UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

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

Date of Report (date of earliest event reported): (March 10, 2021)

Franchise Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	001-35588	27-3561876
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

2387 Liberty Way Virginia Beach, Virginia 23456
(Address of Principal Executive Offices) (Zip Code)

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

n/a
(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	The NASDAQ Stock Market LLC
7.50% Series A Cumulative Perpetual Preferred Stock, par value $0.01 per share and liquidation preference of $25.00 per share	FRGAP	The NASDAQ Stock Market LLC

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 the Current Report on Form 8-K previously filed by Franchise Group, Inc. (the "Company") on March 15, 2021. This Current Report on Form 8-K/A includes the financial statements that had been omitted from the previously filed Current Report on Form 8-K as permitted by Item 9.01(a)(4) of Form 8-K.

On March 10, 2021, the Company completed its acquisition (which was previously announced in the Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on January 28, 2021) of Pet Supplies Plus, LLC (“Pet Supplies Plus”), pursuant to the terms of that certain Amended and Restated Equity Purchase Agreement (the “Equity Purchase Agreement”), dated March 3, 2021, by and among the Company, solely for purposes of agreeing to the covenants set forth in Section 10.19 of the Equity Purchase Agreement, Franchise Group Newco PSP, LLC, Delaware limited liability company and a subsidiary of the Company (the “Purchaser”), PSP Holdings, LLC, a Delaware limited liability company, Sentinel Capital Partners VI-A, L.P., a Delaware limited partnership, Sentinel PSP Blocker, Inc., a Delaware corporation, PSP Midco, LLC, a Delaware limited liability company (“PSP Midco”), PSP Intermediate, LLC, a Delaware limited liability company, Sentinel Capital Partners, L.L.C., a Delaware limited liability company, solely for purposes of agreeing to the covenants set forth in Section 6.8 and Section 6.9 of the Equity Purchase Agreement, and PSP Midco Holdings, LLC, a Delaware limited liability company (collectively, the “Sellers”), pursuant to which the Purchaser acquired all of the outstanding equity interests of PSP Midco (the “Transaction”).

The Company is filing this Current Report on Form 8-K/A to provide certain financial statements of Pet Supplies Plus and unaudited pro forma financial information of Pet Supplies Plus and the Company required by Item 9.01 of Form 8-K and should be read in conjunction with the Company’s Current Report on Form 8-K previously filed on March 15, 2021.

Item 9.01 Financial Statements and Exhibits.

(a) Financial Statements of Business Acquired

The audited consolidated financial statements of Pet Supplies Plus and its subsidiaries as of and for the fiscal years ended January 2, 2021 and December 28, 2019, including the notes to such financial statements and the report of Ernst & Young LLP, are filed with this Current Report on Form 8-K/A as Exhibit 99.1 and are incorporated by reference herein.

(b) Pro forma Financial Information

The unaudited pro forma combined financial statements included with this Current Report on Form 8-K/A give effect to the Transaction and the Company’s previously announced merger with American Freight Group, Inc. (the “American Freight Merger”) and the related debt and equity financings (collectively, the “Transactions”), including the pro forma adjustments intended to illustrate the estimated effects of the Transactions.

The unaudited pro forma combined statement of operations for the fiscal year ended December 26, 2020 combines the historical consolidated statement of operations for the fiscal year ended December 26, 2020 of the Company (that includes certain post-acquisition financial information of American Freight), the pre-acquisition historical consolidated statement of operations of American Freight for the period December 30, 2019 to February 14, 2020 derived from American Freight’s books and records, and the historical consolidated statement of operations for the fiscal year ended January 2, 2021 of Pet Supplies Plus giving effect to the Transactions as if they had occurred on December 29, 2019.

The unaudited pro forma combined balance sheet as of December 26, 2020 combines the historical consolidated balance sheet of the Company as of December 26, 2020, which fully reflects the American Freight Merger, and the historical consolidated balance sheet of Pet Supplies Plus as of January 2, 2021, giving effect to the Transactions as if they had occurred on December 26, 2020, are filed with this Current Report on Form 8-K/A as Exhibit 99.2 and are incorporated by reference herein.

The unaudited pro forma combined financial information is based on various adjustments and assumptions and is not necessarily indicative of what the Company's consolidated statement of operations or consolidated balance sheet actually would have been had the Transactions been completed as of the dates indicated or will be for any future periods. The unaudited pro forma financial statements do not purport to project the future financial position or operating results of the Company following the completion of the Transactions.

(d) Exhibits

The following exhibits are filed herewith:

Exhibit No.	Description
23.1	Consent of Ernst & Young LLP.
99.1	Consolidated Financial Statements for Pet Supplies Plus as of and for the fiscal years ended January 2, 2021 and December 28, 2019.
99.2	Unaudited pro forma combined statement of operations for the fiscal year ended December 26, 2020 and the pro forma combined balance sheet as of December 26, 2020.
104	Cover Page Interactive Data File (embedded within the Inline XBRL document).

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: April 6, 2021	By:	/s/ Eric Seeton
		Eric Seeton
		Chief Financial Officer

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-236211) and S-8 (No. 333-236209 and No. 333-182585) of Franchise Group, Inc. of our report dated March 19, 2021 relating to the consolidated financial statements of Pet Supplies Plus, LLC and Subsidiaries appearing in this Current Report on Form 8-K/A of Franchise Group, Inc.

/s/ Ernst & Young LLP
Detroit, Michigan
April 6, 2021

Exhibit 99.1

CONSOLIDATED FINANCIAL STATEMENTS

Pet Supplies Plus, LLC and Subsidiaries
Fiscal Years Ended January 2, 2021 and
December 28, 2019
With Report of Independent Auditors

Pet Supplies Plus, LLC and Subsidiaries

Consolidated Financial Statements
Fiscal Years Ended January 2, 2021 and December 28, 2019

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Report of Independent Auditors

The Member
Pet Supplies Plus, LLC and Subsidiaries

We have audited the accompanying consolidated financial statements of Pet Supplies Plus, LLC and Subsidiaries, which comprise the consolidated balance sheets as of January 2, 2021 and December 28, 2019, and the related consolidated statements of operations and member's equity and cash flows for the fiscal years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Pet Supplies Plus, LLC and Subsidiaries at January 2, 2021 and December 28, 2019, and the consolidated results of their operations and their cash flows for the fiscal years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Detroit, Michigan
March 19, 2021

Pet Supplies Plus, LLC and Subsidiaries

Consolidated Balance Sheets
(In Thousands)

	January 2, 2021	December 28, 2019
Assets		
Current assets:		
Cash and cash equivalents	**$ 32,983**	$ 13,071
Accounts receivable, net	**29,964**	17,040
Inventories	**96,558**	86,716
Prepaid expenses and other current assets	**12,076**	8,158
Total current assets	**171,581**	124,985
Property and equipment:		
Property and equipment	112,794	97,153
Less accumulated depreciation	**(37,724)**	(18,451)
Net property and equipment	**75,070**	78,702
Other assets:		
Goodwill	**72,363**	72,363
Intangible assets, net	**142,657**	154,849
Other assets	**10,399**	10,941
Total other assets	**225,419**	238,153
Total assets	**$ 472,070**	$ 441,840
Liabilities and member's equity		
Current liabilities:		
Accounts payable	$ **41,927**	$ 33,486
Accrued liabilities	**56,130**	18,167
Current portion of long-term debt	**13,035**	2,314
Total current liabilities	**111,092**	53,967
Long-term liabilities:		
Long-term debt, net of current portion	**230,652**	241,413
Other liabilities	**41,084**	15,162
Total long-term liabilities	**271,736**	256,575
Member's equity	**89,242**	131,298
Total liabilities and member's equity	**$ 472,070**	$ 441,840

See accompanying notes.

Pet Supplies Plus, LLC and Subsidiaries

Consolidated Statements of Operations and Member's Equity
(In Thousands)

	Fiscal Year Ended January 2, 2021	Fiscal Year Ended December 28, 2019
Retail sales	**$ 579,216**	$ 523,461
Wholesale sales	**243,241**	183,450
Royalties	**14,894**	12,063
Franchise fees	**528**	165
Service fees, advertising, and other revenue	**8,081**	7,843
	845,960	726,982
Cost of goods sold	**524,292**	447,658
Gross profit	**321,668**	279,324
Store, selling, general, and administrative expenses	**272,359**	225,561
Depreciation and amortization	**37,907**	30,156
Impairment expense	**994**	1,258
Loss on sale of retail stores	**182**	491
Loss on closure of retail stores	**370**	1,217
Loss on sale or disposal of assets	**2,045**	263
Operating income	**7,811**	20,378
Interest expense	**(20,229)**	(21,862)
Transaction related costs and charges	**(25,455)**	(2,666)
Other expense	**(351)**	(6)
Total other expenses	**(46,035)**	(24,534)
Provision for state and local income taxes	**219**	148
Net loss	**$ (38,443)**	$ (4,304)
Statements of member's equity		
Member's equity, beginning of period	**$ 131,298**	$ 135,988
Cumulative effect adjustment from the adoption of ASC 606	**–**	29
Net loss	**(38,443)**	(4,304)
Distributions	**(3,613)**	(415)
Member's equity, end of period	**$ 89,242**	$ 131,298

See accompanying notes.

Pet Supplies Plus, LLC and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Fiscal Year Ended January 2, 2021	Fiscal Year Ended December 28, 2019
Operating activities		
Net loss	**$ (38,443)**	$ (4,304)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	**39,484**	31,611
Loss on sale or disposal of assets	**2,045**	263
Loss on reacquired franchise right	**46**	–
Non-cash contingent consideration	**19,153**	(183)
Non-cash impairment expense	**994**	1,258
Loss on sale of retail stores	**370**	491
Loss on closure of retail stores	**182**	1,217
Changes in:		
Accounts receivable	**(13,248)**	(770)
Inventories	**(9,991)**	(1,053)
Prepaid expenses and other assets	**(3,438)**	(3,591)
Accounts payable and accrued liabilities	**24,952**	(243)
Transaction related costs	**23,910**	–
Deferred rent and tenant allowances	**1,117**	2,687
Net cash provided by operating activities	**47,133**	27,383
Investing activities		
Purchase of property and equipment	**(21,848)**	(12,867)
Proceeds from sale of fixed assets	**22**	69
Proceeds from sale of retail stores	**993**	457
Inflow of cash from direct financing leases	**1,300**	945
Acquisition, net of cash acquired	**(206)**	–
Net cash used in investing activities	**(19,739)**	(11,396)
Financing activities		
Borrowings on revolving loan	**20,000**	–
Repayments of revolving loan	**(20,000)**	(5,000)
Repayments of debt and capital leases	**(3,869)**	(2,790)
Member distributions	**(3,613)**	(415)
Net cash used in financing activities	**(7,482)**	(8,205)
Net increase in cash and cash equivalents	**19,912**	7,782
Cash and cash equivalents, beginning of period	**13,071**	5,289
Cash and cash equivalents, end of period	**$ 32,983**	$ 13,071
Supplemental cash flow information		
Cash paid for interest	**$ 18,361**	$ 19,243
Cash paid for income taxes	**$ 742**	$ 1,127
Supplemental schedule of non-cash investing and financing activities		
Capital expenditures and subleased assets funded by accounts payable and capital leases	**$ 1,246**	$ 553

See accompanying notes.

1. Nature of the Business and Principles of Consolidation

Pet Supplies Plus, LLC and subsidiaries (the "Company") was formed in 2010 by Pet Supplies "Plus" Holdings, LLC ("Former Parent") in a transaction that involved the acquisition of several companies that operated retail pet supply stores, and the assets of a franchisor of retail pet stores, a wholesale distributor of pet supplies and a company that provided store set-up services.

On December 12, 2018, PSP Holdings, LLC ("Holdings") and its subsidiary entered into an agreement with the Former Parent to acquire all of the member's interest in the Company. The subsidiary of Holdings was then merged into the Company with the Company surviving the merger (collectively, the "Merger Transaction").

The Company and its subsidiaries operate a retail pet food and supplies business under the name Pet Supplies Plus. Operating companies included in the consolidated financial statements are (i) PSP Stores, LLC ("Stores"), the operator of 217 Pet Supplies Plus retail stores; (ii) PSP Franchising, LLC ("Franchising"), the franchisor of Pet Supplies Plus retail stores; (iii) PSP Distribution, LLC, a wholesale distributor of merchandise for the retail stores; (iv) PSP Service Newco, Inc. ("Service"), an entity that provides setup services for new franchisees; and (v) Pet Extreme, LLC, an entity that previously owned several acquired retail stores. Also included in the consolidated financial statements are PSP Group, LLC ("Group") which provides most strategic-level functions, and PSP Subco, LLC that is wholly owned by Group and holds a 1% interest in several of the operating companies. Operations of the Company are primarily in the midwestern and eastern United States.

Intercompany balances and transactions are eliminated in consolidation.

Fiscal Year

The Company utilizes a 52/53-week reporting year ending on the Saturday closest to December 31. Fiscal year 2020 comprised 53 weeks and ended on January 2, 2021 and fiscal year 2019 comprised 52 weeks and ended on December 28, 2019.

2. Summary of Significant Accounting Policies Change in Accounting Principle

Goodwill and Customer-Related Intangible Assets

In connection with the Merger Transaction and application of purchase accounting in 2018, the Company elected certain alternative accounting methods for private companies under ASC 805- 20 – Business Combinations. Under this alternative, customer-based intangible assets were not separately identified on the consolidated balance sheet and were included as a component of goodwill. Additionally, the Company elected to amortize goodwill on a straight-line basis over 10 years under the alternative accounting method for private companies in ASC 350-20 – Goodwill.

As discussed in Note 2 – Subsequent Events section, the Company was acquired in 2021 by Franchise Group, Inc., a publicly traded company. The Company was required to change its method of accounting for goodwill and customer-related intangible assets to comply with U.S. GAAP guidance for public business entities. On a retrospective basis, customer-related intangibles were separately identified from goodwill and the previously recognized amortization of goodwill was reversed. Amortization of the customer-based intangible assets continued to be recorded on a straight-line basis over the estimated useful life. Additionally, goodwill was reviewed at the reporting unit level for past indications of impairment on a qualitative basis for the fiscal year ended December 28, 2019. No qualitative indications of impairment were noted.

Comparative financial statements of the prior year have been adjusted to apply the new methods retrospectively from the date of the Merger Transaction. The following financial statement line items as of January 2, 2021 and December 28, 2019 and for the fiscal years then ended were affected by the changes in accounting principle.

2. Summary of Significant Accounting Policies (continued)

The effects of the changes made to the Company's consolidated balance sheet as of December 28, 2019 for the change in accounting principle were as follows (in thousands):

	As Adjusted	As Originally Reported	Effect of Change
Assets			
Goodwill, net	$ 72,363	$ 78,092	$ (5,729)
Intangible assets, net	154,849	141,536	13,313
Total	$ 227,212	$ 219,628	$ 7,584
Liabilities and member's equity			
Member's equity	$ 131,298	$ 123,714	$ 7,584
Total liabilities and member's equity	$ 131,298	$ 123,714	$ 7,584

The effects of the changes made to the consolidated statement of operations and member's equity as of December 28, 2019 for the change in accounting principle were as follows (in thousands):

	As Adjusted	As Originally Reported	Effect of Change
Depreciation and amortization	$ 30,156	$ 37,438	$ (7,282)
Net loss	$ (30,156)	$ (37,438)	$ 7,282
Member's equity, beginning of period	$ 135,988	$ 135,686	$ 302
Cumulative effect adjustment from adoption of ASC 606	29	29	–
Net loss	(4,304)	(11,586)	7,282
Distributions	(415)	(415)	–
Member's equity, end of period	$ 131,298	$ 123,714	$ 7,584

The effects of the changes made to the Company's consolidated statements of cash flow for the year ended December 28, 2019 for the change in accounting principle were as follows (in thousands):

	As Adjusted	As Originally Reported	Effect of Change
Net loss	$ (4,304)	$ (11,586)	$ 7,282
Depreciation and amortization	$ 31,611	$ 38,893	$ (7,282)

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-09 ("ASU"), *Revenue From Contracts With Customers (Topic 606)* and subsequently issued various amendments which provide additional clarification and implementation guidance. This standard has been codified as ASC 606. This guidance outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers and superseded most revenue recognition guidance issued by the FASB, including industry specific guidance.

The Company completed its review of the impact of the new standard and identified certain key accounting policy changes that resulted from adopting the new standard. Specifically, the standard changes the timing in which the Company recognizes initial fees from franchisees for new store openings and related sales commissions. Franchise arrangements generally include a license and provide for a payment of initial fees, as well as royalties, advertising sales and other fees. Under the franchise agreement, franchisees are granted the right to operate a retail pet supply store under the Pet Supplies Plus name generally for a period of ten years. The franchise agreement can be renewed for two successive five-year terms for a nominal amount provided the franchisee meets the conditions outlined in the franchise agreement. Under ASC 606, initial franchise fees are recognized as the Company satisfies the performance obligation over the franchise term, which is generally twenty years.

The Company utilizes employees, franchise brokers and referral services to assist in the selling of franchises. Commissions are paid to these parties if a franchise agreement is executed. The Company considers these commissions as incremental costs in obtaining a customer contract and, as such, will be amortized over the period of benefit, which is aligned to the related franchise term of twenty years.

2. Summary of Significant Accounting Policies (continued)

The Company adopted ASC 606 as of December 30, 2018 using the modified retrospective method. This method allows the standard to be applied retrospectively through a cumulative catch up adjustment recognized upon adoption. In connection with the adoption of ASC 606, management evaluated the elements of franchisee contracts where the performance obligations had not been fulfilled as of December 30, 2018 (adoption date). As a result of this evaluation, an adjustment to beginning retained earnings and corresponding liabilities of approximately $36 was established on the date of adoption, December 30, 2018. Additionally, an adjustment to the beginning retained earnings and corresponding assets of approximately $7 was established on the date of adoption associated with the commissions paid. Accordingly, the net impact to retained earnings was a reduction of $29.

Retail Sales – Revenue is recognized at the time of sale for retail sales. Promotional and other sales discounts are recorded as a reduction in revenue at the time of sale. Sales taxes imposed and collected from customers and subsequently remitted to the states are not reflected in sales by the Company and are recorded as a liability on the consolidated balance sheets. Recorded in accrued liabilities is sales tax payable of $3,233 and $1,880 at January 2, 2021 and December 28, 2019. Allowances for sales reserves are provided at the time of sale based on past experience.

Wholesale Sales – Revenue from wholesale merchandise sales is recognized at the time goods are shipped and title has transferred. Allowances for sales returns are provided at the time of shipment based on past experience. The Company accounts for shipping and handling activities as fulfillment activities and these costs are accrued within cost of goods sold at the same time revenue is recognized. Franchisees are generally invoiced upon shipment and payment generally occurs within fourteen to thirty days.

Franchise Fees – Franchise fee revenue is comprised of fees received from franchisees and is recognized as revenue on a straight-line basis over the term of each franchise store agreement, which is generally twenty years. Franchise fees for area developments are received from franchisees for the exclusive right to develop franchises within a certain geographic area in accordance with a pre-determined development schedule. Such fees are allocated on a pro rata basis to each material right to open a franchise store and recognized as revenue on a straight-line basis over the term of each franchise store agreement which ranges from ten to twenty years.

Royalties – Royalty revenue is based on a percentage of franchisee sales and is earned as the underlying sales at the franchise stores occur. Franchisees are generally invoiced for royalties on a monthly basis and payment generally occurs within ten to twenty days.

2. Summary of Significant Accounting Policies (continued)

National Advertising Fund – Both company-owned and franchise stores contribute a monthly fee for the development, production, and distribution of national, regional, or local advertising. The Company has determined there are no performance obligations associated with the contributions received by the National Advertising Fund that are separate from the royalty payment stream and as a result these contributions are presented gross in the Company's statement of operations. The amounts are recognized as revenue on a monthly basis upon invoicing. Revenue of $5,869 and $5,418 was billed and expenses of $6,835 and $5,788, including internal costs of $2,232 and $1,823, were expensed during the fiscal years ended January 2, 2021 and December 28, 2019, respectively, related to the fund. Revenue includes amounts for franchise and company-owned stores. Intercompany revenue and expense are eliminated in consolidation.

Contract Assets and Liabilities

The Company records contract assets and contract liabilities related to its revenue generating activities.

Contract assets relate to commissions paid to employees, franchise brokers and referral services to assist in the selling of franchises. These commissions are considered incremental costs in obtaining a customer contract and, as such, are amortized over the period of the benefit, which is aligned to the related franchise term. As of January 2, 2021, and December 28, 2019, the Company recorded contract assets in the amounts of $3,471 and $2,483, respectively. Such amounts are classified in "Other assets" on the consolidated balance sheets.

Contract liabilities relate to the deferral of initial franchise fees, which are paid upon signing a franchise agreement and recognized over the franchise term of twenty years. As of January 2, 2021 and December 28, 2019, the Company recorded contract liabilities in the amounts of $8,334 and $6,205, respectively. Such amounts are classified in "Other liabilities" on the consolidated balance sheet.

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. The bank accounts maintained by the Company are insured by the Federal Deposit Insurance Corporation up to $250. At various times during the year, cash balances exceeded federally insured limits.

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable include promotional funding from vendors, including amounts to be remitted to franchisees for purchases made on their behalf, monthly franchise fees, royalties and other amounts due from franchisees and trade receivables for the sale of product to franchisees. The Company primarily utilizes historical loss and recovery data, combined with information on current conditions and reasonable and supportable forecasts to develop the estimate of the allowance for doubtful accounts. The allowance for doubtful accounts as of January 2, 2021 and December 28, 2019 was $44 and $276, respectively.

Inventories

Store inventories (totaling $46,090 and $47,472 as of January 2, 2021 and December 28, 2019, respectively) are valued at the lower of cost, determined on the average cost method, or net realizable value. The Company includes freight and labor costs on products purchased from its distribution center in inventory cost.

Wholesale inventories (totaling $50,468 and $39,244 as of January 2, 2021 and December 28, 2019, respectively) are valued at the lower of cost (including freight), determined on the average cost method, or net realizable value.

Volume-based vendor allowances, rebates, and credits that relate to the Company’s store merchandising activities are applied to product cost and recognized in cost of goods sold as the related product is sold.

Property and Equipment

Leasehold improvements, furniture, fixtures, equipment, computer equipment and software, equipment under capital leases, and construction-in-process are carried at cost or if valued in connection with a business combination or impairment, the assets are adjusted to fair value. Depreciation of furniture, fixtures, and equipment is provided utilizing the straight-line method over the estimated remaining useful lives of the respective assets, generally three to ten years. Leasehold improvements are depreciated, utilizing the straight-line method, over the shorter of the term of the lease or the economic life of the improvement. Equipment under capital leases are amortized over the shorter of the lease term or estimated useful life.

2. Summary of Significant Accounting Policies (continued)

The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. During the fiscal year ended January 2, 2021, the Company recorded a charge of $994 for impairment related to under-performing stores. The net book value of leasehold improvements and other fixed assets for these stores of $1,077 was written down to fair value of $83. During the fiscal year ended December 28, 2019, the Company recorded a charge of $1,258 for impairment related to under- performing stores. The net book value of leasehold improvements and other fixed assets for these stores of $1,447 was written down to fair value of $189.

As of January 2, 2021 and December 28, 2019, property and equipment consisted of the following:

	January 2, 2021	December 28, 2019	Useful Lives
Furniture, fixtures, and equipment	**$ 31,412**	$ 29,023	3-10 years
Leasehold improvements	**44,854**	38,823	10-20 years
Computer equipment and software	**23,743**	21,942	5-10 years
Equipment under capital leases	**5,237**	4,372	3-5 years
Construction-in-progress	**7,548**	2,993	
Subtotal	**112,794**	97,153	
Accumulated depreciation	**(37,724)**	(18,451)	
Total fixed assets	**$ 75,070**	$ 78,702	

Depreciation expense related to property and equipment was $25,715 and $17,907 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively. Depreciation expense included amortization expense on capital leases of $1,505 and $1,088 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively. Accumulated depreciation included accumulated amortization expense on capital leases of $2,609 and $1,132 at January 2, 2021 and December 28, 2019, respectively.

Construction in progress included $1,246 and $553 of store equipment under capital leases not yet placed in service at January 2, 2021 and December 28, 2019, respectively. The January 2, 2021 amount includes $1,042 of store equipment that the Company expects to sublease to franchisees in 2021. The December 28, 2019 amount subleased to franchisees in 2020 was $466.

2. Summary of Significant Accounting Policies (continued)

Deferred Rent

The Company recognizes rent holidays and escalating rent provisions on a straight-line basis over the term of the related lease. Deferred rent was $2,010 and $1,051 as of January 2, 2021 and December 28, 2019, respectively, and is recorded in accrued liabilities and other liabilities on the consolidated balance sheets.

Payroll and Benefits

The Company recognizes salaries and benefits as earned. Accrued payroll and benefits of $14,762 and $4,708 are recorded in accrued liabilities at January 2, 2021 and December 28, 2019, respectively.

Financial Instruments

The Company has certain financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities. The carrying amounts of these financial instruments approximate fair value due to either the short maturity or the existence of variable interest rates that approximate prevailing market rates.

Federal and State Income Taxes

The Company and its entities, except Service, are organized as limited liability companies. Accordingly, the Company is treated as a partnership and, as such, does not pay federal corporate income taxes on its taxable income. Instead, members of the Company are responsible for reporting and paying federal taxes on their proportionate share of the companies' taxable income. As such, there is no provision for federal income taxes in the accompanying consolidated financial statements, except for Service (which is a wholly owned C-corporation), and Intermediate (which is an upper tier limited liability company taxed as a C-corporation with a fractional ownership share). These two entities collectively incur a nominal federal income tax expense. State and local taxes owed by such members in jurisdictions that recognize limited liability companies as pass- through entities are paid and accrued as distributions on behalf of such members. The provision for income taxes consists primarily of state and city income taxes in those jurisdictions that do not recognize limited liability companies as pass-through entities for income tax purposes.

Uncertain Tax Positions

The Company has evaluated its tax positions, noting no significant uncertainties. There were no significant penalties or interest incurred during the fiscal years presented.

2. Summary of Significant Accounting Policies (continued)

The Company files income tax returns in various state jurisdictions. The Company's U.S. federal statute of limitations has expired for years prior to 2016 and the relevant state statutes vary.

Costs of Goods Sold

Costs of goods sold include product costs and freight charges, net of vendor discounts, rebates, and allowances.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $10,385 and $9,730 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively.

Loss on Closure of Retail Stores

The Company continuously evaluates the performance of its stores and periodically closes underperforming locations. The costs associated with closing the stores, including future lease payments, lease termination fees, disposal of assets and other related costs, are included in operating income as loss on closure of retail stores.

Goodwill

Goodwill represents the amount of consideration exchanged in excess of the assets and liabilities related to the Merger Transaction described in Note 1. Goodwill is reviewed at least annually for impairment at the end of the fiscal year or on an interim basis if indicators of impairment were present. Generally, fair value is determined at the reporting-unit level using a multiple of earnings and discounted projected future cash flows and is compared to the carrying value of the reporting unit for purposes of identifying potential impairment. The Company identified its company-owned stores, distribution and franchise operations as its reporting units. Projected future cash flows are based on management's knowledge of the operating environment and expectations for the future. Goodwill impairment would be recognized for any amount by which the reporting unit's carrying value exceeds its fair value. The Company concluded that there was no goodwill impairment during the fiscal years ended January 2, 2021 and December 28, 2019.

2. Summary of Significant Accounting Policies (continued)

Definite-Lived Intangible Assets

ASC 805, *Business Combinations*, requires acquired identifiable intangible assets to be recognized if the intangible asset is either contractual or separable. The Company recorded intangible assets for franchise rights, trade names and trademarks, customer-related intangibles and non- competition agreements in connection with the Merger Transaction. The values attributed to each intangible asset were determined with the assistance of an independent valuation specialist. These amounts are amortized using the straight-line method over the estimated useful lives of each asset.

Definite-lived intangible assets are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. No impairment was recorded on definite-lived intangible assets during the fiscal years ended January 2, 2021 and December 28, 2019.

Fair Value Measurements

Accounting standards require that certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritized the valuation techniques and inputs used to measure fair value.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level of input that is significant to the valuation. The Company’s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

2. Summary of Significant Accounting Policies (continued)

Assets and liabilities measured at fair value are based on one or more of the following three valuation techniques:

A. Market approach: prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
B. Cost approach: amounts that would be required to replace the service capacity of an asset (replacement cost).
C. Income approach: techniques to convert future amounts to a single present amount based upon market expectations (including present value techniques, option-pricing and excess earnings models).

Assets and liabilities measured at fair value on a recurring basis during the year ended January 2, 2021 are set forth below:

	Asset	Liability	Level 3	Valuation Technique
Contingent consideration *(Note 9)*	**$ –**	**$ (21,870)**	**$ (21,870)**	**C**
Equity-based compensation *(Note 9)*	**–**	**(20,591)**	**(20,591)**	**C**

Assets and liabilities measured at fair value on a recurring basis during the year ended December 28, 2019 are set forth below:

	Asset	Liability	Level 3	Valuation Technique
Contingent consideration (*Note 9*)	$ –	$ (2,717)	$ (2,717)	C
Equity-based compensation (*Note 9*)	$ –	$ (2,547)	$ (2,547)	C

2. Summary of Significant Accounting Policies (continued)

Assets and liabilities measured at fair value on a non-recurring basis during the period January 2, 2021 are set forth below:

	Asset	Liability	Level 3	Valuation Technique
Property and equipment (*Note 2*)	**$ 83**	**$ –**	**$ 83**	**B**

Assets and liabilities measured at fair value on a non-recurring basis during the period December 28, 2019 are set forth below:

	Asset	Liability	Level 3	Valuation Technique
Property and equipment (*Note 2*)	$ 189	$ –	$ 189	B

Franchise Operations

The Company enters into franchise agreements through Franchising. The number of franchise stores during fiscal years 2019 and 2020 is summarized below:

Franchise store count, December 29, 2018	234
New stores	29
Closed stores	(4)
Acquired from Stores	2
Franchise store count, December 28, 2019	261
New stores	39
Acquired from Stores	3
Acquired by Stores	(1)
Franchise store count, January 2, 2021	302

Franchise stores are not considered variable interest entities and have not been consolidated under the guidance of ASC 810, *Consolidation*.

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Recently Adopted Pronouncement

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This guidance requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. This guidance also requires enhanced disclosures regarding significant estimates and judgments used in estimating credit losses. The Company adopted this guidance effective December 29, 2019. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Future Accounting Pronouncement

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which requires lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to today's accounting. This ASU is effective for fiscal years beginning after December 15, 2021 and for interim periods the following year, with early adoption permitted. This ASU is required to be applied using the modified retrospective approach and full retrospective application is prohibited. The Company is currently evaluating the impact of adopting this standard on the financial statements.

Subsequent Events

The financial statements and related disclosures include evaluation of events up through and including March 19, 2021, which is the date the accompanying consolidated financial statements were available to be issued.

On January 23, 2021, PSP Holdings, LLC and other related parties entered into a definitive Equity Purchase Agreement with Franchise Group Newco PSP, LLC, a subsidiary of Franchise Group, Inc. (a Delaware corporation), pursuant to which Franchise Group will acquire 100% of the equity of the Company and its subsidiaries in an all cash transaction valued at approximately $700 million. Under the terms of the agreement, all outstanding equity-based compensation units will fully vest and will be converted into the right to receive purchase consideration in amounts determined under various Equity Grant Agreements. The Company completed the sale on March 10, 2021.

3. Business Combinations and Transaction Costs Disposals

During 2020, the Company completed the sale of three of its stores to three existing franchisees of the Company for total consideration of $1,099, comprised of cash of $993 and a receivable of $106 related primarily to final inventory. The sales resulted in an aggregate loss of $182. The receivable of $106 is included in accounts receivable in the accompanying consolidated balance sheet as of January 2, 2021 and is due in the first quarter of 2021. Under the terms of the sale agreement, the real estate leases for the stores were assigned to the franchisees.

During 2019, the Company completed the sale of two of its stores to two existing franchisees of the Company for total consideration of $467, comprised of cash of $457 and a receivable of $10 related to final inventory. The sales resulted in an aggregate loss of $491. The receivable of $10 is included in accounts receivable in the accompanying consolidated balance sheet as of December 28, 2019 and was paid in the first quarter of 2020. Under the terms of the sale agreement, the real estate leases for the stores were assigned to the franchisees.

The Company remains secondarily liable under the leases. In the event of a failure of the franchisees to pay lease payments, the Company could be obligated to pay the remaining minimum lease payments, which aggregated $2,380 and $1,664 as of January 2, 2021 and December 28, 2019, respectively. If the Company is required to make payments under this guarantee, the Company could seek to recover those amounts from the franchisees and its parent company under the sale agreement. The Company has concluded that an event of default is remote.

Transaction Costs

Transaction related costs of $25,455 and $2,666 were expensed for the fiscal year ended January 2, 2021 and December 28, 2019, respectively, and are included in transaction related costs and charges on the accompanying consolidated statements of operations. Recorded in accrued liabilities are transaction costs of $23,910 and $0 at January 2, 2021 and December 28, 2019, respectively. Transaction costs for fiscal 2020 were primarily related to the definitive Equity Purchase Agreement (Note 2). Transaction costs for fiscal 2019 include costs associated with a potential recapitalization that the Company pursued but did not ultimately complete.

4. Intangible Assets and Goodwill

Intangible assets of the Company as of January 2, 2021, which are being amortized, are summarized as follows:

	Gross Carrying Amount	Accumulated Amortization	Ending Balance	Useful Life
Franchise rights	$ 49,000	$ (6,669)	$ 42,331	15 Years
Trade names and trademarks	59,000	(8,031)	50,969	15 Years
PSP trade name	33,700	(2,752)	30,948	25 Years
Customer relationships	14,000	(2,382)	11,618	12 Years
Non-competition agreements	11,040	(4,508)	6,532	5 Years
Customer lists	810	(551)	259	3 Years
	$ 167,550	$ (24,893)	$ 142,657	

Intangible assets of the Company as of December 28, 2019, which are being amortized, are summarized as follows:

	Gross Carrying Amount	Accumulated Amortization	Ending Balance	Useful Life
Franchise rights	$ 49,000	$ (3,403)	$ 45,597	15 Years
Trade names and trademarks	59,000	(4,097)	54,903	15 Years
PSP trade name	33,700	(1,404)	32,296	25 Years
Customer relationships	14,000	(1,216)	12,784	12 Years
Non-competition agreements	11,040	(2,300)	8,740	5 Years
Customer lists	810	(281)	529	3 Years
	$ 167,550	$ (12,701)	$ 154,849	

4. Intangible Assets and Goodwill (continued)

Amortization expense for the fiscal years ended January 2, 2021 and December 28, 2019 was $12,192 and $12,247, respectively.

Estimated amortization expense on definite-lived intangible assets for the next five fiscal years is as follows:

2021	$ 12,181
2022	11,923
2023	11,831
2024	9,714
2025	9,714
Thereafter	87,294
Total	$ 142,657

The carrying value of goodwill was $72,363 as of January 2, 2021 and December 28, 2019 and includes no accumulated impairment.

5. Debt

Long-term debt consists of the following:

	January 2, 2021	**December 28, 2019**
Senior Note	**$ 191,100**	$ 193,538
Subordinated Note	**56,000**	56,000
Capital leases	**3,964**	3,022
Deferred financing costs, net of accumulated amortization	**(5,014)**	(6,008)
Original issue discount, net of accumulated amortization	**(2,363)**	(2,825)
Total	**243,687**	243,727
Less current portion	**(13,035)**	(2,314)
Long-term portion	**$ 230,652**	$ 241,413

5. Debt (continued)

Future maturities of long-term debt (excluding capital lease obligations, see Note 6) as of January 2, 2021 are as follows:

2021	$	13,010
2022		1,950
2023		1,950
2024		174,190
2025		56,000
Total	$	247,100

During 2018, the Company entered into two credit agreements, a senior credit agreement (“Credit Agreement”) and a subordinated note agreement (“Subordinated Note”) each with various lenders. Proceeds from the initial borrowings under the agreements aggregated to $256,000. In connection with entering into the two credit agreements, the Company paid $3,270 of original issue discount and $7,560 in third-party costs which are accounted for as deferred financing costs.

Credit Agreement

The Credit Agreement includes a $195,000 term loan (“Senior Note”) and a $20,000 revolving loan and letter of credit facility (“Revolving Loan”). Borrowings under the Credit Agreement are secured by substantially all of the assets of the Company. Interest on borrowings under the Credit Agreement is calculated at the Company’s choice of either LIBOR plus a Fixed Rate or a Base Rate plus 3.50%. The Fixed Rate is determined by the Company’s Maximum Leverage Ratio. The Fixed Rate was 4.25% and 4.50% at January 2, 2021 and December 28, 2019, respectively. The Base Rate is defined as the higher of the prime rate or a rate equal to the federal funds rate plus 0.50% or a rate equal to 30-day LIBOR plus 1.00%.

The Senior Note requires quarterly principal payments of $487.5 which commenced March 31, 2019. Beginning with the fiscal year ending December 28, 2019, the Credit Agreement requires an additional principal payment equal to excess cash flow as defined in the agreement (“ECF Payment”). ECF Payments, if any, are due 125 days after the end of each fiscal year. An ECF payment of $11,060 was calculated as of January 2, 2021 and is reflected in the current portion of long-term debt. No payment was due in 2020 for excess cash flows for the fiscal year ended December 28, 2019. Any remaining outstanding balance on the Senior Note is due December 12, 2024. The Credit Agreement provides for borrowings under a Revolving Loan of up to $20,000. The Company borrowed and repaid $20,000 on the Revolving Loan during 2020. The Company had no outstanding borrowings under the Revolving Loan at January 2, 2021 and December 28, 2019. The revolving loan matures December 12, 2023. The available amount under the Revolving Loan commitment may be used by the Company for letters of credit. There were no letters of credit outstanding at January 2, 2021 and December 28, 2019.

5. Debt (continued)

Subordinated Note

The Subordinated Note is subordinated to the prior payment of the indebtedness under the Credit Agreement and is due June 12, 2025. The Subordinated Note requires interest only payments quarterly at the rate of 11.50% per annum. The Company may elect to pay up to 1.00% of such interest as payment-in-kind interest ("PIK") rather than in cash. PIK interest is added to the outstanding principal balance. If the Subordinated Note is still outstanding as of December 12, 2023, a portion, as defined in the agreement, of outstanding PIK interest may be payable. As of January 2, 2021 and December 28, 2019, the Company had not elected the PIK option on any interest payments.

The Credit and Subordinated Note Agreements include various restrictive covenants, including the requirement for the Company to maintain a minimum leverage ratio. As of January 2, 2021 and December 28, 2019, the Company was in compliance with all covenants.

Original issue discount and deferred financing costs are being amortized as interest expense over the term of the various notes utilizing the effective interest method. The Company recorded amortization of original issue discounts under the Credit Agreement and Subordinated Note Agreements of $463 and $425 and deferred financing costs of $994 and $911 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively.

6. Leases

The Company leases its corporate office, its distribution center, its retail stores and other office equipment from third parties under operating leases expiring through 2031. Many leases require additional payments for property taxes and various common area charges, provide for scheduled rent increases during their base terms (which results in deferred rent liability), and provide for renewal options or escalation clauses. Certain store equipment is leased under capital leases.

Total rent expense was $31,060 and $31,429 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively.

6. Leases (continued)

Future minimum lease payments required under these leases are as follows:

	Operating Leases	Capital Leases
2021	$ 32,252	$ 1,816
2022	29,767	957
2023	25,355	687
2024	21,254	635
2025	16,648	331
Thereafter	32,684	17
Total minimum lease payments	$ 157,960	4,443
Less imputed interest		(479)
Net present value of capital lease obligations		3,964
Less current installments		(1,614)
Long-term capital lease obligations		$ 2,350

Short and long-term obligations for capital leases are included in the accompanying consolidated balance sheets in current portion of long-term debt and long-term debt, respectively. The assets under capital leases are included in property and equipment.

The Company enters into subleases for certain store equipment with franchisees which are classified as direct finance leases. Investments in direct finance leases are recorded on a net basis, consisting of gross investment in the lease less unearned income. Unearned income is recognized over the lease term yielding a periodic rate of return on the net investment. Earned income of $221 and $222 is included in store, selling, general, and administrative expenses for the fiscal years ended January 2, 2021 and December 28, 2019, respectively. There was no allowance for uncollectible lease payments as of January 2, 2021 and December 28, 2019.

Net investment in direct financing leases was as follows:

	January 2, 2021	**December 28, 2019**
Future minimum lease receipts	**$ 3,030**	$ 2,692
Unearned income	**(394)**	(273)
Current portion included within accounts receivable	**(1,288)**	(1,022)
Net investment in store equipment leased to franchisees	**$ 1,348**	$ 1,397

6. Leases (continued)

As of January 2, 2021, future minimum lease receipts under direct financing leases were as follows:

2021	$	1,288
2022		734
2023		458
2024		359
2025		191
Total minimum lease receipts	$	3,030

7. Employee Benefit Plans

The Company sponsors a 401(k) employee benefit plan. Generally, all full-time employees meeting certain requirements as to age and length of service are eligible to participate in the 401(k) plan. The Company matches employee contributions at various rates up to 4% of eligible employee contributions. The expense related to the matching contributions to the plan were $1,040 and $946 in the fiscal years ended January 2, 2021 and December 28, 2019, respectively.

8. Commitments and Contingencies

The Company is occasionally named as a defendant in lawsuits, primarily related to employment or general liability claims, in the ordinary course of business. In the opinion of the Company’s management, these matters, individually or in the aggregate, will not have a material adverse effect on the Company’s consolidated financial position or results of operations.

Guarantees

The Company remains secondarily liable under various real estate leases that were assigned to franchisees who acquired retail stores from the Company. In the event of failure of an acquirer to pay lease payments, the Company could be obligated to pay the remaining lease payments which extend through 2030 and aggregated $9,526 as of January 2, 2021. If the Company is required to make payments under these guarantees, the Company could seek to recover those amounts from the franchisees or in some cases their affiliates. The Company believes that payment under these guarantees is remote as of January 2, 2021.

9. Equity-Based Compensation and Contingent Consideration

Equity-Based Compensation

In fiscal 2019, the Company established an equity-based compensation plan (the "Plan") and issued Class B, Class C-1, and Class C-2 interests in Pet Supplies Plus Holdings, LLC. Class B units vest upon satisfaction of a service condition, defined as a 20% increment for each year of service, or immediately upon a change in control transaction or the consummation of an initial public offering ("IPO"). Class C-1 and Class C-2 units vest upon satisfaction of liquidity conditions, defined as a change in control transaction or the consummation of an IPO. Units awarded are subject to certain risks of forfeiture and acceleration of vesting provisions.

Though the various equity-based awards are issued at Pet Supplies Plus Holdings, LLC, the compensation expense has been pushed down to the Company and disclosures have been provided in accordance with push-down accounting.

The units have been accounted for as liability awards under ASC 718, Compensation – Stock Compensation, due to certain repurchase features, and the Company has elected to use the option pricing method and the Black-Scholes option pricing model to determine compensation expense. The fair value of the units is determined at each reporting period based on the estimated fair value of the Company and expected payout to each unit (Level 3 of the fair value hierarchy). To the extent certain market conditions, management's estimate of enterprise value, or performance based on vesting conditions are adjusted in future periods, the recognition of expense would change.

In 2020, the following assumptions were used in estimating the fair values: discount for lack of marketability of 10.4%, volatility of 57.5%, a risk-free interest rate of 0.1% and a term of 0.25 years.

In 2019, the following assumptions were used in estimating the fair values: discount for lack of marketability of 31%, volatility of 60%, a risk-free interest rate of 1.7% and a term of 4.0 years.

The Company records compensation expense for the service-based Class B units once the award vests utilizing the fair value of the equity awards. The compensation expense for the service-based Class B units is then adjusted to the fair value of the award at each measurement period. As of January 2, 2021 and December 28, 2019, the fair value of the Class B units was $6,918 and $835, respectively. Compensation expense for the Class B units related to the equity awards was $2,355 and $162 for the fiscal years ended January 2, 2021 and December 28, 2019, respectively. Forfeitures of $28 were included in compensation expense for the fiscal year ended January 2, 2021. As of January 2, 2021 and December 28, 2019, the total unrecognized compensation expense for unvested Class B units was $4,401 and $673 respectively. This expense is expected to be recorded over a weighted-average period of 2.3 years.

9. Equity-Based Compensation and Contingent Consideration (continued)

Compensation expense for the Class C-1 and Class-2 will be recorded upon satisfaction of liquidity conditions, based on the fair value of the award at the date the liquidity condition is satisfied. As of January 2, 2021 and December 28, 2019, the fair value of the Class C units was $13,673 and $1,712, respectively. In fiscal years 2020 and 2019, no compensation expense was recognized for these units, as no liquidity conditions were satisfied.

A summary of equity-based compensation award activity is presented below.

(units in thousands)	**Units**	**Fair Value**
Class B Units		
Granted	3,866.6	
Vested	(749.5)	
Forfeited	–	
Unvested as of December 28, 2019	3,117.1	$ 673
Granted	678.2	
Vested	(672.2)	
Forfeited	(636.5)	
Unvested as of January 2, 2021	**2,486.6**	**$ 4,401**
Class C-1 Units		
Granted	4,142.8	
Vested	–	
Forfeited	–	
Unvested as of December 28, 2019	4,142.8	$ 864
Granted	726.6	
Vested	–	
Forfeited	(764.8)	
Unvested as of January 2, 2021	**4,104.6**	**$ 7,060**
Class C-2 Units		
Granted	4,449.7	
Vested	–	
Forfeited	–	
Unvested as of December 28, 2019	4,449.7	$ 848
Granted	780.4	
Vested	–	
Forfeited	(821.5)	
Unvested as of January 2, 2021	**4,408.6**	**$ 6,613**
All unvested units as of January 2, 2021	**10,999.8**	**$ 18,074**

9. Equity-Based Compensation and Contingent Consideration (continued)

Contingent Consideration

Under the terms of the Merger Transaction discussed in Note 1, additional consideration of up to $22,500 may be payable contingent on a future sale of the Company and the achievement of certain minimum returns on the invested capital resulting from the sale, as defined in the agreement. With the assistance of an independent valuation specialist, the contingent consideration was remeasured to fair value. Included in Other liabilities is $21,870 as of January 2, 2021 and $2,717 as of December 28, 2019. The effect of the remeasurement is included in store, selling, general, and administrative expenses in the accompanying consolidated statements of operations.

The increased value of the equity-based compensation awards and contingent consideration as of January 2, 2021 is reflective of the anticipated equity sale referenced in subsequent events (Note 2).

10. Related-Party Transactions

The Company had the following transactions with the majority owner of Holdings:

Paid management fees of $2,250 and $2,320 ($2,250 and $2,320 expensed and $295 and $295 in prepaid expenses). Included in accrued liabilities were transaction costs of $10,500 and $0 for the fiscal years ended January 2, 2021 and December 28, 2019 pursuant to a services agreement. Management fees are included in store, selling, general and administrative expenses and transaction costs are included in transaction related costs and charges in the accompanying consolidated statements of operations.

Paid $2,634 and $1,679 in interest expense for the fiscal years ended January 2, 2021 and December 28, 2019, respectively, related to $18,000 of Subordinated Note indebtedness as of January 2, 2021 and December 28, 2019.

Exhibit 99.2

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

Introduction

The following unaudited pro forma combined financial statements as of and for the fiscal year ended December 26, 2020 are based on the historical financial statements of Franchise Group, Inc. ("Franchise Group" or the "Company"), Pet Supplies Plus, LLC and Subsidiaries ("Pet Supplies Plus" or "PSP") and American Freight Group, Inc. ("American Freight"), after giving effect to i) the transaction consummated pursuant to the Amended and Restated Equity Purchase Agreement (as amended, the "Purchase Agreement"), dated March 3, 2021, by and among the Company, solely for purposes of agreeing to the covenants set forth in Section 10.19 of the Purchase Agreement, Franchise Group Newco PSP, LLC, Delaware limited liability company and a subsidiary of the Company (the "Purchaser"), PSP Holdings, LLC, a Delaware limited liability company, Sentinel Capital Partners VI-A, L.P., a Delaware limited partnership, Sentinel PSP Blocker, Inc., a Delaware corporation, PSP Midco, LLC, a Delaware limited liability company ("PSP Midco"), PSP Intermediate, LLC, a Delaware limited liability company, Sentinel Capital Partners, L.L.C., a Delaware limited liability company, solely for purposes of agreeing to the covenants set forth in Section 6.8 and Section 6.9 of the Purchase Agreement, and PSP Midco Holdings, LLC, a Delaware limited liability company (collectively, the "Sellers"), pursuant to which the Purchaser acquired all of the outstanding equity interests of PSP Midco (the "PSP acquisition") and ii) the transaction consummated pursuant to the Agreement and Plan of Merger (as amended, the "Merger Agreement") by and among Franchise Group Newco Intermediate AF, LLC ("Parent"), American Freight, Franchise Group Merger Sub AF, Inc., a Delaware limited liability company and a subsidiary of Parent ("Merger Sub"), and The Jordan Company, L.P., a Delaware limited partnership, solely in its capacity as representative for the Fully-Diluted Stockholders (as defined in the Merger Agreement), pursuant to which, among other things, Merger Sub merged with and into American Freight, with American Freight surviving as a wholly owned subsidiary of Parent (the "American Freight merger").

The unaudited pro forma combined financial statements give effect to the PSP acquisition and American Freight merger as well as the related debt financings (collectively, the "Transactions"), including the pro forma adjustments intended to illustrate the estimated effects of the Transactions (collectively, "Adjustments" or "Transaction Accounting Adjustments").

The unaudited pro forma combined statement of operations for the fiscal year ended December 26, 2020 combines the historical consolidated statement of operations for the fiscal year ended December 26, 2020 of Franchise Group (that includes certain post-acquisition financial information of American Freight), the pre-acquisition historical consolidated statement of operations of American Freight for the period December 30, 2019 to February 14, 2020 derived from American Freight's books and records, and the historical consolidated statement of operations for the fiscal year ended January 2, 2021 of PSP giving effect to the Transactions as if they had occurred on December 29, 2019.

The unaudited pro forma combined balance sheet as of December 26, 2020 combines the historical consolidated balance sheet of Franchise Group as of December 26, 2020, which fully reflects the American Freight merger, and the historical consolidated balance sheet of PSP as of January 2, 2021, giving effect to the Transactions as if they had occurred on December 26, 2020.

The unaudited pro forma combined financial information is based on various adjustments and assumptions and is not necessarily indicative of what Franchise Group's consolidated statement of operations or consolidated balance sheet actually would have been had the Transactions been completed as of the dates indicated or will be for any future periods. The unaudited pro forma financial statements do not purport to project the future financial position or operating results of Franchise Group following the completion of the Transactions. The unaudited pro forma financial information does not include adjustments to reflect any potential synergies or cost savings that may be achievable in connection with the Transactions.

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 historical consolidated financial statements and related notes for the year ended December 26, 2020; and
- PSP's audited historical consolidated financial statements and related notes for the fiscal years ended January 2, 2021 and December 28, 2019.

Description of the Transactions

American Freight merger and the refinancing of Buddy's and Sears Outlet's term loan

On February 14, 2020, pursuant to the terms of the Merger Agreement, Franchise Group completed the acquisition of American Freight for $357.3 million in cash. The acquisition costs related to the American Freight acquisition were financed through a term loan and credit facility that were refinanced in connection with the PSP financing further discussed below.

Pet Supplies Plus acquisition and the refinancing of New Holdco's term loan and credit facility

On March 10, 2021, pursuant to the terms of the Purchase Agreement, Franchise Group completed the PSP acquisition in an all-cash transaction valued at approximately $453.3 million from affiliates of Sentinel Capital Partners. In connection with the PSP acquisition, the Company entered into commitments with its lenders for $1.3 billion in new term loan credit facilities to refinance its existing term loan and credit facility and to provide financing for the PSP acquisition:

- Term loan financing: On March 10, 2021, Franchise Group and various of its subsidiaries entered into a First Lien Credit Agreement with various lenders for an amount of $1 billion senior secured term loan ("First Lien Term Loan"). On the same date, the Company and various of its subsidiaries also entered into a Second Lien Credit Agreement with various lenders for a $300 million senior secured term loan ("Second Lien Term Loan", and together with the First Lien Term Loan, the "Term Loans"). The First Lien Term Loan will mature on March 10, 2026 and the Second Lien Term Loan will mature on September 10, 2026, unless the maturities are accelerated subject to the terms set forth in the Credit Agreements. The Term Loans will 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 4.75% with a 0.75% LIBOR floor for the First Lien Term Loan and an interest margin of 7.50% with a 1.00% LIBOR floor for the Second Lien Term Loan.

- ABL credit facility financing: On March 10, 2021, Franchise Group and various of its subsidiaries entered into a Third Amended and Restated Loan and Security Agreement with various lenders which provided Franchise Group with an aggregate commitment of a $150 million credit facility. The ABL credit facility will mature on March 10, 2026, unless the maturity is accelerated subject to terms set forth in the ABL Agreement. As of the closing date of the PSP acquisition, Franchise Group had not drawn down any amount from this credit facility.

Other transaction

On December 27, 2020, the Company completed the acquisition of Furniture Factory Ultimate Holding, L.P. ("FFO"), a regional retailer of furniture and mattresses, for an all cash purchase price of $13.8 million (the "FFO Acquisition"). In connection with the FFO Acquisition, the Company acquired 31 operating locations which the Company intends to rebrand to its existing American Freight reportable segment. The pro forma financial statements do not reflect the FFO Acquisition as it was not deemed significant pursuant to Rule 3-05 of Regulation S-X.

Unaudited Pro Forma Combined Statement of Operations
for the year ended December 26, 2020

(In thousands, except per share data)	Adjusted Franchise Group (Note 2a) Year Ended December 26, 2020	Adjusted Pet Supplies Plus (Note 2b) Year Ended January 2, 2021	Transaction Accounting Adjustments (Note 3 and 4)		Pro Forma Combined Year Ended December 26, 2020
Revenues:					
Product	$ 1,948,321	$ 822,457	$ -		$ 2,770,778
Service and other	188,575	23,503	-		212,078
Rental	64,267	-	-		64,267
Total revenues	**$ 2,201,163**	**$ 845,960**	**$ -**		**$ 3,047,123**
Operating Expenses:					
Cost of revenue:					
Product	1,163,596	524,292	4,828	(3k)	1,692,716
Service and other	2,149	-	-		2,149
Rental	21,905	-	-		21,905
Total cost of revenue	**$ 1,187,650**	**$ 524,292**	**$ 4,828**		**$ 1,716,770**
Selling, general, and administrative expenses	947,325	339,312	(3,586)	(3i)	1,285,209
			2,158	(3j)	
Total operating expenses	2,134,975	863,604	3,400		3,001,979
Income (loss) from operations	**$ 66,188**	**$ (17,644)**	**$ (3,400)**		**$ 45,144**
Other income (expense):					
Interest expense, net	(101,751)	(20,229)	24,471	(4c)	(97,509)
Other	(5,187)	(351)	(30,360)	(4d)	(35,898)
Income (loss) before income taxes	(40,750)	(38,224)	(9,289)		(88,263)
Income tax expense (benefit)	(60,433)	219	(12,249)	(4e)	(72,463)
Net income (loss)	**$ 19,683**	**$ (38,443)**	**$ 2,960**		**$ (15,800)**
Less: Net (income) loss attributable to non-controlling interest	$ -	$ -	$ -		$ -
Net (loss) income attributable to Franchise Group, Inc.	**$ 19,683**	**$ (38,443)**	**$ 2,960**		**$ (15,800)**
Net income (loss) per share of common stock:					
Basic	$ 0.57				$ (0.46)
Diluted (a)	$ 0.56				$ (0.46)
Weighted-average shares outstanding:					
Basic	34,531,362				34,531,362
Diluted (a)	34,971,935				34,531,362

(a) Due to the pro forma combined net loss for the year ended December 26, 2020, dilutive common share equivalents were excluded from diluted weighted average common shares outstanding as they would have been anti-dilutive.

Unaudited Pro Forma Combined Balance Sheet
as of December 26, 2020

(In thousands, except share count and per share data)	Historical: Franchise Group As of December 26, 2020	Historical: Adjusted Pet Supplies Plus (Note 2b) As of January 2, 2021	Transaction Accounting Adjustments (Note 3 and 4)		Pro Forma Combined As of December 26, 2020
Assets					
Current assets:					
Cash and cash equivalents	$ 151,502	$ 32,983	$ (455,480)	(3a)	$ 102,621
			373,615	(4a)	
Current receivables, net	90,610	29,964			120,574
Inventories, net	302,307	96,558	4,828	(3b)	403,693
Other current assets	20,772	12,076	6,000	(3a)	38,848
Total Current Assets	**$ 565,191**	**$ 171,581**	**$ (71,036)**		**$ 665,736**
Operating lease right-of-use assets	510,875		129,433	(3d)	640,308
Property, equipment, and software, net	143,506	75,070			218,576
Non-current receivables, net	16,689				16,689
Goodwill	456,977	72,363	283,812	(3e)	813,152
Intangible assets, net	134,695	142,657	84,843	(3c)	362,195
Other non-current assets	9,728	10,399	300	(4b)	16,391
			(353)	(3l)	
			(3,683)	(3d)	
Total Assets	**$ 1,837,661**	**$ 472,070**	**$ 423,316**		**$ 2,733,047**
Liabilities and Equity					
Current liabilities:					
Current installments of long-term obligations	105,388	13,035	(104,731)	(4b)	13,692
Accounts payable and accrued expenses	265,016	98,057	(2,293)	(4b)	366,780
			6,000	(3a)	
Current operating lease liabilities	131,690		25,558	(3d)	157,248
Other current liabilities	36,879				36,879
Total Current Liabilities	**$ 538,973**	**$ 111,092**	**$ (75,467)**		**$ 574,598**
Long-term obligations, excluding current installments	468,655	230,652	511,300	(4b)	1,217,984
			7,377	(3l)	
Non-current operating lease liabilities	407,014	-	104,672	(3d)	511,686
Other non-current liabilities	37,852	41,084	(556)	(3g)	75,573
			(2,010)	(3d)	
			(797)	(3d)	
Total Liabilities	**$ 1,452,494**	**$ 382,828**	**$ 544,520**		**$ 2,379,842**
Stockholders and Members' equity:					
Preferred stock, $0.01 par value per share,	13				13
Common stock, $0.01 par value per share	401				401
Additional paid-in capital	382,383				382,383
Accumulated other comprehensive loss, net of taxes	(1,399)				(1,399)
Retained earnings	3,769	89,242	(90,844)	(3h)	(28,193)
			(30,360)	(4d)	
Total Equity	**$ 385,167**	**$ 89,242**	**$ (121,204)**		**$ 353,205**
Total Liabilities and Equity	**$ 1,837,661**	**$ 472,070**	**$ 423,316**		**$ 2,733,047**

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 as amended by the final rule, Release No. 33-10786 “Amendments to Financial Disclosures about Acquired and Disposed Businesses.” The pro forma statement of operations and pro forma balance sheet of the combined company are based on the historical financial statements of Franchise Group, American Freight, and PSP (the “Combined Company”), after giving effect to the Transactions as described above. The historical financial statements of Franchise Group, American Freight, and PSP have been adjusted in the accompanying pro forma financial statements to reflect Transaction Accounting Adjustments that depict the estimated accounting effects of the Transactions in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”).

The Transactions are accounted for using the acquisition method of accounting with Franchise Group considered the accounting and legal acquirer of PSP and American Freight. The unaudited pro forma financial statements reflect the preliminary assessment of fair values and useful lives assigned to the assets acquired and liabilities assumed. Fair value estimates were determined based on preliminary valuation analysis. The detailed valuation studies necessary to arrive at the required estimates of the fair values for the PSP assets acquired and liabilities assumed have not been completed. Since this pro forma financial information has been prepared based on preliminary estimates of consideration and fair values attributable to the PSP acquisition and American Freight merger, the actual amounts eventually recorded for the purchase accounting, including the identifiable intangibles and goodwill, may differ materially from the information presented.

Note 2: Adjustments to American Freight’s and PSP’s Historical Financial Statements

(2a) Adjustments to Franchise Group’s historical financial statements:

The Franchise Group adjusted combined statement of operations for the year ended December 26, 2020 was prepared by combining the historical consolidated statement of operations for the year ended December 26, 2020 of Franchise Group, the pre-acquisition operations of American Freight for the period December 30, 2019 to February 14, 2020, and the Transaction Accounting Adjustments related to the American Freight merger for the period December 31, 2019 to February 14, 2020. No corresponding adjustments to the unaudited pro forma income statement for the period February 15, 2020 to December 26, 2020 are recorded as they have been reflected in the Franchise Group’s audited statement of operations for the year ended December 26, 2020.

Unaudited Pro Forma Combined Statement of Operations
for the year ended December 26, 2020

Dollars in thousands, except per share amounts	**Historical Franchise Group** **Year Ended December 26, 2020**	**Historical American Freight** **For the period December 30, 2019 to February 14, 2020**	**Transaction Accounting Adjustments** **American Freight Transaction**		**Adjusted Franchise Group** **Year Ended December 26, 2020**
Revenue:					
Product	$ 1,899,662	$ 48,659			$ 1,948,321
Service and other	188,575				188,575
Rental	64,267				64,267
Total revenues	**$ 2,152,504**	**$ 48,659**	**$ -**		**$ 2,201,163**
Operating expenses:					
Cost of revenue:					
Product	1,136,054	27,542			1,163,596
Service and other	2,149				2,149
Rental	21,905				21,905
Total cost of revenue	1,160,108	27,542	-		1,187,650
Selling, general, and administrative expenses	916,274	30,729	322	(2a1)	947,325
Total operating expenses	**$ 2,076,382**	**$ 58,271**	**$ 322**		**$ 2,134,975**
Income (Loss) from operations	**$ 76,122**	**$ (9,612)**	**$ (322)**		**$ 66,188**
Other income (expense):					
Interest expense, net	(101,751)	(624)	624	(2a2)	(101,751)
Other	(5,187)				(5,187)
Loss before income taxes	**$ (30,816)**	**$ (10,236)**	**$ 302**		**$ (40,750)**
Income tax (benefit) expense	(57,970)	(2,541)	78	(2a3)	(60,433)
Net loss	**$ 27,154**	**$ (7,695)**	**$ 224**		**$ 19,683**
Less: Net loss attributable to non-controlling interest	(2,090)	-	2,090	(2a4)	-
Net loss attributable to Franchise Group, Inc.	**$ 25,064**	**$ (7,695)**	**$ 2,314**		**$ 19,683**

(2a1) Represents $0.3 million adjustment to selling, general, and administrative expenses related to American Freight's fair value adjustments to leases and property, equipment and software for the period December 30, 2019 to February 14, 2020. No corresponding adjustment was made to the unaudited pro forma balance sheet as the historical audited balance sheet of Franchise Group as of December 26, 2020 already reflects the American Freight merger.

(2a2) Represents the elimination of the American Freight's historical term loan interest incurred from December 30, 2019 to February 14, 2020 prior to the American Freight merger.

(2a3) Represents the adjustment to income tax expense. The income tax expense is calculated based on the pre-tax adjustment of American Freight's Transaction Accounting Adjustment and the estimated U.S. statutory tax rates of the of 25.8% for the year ended December 26, 2020. 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.

(2a4) Represents the adjustment to reclassify the income (loss) attributable to non-controlling interests to income (loss) attributable to common stockholders given the full exchange of New Holdco common units held by Buddy's equity members into Franchise Group common shares.

(2b) Reclassification of PSP's historical financial statements:

Certain reclassifications have been made to the historical presentation of the statement of operations and balance sheet of PSP 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 and balance sheet for the year ended and as of December 26, 2020.

Pet Supplies Plus Statement of Operations
For the Year Ended January 2, 2021

(in thousands)	Before Adjustment	Reclassification	After Adjustment
Revenue			
Retail sales	$ 579,216	$ (579,216)	$ -
Wholesale sales	243,241	(243,241)	-
Product	-	822,457	822,457
Royalties	14,894	(14,894)	-
Franchise fees	528	(528)	-
Service fees, advertising, and other revenue	8,081	(8,081)	-
Service and other	-	23,503	23,503
Cost of revenue			
Cost of goods sold	524,292	(524,292)	-
Product		524,292	524,292
Gross profit	321,668	-	321,668
Store, selling, general, and administrative expenses	272,359	(272,359)	-
Depreciation and amortization	37,907	(37,907)	-
Impairment expense	994	(994)	-
Loss on sale of retail stores	182	(182)	-
Loss on closure of retail stores	370	(370)	-
Loss of sale or disposal of assets	2,045	(2,045)	-
Selling, general, and administrative expenses	-	339,312	339,312
Operating income	$ 7,811	$ (25,455)	$ (17,644)
Interest expense, net	(20,229)		(20,229)
Transaction related costs and charges	(25,455)	25,455	-
Other	(351)		(351)
Total other expense	$ (46,035)	$ 25,455	$ (20,580)
Provision for state and local income taxes	219	(219)	-
Income tax expense (benefit)	-	219	219
Net (loss) income	**$ (38,443)**	**$ -**	**$ (38,443)**

Pet Supplies Plus, LLC and Subsidiaries Balance Sheet

As of January 2, 2021

(in thousands)	Before Reclassification	Reclassification	As Adjusted
Assets			
Cash and cash equivalents	$ 32,983		$ 32,983
Accounts receivable, net	29,964	(29,964)	-
Current receivables, net	-	29,964	29,964
Prepaid expenses and other current assets	12,076	(12,076)	-
Other current assets	-	12,076	12,076
Inventories, net	96,558		96,558
Total Current Assets	171,581	-	171,581
Property, equipment, and software, net	75,070		75,070
Goodwill	72,363		72,363
Intangible assets, net	142,657		142,657
Other assets	10,399	(10,399)	-
Other non-current assets	-	10,399	10,399
Total Assets	$ 472,070	$ -	$ 472,070
Liabilities and Equity			
Account payable	41,927	(41,927)	-
Accrued liabilities	56,130	(56,130)	-
Accounts payable and accrued expenses	-	98,057	98,057
Current portion of long-term debt	13,035	(13,035)	-
Current installments of long-term obligations	-	13,035	13,035
Total Current Liabilities	111,092	-	111,092
Long term debt, net of current portion	230,652	(230,652)	-
Long-term obligations, excluding current installments	-	230,652	230,652
Other liabilities	41,084	(41,084)	-
Other non-current liabilities	-	41,084	41,084
Total Liabilities	$ 382,828	$ -	$ 382,828
Stockholders' Equity			
Member's equity	89,242	(89,242)	-
Retained earnings	-	89,242	89,242
Total Stockholders' Equity	89,242	-	89,242
Total Liabilities and Equity	$ 472,070	$ -	$ 472,070

Note 3: Preliminary Fair Value Estimate of Assets Acquired and Liabilities Assumed

The unaudited pro forma combined balance sheet as of December 26, 2020 has been adjusted to reflect the preliminary allocation of purchase price to identifiable assets acquired and liabilities assumed related to PSP, with the excess recorded as goodwill. The historical audited balance sheet of Franchise Group as of December 26, 2020 already reflects the American Freight merger. The unaudited pro forma statement of operations for the year ended December 26, 2020 gives effect to the American Freight merger and PSP acquisition as if they occurred on December 29, 2019. The pro forma adjustments to the income statement related to the American Freight merger are reflected in Note 2a above and the pro forma adjustments to the income statement related to the PSP acquisition are reflected in the note herein.

Estimated purchase price and purchase price allocation of PSP

Below includes the preliminary calculation of assets acquired and liabilities assumed performed for the purpose of these unaudited pro forma financial statements. The allocation of the purchase price to the fair values of the assets acquired and liabilities assumed includes pro forma adjustments to the fair values of PSP assets and liabilities. At the time of this filing, the Company has not finalized the detailed valuation analysis related to the fair values of identifiable assets acquired and liabilities assumed. The final amounts recorded for the acquisition may differ materially from the information presented below. The preliminary purchase price for PSP is estimated to be $453.3 million cash consideration, net of cash acquired.

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

(in thousands)	January 2, 2021 Pet Supplies Plus Historical Information	Pet Supplies Plus Fair Value and Accounting Policy Adjustments		Purchase Price Allocation
Cash and cash equivalents	$ 32,983			$ 32,983
Current receivables, net	29,964			29,964
Inventories, net	96,558	4,828	(3b)	101,386
Other current assets	12,076			12,076
Operating lease right-of-use assets	-	129,433	(3d)	129,433
Property, equipment, and software, net	75,070			75,070
Intangible assets, net	142,657	84,843	(3c)	227,500
Goodwill	72,363	283,812	(3e)	356,175
Other non-current assets	10,399	(353)	(3l)	6,363
		(3,683)	(3d)	
Total assets acquired	**$ 472,070**	**$ 498,880**		**$ 970,950**
Accounts payable and accrued expenses	98,057			98,057
Current portion of operating lease liabilities	-	25,558	(3d)	25,558
Current installments of long-term obligations	13,035			13,035
Long-term obligations, excluding current installments	230,652	7,377	(3l)	238,029
Non-current operating lease liabilities	-	104,672	(3d)	104,672
Other non-current liabilities	41,084	(2,010)	(3d)	38,277
		(797)	(3d)	
Total liabilities assumed	**$ 382,828**	**$ 134,800**		**$ 517,628**
Historical equity value of PSP				
Retained earnings	89,242	(89,242)	(3f)	-
Total equity	**$ 89,242**	**$ (89,242)**		**$ 453,322**

(3a) Represents adjustments related to the payment of the cash purchase price of PSP and the estimated Transaction-related costs, as follows:

Pro forma adjustment to cash		**Cash**
(in thousands)		
Purchase price of Pet Supplies Plus	$	(453,322)
Transaction-related costs		(2,158)
Pro forma adjustment to cash	**$**	**(455,480)**

$6.0 million of the cash purchase price was placed in an escrow account to be delivered to the seller pending certain conditions as contemplated in the Purchase Agreement. This amount has been classified as restricted cash.

(3b) Represents adjustments to record the preliminary fair value of PSP's inventory resulting in an increase of $4.8 million over the carrying value. The fair value of inventory was determined using a "market approach", which is a commonly accepted valuation approach resulting in a 5% increase of the carrying value. The Company is in the process of performing a more detailed valuation analysis the result of which may differ materially from this preliminary analysis.

(3c) Represents adjustments to record the preliminary fair value of PSP's intangible assets resulting in an increase of $84.8 million and related to trade names, trademarks, franchise rights, customer relationships and customer lists. The fair values of these intangible assets were determined using an "income approach", which is a commonly accepted valuation approach. The Company is in the process of performing a more detailed valuation analysis the result of which may differ materially from this preliminary analysis.

(3d) Represents adjustments to align the accounting policies of PSP to reflect the adoption of the new lease standard – ASC 842, including adjustments to the operating lease right-of-use assets of $129.4 million, the current operating lease liabilities of $25.6 million, and non-current operating lease liabilities of $104.7 million. In addition, PSP's historical deferred rent of $2.0 million and historical ASC 420 cease use liability of $0.8 million were also eliminated in connection with the adoption of the new lease standard. PSP's historical net favorable lease balance of $3.7 million is also eliminated as the book value of PSP's leases equates to their fair value based on a preliminary valuation analysis. The Company is in the process of performing a more detailed valuation analysis the result of which may differ materially from this preliminary analysis.

(3e) Represents the excess of the purchase price over the preliminary fair value of the underlying net intangible and identifiable tangible assets, net of liabilities, which is an estimated increase of $283.8 million over PSP's book value of goodwill prior to the acquisition. The estimated goodwill to be recognized is attributable to the assembled workforce and operational synergies in the expected franchise models.

(3f) Represents the elimination of PSP's historical retained earnings of $89.2 million in connection with the acquisition.

(3g) Represents $2.2 million of additional Transaction-related expenses that were incurred subsequent to December 26, 2020 to close the PSP Transaction. Therefore, an adjustment, net of tax, of $1.6 million is reflected to retained earnings along with a reduction of income tax liabilities by $0.6 million.

(3h) Represents the overall adjustment to retained earnings as described in (3f) and (3g) above and as follows:

Pro forma adjustment to retained earnings		**Retained earnings**
(in thousands)		
Pet Supplies Plus PPA adjustment	$	(89,242)
Transaction-related costs net tax		(1,602)
Pro forma adjustment to retained earnings	**$**	**(90,844)**

(3i) Represents the ($3.6) million adjustment to selling, general, and administrative expenses in connection with the intangible assets and property, equipment and software fair value step-up of those of PSP, as described in (3c) above:

	Pet Supplies Plus			
	Fair Value	**Estimated Useful Life**	**Amortization Method**	**Amortization expense For the year ended January 2, 2021**
Trade names and trademarks	65,331	Indefinite	N/A	-
PSP trade name	39,669	Indefinite	N/A	-
Franchise rights	96,119	15.0	Straight-line	6,408
Customer relationships	26,381	12.0	Straight-line	2,198
Total acquired intangible assets	227,500			8,606
Less: historical intangible assets				(12,192)
Pro forma adjustment				**$ (3,586)**

(3j) Represents the $2.2 million adjustment to selling, general, and administrative expenses in connection with the additional Transaction-related expenses that were incurred subsequent to December 26, 2020 to close the PSP acquisition as described in (3a) and (3g) above.

(3k) Represents the $4.8 million adjustment to cost of revenue in connection with the preliminary fair value adjustments to increase PSP's inventory estimated to turn in approximately 2 months. The corresponding adjustment to the unaudited pro forma balance sheet is described in (3b) above.

(3l) Represents the $0.4 million adjustment to the unamortized deferred financing cost on PSP's existing revolver and the $7.4 million adjustment to the unamortized deferred financing cost on PSP's existing term loan.

Note 4: Calculation of Transaction Financing

In connection with the PSP acquisition, Franchise Group entered into commitments with its lenders for $1.3 billion in new term loans and $150 million in credit facilities to refinance its existing term loan and credit facility as described above, and to provide financing for the PSP acquisition. The pro forma balance sheet reflects the issuance of debt to finance the PSP acquisition and repay the existing New Holdco term loan and credit facility, and the Vitamin Shoppe credit facility. Franchise Group entered into new term loan agreements with various lenders for an amount of $1.3 billion which consists of a $1 billion First Lien Term Loan and a $300 million Second Lien Term Loan. Franchise Group also entered an ABL credit facility which provides for an aggregate of $150 million commitment. None was drawn down on the ABL credit facility as of the closing date of the PSP acquisition of March 10, 2021. The pro forma adjustments, as illustrated below, reflect the incurrence of the debt, net of financing costs and the repayment of the existing New Holdco term loan and credit facility, and the Vitamin Shoppe credit facility.

(4a) A summary of the total pro forma adjustments to cash related to the transaction financing include the following:

Pro forma adjustment to cash	**Issuance of New PSP term loans**	**Prepayment of PSP's term loan and credit facility**	**Prepayment of New Holdco's term loan and credit facility**	**Prepayment of Vitamin Shoppe's credit facility**	**Total**
(in thousands)					
Increase from issuance of PSP term loan	1,222,269				1,222,269
Repayment of PSP's existing term loan		(249,265)			(249,265)
Repayment of New Holdco's existing term loan and credit facility			(551,260)		(551,260)
Repayment of Vitamin Shoppe's existing credit facility				(48,128)	(48,128)
Pro forma adjustment to cash	1,222,269	(249,265)	(551,260)	(48,128)	**$ 373,615**

(4b) The total pro forma adjustment to debt and the credit facility includes the following:

Pro forma adjustment to debt	**Issuance of New PSP term loan and credit facility**	**Prepayment of PSP's term loan and credit facility**	**Prepayment of New Holdco's term loan and credit facility**	**Prepayment of Vitamin Shoppe's credit facility**	**Total**
(in thousands)					
Term loan financing	$ 1,300,000				1,300,000
Less: Debt issuance costs	(76,185)				(76,185)
Debt, net of debt issuance costs	1,223,815	-	-	-	1,223,815
Pro forma adjustment to current portion of debt:	10,000	(11,421)	(25,000)		**$ (26,421)**
Pro forma adjustment to debt, net of current portion:	1,213,815	(235,679)	(466,836)	-	**$ 511,300**
Pro forma adjustment to revolver	-	-	(30,310)	(48,000)	**$ (78,310)**
Pro forma adjustment to other non-current assets (deferred financing costs)	1,546			(1,246)	**$ 300**

In addition, there is a $2.3 million pro forma adjustment to accrued interest on the repayment of debt, including $0.1 million related to Vitamin Shoppe's credit facility and $2.2 million related to PSP's term loan and credit facility.

(4c) A summary of the total pro forma adjustments to interest expense includes the following:

Pro forma adjustment to interest expense					
(in thousands)	**New Holdco**	**Vitamin Shoppe**	**PSP**		**Total**
Estimated interest expense on new financing (1)			80,292		80,292
Elimination of historical interest expenses (2)	(84,979)	(11,899)	(20,229)		(117,107)
Amortization of deferred debt issuance costs (3)			12,344		12,344
Total pro forma adjustment to interest expense				**$**	**(24,471)**

(1) Represents the additional interest expense calculated at a 5.50% estimated interest rate in connection with the First Lien Term Loan and an 8.50% estimated interest rate in connection with the Second Lien Term Loan. The estimated interest rates and adjustments are based on current LIBOR rates and estimated interest rate spreads in accordance with the terms of the executed credit agreements.

(2) Represents the elimination of New Holdco's, Vitamin Shoppe's and PSP's historical interest expense as a result of the extinguishment of its historical term loans and lines of credit pursuant to the acquisition agreements.

(3) Represents the amortization of the estimated deferred financing costs in connection with the First Lien Term Loan, the Second Lien Term Loan, and the ABL credit facility.

A 0.125% change in the interest assumed above would result in an aggregate increase or decrease to interest expense of $1.6 million for the year ended December 26, 2020.

(4d) Represents a $30.4 million adjustment to retained earnings as it relates to the unamortized debt issuance cost on the existing indebtedness of New Holdco and Vitamin Shoppe. The corresponding $30.4 million adjustment on the unaudited pro forma income statement is recorded under other income (expense) as these expenses are non-recurring in nature.

(4e) Represents adjustments to income tax benefit. The income tax benefit adjustment is calculated by applying the estimated U.S. statutory tax rates of 25.8% for the year ended December 26, 2020 to the historical PSP pre-tax loss of $38.2 million as PSP was historically a pass-through entity and to the $20.1 million pre-tax pro forma adjustments of PSP, resulting in a net pro forma adjustment of $4.7 million. 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, the realizability of income tax benefits and income tax reserves determined in connection with the acquisition and tax planning.