company. Under the Revolving Credit Facility, VSI has guaranteed the Company's obligations, and Industries and its wholly-owned subsidiaries have each guaranteed the obligations of the other respective entities. The Revolving Credit Facility provides for affirmative and negative covenants affecting the Company. The Revolving Credit Facility restricts, among other things, the Company's ability to incur

indebtedness, create or permit liens on the Company's assets, declare or pay dividends and make certain other restricted payments, consolidate, merge or recapitalize, sell assets, make certain investments, loans or other advances, enter into transactions with affiliates, change our line of business, and restricts the types of hedging activities the Company can enter into. The largest amount borrowed during the nine months ended September 28, 2019 and September 29, 2018 was $10.0 million and $44.0 million, respectively. The unused available line of credit under the Revolving Credit Facility at September 28, 2019 was $85.5 million.

Borrowings under the Revolving Credit Facility accrue interest, at the Company's option, at the rate per annum based on an "alternative base rate" plus 0.00%, 0.125% or 0.25% or the adjusted Eurodollar rate plus 1.00%, 1.125% or 1.25%, in each case with the highest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is less than 33% of the borrowing base availability under the Revolving Credit Facility, the second highest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is less than 66% and greater than or equal to 33% of the borrowing base availability under the Revolving Credit Facility and the lowest spread applicable in the event that the average excess collateral availability under the Revolving Credit Facility is greater than or equal to 66% of the borrowing base availability under the Revolving Credit Facility. The weighted average interest rate for the Revolving Credit Facility during the nine months ended September 28, 2019 and September 29, 2018 was 3.86% and 2.92%, respectively. The commitment fee on the undrawn portion of the $90.0 million Revolving Credit Facility is 0.25% per annum.

Interest expense, net for the three and nine months ended September 28, 2019 and September 29, 2018 consists of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Amortization of debt discount on Convertible Notes	$ 544	$ 594	$ 1,612	$ 2,570
Interest on Convertible Notes	340	390	1,020	1,738
Amortization of deferred financing fees	110	120	329	485
Interest / fees on the Revolving Credit Facility and other interest	86	185	260	636
Interest expense, net	$ 1,080	$ 1,289	$ 3,221	$ 5,429

7. Leases

The Company's lease contracts consist of real estate leases and non-real estate leases primarily related to equipment. The Company leases the property for all of its stores as well as its distribution centers and corporate offices. In addition, the Company leases the facilities for its discontinued manufacturing operations. As of September 28, 2019, all of the Company's real estate leases are classified as operating leases. Generally, the initial term of leases for stores is ten years. These leases generally contain renewal options for periods ranging from one to ten years, a few of which are considered "reasonably certain" in the measurement of lease liabilities and the corresponding right-of-use assets due to significant capital expenditures related to those store locations. The Company is also required under these leases to pay costs such as real estate taxes and common area maintenance. Contingent rentals are paid based on a percentage of gross sales as defined by lease agreements. These costs and contingent rentals are not considered as lease payments in the measurement of lease liabilities and the corresponding right-of-use assets as they represent non-lease components or variable lease payments other than those that depend on an index or rate. The Company sub-leases a portion of its stores, as well as certain manufacturing facilities related to its discontinued operations.

Non-real estate leases consist primarily of leases for equipment used in our distribution centers, corporate offices and for store connectivity. These leases, based on the underlying lease agreements, are classified as operating or finance leases.

Adoption and Transition

The Company has elected to adopt Accounting Standards Update No. 2016-02 (“ASU 2016-02”), Leases (Topic 842) in accordance with Accounting Standards Update No. 2018-11 (“ASU 2018-11”), Leases (Topic 842) Targeted Improvements. Under the transition method included in ASU2018-11, the Company initially applies ASU 2016-02 at the adoption date of December 30, 2018 (first day of Fiscal 2019) and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company’s reporting for the comparative periods presented in its financial statements will continue to be in accordance with previous GAAP (Topic 840, Leases). Under this transition method, the Company must provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840.

On December 30, 2018, the Company recognized a cumulative-effect charge of $3.3 million net of tax to the opening balance of retained earnings which represents impairment charges to the right-of-use assets associated with stores whose fixed assets have been previously impaired, and whose lease liabilities were determined to be above fair market value.

Transition of Operating Leases

For existing operating leases under Topic 840, the transition to operating leases under Topic 842 was as follows:

- Lease liability and right-of use asset are recognized at the later of the lease commencement date and the date of adoption of December 30, 2018.
- The lease liability is measured as the present value of the remaining lease payments using the discount rate based on the Company’s incremental borrowing rates as no interest rates are explicitly stated in the lease agreements.
- The right-of-use asset is measured based on the value of the lease liability, adjusted for the following:
    - Additions to the amount of the lease liability include:
        - Prepaid rent
        - Unamortized initial direct costs
        - Favorable assets resulting from business combinations
    - Reductions to the amount of the lease liability include:
        - Accrued / deferred rent
        - Lease incentives
        - Impairment charges
        - Cease use liabilities, such as lease termination costs
        - Unfavorable liabilities resulting from business combinations
- Write-off of any unamortized initial direct costs that are no longer initial direct costs under Topic 842 as an adjustment to equity. For leases which commenced prior to adoption, this write-off is not applicable as the Company has elected the package of practical expedients, as noted below.

Transition of Finance Leases

For existing capital leases under Topic 840, the transition to finance leases under Topic 842 was as follows:

- Lease liability and right-of-use asset are recognized based on the carrying value of the existing asset and liability at the later of the lease commencement date and the date of adoption of December 30, 2018.
- Include any unamortized initial direct costs that meet the Topic 842 initial direct costs definition;write-off any unamortized initial direct costs that are no longer initial direct costs under Topic 842 as an adjustment to equity. For existing leases, this write-off is not applicable as the Company has elected the package of practical expedients, as noted below.

Practical Expedients

The Company has elected to use the following practical expedients for the adoption of ASU2016-02:

- For leases that commenced before the effective date, (1) the Company need not reassess whether any expired or existing contracts are or contain leases, (2) the Company need not reassess the lease classification for any expired or existing leases and (3) the Company need not reassess initial direct costs for any existing leases.
- To use hindsight in determining lease term and in assessing impairment of the Company’sright-of-use assets.
- To not allocate the consideration in the contract between separatenon-lease components and lease components.

Significant Assumptions and Judgments

Discount rate

The discount rate is the rate implicit in the lease unless that rate cannot be readily determined. In that case, the Company is required to use its incremental borrowing rate. The discount rate for a lease is determined based on the information available at the later of the adoption of ASU 2016-02 or at lease commencement. The incremental borrowing rate is the rate of interest that the Company would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment. The Company engaged outside valuation consultants for the determination of the incremental borrowing rates for its operating leases.

	Three Months Ended September 28, 2019 (in thousands)	Nine Months Ended September 28, 2019 (in thousands)
Lease cost		
Finance lease cost:		
Amortization of right-of-use assets	$ 110	$ 349
Interest on lease liabilities	13	45
Operating lease cost	29,252	88,315
Variable lease cost	2,884	8,390
Sublease income	(337)	(879)
Total lease cost	$ 31,922	$ 96,220
Other Information		
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from finance leases	$ 13	$ 45
Operating cash flows from operating leases	$ 30,628	$ 91,978
Financing cash flows from finance leases	$ 126	$ 373
Right-of-use assets obtained in exchange for new finance lease liabilities	$ —	$ —
Right-of-use assets obtained in exchange for new operating lease liabilities	$ 12,416	$ 40,435

	As of September 28, 2019
Weighted-average remaining lease term, in years – finance leases	2.0
Weighted-average remaining lease term, in years – operating leases	5.1
Weighted-average discount rate – finance leases	4.7%
Weighted-average discount rate – operating leases	5.4%

As of September 28, 2019, the Company's right-of-use assets consist of the following (in thousands):

Right-of-use assets - operating leases	$ 423,987
Right-of-use assets - finance leases	881
Total right-of-use assets	$ 424,868

As of September 28, 2019, the reconciliation of undiscounted cash flows to lease liabilities, by lease type, is as follows (in thousands):

	Operating Leases	Finance Leases
Undiscounted cash flows:		
Year 1	$118,458	$ 558
Year 2	107,318	502
Year 3	92,140	56
Year 4	74,340	—
Year 5	53,768	—
Beyond Year 5	97,060	—
	$543,084	$1,116
Present values	$464,523	$1,061
Short-term lease liabilities	$ 96,238	$ 518
Long-term lease liabilities	368,285	543
Total lease liabilities	$464,523	$1,061
Difference between undiscounted cash flows and discounted cash flows	$ 78,561	$ 55

Prior to the adoption of ASU 2016-02, as of December 29, 2018, the Company's real estate lease commitments were as follows (in thousands):

Fiscal year	Total Operating Leases (1)
2019	$121,227
2020	108,993
2021	95,529
2022	80,274
2023	61,847
Thereafter	115,852
	$583,722

(1) Store operating leases included in the above table do not include contingent rent based upon sales volume. Operating leases do not include common area maintenance costs or real estate taxes that are paid to the landlord during the year, which combined represented approximately 18.5% of our minimum lease obligations for Fiscal 2018.

8. Revenue Recognition

The Company recognizes revenue from retail customers when merchandise is sold "at point of sale" in retail stores or upon delivery to a customer. Substantially all revenue from customers represents goods transferred at a point in time.

Upon adoption, at the beginning of Fiscal 2018, the Company applied the modified retrospective method for the transition to FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The modified retrospective method requires application of the new revenue standard beginning with the financial statements for the year in which the new revenue standard is first implemented. Under the modified retrospective method, an entity records a cumulative-effect adjustment on the opening balance sheet to retained earnings. The opening adjustment to retained earnings is determined on the basis of the impact of the new revenue standard's application on contracts that were not completed as of the date of initial application. The Company did not record an opening adjustment to retained earnings as the impact of the application of the new revenue standard was de minimis.

Disaggregation of Revenue

The Company disaggregates revenue from contracts with customers into two categories, sales fulfilled in stores and direct to consumer sales. The Company determines that disaggregating revenue into these categories achieves the disclosure objective to depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.

The following table contains net sales by fulfillment category (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Net sales:				
Sales fulfilled in stores	$ 216,636	$ 240,642	$ 693,215	$ 752,933
Direct to consumer sales	36,497	35,994	114,126	112,770
Net sales	$ 253,133	$ 276,636	$ 807,341	$ 865,703

The following table represents net sales by major product category (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Product Category				
Vitamins, Minerals, Herbs and Homeopathy	$ 73,836	$ 80,825	$ 236,384	$ 253,626
Sports Nutrition	71,608	82,143	230,827	261,151
Specialty Supplements	69,087	72,019	215,151	223,427
Other	37,991	41,078	123,198	125,700
	252,522	276,065	805,560	863,904
Delivery Revenue	611	571	1,781	1,799
Total net sales	$ 253,133	$ 276,636	$ 807,341	$ 865,703

Delivery revenue represents shipping fees billed to customers which are included in net sales in the consolidated statements of operations.

Contract Balances

Receivables primarily consist of amounts due from debit and credit card processors, wholesale customers and amounts due from third-party e-commerce marketplaces. These receivables balances are included in prepaid expenses and other current assets in the consolidated balance sheets.

For the periods presented, the Company does not have contract assets. A contract asset would exist when an entity has a contract with a customer for which revenue has been recognized but payment is contingent on a future event other than the passage of time (e.g., unbilled receivables).

Contract liabilities primarily include deferred sales related to the loyalty program, a liability for future gift card redemptions and a liability for sales in transit. These liabilities are included in accrued expenses and other current liabilities in the consolidated balance sheets.

The opening and closing balances of the Company's receivables and contract liabilities are as follows (in thousands):

	Receivables	Contract Liabilities
Balances as of December 29, 2018	$ 8,211	$ 7,287
Increase / (Decrease)	771	(1,034)
Balances as of March 30, 2019	8,982	6,253
Increase / (Decrease)	772	(1,113)
Balances as of June 29, 2019	9,754	5,140
Increase / (Decrease)	(1,145)	179
Balances as of September 28, 2019	$ 8,609	$ 5,319
Balances as of December 30, 2017	$ 10,937	$ 7,511
Increase	1,055	899
Balances as of March 31, 2018	11,992	8,410
Increase / (Decrease)	(560)	1,013
Balances as of June 30, 2018	11,432	9,423
Decrease	(515)	(2,498)
Balances as of September 29, 2018	$ 10,917	$ 6,925

The amounts of revenue recognized during the three month periods ended March 30, 2019 and March 31, 2018 that were included in the opening contract liability balances as of December 29, 2018 and December 30, 2017 were $6.0 million and $6.5 million, respectively. The amounts of revenue recognized during the three month periods ended June 29, 2019 and June 30, 2018 that were included in the opening contract liability balances as of March 30, 2019 and March 31, 2018 were $5.2 million and $6.4 million, respectively. The amounts of revenue recognized during the three month periods ended September 28, 2019 and September 29, 2018 that were included in the opening contract liability balances as of June 29, 2019 and June 30, 2018 were $3.5 million and $8.4 million, respectively. This revenue consists primarily of loyalty point redemptions, the delivery of sales in transit and gift card redemptions.

Performance Obligations

For retail sales, the performance obligation is the transfer of retail merchandise to the customer at the retail store or at the time of delivery to the customer. Variable consideration for retail sales is primarily related to our loyalty program. Under the loyalty program, sales are deferred at the time points are earned based on the value of points that are projected to be redeemed, which are based on historical redemption data and current trends. The Company records a liability in the period points are earned with a corresponding reduction of sales. Through the first fiscal quarter of Fiscal 2019, loyalty points were earned each calendar quarter and must have been redeemed within the subsequent calendar quarter or they expired. Enhancements to the loyalty program were rolled out in the second fiscal quarter of Fiscal 2019 and include providing Healthy Awards® members with flexibility when redeeming loyalty points. Under the enhanced loyalty program, Healthy Awards® members have the option to redeem loyalty points as they are earned or accumulate loyalty points over an extended period of time.

The Company considers shipping and handling costs as fulfillment costs, and does not consider such activities as a separate performance obligation. When applicable, the Company is responsible for shipment and delivery of the merchandise, even when using a third-party shipping company.

9. Stock Based Compensation

Equity Incentive Plans – Through its 2018 Long-term Incentive Plan (the "2018 Plan"), the Company provides stock based compensation to certain directors, officers, consultants and employees of the Company. As of September 28, 2019, there were 2,658,423 shares available to grant under the 2018 Plan which includes 240,900 shares currently held by the Company as treasury stock.

During Fiscal 2018, the Company granted inducement awards to certain executives, which were granted outside of the 2018 Plan, but generally incorporate the terms and conditions of the 2018 Plan. These inducement awards consisted of 104,510 performance share units and 31,250 restricted share units.

The following table summarizes restricted shares for the 2018 Plan as of September 28, 2019 and changes during the nine month period then ended:

	Number of Unvested Restricted Shares	Weighted Average Grant Date Fair Value
Unvested at December 29, 2018	436,397	$ 11.70
Granted	226,539	$ 6.47
Vested	(104,222)	$ 21.17
Canceled/forfeited	(214,140)	$ 6.74
Unvested at September 28, 2019	344,574	$ 8.49

The total intrinsic value of restricted shares vested during the nine months ended September 28, 2019 and September 29, 2018 was $0.7 million and $0.7 million, respectively.

The following table summarizes stock options for the 2018 Plan as of September 28, 2019 and changes during the nine month period then ended:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 29, 2018	272,000	$ 17.13		
Granted	—	$ —		
Exercised	—	$ —		
Canceled/forfeited	(36,050)	$ 30.17		
Outstanding at September 28, 2019	235,950	$ 15.13	7.03	$ 261
Vested or expected to vest at September 28, 2019	225,677	$ 15.54	6.98	
Vested and exercisable at September 28, 2019	133,222	$ 22.08	6.12	$ 87

No options were exercised during the nine months ended September 28, 2019 and September 29, 2018.

Stock options were not granted during the nine months ended September 28, 2019. The weighted-average grant date fair value of stock options during the nine months ended September 29, 2018 was $1.76. The fair value of each option grant was estimated on the date of grant using the Monte Carlo option-pricing model, because these awards contain a market condition based on the achievement of predetermined targets related to the share price of our common stock, with the following assumptions:

	Nine Months Ended September 29, 2018
Expected dividend yield	0.0%
Weighted average expected volatility	42.61%
Weighted average risk-free interest rate	2.54%
Expected holding period	6.02 years

The following table summarizes performance share units for the 2018 Plan, as well as inducement awards, as of September 28, 2019 and changes during the nine month period then ended:

	Number of Unvested Performance Share Units	Weighted Average Grant Date Fair Value
Unvested at December 29, 2018	443,869	$ 10.64
Granted	372,504	$ 6.82
Vested	(3,028)	$ 30.26
Canceled/forfeited	(171,252)	$ 10.15
Unvested at September 28, 2019	642,093	$ 8.46

Performance share units granted during the nine months ended September 28, 2019 will vest on December 25, 2021 if the performance criteria are achieved. These performance share units can vest at a range of 0% to 300% based on the achievement of pre-established performance targets.

The total intrinsic value of performance share units vested during the nine months ended September 28, 2019 was de minimis.

The following table summarizes restricted share units for the 2018 Plan, as well as inducement awards, as of September 28, 2019 and changes during the nine month period then ended:

	Number of Unvested Restricted Share Units	Weighted Average Grant Date Fair Value
Unvested at December 29, 2018	89,340	$ 7.84
Granted	159,144	$ 3.77
Vested	(58,090)	$ 7.75
Canceled/forfeited	—	$ —
Unvested at September 28, 2019	190,394	$ 4.46

The total intrinsic value of restricted share units vested during the nine months ended September 28, 2019 and September 29, 2018 was $0.4 million and $0.7 million, respectively.

Compensation expense attributable to stock based compensation for the three and nine months ended September 28, 2019 was approximately $(0.1) million and $0.8 million, respectively, and for the three and nine months ended September 29, 2018 was approximately $0.8 million and $1.7 million, respectively. As of September 28, 2019, the remaining unrecognized stock based compensation expense for non-vested stock options, restricted shares, performance share units and restricted share units to be expensed in future periods is $1.8 million, and the related weighted-average period over which it is expected to be recognized is 1.6 years. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company estimates forfeitures based on its historical forfeiture rate since the inception of granting stock based awards. The estimated value of future forfeitures for stock options, restricted shares, performance share units and restricted share units as of September 28, 2019 is approximately $0.2 million.

Treasury Stock – As part of the Company's equity incentive plan, the Company makes required tax payments on behalf of employees as their equity awards vest. The Company withholds the number of vested shares having a value on the date of vesting equal to the minimum statutory tax obligation. The shares withheld are recorded as treasury shares. During the nine months ended September 28, 2019, the Company purchased 45,381 shares in settlement of employees' tax obligations for a total of $0.3 million. The Company accounts for treasury stock using the cost method. 240,900 treasury shares are available to grant under the Company's equity incentive plan.

10. Advertising Costs

The costs of advertising for online marketing arrangements, direct mail, magazines and radio are expensed as incurred, or the first time the advertising takes place. Advertising expense was $6.4 million and $5.9 million for the three months ended September 28, 2019 and September 29, 2018, respectively, and $21.6 million and $19.3 million for the nine months ended September 28, 2019 and September 29, 2018, respectively.

11. Net Income (Loss) Per Share

The Company's basic net income (loss) per share excludes the dilutive effect of stock options, unvested restricted shares, unvested performance share units, unvested restricted share units and warrants. It is based upon the weighted average number of common shares outstanding during the period divided into net income (loss).

Diluted net income (loss) per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. Stock options, unvested restricted shares, unvested performance share units, unvested restricted share units and warrants are included as potential dilutive securities for the periods applicable, using the treasury stock method to the extent dilutive.

The components of the calculation of basic net income (loss) per common share and diluted net income (loss) per common share are as follows (in thousands except share and per share data):

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Numerator:				
Net income (loss) from continuing operations	$ (3,409)	$ 1,880	$ (3,482)	$ 16,820
Net loss from discontinued operations	—	(3,626)	—	(15,245)
Net income (loss)	$ (3,409)	$ (1,746)	$ (3,482)	$ 1,575
Denominator:				
Basic weighted average common shares outstanding	23,716,403	23,545,842	23,646,617	23,477,982
Effect of dilutive securities (a):				
Stock options	—	—	—	20,807
Restricted shares	—	—	—	137,697
Performance share units	—	—	—	80,543
Restricted share units	—	—	—	26,827
Diluted weighted average common shares outstanding	23,716,403	23,545,842	23,646,617	23,743,856
Basic net income (loss) from continuing operations per common share	$ (0.14)	$ 0.08	$ (0.15)	$ 0.72
Diluted net income (loss) from continuing operations per common share	$ (0.14)	$ 0.08	$ (0.15)	$ 0.71
Basic net loss from discontinued operations per common share	$ —	$ (0.15)	$ —	$ (0.65)
Diluted net loss from discontinued operations per common share	$ —	$ (0.15)	$ —	$ (0.64)
Basic net income (loss) per common share	$ (0.14)	$ (0.07)	$ (0.15)	$ 0.07
Diluted net income (loss) per common share	$ (0.14)	$ (0.07)	$ (0.15)	$ 0.07

(a) For the three and nine months ended September 28, 2019 and for the three months ended September 29, 2018, due to a loss for the period, no incremental shares are included because the effect would be anti-dilutive.

Securities for the three months ended September 28, 2019 and September 29, 2018 in the amount of 507,116 shares and 43,482 shares, respectively, have been excluded from the above calculation as they were anti-dilutive. Securities for the nine months ended September 28, 2019 and September 29, 2018 in the amount of 574,197 shares and 664,916 shares, respectively, have been excluded from the above calculation as they were anti-dilutive.

The Company has the intent and ability to settle the principal portion of its Convertible Notes in cash, and as such, has applied the treasury stock method, which has resulted in the underlying convertible shares, and related warrants, being anti-dilutive for the three and nine months ended September 28, 2019 and September 29, 2018 as the Company's average stock price from the date of issuance of the Convertible Notes through September 28, 2019 was less than the conversion price as well as less than the strike price of the warrant transaction. Refer to Note 6., "Credit Arrangements" for additional information on the Convertible Notes.

12. Share Repurchase Programs

Beginning in August 2014, the Company's board of directors approved share repurchase programs that enable the Company to purchase up to an aggregate of $403.8 million of its shares of common stock and / or its Convertible Notes, from time to time. As of September 28, 2019, 8,064,325 shares of common stock pursuant to these programs, and 83,311 Convertible Notes, have been repurchased for a total of $333.8 million. There is $70.0 million remaining in this program. On October 31, 2018, the Company's board of directors approved a two year extension of the remaining repurchase program. This repurchase program will expire on November 22, 2020.

The repurchase programs do not obligate the Company to acquire any specific number of securities and may be suspended, terminated or modified at any time for any reason, including market conditions, the cost of repurchasing securities, the availability of alternative investment opportunities, liquidity, restrictions under the Company's credit agreement, applicable law and other factors deemed appropriate.

No shares of the Company were repurchased under these programs during the three and nine month periods ended September 28, 2019 and September 29, 2018. During the nine month period ended September 29, 2018, the Company repurchased $75.3 million in aggregate principal amount of its Convertible Notes for an aggregate purchase price of $57.2 million, which includes accrued interest of $0.3 million. Refer to Note 6., "Credit Arrangements" for additional information.

13. Legal Proceedings

In addition to the lawsuits noted below, the Company is party to various lawsuits arising from time to time in the normal course of business, some of which are covered by insurance. Although the impact of the final resolution of these matters on the Company's financial condition, results of operations or cash flows is not known, management does not believe that the resolution of these lawsuits will have a material adverse effect on the financial condition, results of operations or liquidity of the Company.

On September 30, 2019, a purported stockholder of the Company commenced a federal securities action in the United States District Court for the District of New Jersey against the Company and its directors, captioned *Shiva Stein v. Vitamin Shoppe, Inc., et al*, No. 19 Civ. 18543 (D.N.J.). On October 1, 2019, a second purported Company stockholder commenced a putative securities class action in the United States District Court for the District of Delaware against the same defendants, captioned *Jordan Rosenblatt v. Vitamin Shoppe, Inc., et al*, No. 19 Civ. 1848 (D. Del.). On October 25, 2019, a third purported stockholder of the Company commenced a federal securities action in the United States District Court for the District of New Jersey against the same defendants, captioned *Kathleen S. Bell v. Vitamin Shoppe, Inc., et al*, No. 19 Civ. 19334 (D.N.J.). All three lawsuits were brought under Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, and challenge as allegedly materially false and misleading the disclosures the Company made in its September 30, 2019 preliminary proxy statement filed with the SEC in connection with the Merger. The complaints seek injunctive relief against the closing of the Merger pending additional disclosures, attorneys' fees, and other relief. Other, similar lawsuits may follow. The defendants believe that the lawsuits are without merit.

14. Fair Value of Financial Instruments

The fair value hierarchy requires the categorization of assets and liabilities into three levels based upon the assumptions (inputs) used to price the assets or liabilities. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets and liabilities.
- Level 2: Observable inputs other than those included in Level 1. For example, quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.
- Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

The Company's financial instruments include cash, accounts receivable, accounts payable, contract liabilities and its Revolving Credit Facility. The Company believes that the recorded values of these financial instruments approximate their fair values due to their nature and respective durations.

The Company's financial instruments also include its Convertible Notes (in thousands):

	September 28, 2019	December 29, 2018
Fair Value	$ 60,179	$ 50,914
Carrying Value (1)	57,422	55,570

(1) Represents the net carrying amount of the liability component of the Convertible Notes.

The fair value of the Convertible Notes was determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, including the trading price of the Company's Convertible Notes, when available, the Company's stock price and interest rates based on similar debt issued by parties with credit ratings similar to the Company (Level 1 or 2).

Intangible assets, fixed assets and right-of-use assets are measured at fair value on anon-recurring basis, that is, the assets are subject to fair value adjustments in certain circumstances such as when there is evidence of impairment. These measures of fair value, and related inputs, are considered Level 3 measures under the fair value hierarchy.

The Company recognized store impairment charges of $2.4 million during Fiscal 2019 on fixed assets andright-of-use assets related to six of its underperforming retail locations, which are still in use in the Company's operations. Impairment charges on the fixed assets of these retail locations represented the full net book value of the fixed assets of these retail locations. Impairment charges on the right-of-use assets of these retail locations were based on a market analysis of the fair value of the applicable real estate operating leases.

Exhibit 99.5

UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS OF THE COMBINED COMPANY AND RELATED NOTES

Introduction

The following unaudited pro forma combined statement of operations for the six months ended October 31, 2019 and for the year ended April 30, 2019 and the pro forma combined balance sheet as of October 31, 2019 are based on the historical financial statements of Franchise Group, Inc. ("Franchise Group"), Buddy's Newco, LLC ("Buddy's"), the SHOS business (for purposes of this section, the SHOS business, which represents the Outlet business segment of SHOS and certain Buddy's stores in respect of which an affiliate of SHOS is the franchisee, will be referred to as "Sears Outlet") and Vitamin Shoppe Inc. ("VSI"), after giving effect to the mergers of Franchise Group with Buddy's and the acquisitions by Franchise Group of Sears Outlet and VSI, the completion of the offer to acquire any and all outstanding shares of Franchise Group common stock other than shares of Franchise Group common stock held by the Vintage Group and B. Riley and certain of its affiliates, who have agreed not to tender their shares of Franchise Group common stock in the offer, for a purchase price of $12.00 per share in cash, and the related debt and equity financings, together the "Transactions." The unaudited pro forma combined financial statements are based on the assumptions, adjustments and eliminations described in the accompanying notes to the unaudited pro forma combined financial statements.

The unaudited pro forma combined statement of operations for the fiscal year ended April 30, 2019 combines the historical consolidated statement of operations for the fiscal year ended April 30, 2019 of Franchise Group and the historical consolidated trailing twelve months statement of operations for (i) the period ended March 31, 2019 of Buddy's and VSI and (ii) the period ended May 4, 2019 of Sears Outlet, giving effect to the Transactions as if they had occurred on the first day of the fiscal year, May 1, 2018. The unaudited pro forma combined statement of operations for the six month period ended October 31, 2019 combines the historical consolidated statement of operations for the six month period ended October 31, 2019 of Franchise Group that includes the three months ended October 31, 2019 of Buddy's financial information, the historical consolidated statement of operations for the three months ended June 30, 2019 of Buddy's, the historical combined statement of operations for the six months ended August 3, 2019 of Sears Outlet and the historical consolidated statement of operations for the six months ended September 28, 2019 of VSI giving effect to the Transactions as if they had occurred on the first day of the fiscal year May 1, 2018.

The unaudited pro forma combined balance sheet as of October 31, 2019 combines the historical consolidated balance sheet of Franchise Group as of October 31, 2019, which includes Buddy's and Sears Outlet, and the historical consolidated balance sheet of VSI as of September 28, 2019, giving effect to the Transactions as if they had occurred on October 31, 2019.

On November 12, 2019, Franchise Group completed its previously announced tender offer with 3.94 million shares tendered for an aggregate purchase price of approximately $47.2 million. As result of the offer, including additional equity contribution made by the Vintage Group or other members of Buddy's, and ultimate financing to consummate all of the Transactions, the pre-closing Franchise Group stockholders had an ownership interest of 68.31% in the Franchise Group and the preclosing members of Buddy's held 31.69% of non-controlling interest in the Franchise Group.

Under the acquisition method of accounting, the preliminary purchase price is allocated to the underlying tangible and intangible assets acquired and liabilities assumed based on their respective fair market values, with any excess purchase price allocated to goodwill. The pro forma purchase price allocation was based on an estimate of the fair market values of the tangible and intangible assets and liabilities related to Buddy's, Sears Outlet and VSI. Franchise Group considered multiple factors in arriving at the estimated fair market values, which were based on a preliminary and limited review of the assets and liabilities related to Buddy's, acquisition of VSI and Sears Outlet acquisition. We expect to complete the purchase price allocation after considering Buddy's, VSI's and Sears Outlet's assets and liabilities at the level of detail necessary to finalize the required purchase price allocation under the acquisition method of accounting. The final purchase price allocation may be different than that reflected in the pro forma purchase price allocation presented herein, and these differences may be material.

The unaudited pro forma combined financial statements contain only adjustments that are factually supportable and directly attributable to the Transactions and do not reflect the costs of any integration activities or benefits that may result from realization of future revenue growth or operational synergies expected to result from the Transactions.

Franchise Group historically has had a fiscal year ending on April 30 while Buddy's reports its results of operations on a calendar year basis, Sears Outlet has a fiscal year ending on February 2 and VSI has a fiscal year ending on the last Saturday in December. As a result:

- the historical statement of operations for the fiscal year ended December 31, 2018 of Buddy's and the historical statement of operations for the fiscal year ended December 29, 2018 of VSI have been adjusted to reflect a trailing twelve month period ending March 31, 2019 by adding Buddy's' and VSI's statement of operations for the three months ended March 31, 2019 and March 30, 2019, respectively, and subtracting their statement of operations for the three months ended March 31, 2018; and
- the historical combined statement of operations for the fiscal year ended February 2, 2019 of Sears Outlet has been adjusted to reflect a trailing twelve month period ending May 4, 2019 by adding Sears Outlet's statement of operations for the three months ended May 4, 2019 and subtracting Sears Outlet's statement of operations for the three months ended May 5, 2018.

The unaudited pro forma combined financial statements should be read in conjunction with:

- the accompanying notes to the unaudited pro forma combined financial statements;
- Franchise Group's audited and unaudited historical consolidated financial statements and related notes for the year ended April 30, 2019 and as of and for the six months ended October 31, 2019;
- Buddy's audited and unaudited historical consolidated financial statements and related notes for the fiscal year ended December 31, 2018 and as of and for the three months ended June 30, 2019, March 31, 2019 and March 31, 2018;
- Sears Outlet's audited and unaudited historical combined financial statements and related notes for the fiscal year ended February 2, 2019 and for the six months ended August 3, 2019 and August 4, 2018; and
- VSI's audited and unaudited historical consolidated financial statements and related notes for the fiscal year ended December 31, 2018 and as of and for the nine months ended September 28, 2019.

Description of the Transactions

Buddy's merger and the offer

Pursuant to the business combination agreement, Franchise Group and Buddy's consummated the merger whereby Buddy's became a wholly-owned subsidiary of New Holdco. In connection with the merger, Franchise Group formed New Holdco, which holds, directly or indirectly, all of Franchise Group's and Buddy's operating subsidiaries. In connection with the business combination agreement and the merger, Franchise Group designated the Franchise Group preferred stock pursuant to the certificate of designation. The certificate of designation, which was approved by the Board on July 10, 2019, and filed by Franchise Group with the Secretary of State of the State of Delaware on July 10, 2019, designates 1,616,667 shares of Franchise Group preferred stock, substantially all of which were issued to the Buddy's equity holders as consideration in the merger along with approximately 8,083,333 New Holdco common units. Buddy's equity holders have the option to exchange each New Holdco common unit and one-fifth (1/5) of a share of Franchise Group preferred stock, respectively, for one share of Franchise Group common stock beginning six months following the date of the merger, provided, however that the Board, in its sole discretion, may waive the application of the six-month period. The certificate of designation also provides for a mandatory redemption in shares of Franchise Group common stock under the terms stated above upon a change in

control event with respect to Franchise Group or New Holdco. Following the merger, Franchise Group became the sole managing member of New Holdco and consolidates New Holdco for financial reporting purposes. The New Holdco common units held by Buddy's equity holders were recorded as a non-controlling interest on the consolidated financial statements.

Concurrently with the execution of the business combination agreement, Franchise Group and the Buddy's equity holders entered into the tax receivable agreement. Subject to certain exceptions set forth in the tax receivable agreement, the tax receivable agreement generally provides that Franchise Group will pay the Buddy's equity holders 40% of the cash savings, if any, in federal, state and local taxes that Franchise Group realizes or is deemed to realize as a result of any increase in tax basis of the assets of New Holdco resulting from future redemptions or exchanges of New Holdco common units held by Buddy's equity holders. In connection with the merger, none of the New Holdco common units were purchased or exchanged by Franchise Group and the Buddy's equity holders and therefore an initial tax receivable liability was not recorded. However, subsequent to the merger, the effects of each purchase or exchange of New Holdco common units may result in adjustments to record a change in deferred tax balances, tax receivable liabilities equal to 40% of the estimated realizable tax benefits, and an increase to additional paid-in capital for the remainder. The total amount of future payments under the tax receivable agreement could be substantial. However, Franchise Group is not able to anticipate the expected timing of, or quantify the dollar amount of, these payments. The timing and amount of these payments will depend on a number of factors, including, among other things, (1) the amount and timing of future exchanges of New Holdco common units by the Buddy's equity holders, and the extent to which these exchanges are taxable, (2) the price per share of the Franchise Group common stock at the time of any exchange, (3) the amount and timing of future income against which to offset the potential tax benefits resulting from the subsequent exchange of New Holdco common units pursuant to the certificate of designation and (4) the tax laws then in effect.

Following the merger, on August 1, 2019, Franchise Group commenced the offer to acquire any and all outstanding shares of Franchise Group common stock other than shares of Franchise Group common stock held by the Vintage Group and B. Riley and certain of its affiliates, who had agreed not to tender their shares of Franchise Group common stock in the offer, for a price per share of $12.00 in cash. The offer was subject to a minimum tender condition and was completed on November 13, 2019. The offer and transaction costs related to the Buddy's merger were financed through both term loan financing and equity investments:

- Term loan financing: Buddy's has executed the Buddy's initial credit agreement with various lenders from time to time party thereto and Kayne Solutions Fund, L.P., as administrative agent and as collateral agent, with proceeds, net of financing costs, of approximately $80.2 million. The debt financing has been used to repay approximately $25.0 million of the existing line of credit financing of Buddy's, $22.2 million towards the tender offer and the remaining amount of approximately $23.0 million was used towards the acquisition costs.
- Equity investment from Tributum: Contemporaneously with the consummation of the merger and pursuant to the closing subscription agreement between Franchise Group and Tributum, Tributum purchased approximately 2,083,333 shares of Franchise Group common stock at a purchase price of $12.00 per share, for an aggregate purchase price of $25.0 million in cash. Such commitment financed the first $25.0 million of tender offer acceptances.

The unaudited pro forma combined financial information has been prepared based on Franchise Group's final results of the offer completed on November 13, 2019. Franchise Group shareholders accepted the offer for 3.94 million shares of Franchise Group common stock, or approximately $47.2 million, financed by the closing subscription agreement of $25.0 million and $22.2 million cash from the Buddy's term loan financing, all discussed above.

Sears Outlet Acquisition

On October 23, 2019, Franchise Group completed its acquisition of Sears Outlet pursuant to the terms of Sears Outlet purchase agreement dated as of August 27, 2019. Pursuant to the terms of the purchase agreement, Franchise Group paid SHOS an aggregate purchase price of $131.3 million including working capital adjustments. The purchase price includes $11.3 million paid towards transaction expenses, employee payments and insurance payments incurred by SHOS and $1.0 million of work capital adjustments. The acquisition costs related to the Sears Outlet acquisition were financed through the following term loan and equity investment:

- Term loan financing: Franchise Group Newco S, LLC, an indirect subsidiary of Franchise Group, has executed a term loan agreement with Guggenheim Credit Services, LLC providing Franchise Group with a senior secured term loan facility in an amount equal to $105.0 million (the "Sears Outlet term loan"). The Sears Outlet term loan will mature on October 23, 2023 and bear interest at a rate per annum based on LIBOR for an interest period of one, two, three or six months, plus an interest margin of 6.5% with a 1.50% LIBOR floor.
- Equity contributions from the Investors: On October 23, 2019, Stefac LP, an affiliate of Vintage Capital management, LLC, Brian R. Kahn, Lauren Kahn, and B. Riley FBR, Inc. (collectively, the "Investors") provided Franchise Group with an aggregate $40.0 million of equity financing to fund a portion of the Sears Outlet acquisition through the purchase of Franchise Group common stock shares at $12.00 per share.

VSI acquisition

On December 16, pursuant to the term of the VSI merger agreement, dated August 7, 2019, Franchise Group completed the acquisition of VSI for an all cash transaction valued at $157.1 million. In connection with the acquisition of VSI, the VSI stockholders received $6.50 per share. In addition, all of the vested and unvested equity awards including restricted stock units, performance share units, options and restricted stock were canceled and converted into a right to receive an amount of $7.9 million in cash, out of which approximately $2.6 million was allocated to purchase price as it relates to the pre-combination service period and the remaining $5.3 million was expensed. The acquisition of VSI, including the related acquisition costs, are being financed through a mix of a term loan, credit facility and an equity investment:

- Term loan financing: On December 16, 2019, Vitamin Shoppe Industries, LLC, an indirect subsidiary of Franchise Group executed a term loan agreement with GACP Finance Co., LLC for an amount of $70.0 million (the "VSI term loan"). The term loan will mature on December 16, 2022, unless the maturity is accelerated subject to the terms set forth in the term loan agreement. The term loan will bear interest at a rate per annum based on LIBOR for an interest period of one month plus an interest rate margin of 9.0%.
- Credit facility financing: On December 16, 2019, Franchise Group entered into a Second Amendment and Restated Loan and Security Agreement (the "ABL Agreement") with JPMorgan Chase Bank, N.A. whereby JP Morgan Chase Bank, N.A. provided Franchise Group with a $100.0 million credit facility (the "VSI credit facility"). On December 16, 2019, Franchise Group borrowed $70.0 million on the VSI credit facility to finance the acquisition of VSI. The VSI credit facility will mature on December 16, 2022 unless the maturity is accelerated subject to the terms set forth in the ABL Agreement. The VSI credit facility bears interest at a rate per annum based on LIBOR for an interest period of one, two, three or six months, plus an interest rate margin that ranges from 1.25% to 1.75% depending on excess availability.
- Equity contributions from Tributum: In addition, on December 16, 2019, Tributum provided Franchise Group with an aggregate of approximately $30.0 million of equity financing in order to partially fund the closing of the acquisition (the "VSI equity contribution"). The VSI equity contribution is through purchases of Franchise Group's common stock at $12.00 per share under the equity commitment letter entered into on August 7, 2019. Pursuant to the VSI equity commitment, Tributum has agreed to purchase a number of shares of Franchise Group's common stock at a purchase price of $12.00 per share to finance the VSI acquisition. The purchase price under the VSI equity commitment will not exceed $70.0 million in the aggregate. Further, on December 16, 2019, Franchise Group and Tributum agreed to amend the equity commitment letter they entered on August 7, 2019 to provide that any portion of the equity commitment that is not funded at the closing of the VSI acquisition would remain available to fund the repurchase of VSI's 2.25% Convertible Senior note that is due in 2020. Such equity commitment to fund the repurchase of the Convertible Senior note would remain available until

the earlier to occur of (i) the Fundamental Change Repurchase Date and (ii) February 14, 2020. The pro forma financial information assumes the repayment of the VSI's 2.25% Convertible Senior note financed through the equity contribution from Tributum. On January 3, 2020, Franchise Group entered into a subscription agreement with Stefac LP, an affiliate of Vintage Capital Management, LLC, pursuant to the terms of the equity commitment letter, Tributum has the right to fund its equity commitment directly and indirectly through one or more affiliates. Pursuant to the subscription agreement, Stefac purchased 2.4 million shares of common stock from Franchise at $12.00 per share with an aggregate of approximately $28.2 million of equity financing to fund the repurchase of VSI's 2.25% Convertible Senior note.

Other transactions

On August 23, 2019, the Buddy's segment of Franchise Group entered into an asset purchase agreement withA-Team pursuant to which Buddy's completed the Asset Acquisition for total consideration of $26.6 million. To finance the Asset Acquisition, Buddy's entered into the Buddy's first amendment to amend the Buddy's initial credit agreement which provided for the Buddy's additional term loan in an amount of $23.0 million. The Buddy's additional term loan was used to consummate the Asset Acquisition, including to repay certain existing indebtedness of A-Team and secure the release of liens on the assets acquired in connection with the Asset Acquisition and to pay fees and expenses in connection with the Asset Acquisition.

On September 30, 2019, the Buddy's segment of Franchise Group entered into and completed an asset purchase agreement with various parties to acquire certain Buddy's stores previously franchised in exchange for 1.35 million shares of New Holdco common units and 0.27 million shares of Franchise Group preferred stock for an estimated fair value of $16.2 million.

While these acquisitions are included in Franchise Group's historical financial statements, the pro forma statement of operations were not adjusted to give effect to these acquisitions as they were not deemed significant pursuant to Rule 3-05 of Regulation S-X.

The unaudited pro forma combined financial statements are provided for illustrative purposes only and do not purport to represent what the actual consolidated results of operations or financial position of the Combined Company (as defined below) would have been had the Transactions occurred on the dates assumed, nor are they necessarily indicative of future consolidated results of operations or financial position of the Combined Company on a standalone basis.

Unaudited Pro Forma Combined Statement of Operations

Year Ended April 30, 2019

Dollars in thousands, except per share amounts	Adjusted Franchise Group (Note 2) Year Ended April 30, 2019	Adjusted Buddy's (Note 2b) Year Ended March 31, 2019	Adjusted Sears Outlet (Note 2c) Year Ended May 4, 2019	Adjusted VSI (Note 2d) Year Ended March 30, 2019	Acquisition and related Pro Forma Adjustments (Note 3)		Financing and offer Pro Forma Adjustments (Note 4)		Pro Forma Combined Year Ended April 30, 2019
Revenue:									
Product	—	2,592	448,573	1,101,528	—		—		1,552,693
Service	132,546	23,005	41,626	—	(177)	(3g)	—		197,000
Leasing	—	26,504	—	—	—		—		26,504
Total revenues	**132,546**	**52,101**	**490,199**	**1,101,528**	**(177)**		**—**		**1,776,197**
Operating Expenses:									
Cost of revenue:									
Product	—	1,844	334,068	745,028	—		—		1,080,940
Service	—	—	20,428	—	(177)	(3g)	—		20,251
Leasing	—	9,230	—	—	—		—		9,230
Total cost of revenue	**—**	**11,074**	**354,496**	**745,028**	**(177)**		**—**		**1,110,421**
Selling, general, and administrative expenses	124,060	29,098	133,364	347,191	624	(3b)	—		634,337
Restructuring Costs	9,345	—	—	—	—		—		9,345
Total operating expenses	133,405	40,172	487,860	1,092,219	447		—		1,754,103
Total operating (loss) income	**(859)**	**11,929**	**2,339**	**9,309**	**(624)**		**—**		**22,094**
Other (expense) income:									
Gain on extinguishment of debt	—	—	—	4,400	—		—		4,400
Interest expense	(3,023)	(1,412)	(6,410)	(5,227)	—		(17,677)	(4a)	(33,749)
Other income	(113)	259	1,440	—	—		—		1,586
(Loss) income before income taxes	(3,995)	10,776	(2,631)	8,482	(624)		(17,677)		(5,669)
Income tax (benefit) expense	(1,839)	—	271	1,101	—		(593)	(4b)	(1,060)
Net (loss) income	**(2,156)**	**10,776**	**(2,902)**	**7,381**	**(624)**		**(17,084)**		**(4,609)**
Less: Income/ (Loss) attributable to noncontrolling interests	—	—	—	—	—		(1,796)	(4c)	(1,796)
Net (loss) income attributable to common stockholders	**(2,156)**	**10,776**	**(2,902)**	**7,381**	**(624)**		**(15,288)**		**(2,813)**
Earnings per common share									
Basic (a)	(0.16)								(0.14)
Diluted (b)	(0.16)								(0.14)
Weighted average common share									
Basic (a)	13,800,884								20,135,812
Diluted (b)	13,800,884								20,135,812

See accompanying notes to the unaudited pro forma combined financial statements

	Unaudited Pro Forma Combined Statement of Operations for the six months ended October 31, 2019								
	Adjusted Franchise Group (Note 2a)	**Adjusted Buddy's (Note 2b)**	**Adjusted Sears Outlet (Note 2c)**	**Adjusted VSI (Note 2d)**					
Dollars in thousands, except per share amounts	**Six Months Ended October 31, 2019**	**Three Months Ended June 30, 2019**	**Six Months Ended August 3, 2019**	**Six Months Ended September 28, 2019**	**Acquisition and related Pro Forma Adjustments**		**Financing and offer Pro Forma Adjustments**		**Pro Forma Combined Three Month Ended October 31, 2019**
Revenue:									
Product	765	549	217,187	524,009	—		—		742,510
Service	17,177	5,935	16,998	—	(174)	(3g)	—		39,936
Leasing	11,900	6,589	—	—	—		—		18,489
Total revenues	**29,842**	**13,073**	**234,185**	**524,009**	**(174)**		**—**		**800,935**
Operating Expenses:									
Cost of revenue:									
Product	606	441	161,350	353,173	—		—		515,570
Service	—	—	7,975	—	(174)	(3g)	—		7,801
Leasing	4,463	2,400	—	—	—		—		6,863
Total cost of revenue	**5,069**	**2,841**	**169,325**	**353,173**	**(174)**		**—**		**530,234**
Selling, general, and administrative expenses	71,070	8,466	53,695	176,948	(12,637)	(3i)	—		297,358
					(184)	(3b)			
Total operating expenses	76,139	11,307	223,020	530,121	(12,995)		—		827,592
Total operating (loss) income	**(46,297)**	**1,766**	**11,165**	**(6,112)**	**12,821**		**—**		**(26,657)**
Other (expense) income:									
Gain on extinguishment of debt	—	—	—	—	—		—		—
Interest expense	(3,863)	(360)	(1,786)	(2,155)	—		(7,742)	(4a)	(15,906)
Other income	2	11	2,883	—	—		—		2,896
(Loss) income before income taxes	(50,158)	1,417	12,262	(8,267)	12,821		(7,742)		(39,667)
Income tax (benefit) expense	(8,960)	—	(290)	(1,288)	—		3,123	(4b)	(7,415)
Net (loss) income	**(41,198)**	**1,417**	**12,552**	**(6,979)**	**12,821**		**(10,865)**		**(32,252)**
Less: Income/ (Loss) attributable to noncontrolling interests	(13,892)	—	—	—	—		1,323	(4c)	(12,569)
Net (loss) income attributable to common stockholders	**(27,306)**	**1,417**	**12,552**	**(6,979)**	**12,821**		**(12,188)**		**(19,683)**
Earnings per common share									
Basic (a)	(1.75)								(0.98)
Diluted (b)	(1.75)								(0.98)
Weighted average common share									
Basic (a)	15,572,099								20,135,812
Diluted (b)	15,572,099								20,135,812

See accompanying notes to the unaudited pro forma combined financial statements

(a) Pro forma basic earnings per share and pro forma weighted average basic shares outstanding for the year ended April 30, 2019 and the six months ended October 31, 2019 reflect the number of shares of Franchise Group common stock that are outstanding upon completion of the Transactions. The following represent the pro forma adjustments to the basic and weighted average earnings per share:

	Number of shares
Common stock repurchased as part of the offer	(3,935,738)
Common stock purchased by Tributum in connection with the offer	2,083,333
Common stock purchased by Stefac LP, Brian R. Kahn and Lauren Kahn, and B. Riley FBR, Inc. in connection with the Sears Outlet acquisition	3,333,333
Common stock purchased by Tributum/Stefac LP in connection with the VSI acquisition and repayment of VSI convertible notes	4,854,000

(b) Due to the pro forma combined net loss attributable to the Franchise Group common stockholders for the year ended April 30, 2019 and the six months ended October 31, 2019, dilutive common share-equivalents, including the potential conversion of New Holdco common units to shares of Franchise Group common stock and the potential issuance of shares of Franchise Group common stock under equity plans in which Franchise Group employees participate, were excluded from diluted weighted average common shares outstanding as they would have been anti-dilutive.

Unaudited Pro Forma Combined Balance Sheet
as of October 31, 2019

Dollars in thousands, except per share amounts	Historical						
	Franchise Group	VSI (Note 2)	Acquisition and related Pro Forma Adjustments (Note 3)		Financing and offer Pro Forma Adjustments (Note 4)		Pro Forma Combined As of October 31, 2019
	As of October 31, 2019	As of September 28, 2019					
Assets							
Current assets:							
Cash and cash equivalents	86,306	15,995	(157,068)	(3f)	90,795	(4d)	27,315
			(8,713)	(3h)			
Receivables:							
Accounts receivable	39,318	—	(120)	(3g)	—		39,198
Notes receivable - current	30,541	—	—		—		30,541
Interest receivable, net of uncollectible amounts	2,281	—	—		—		2,281
Allowance for doubtful accounts - current	(8,563)	—	—		—		(8,563)
Total current receivables, net	63,577	—	(120)		—		63,457
Income tax receivable	427	—	1,629	(3h)	—		2,056
Inventories, net	144,981	181,815	—		—		326,796
Other current assets	8,763	23,601	—		—		32,364
Total Current Assets	**304,054**	**221,411**	**(164,272)**		**90,795**		**451,988**
Lease right-of-use assets	127,618	424,868	—		—		552,486
Property, equipment, and software, net	45,760	112,755	(27,794)	(3a)	—		130,721
Notes receivable - non-current	20,054	—	—		—		20,054
Allowance for doubtful accounts - non-current	(781)	—	—		—		(781)
Total non-current notes receivables, net	19,273	—	—		—		19,273
Goodwill	118,844	—	—		—		118,844
Other intangible assets, net	64,268	2,283	(2,283)	(3b)	—		64,268
Deferred income taxes	1,038	35,695	4,737	(3c)	—		41,470
Other assets	5,666	3,250	—		1,002	(4d)	9,918
Total Assets	**686,521**	**800,262**	**(189,612)**		**91,797**		**1,388,968**
Liabilities and Equity							
Current liabilities:							
Revolving credit facility	39,260	—	—		—		39,260
Current installments of long-term obligations	13,454	—	—		17,000	(4d)	30,454
Accounts payable and accrued expenses	63,836	94,540	(120)	(3g)	—		158,256
Due to Area Developers (ADs)	3,550	—	—		—		3,550
Income taxes payable	—	—	—		—		—
Deferred revenue - current	3,188	—	—		—		3,188
Current portion of operating lease liabilities	32,290	96,756	—		—		129,046
Current portion of financing lease liabilities	418	—	—		—		418
Other current liabilities	—	—	—		—		—
Total current Liabilities	**155,996**	**191,296**	**(120)**		**17,000**		**364,172**
Revolving credit facility	—	—	—		70,000	(4d)	70,000
Long-term obligations, excluding current installments, net	193,472	—	—		51,200	(4d)	244,672
Long-Term Operating Lease Liabilities	90,861	368,828	—		—		459,689
Long-Term Financing Lease Liabilities	703	—	—		—		703
Convertible notes, net	—	57,422	—		(57,422)	(4d)	—
Deferred revenue and other - non-current	3,220	308	—		—		3,528
Deferred income tax liability	—	—	—		—		—
Total Liabilities	**444,252**	**617,854**	**(120)**		**80,778**		**1,142,764**
Common stock subject to potential redemption, 9,096,435 shares (at redemption value of $12 per share)	109,157	—	—		(109,157)	(4f)	—
Stockholders and Members' equity:							
Net parent investment	—	—	—		—		—
Preferred stock, $0.01 par value per share,	19	—	—		—		19
Common stock, $0.01 par value per share	197	244	(244)	(3d)	49	(4d)	246
Additional paid-in capital	—	86,990	(86,990)	(3e)	58,199	(4d)	160,117
					(7,239)	(4e)	
					109,157	(4f)	
Treasury stock	—	(7,625)	7,625	(3d)	(47,229)	(4d)	(47,229)
Accumulated other comprehensive loss, net of taxes	(1,583)	—	—		—		(1,583)
Retained earnings	63,706	102,799	(102,799)	(3d)	—		56,622
			(7,084)	(3h)	—		
Total stockholders' equity attributable to Liberty	**62,339**	**182,408**	**(189,492)**		**112,937**		**168,192**
Non-controlling interest	70,773	—	—		7,239	(4e)	78,012
Total stockholders' equity	133,112	182,408	(189,492)		120,176		246,204
Total Liabilities and Equity	686,521	800,262	(189,612)		91,797		1,388,968

See accompanying notes to the unaudited pro forma combined financial statements.

Notes to the Unaudited Pro Forma Combined Financial Statements
(dollars in thousands, except share and per share data)

Note 1: Basis of Presentation

The accompanying pro forma financial statements were prepared in accordance with Article 11 of Regulation S-X and present the pro forma statement of operations and pro forma balance sheet of the combined company based on the historical financial statements of Franchise Group, Buddy's, Sears Outlet and VSI (the "Combined Company"), after giving effect to the Transactions as described above. The historical financial statements of Franchise Group, Buddy's, Sears Outlet and VSI have been adjusted in the accompanying pro forma financial statements to give effect to pro forma events that are (i) directly attributable to the Transactions, (ii) factually supportable and (iii) with respect to the statement of operations, expected to have a continuing impact on the combined results of operations of the Combined Company.

The accompanying pro forma financial statements are presented for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the Combined Company if the Transactions had been consummated for the periods presented or that will be achieved in the future. The pro forma financial statements do not reflect the costs of any integration activities or benefits that may result from realization of revenue growth or operational synergies expected to result from the Transactions.

In addition, the historical statement of operations for the fiscal year ended December 31, 2018 of Buddy's and VSI have been adjusted to reflect a trailing twelve-month period ended March 31, 2019 by adding the statement of operations for the three months ended March 31, 2019 and subtracting the statement of operations for the three months ended March 31, 2018. Similarly, the historical combined statement of operations for the fiscal year ended February 2, 2019 of Sears Outlet has been adjusted to reflect a trailing twelve-month period ending May 4, 2019 by adding Sears Outlet's statement of operation for the three months ended May 4, 2019 and subtracting Sears Outlet's statement of operations for the three months ended May 5, 2018.

Note 2: Adjustments to Franchise Group's, Buddy's, Sears Outlet's and VSI's Historical Financial Statements

(2a) Adjustments and reclassifications to Franchise Group's historical financial statements:

Certain reclassifications have been made to the historical presentation of the statement of operations for the fiscal year ended April 30, 2019 of Franchise Group to conform to its financial statement presentation for the six months ended October 31, 2019. The pro forma combined statement of operations for the six month period ended October 31, 2019 was prepared by combining the historical consolidated statement of operations for the six month period ended October 31, 2019 of Franchise Group and the pre-merger historical consolidated statement of operations for the three month period ended June 30, 2019 of Buddy's and the pre-merger historical consolidated statement of operations for the six month period ended September 28, 2019 of VSI and the pre-acquisition historical combined statement of operations for the six month period ended August 3, 2019 of Sears Outlet giving effect to the Transactions as if they had occurred on the first day of the fiscal year May 1, 2018. On December 10, 2019, subsequent to the completion of the Buddy's merger and acquisition of Sears Outlet, Franchise Group filed its unaudited combined financial statements as of and for the three and six months ended October 31, 2019 with the SEC on its Quarterly Report on Form 10-Q, which included post-merger operations of Buddy's for the period July 10, 2019 to October 31, 2019 and post-acquisition operations of Sears Outlet for the period October 23, 2019 to October 31, 2019. Accordingly, the following adjustments to Franchise Group's statement of operations were made to eliminate the post-merger operations of Buddy's for the period July 11, 2019 to July 31, 2019 and the post-acquisition operations of Sears Outlet for the period October 23, 2019 to October 31, 2019 in order to avoid combining operating results of Buddy's and Sears Outlet that exceed a six-month period.

Dollars in thousands, except per share amounts	Historical Franchise Group	Reclassification	After Reclassification
Revenue:			
Franchise fees	2,766	(2,766)	—
Area Developer fees	3,146	(3,146)	—
Royalties and advertising fees	63,716	(63,716)	—
Financial products	33,478	(33,478)	—
Interest income	8,189	(8,189)	—
Assisted tax preparation fees, net of discounts	14,611	(14,611)	—
Electronic Filing Fee	2,675	(2,675)	—
Product	—	—	—
Service	—	132,546	132,546
Leasing	—	—	—
Other revenues	3,965	(3,965)	—
Total revenues	**132,546**	**—**	**132,546**
Operating Expenses:			
Cost of revenue:	—	—	—
Product	—	—	—
Service	—	—	—
Leasing	—	—	—
Total cost of revenue	—	—	—
Employee compensation and benefits	39,822	(39,822)	—
Selling, general, and administrative expenses	42,038	82,022	124,060
Area Developer expense	15,584	(15,584)	—
Advertising expense	12,532	(12,532)	—
Depreciation, amortization, and impairment charges	14,084	(14,084)	—
Restructuring Costs	9,345	—	9,345
Total operating expenses	133,405	—	133,405
Total operating loss	**(859)**	**—**	**(859)**
Other (expense) income:			
Foreign currency transaction (loss) gain	(113)	113	—
Interest expense	(3,023)	—	(3,023)
Other income	—	(113)	(113)
Loss before income taxes	(3,995)	—	(3,995)
Income tax benefit	(1,839)	—	(1,839)
Net loss	(2,156)	—	(2,156)
Less: Net (loss) income attributable to participating securities	—	—	—
Net loss attributable to Class A and Class B common stockholders	(2,156)	—	(2,156)

Dollars in thousands, except per share amounts	Historical Franchise Group Six Months Ended October 31, 2019	Less: Buddy's adjustments July 10, 2019 - July 31, 2019	Less: Sears Outlet adjustments October 23, 2019 - October 31, 2019	Adjusted Franchise Group Six Months Ended October 31, 2019
Revenue:				
Product	12,064	118	11,181	765
Service	19,384	1,191	1,016	17,177
Leasing	13,233	1,334	(1)	11,900
Total revenues	**44,681**	**2,643**	**12,196**	**29,842**
Operating expenses:				
Cost of revenue:				
Product	8,264	93	7,565	606
Service	1,210	—	1,210	—
Leasing	5,003	540	—	4,463
Total cost of revenue	14,477	633	8,775	5,069
Selling, general, and administrative expenses	77,837	1,479	5,288	71,070
Total operating expenses	**92,314**	**2,112**	**14,063**	**76,139**
Loss from operations	**(47,633)**	**531**	**(1,867)**	**(46,297)**
Other income (expense):				—
Interest expense, net	(4,562)	(487)	(212)	(3,863)
Other income	2	—	—	2
Loss before income taxes	**(52,193)**	**44**	**(2,079)**	**(50,158)**
Income tax benefit	(8,960)	—	—	(8,960)
Net loss	**(43,233)**	**44**	**(2,079)**	**(41,198)**
Less: Net loss attributable to non-controlling interest	13,892	—	—	13,892
Net loss attributable to Franchise Group, Inc.	**(29,341)**	**44**	**(2,079)**	**(27,306)**

(2b) Adjustments and reclassifications of Buddy's historical financial statements:

Certain reclassifications have been made to the historical presentation of the statement of operations of Buddy's to conform to the financial statement presentation of Franchise Group. In addition, certain operations of Buddy's, including its Flexi Buddy's, BGTG LLC and 1357 LLC subsidiaries, were divested to the Buddy's equity holders in December 2018 and therefore were not acquired or assumed by Franchise Group. The following summarizes the reclassification adjustments and elimination of the operations that were not acquired as part of the merger in the unaudited pro forma combined statement of operations for the trailing twelve-month period ended March 31, 2019 and the three months ended June 30, 2019.

	Buddy's Statement of Operations						
	April 1, 2018 - March 31, 2019				April 1, 2019 - June 30, 2019		
(in thousands)	Before Adjustment	Operations not contributed	Reclassification	After Adjustment	Before Adjustment	Reclassification	After Adjustment
Revenue							
Lease revenue	30,560	(4,056)	(26,504)	—	6,589	(6,589)	—
Agreement, club and damage waiver fee	6,160	(792)	(5,368)	—	1,352	(1,352)	—
Retail sales	2,874	(282)	(2,592)	—	549	(549)	—
Franchising and licensing fees	15,204	532	(15,736)	—	4,270	(4,270)	—
Other support revenue	2,023	(122)	(1,901)	—	313	(313)	—
Product	—	—	2,592	2,592	—	549	549
Service	—	—	23,005	23,005	—	5,935	5,935
Leasing	—	—	26,504	26,504	—	6,589	6,589
Revenue, net	56,821	(4,720)	—	52,101	13,073	—	13,073
Leasing cost of sales	10,949	(1,719)	(9,230)	—	2,400	(2,400)	—
Retail cost of sales	2,197	(353)	(1,844)	—	441	(441)	—
Cost of revenue:							—
Product	—	—	1,844	1,844		441	441
Leasing	—	—	9,230	9,230		2,400	2,400
Total cost of revenue	13,146	(2,072)	—	11,074	2,841	—	2,841
Operating expenses:							
Personnel expense	16,375	(2,074)	(14,301)	—	3,722	(3,722)	—
Occupancy expense	4,845	(635)	(4,210)	—	1,050	(1,050)	—
Marketing expense	1,927	(89)	(1,838)	—	603	(603)	—
Delivery/Vehicle expense	1,356	(208)	(1,148)	—	257	(257)	—
General & Administrative expense	7,426	(339)	(7,087)	—	2,490	(2,490)	—
Selling, general, and administrative expenses	—	—	29,098	29,098	—	8,466	8,466
Depreciation expenses	608	(95)	(513)	—	107	(107)	—
Total operating costs	45,683	(5,512)	1	40,172	11,070	237	11,307
Operating income	11,138	792	(1)	11,929	2,003	(237)	1,766
Other income (expense)							
Net gain on sale of store related assets	178	81	(259)	—	11	(11)	—
Other	—	—	259	259	—	11	11
Amortization expense	(178)	177	1	—	(237)	237	—
Interest expense	(1,453)	41	—	(1,412)	(360)	—	(360)
Total other income (expense)	(1,453)	299	1	(1,153)	(586)	237	(349)
Net income before income taxes	**9,685**	**1,091**	**—**	**10,776**	**1,417**	**—**	**1,417**
Income taxes	—	—		—	—		—
Net income from continuing operations	**9,685**	**1,091**	**—**	**10,776**	**1,417**	**—**	**1,417**

(2c) Reclassification of Sears Outlet's historical combined financial statements:

Certain reclassifications have been made to the historical presentation of the statement of operations and balance sheet of Sears Outlet to conform to the financial statement presentation of Franchise Group. The following summarizes the reclassification adjustments in the unaudited pro forma carve-out statement of operations and balance sheet for the trailing twelve-month period ended May 4, 2019 and reclassification adjustment in the unaudited pro forma carve-out statement of operations for the six months ended August 3, 2019.

(in thousands)	Sears Outlet Statement of Operations May 5, 2018 - May 4, 2019 Before Adjustment	Reclassification	After Adjustment	Feb. 5, 2019 - August 3, 2019 Before Adjustment	Reclassification	After Adjustment
Revenue						
Product	—	448,573	448,573	—	217,187	217,187
Service	—	41,626	41,626	—	16,998	16,998
Net sales	490,199	(490,199)	—	234,185	(234,185)	—
Operating expenses:						
Cost of revenue:						
Product	—	334,068	334,068	—	161,350	161,350
Service	—	20,428	20,428		7,975	7,975
Cost of goods sold	354,496	(354,496)	—	169,325	(169,325)	—
Selling, general, and administrative expenses	126,296	7,068	133,364	51,582	2,113	53,695
Impairment of property and equipment	1,082	(1,082)	—	—	—	—
Depreciation and amortization	5,986	(5,986)	—	2,113	(2,113)	—
Loss (gain) on sale of assets	(1,306)	1,306	—	(2,877)	2,877	—
Total costs and expenses	486,554	1,306	487,860	220,143	2,877	223,020
Operating income (loss)	3,645	(1,306)	2,339	14,042	(2,877)	11,165
Other income (expense)						
Interest expense	(6,410)	—	(6,410)	(1,786)	—	(1,786)
Other income	134	1,306	1,440	6	2,877	2,883
Income (loss) before income taxes	(2,631)	—	(2,631)	12,262	—	12,262
Income tax expense (benefit)	271	—	271	(290)	—	(290)
Net income (loss)	**(2,902)**	**—**	**(2,902)**	**12,552**	**—**	**12,552**

(2d) Reclassification of VSI's historical financial statements:

Certain reclassifications have been made to the historical presentation of the statement of operations and balance sheet of VSI to conform to the financial statement presentation of Franchise Group. The following summarizes the reclassification adjustments in the unaudited pro forma combined statement of operations for the trailing twelve-month period ended March 31, 2019 and reclassification adjustment in the unaudited pro forma combined statement of operations and balance sheet as of and for the six months ended September 28, 2019.

(in thousands)	VSI Statement of Operations April 1, 2018 - March 31, 2019 Before Adjustment	Reclassification	After Adjustment	April 1, 2019 - September 28, 2019 Before Adjustment	Reclassification	After Adjustment
Revenue						
Product	—	1,101,528	1,101,528	—	524,009	524,009
Net sales	1,101,528	(1,101,528)	—	524,009	(524,009)	—
Cost of revenue:						
Product	—	745,028	745,028	—	353,173	353,173
Cost of goods sold	745,028	(745,028)	—	353,173	(353,173)	—
Gross profit	356,500	—	356,500	170,836	—	170,836
Selling, general, and administrative expenses	344,174	3,017	347,191	165,544	11,404	176,948
Goodwill, tradename and store fixed-assets impairment charges	3,017	(3,017)	—	11,404	(11,404)	—
Income (loss) from operations	9,309	—	9,309	(6,112)	—	(6,112)
Gain on extinguishment of debt	4,400	—	4,400	—	—	—
Interest expense	(5,227)	—	(5,227)	(2,155)	—	(2,155)
Income (loss) before provision (benefit) for income taxes	8,482	—	8,482	(8,267)	—	(8,267)
Income tax expense (benefit)	1,101	—	1,101	(1,288)	—	(1,288)
Net income (loss) from continuing operations	7,381	—	7,381	(6,979)	—	(6,979)

VSI Balance sheet

As of September 28, 2019

(in thousands)	Before Reclassification	Reclassification	As Adjusted
Assets			
Cash and cash equivalents	15,995	—	15,995
Other current assets	—	23,601	23,601
Prepaid expenses and other current assets	23,601	(23,601)	—
Inventories, net	181,815	—	181,815
Total Current Assets	221,411	—	221,411
Right-of-use assets	424,868	—	424,868
PP&E	112,755	—	112,755
Intangible assets - goodwill	2,283	—	2,283
Deferred taxes	35,695	—	35,695
Other Assets	3,250	—	3,250
Total Assets	800,262	—	800,262
Liabilities and Equity			
Account payable	38,203	(38,203)	—
Accrued expenses	56,337	(56,337)	—
Accounts Payable and Accrued Expenses	—	94,540	94,540
Short-term lease liabilities	96,756	—	96,756
Total Current Liabilities	191,296	—	191,296
Long-term lease liabilities	368,828	—	368,828
Convertible notes, net	57,422	—	57,422
Other long-term liabilities	308	(308)	—
Deferred revenue and other - non-current	—	308	308
Total Liabilities	617,854	—	617,854
Commitments and Contingencies			
Members' Equity			
Common stock, $0.01 par value; 400,000,000 shares authorized, 24,389,426 shares issued and 24,087,459 shares outstanding at March 30, 2019	244	—	244
Additional paid-in capital	86,990	—	86,990
Treasury stock, at cost; 301,967 shares at March 30, 2019	(7,625)	—	(7,625)
Retained earnings	102,799	—	102,799
Total stockholders' equity	182,408	—	182,408
Total Liabilities and Equity	$ 800,262	$ —	$ 800,262

Note 3: Purchase Price Accounting and Related Adjustments

The unaudited pro forma combined balance sheet as of October 31, 2019 has been adjusted to reflect the preliminary allocation of the purchase price to identifiable assets acquired and liabilities assumed related to VSI, with the excess recorded as goodwill. The historical unaudited balance sheet of Franchise Group as of October 31, 2019 already reflects the acquisitions of Buddy's and Sears Outlet. However, the unaudited pro forma statement of operations for the six months ended October 31, 2019 and the year ended April 30, 2019 gives effect to the VSI, Buddy's and Sears Outlet acquisitions as if they occurred on May 1, 2018.

The fair value adjustments of the Buddy's merger and the acquisitions of Sears Outlet and VSI to the pro forma statement of operations are stated below:

	For the year ended April 30, 2019							
(in thousands)	**Buddy's**		**Sears Outlet**		**VSI**		**Total Acquisition Pro Forma Adjustments**	**Notes**
Revenue:								
Service	(177)	(3g)	—		—		(177)	(3g)
Total	**(177)**		**—**		**—**		**(177)**	
Operating Expenses:								
Cost of revenue:								
Service			(177)	(3g)			(177)	(3g)
Selling, general, and administrative expenses	1,902	(3b3)	3,026	(3b2)	(4,304)	(3b1)	624	(3b)
Total	**1,902**		**2,849**		**(4,304)**		**447**	
Total operating income/ (expense)	(2,079)		(2,849)		4,304		(624)	

	For the 6-months ended October 31, 2019							
(in thousands)	**Buddy's**		**Sears Outlet**		**VSI**		**Total Acquisition Pro Forma Adjustments**	
Revenue:								
Service	(174)	(3g)	—		—		(174)	(3g)
Total	**(174)**		**—**		**—**		**(174)**	
Operating Expenses:								
Cost of revenue:								
Service	—		(174)	(3g)	—		(174)	(3g)
Selling, general, and administrative expenses	(6,375)	(3i)	(4,253)	(3i)	(2,009)	(3i)	(12,637)	(3i)
Selling, general, and administrative expenses	476	(3b3)	1,513	(3b2)	(2,173)	(3b1)	(184)	(3b)
Total	**(5,899)**		**(2,914)**		**(4,182)**		**(12,995)**	
Total operating income/ (expense)	5,725		2,914		4,182		12,821	

Estimated purchase price and purchase price allocation of VSI

In preparing the unaudited pro forma combined financial statements, Franchise Group performed a preliminary analysis of the accounting policies of VSI and identified differences requiring pro forma adjustments. Franchise Group will complete its review of accounting policies to determine whether any additional adjustments are necessary to conform the accounting policies of VSI to those of Franchise Group. That review could result in additional accounting policy conformity changes that impact the pro forma combined financial statements.

The preliminary estimated purchase price for VSI is calculated as follows:

(in thousands)	
Estimated fair value of VSI shares purchased	
(23.8 million outstanding common shares at $6.50 per share): Common stock, $.01 par value	154,472 (i)
Fair value of outstanding equity awards vested at close	2,596 (ii)
Total Estimated Purchase Price	**$ 157,068**

(i) Represents the cash consideration paid to VSI stockholders. The fair value of the VSI outstanding shares purchased was estimated based on the total outstanding shares of VSI common stock as of December 15, 2019 and the share price of $6.50 per the VSI merger agreement.

(ii) In accordance with the VSI merger agreement, at the time of the VSI acquisition, each outstanding equity awards, including restricted stock units, performance share units, options and restricted stock held by the employees of VSI were canceled and converted into right to receive an amount in cash. The conversion was based on $6.50 per share price multiplied by the total number of shares of restricted stock units, performance share units, and restricted stock outstanding. For the options, the conversion was based on $6.50 per share price less the exercise price per share attributable to such options and multiplied by the total number of shares of VSI common stock issuable upon exercise in full. Because the VSI equity agreements provide for a "double trigger" vesting, a portion of the unvested equity awards attributable to post-VSI combination services will be recorded as a one-time expense of Franchise Group while the remaining payout is considered part of the purchase price as attributable topre-VSI combination services. Out of the total estimated payout of $7.3 million, $2.6 million relates to payout towards pre-VSI combination services are reflected as part of the purchase price and the remaining $4.7 million payout relates to post-VSI combination services, which is reflected as compensation expense as described in Note (3h) below.

The preliminary estimated purchase price allocation of VSI is calculated as follows:

(in thousands)	**September 28, 2019 Vitamin Shoppe, Inc. Historical Information**	**VSI Fair Value Adjustments**		**Purchase Price Allocation**	
Cash and cash equivalents	15,995	—		15,995	
Other current assets	23,601	—		23,601	
Inventories, net	181,815	—		181,815	
Right-of-use assets	424,868	—		424,868	
PP&E	112,755	(27,794)	(3a)	84,961	
Intangible assets - other than goodwill	2,283	(2,283)	(3b)	—	
Deferred taxes	35,695	4,737	(3c)	40,432	
Goodwill	—	—		—	
Other Assets	3,250	—		3,250	
Total assets acquired	**800,262**	**(25,340)**		**774,922**	
Accounts Payable and Accrued Expenses	94,540	—		94,540	
Short-term lease liabilities	96,756	—		96,756	
Long-term lease liabilities	368,828	—		368,828	
Convertible notes, net	57,422	—		57,422	
Deferred revenue and other - non-current	308	—		308	
Total liabilities assumed	**617,854**	**—**		**617,854**	
Historical equity value of VSI					
Common stock, $0.01 par value per share	244	(244)	(3d)	—	
Additional paid-in capital	86,990	(86,990)	(3e)	—	
Treasury stock	(7,625)	7,625	(3d)	—	
Retained earnings	102,799	(102,799)	(3d)	—	
Total purchase consideration	**$ 182,408**	**$ (182,408)**		**$ 157,068**	(3f)

(3a) Represents adjustments to record the preliminary estimated fair value of PP&E of VSI of approximately $85.0 million representing a step down of $27.8 million from the historical book values. This resulted in a pro forma adjustment to decrease the depreciation charge of $4.0 million for the year ended April 30, 2019 and $2.0 million for six months ended October 31, 2019.

The final determination of fair value of PP&E, as well as estimated useful lives, if any, remains subject to change and will be finalized during the measurement period that does not exceed twelve months.

(3b) Represents adjustments to record the step down of historical intangibles of $2.3 million to zero as the amount of estimated intangible assets is not expected to be material. As a result, the historical amortization expense related to intangible assets of $0.3 million and $0.2 million for the year ended April 30, 2019 and the six months ended October 31, 2019, respectively, have been removed.

The final determination of fair value of intangible assets, as well as estimated useful lives, if any, remains subject to change and will be finalized during the measurement period that does not exceed twelve months.

(3c) Represents deferred tax assets resulting from the fair valuation of the PP&E and identifiable intangible assets as a result of the VSI acquisition. This estimate of deferred tax assets was determined based on the book and tax basis differences attributable to the removal of identifiable intangible assets and based on estimated U.S. statutory tax rates of the Combined Company of 27.4% as of and for the period ended October 31, 2019.

(3d) Represents the elimination of VSI's stockholders' equity common stock of $0.2 million, treasury stock of $7.6 million, and retained earnings of $102.8 million.

(3e) Represents the elimination of VSI's historical additionalpaid-in capital in an amount of $87.0 million.

(3f) Represents cash consideration of $157.1 million for the VSI acquisition.

Purchase price and purchase price allocation of Sears Outlet

(3b2) Upon consummation of the Sears Outlet acquisition, Franchise Group recognized a fair value adjustment to the Right of use assets balance relating to below market leases for an amount $8.0 million. This adjustment is depreciated on a straight-line basis over the average remaining lease terms and is recognized to Selling, general, and administrative expenses.

(in thousands)	Estimated Useful Life	Estimated Fair Value	April 30, 2019 Depreciation Estimates	October 31, 2019 Depreciation Estimates
Above/ (below) market leases	3	8,040	2,594	1,297
Total Pro forma adjustment		**$ 8,040**	**$ 2,594**	**$ 1,297**

The fair value of PP&E increased the book value of furniture, fixture and equipment by $2.2 million. This resulted in a pro forma adjustment to increase the depreciation charge of $0.4 million for the year ended April 30, 2019 and $0.2 million for six months ended October 31, 2019.

All amortization adjustments related to identified intangible assets and PP&E as a result of the Sears Outlet acquisition are recorded to Selling, general, and administrative expenses. The estimated amortization and depreciation expenses were computed using the straight-line method based on an estimated useful life of the identifiable definite-lived intangible assets or the PP&E.

(3g) Represents intercompany elimination of balances and transactions between the Buddy's segment of Franchise Group and Buddy's franchise stores owned by Sears Outlet.

Purchase price and purchase price allocation of Buddy's

(3b3) Upon consummation of the merger with Buddy's, Franchise Group identified the Buddy's tradename as an indefinite-lived intangible asset with a fair value of $11.1 million. Franchise Group also recognized an asset of $10.1 million for franchise agreements, $7.7 million for customer contracts and below market leases of $2.3 million.

All amortization adjustments related to identified intangible assets as a result of the merger of Buddy's are recorded to Selling, general, and administrative expenses. The estimated amortization expense was computed using the straight-line method based on an estimated useful life of the identifiable definite-lived intangible assets.

(in thousands)	Estimated Useful Life	Estimated Fair Value	Buddy's April 30, 2019 Amortization Estimates	Buddy's July 31, 2019 Amortization Estimates
Trademark / trade name	Indefinite	11,100	—	—
Franchise agreements / relationships	10	10,100	1,010	253
Customer contacts / relationships	6	7,700	1,283	321
Above/ (below) market leases	6	(2,345)	(391)	(98)
Total		**$ 26,555**	**$ 1,902**	**$ 476**
Historical amortization expense			—	—
Pro forma adjustment			**$ 1,902**	**$ 476**

(3h) Represents adjustments related to post-combination compensation expense and transaction-related costs related to the VSI acquisition as follows:

(in thousands)	
Post-combination stock compensation expense	(4,722)
Transaction-related expenses, including legal, accounting and other third-party advisor expenses	(3,991)
Adjustment to cash	**(8,713)**
Adjustment to income tax receivable	**1,653**
Adjustment to retained earnings	**$(7,060)**

These transaction-related expenses are not reflected in the pro forma combined statements of operations because they do not have a continuing impact.

(3i) Represents the removal of actual transaction costs related to the Transactions included in the statement of operations of Franchise Group for six months ended October 31, 2019 as follows:

Buddy's Merger	6,375
VSI acquisition	2,009
Sears Outlet acquisition	4,253
Total	**12,637**

Note 4: Financing and Offer Adjustments

(4a) Represents an increase to interest expense of $18.4 million and $9.5 million for the fiscal year ended April 30, 2019 and six months ended October 31, 2019, respectively, which includes the following:

(in thousands)	For the twelve months ended April 30, 2019				
	Buddy's	Sears Outlet	Buddy's – Additional loan	VSI	Total
Estimated interest expense on new financing (1)	7,972	8,596	2,221	9,544	28,333
Elimination of historical interest expenses (2)	(1,412)	(6,410)	—	(5,227)	(13,049)
Amortization of deferred debt issuance costs (3)	439	752	90	1,112	2,393
Total pro forma adjustment to interest expense					**17,677**

(in thousands)	For the six months ended October 31, 2019				
	Buddy's	Sears Outlet	Buddy's – Additional loan	VSI	Total
Estimated interest expense on new financing (1)	3,834	4,044	1,079	4,102	13,059
Elimination of historical interest expenses (2)	(2,501)	(1,786)	—	(2,155)	(6,442)
Amortization of deferred debt issuance costs (3)	219	367	45	494	1,125
Total pro forma adjustment to interest expense					**7,742**

(1) Represents additional interest expense calculated at an estimated 9.91% interest rate in connection with the $82.0 million 5-year Buddy's initial term loan, an estimated 8.41% interest rate on the $105.0 million 4-year Sears Outlet term loan, an estimated 9.91% interest rate in connection with the $23.0 million Buddy's additional term loan, an estimated 11.00% interest rate on the $70.0 million 3-year VSI term loan, and an estimated 3.66% on the $70.0 million 3-year VSI credit facility. The estimated interest rates and adjustments are based on current LIBOR rates and estimated interest rate spreads based on the terms of the executed debt agreements. Refer to Note 4d for further summary of the financing transactions.

(2) Represents the elimination of Buddy's, Sears Outlet's and VSI's historical interest expense as a result of the extinguishment of Buddy's $25.0 million of line of credit pursuant to the merger agreement, $57.4 million of VSI's convertible notes pursuant to the VSI merger agreement and the exclusion of Sears Outlet's $48.5 million indebtedness pursuant to the Sears Outlet purchase agreement.

(3) Represents the amortization of the estimated deferred financing costs in connection with the Buddy's initial term loan, the VSI term loan, the VSI credit facility, the Sears Outlet term loan and the Buddy's additional term loan.

A 1/8 percent change in the interest assumed above would result in an aggregate increase or decrease to interest expense of $0.4 million for the twelve months ended April 30, 2019 and $0.2 million for six months ended October 31, 2019.

(4b) Represents adjustments to income tax (benefit) expense. Following the merger, the Sears Outlet and VSI acquisitions, the income of New Holdco which includes the operations of Liberty Tax, Buddy's, Sears Outlet and VSI attributable to Franchise Group's controlling interest will be subject to U.S. income taxes, in addition to state,

and local taxes. The income tax expense is based on estimated U.S. statutory tax rates of the Combined Company of 27.4% for the year ended April 30, 2019 and six months ended October 31, 2019. The actual effective tax rate of Franchise Group may differ materially from the pro forma tax rates due to, among other factors, changes in tax laws, the impact of permanent tax differences, income tax reserves determined in connection with the merger and tax planning.

(4c) Represents the adjustment to the loss attributable tonon-controlling interests based on the outcome of the Buddy's merger, the acquisitions of Sears Outlet and VSI and the final acceptances of the offer as described in Note 4(e) below. Accordingly, the loss attributable to the non-controlling interests is $1.8 million for the twelve months ended April 30, 2019 and $12.6 million for the six months ended October 31, 2019.

(4d) Various agreements were executed to finance the Transactions. The following agreements are fully reflected in the historical balance sheet of Franchise Group as of October 31, 2019:

1. In connection with the Buddy's merger and offer, Buddy's has signed the Buddy's initial credit agreement for debt financing of the Transactions consisting of a $82.0 million, 5-year term loan, which bears interest at variable rates. The proceeds were used to finance transaction costs, a portion of the tender offer acceptances and general working capital purposes.
2. In connection with the Sears Outlet acquisition, Franchise Group Newco S, LLC, an indirect subsidiary of Franchise Group has signed the Sears Outlet term loan to finance the Sears Acquisition in an amount equal to $105.0 million. The Sears Outlet term loan bears a variable interest rate. The total proceeds from the debt financing and the equity contribution from the Investors of $40 million as explained above were used to pay the cash consideration in connection with the Sears Outlet acquisition.
3. In connection with the A-team Asset Acquisition, the Buddy's segment of Franchise Group entered into the Buddy's first amendment to the Buddy's initial term loan to provide for a $23.0 million first priority senior secured term loan. The proceeds from the debt were used to acquire 41 Buddy's Home Furnishings stores from A-Team. The purchase price allocation related to the Asset Acquisition of the 41 stores is reflected in the historical financial statements of Franchise Group but is not reflected in the pro forma statements of operations as the A-team Asset Acquisition was not considered material to the pro forma results.

The pro forma balance sheet reflects the debt and equity issuances in connection with the VSI acquisition and the purchase of shares in connection with the final offer acceptances of $47.2 million.

In connection with the VSI acquisition, Vitamin Shoppe Industries, LLC, an indirect subsidiary of Franchise Group has executed the VSI credit facility for a 3-year term loan in the amount of $70.0 million to finance the VSI acquisition. The pro forma adjustments reflect the incurrence of $68.2 of indebtedness, net of estimated debt issuance costs of $1.8 million. In addition to the VSI term loan, Franchise Group also entered into the VSI credit facility with JPMorgan Chase Bank, N.A. to increase VSI's existing credit facility from $90.0 million to $100.0 million and the VSI credit facility is expected to be repaid at the end of the term. On the acquisition closing date, VSI borrowed $70.0 million and use the proceeds to finance the acquisition. The pro forma adjustment reflects the incurrence of $69.0 million line of credit, net of estimated debt issuance costs of $1.0 million which will be capitalized as a long-term asset and amortized over the term of the VSI credit facility. The VSI term loan and the VSI credit facility bear variable interest rates. The pro forma adjustment also reflects Tributum and Stefac LP's equity contribution for a total amount of $58.2 million pursuant to the VSI equity commitment letter. The total proceeds from the debt and equity financings was used to pay the cash consideration in connection with the acquisition of VSI, which included the cash payment to the VSI stockholders and the employees in connection with the redemption and cancelation of outstanding equity awards. The financing was also used to repay the existing VSI convertible debt of $57.4 million.

A summary of the total pro forma adjustments to cash related to the financing transactions include the following:

Pro forma adjustment to cash *(in thousands)*	VSI	Tender offer	Total
Increase from issuance of debt	68,200	—	68,200
Increase of Line of Credit	68,998	—	68,998
Increase of Buddy's Additional Term Loan	—	—	—
Vintage equity contribution	58,248	—	58,248
Offer redemptions	—	(47,229)	(47,229)
Repayment of Convertible Notes	(57,422)	—	(57,422)
Net Pro forma adjustment to cash	**138,024**	**(47,229)**	**90,795**

The total pro forma adjustment to debt includes the following:

Pro forma adjustment to debt *(in thousands)*	VSI
Term loan financing	$70,000
Less: Debt issuance costs	(1,800)
Debt, net of debt issuance costs	**68,200**
Pro forma adjustment to current portion of debt:	**17,000**
Pro forma adjustment to debt, net of current portion:	**51,200**
Increase of Line of Credit (long-term)	**70,000**
Revolver commitment fee—capitalized as other asset	**1,002**
Repayment of Convertible Notes	**57,422**

(4e) Represents the adjustment to non-controlling interests in connection with the merger and the final outcome of the offer. Based on the final acceptances of $47.2 million in the offer, the pre-closing members of Buddy's hold a non-controlling interest in New Holdco of approximately 31.69% or approximately $78.0 million as of October 31, 2019 on a pro forma basis, after giving effect to the Transactions discussed above.

(4f) Represents the reclassification of Common stock subject to potential redemption, from the temporary equity to the permanent equity (i.e., APIC) in connection with the final results of the tender offer. On November 13, 2019, Franchised Group completed the tender offer which resulted in a total payment of $47.2 million. As a result, the carrying amount of the Common stock subject to potential redemption was reclassified to permanent equity.