ABM INDUSTRIES INC /DE/
Form 10-Q
September 08, 2016

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

FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2016
or
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-8929
ABM INDUSTRIES INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	94-1369354
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Liberty Plaza, 7th Floor
New York, New York 10006
(Address of principal executive offices)

(212) 297-0200
(Registrant's telephone number, including area code)

551 Fifth Avenue, Suite 300
New York, New York 10176
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

Large accelerated filer	þ	Accelerated filer	¨	Non-accelerated filer	¨	Smaller reporting company	¨

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

Number of shares of the registrant’s common stock outstanding as of September 1, 2016: 55,756,099

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES

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FORWARD-LOOKING STATEMENTS

This Form 10-Q contains both historical and forward-looking statements regarding ABM Industries Incorporated ("ABM") and its subsidiaries (collectively referred to as "ABM," "we," "us," "our," or the "Company"). We make forward-loo statements related to future expectations, estimates, and projections that are uncertain and often contain words such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "likely," "may," "outlook," "plan," "predict," "shou similar words or phrases. These statements are not guarantees of future performance and are subject to known and unknown risks, uncertainties, and assumptions that are difficult to predict. For us, particular uncertainties that could cause our actual results to be materially different from those expressed in our forward-looking statements include:

- the extent to which changes to our business, operating structure, capital structure, or personnel relating to the implementation of our 2020 Vision strategic transformation initiative are successful;
- the effectiveness of our risk management and safety programs;
- the extent to which changes in estimates of ultimate insurance losses could result in a material charge against our earnings;
- our ability to preserve long-term client relationships;
- our ability to attract and retain qualified personnel and senior management;
- our success in identifying, acquiring, and integrating synergistic businesses;
- our ability to continue to gain business despite competitive pressures;
- the impact of costs that we cannot pass through to clients;
- the effect of negative or unexpected tax consequences;
- the achievement of expected benefits from our captive insurance company;
- the impact of losses from accidents or other incidents at facilities in which we operate;
- changes in energy prices and government regulations;
- significant delays or reductions in appropriations for our government contracts;
- potential failure of our joint venture partners to perform their obligations;
- the effect of changes to federal health care reform legislation;
- potential cyber-security breaches, information technology interruptions, data loss, or business continuity risks;
- the effectiveness of managing operations in areas of military conflict;
- the impact of general reductions in commercial office building occupancy;
- the impact of deterioration in general economic conditions;
- client-specific developments, such as financial difficulties or bankruptcy;
- future increases in the level of our debt or in interest rates;
- our ability to fund our operations and pay our debt obligations;
- impairment of goodwill and long-lived assets;
- unfavorable developments in our class and representative actions and other lawsuits alleging various claims;
- changes in immigration laws or enforcement actions or investigations under such laws;
- the impact of liabilities associated with participation in multiemployer pension plans;
- disruptions to our business through the actions of activist investors; and
- weather conditions, catastrophic events and disasters, and terrorist attacks.

The list of factors above is illustrative and by no means exhaustive. Additional information regarding these and other risks and uncertainties we face is contained in our Annual Report on Form 10-K for the year ended October 31, 2015 and in other reports we file from time to time with the Securities and Exchange Commission (including all amendments to those reports).

We urge readers to consider these risks and uncertainties in evaluating our forward-looking statements. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law.

PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.
ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in millions, except share and per share amounts)	July 31, 2016	October 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$51.6	$ 55.5
Trade accounts receivable, net of allowances of $17.3 and $8.6 at July 31, 2016 and October 31, 2015, respectively	774.1	742.9
Prepaid expenses	92.7	68.6
Other current assets	27.6	27.0
Total current assets	946.0	894.0
Other investments	29.6	35.7
Property, plant and equipment, net of accumulated depreciation of $170.9 and $148.7 at July 31, 2016 and October 31, 2015, respectively	76.8	74.0
Other intangible assets, net of accumulated amortization of $168.2 and $149.4 at July 31, 2016 and October 31, 2015, respectively	111.5	111.4
Goodwill	910.6	867.5
Deferred income taxes, net	32.7	34.1
Other noncurrent assets	132.2	114.0
Total assets	$2,239.4	$ 2,130.7
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Trade accounts payable	$177.5	$ 179.1
Accrued compensation	128.9	128.8
Accrued taxes—other than income	44.0	31.6
Insurance claims	92.9	90.0
Income taxes payable	0.6	8.9
Other accrued liabilities	144.1	129.8
Total current liabilities	588.0	568.2
Noncurrent income taxes payable	34.2	53.2
Line of credit	224.3	158.0
Noncurrent insurance claims	329.7	297.4
Other noncurrent liabilities	65.3	46.4
Total liabilities	1,241.5	1,123.2
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value; 500,000 shares authorized; none issued	—	—
Common stock, $0.01 par value; 100,000,000 shares authorized; 55,804,814 and 56,105,761 shares issued and outstanding at July 31, 2016 and October 31, 2015, respectively	0.6	0.6
Additional paid-in capital	262.0	275.5
Accumulated other comprehensive loss, net of taxes	(22.6)	(5.1)
Retained earnings	757.9	736.5
Total stockholders' equity	997.9	1,007.5
Total liabilities and stockholders' equity	$2,239.4	$ 2,130.7

See accompanying notes to unaudited consolidated financial statements.

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended July 31,		Nine Months Ended July 31,	
(in millions, except per share amounts)	2016	2015	2016	2015
Revenues	$1,296.9	$1,249.9	$3,822.4	$3,620.8
Expenses				
Operating	1,166.5	1,156.3	3,445.2	3,281.9
Selling, general and administrative	102.8	92.8	295.1	282.1
Restructuring and related	3.3	2.2	19.3	2.2
Amortization of intangible assets	5.8	6.2	18.8	18.2
Total expenses	1,278.4	1,257.5	3,778.4	3,584.4
Operating profit (loss)	18.5	(7.6)	44.0	36.4
Income from unconsolidated affiliates, net	2.1	2.6	5.3	6.3
Interest expense	(2.6)	(2.4)	(7.7)	(7.6)
Income (loss) from continuing operations before income taxes	18.0	(7.4)	41.6	35.1
Income tax benefit (provision)	14.9	8.6	11.7	(3.6)
Income from continuing operations	32.9	1.2	53.3	31.5
Net (loss) income from discontinued operations	(1.8)	0.3	(3.9)	6.0
Net income	31.1	1.5	49.4	37.5
Other comprehensive income (loss):				
Foreign currency translation	(12.6)	0.1	(17.0)	(1.6)
Other	(0.6)	0.1	(0.5)	0.1
Comprehensive income	$17.9	$1.7	$31.9	$36.0
Net income per common share — Basic:				
Income from continuing operations	$0.58	$0.02	$0.94	$0.56
(Loss) income from discontinued operations	(0.03)	0.01	(0.06)	0.10
Net income	$0.55	$0.03	$0.88	$0.66
Net income per common share — Diluted:				
Income from continuing operations	$0.58	$0.02	$0.94	$0.55
(Loss) income from discontinued operations	(0.03)	0.01	(0.07)	0.10
Net income	$0.55	$0.03	$0.87	$0.65
Weighted-average common and common equivalent shares outstanding				
Basic	56.2	56.8	56.4	56.7
Diluted	56.8	57.5	56.9	57.4
Dividends declared per common share	$0.165	$0.160	$0.495	$0.480

See accompanying notes to unaudited consolidated financial statements.

ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended July 31,	
(in millions)	2016	2015
Cash flows from operating activities:		
Net income	$49.4	$37.5
Net loss (income) from discontinued operations	3.9	(6.0)
Income from continuing operations	53.3	31.5
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	43.1	42.6
Deferred income taxes	2.1	0.2
Share-based compensation expense	11.7	10.1
Provision for bad debt	11.5	0.2
Discount accretion on insurance claims	0.2	0.2
Gain on sale of assets	(0.1)	(2.4)
Income from unconsolidated affiliates, net	(5.3)	(6.3)
Distributions from unconsolidated affiliates	6.4	5.4
Changes in operating assets and liabilities, net of effects of acquisitions:		
Trade accounts receivable	(26.7)	(28.8)
Prepaid expenses and other current assets	(4.2)	(2.6)
Other noncurrent assets	(21.7)	0.2
Trade accounts payable and other accrued liabilities	9.7	27.7
Insurance claims	32.5	41.4
Income taxes payable	(20.0)	(17.1)
Other noncurrent liabilities	6.0	2.6
Total adjustments	45.2	73.4
Net cash provided by operating activities of continuing operations	98.5	104.9
Net cash used in operating activities of discontinued operations	(25.6)	(3.5)
Net cash provided by operating activities	72.9	101.4
Cash flows from investing activities:		
Additions to property, plant and equipment	(27.4)	(20.9)
Proceeds from sale of assets	0.6	4.5
Purchase of businesses, net of cash acquired	(81.0)	(19.2)
Proceeds from redemption of auction rate security	5.0	—
Investments in unconsolidated affiliates	—	(0.1)
Net cash used in investing activities of continuing operations	(102.8)	(35.7)
Net cash used in investing activities of discontinued operations	(3.1)	(0.2)
Net cash used in investing activities	(105.9)	(35.9)
Cash flows from financing activities:		
Proceeds from issuance of share-based compensation awards, net of taxes withheld	5.7	16.5
Incremental tax benefit from share-based compensation awards	—	1.7
Repurchases of common stock	(31.2)	(20.0)
Dividends paid	(27.7)	(27.0)
Deferred financing costs paid	(0.1)	(0.3)
Borrowings from line of credit	779.3	729.3
Repayment of borrowings from line of credit	(713.0)	(744.0)
Financing of energy savings performance contracts	15.3	—

Changes in book cash overdrafts	1.8	(5.3)
Repayment of capital lease obligations	(1.0)	(1.9)
Net cash provided by (used in) financing activities	29.1	(51.0)
Net (decrease) increase in cash and cash equivalents	(3.9)	14.5
Cash and cash equivalents at beginning of year	55.5	36.7
Cash and cash equivalents at end of period	$51.6	$51.2

See accompanying notes to unaudited consolidated financial statements.

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ABM INDUSTRIES INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. THE COMPANY AND NATURE OF OPERATIONS

ABM Industries Incorporated, which operates through its subsidiaries (collectively referred to as “ABM,” “we,” “us,” “our,” or the “Company”), is a leading provider of integrated facility solutions, customized by industry, that enable our clients to deliver exceptional facilities experiences. ABM’s comprehensive capabilities include airport operation support services, commercial cleaning, electrical and lighting maintenance, energy solutions, facilities engineering, HVAC and mechanical maintenance services, landscaping, and parking. We provide custom facility solutions in urban, suburban, and rural areas to properties of all sizes—from schools and commercial buildings to airports, hospitals, and manufacturing plants.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared in accordance with (i) United States generally accepted accounting principles (“U.S. GAAP”) for interim financial information and (ii) the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

In the opinion of our management, our unaudited consolidated financial statements and accompanying notes (the “Financial Statements”) include all normal recurring adjustments that are necessary for the fair statement of the interim periods presented. Interim results of operations are not necessarily indicative of the results for the full year. The Financial Statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) in our Annual Report on Form 10-K for the fiscal year ended October 31, 2015 (“Annual Report”). Unless otherwise noted, all references to years are to our fiscal year, which ends on October 31.

Rounding

We round amounts in the Financial Statements to millions and calculate all percentages and per-share data from the underlying whole-dollar amounts. As a result, certain amounts may not foot, crossfoot, or recalculate based on reported numbers due to rounding.

Accounting Pronouncements Adopted During the Quarter

Effective November 1, 2015, we early adopted Accounting Standards Update (“ASU”) 2016-09, Improvements to Employee Share-Based Payment Accounting. Prior to the adoption of this guidance, we recognized the income tax effects of vested or settled awards in additional paid-in capital. This ASU requires prospective recognition of these excess tax benefits and deficiencies in the income statement. As a result, for the three and nine months ended July 31, 2016, we recognized a $1.8 million benefit within our income tax provision, or $0.03 per diluted share, related to excess tax benefits that occurred between November 1, 2015 and July 31, 2016. The activity related to the first and second quarter was not material. As required by this ASU, we have classified these excess tax benefits as cash flows from operating activities for the nine months ended July 31, 2016, rather than cash flows from financing activities. Pursuant to the new guidance, we elected not to adjust the prior period cash flows from operating activities for the nine months ended July 31, 2015. In regards to this ASU’s forfeiture policy election, we will continue to estimate the number of awards expected to vest, rather than electing to account for forfeitures as they occur.

Accounting Pronouncements Adopted During the Year

During the first quarter of 2016, we early adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes, on a retrospective basis. As a result, all deferred tax assets and liabilities are now classified as noncurrent on our consolidated balance sheets.

Prior Year Reclassifications

(in millions)	Previously Reported October 31, 2015	Adjustment	Revised October 31, 2015
Deferred income tax asset, net (current)	$ 53.2	$ (53.2)	$ —
Deferred income tax liability, net (noncurrent)	$ 19.1	$ (19.1)	$ —
Deferred income tax asset, net (noncurrent)	$ —	$ 34.1	$ 34.1

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In addition, we reclassified prior year amounts throughout the Financial Statements to conform to the current year presentation of discontinued operations. See Note 4, "Discontinued Operations," for more information.

Parking Revenue Presentation

Our Parking business operates certain parking facilities under managed location arrangements. Under these arrangements, we manage the parking facility for a management fee and pass through the revenue and expenses associated with the facility to the owner. These revenues and expenses are reported in equal amounts for costs reimbursed from our managed locations.

Management Reimbursement Revenues

(in millions)	Three Months Ended July 31, 2016	2015	Nine Months Ended July 31, 2016	2015
Management reimbursement revenues	$81.3	$78.5	$243.8	$230.6

3. RESTRUCTURING AND RELATED COSTS

On September 2, 2015, our Board of Directors approved a comprehensive strategy intended to have a positive transformative effect on ABM (the "2020 Vision"). As part of the 2020 Vision, we identified a number of key priorities to differentiate ABM in the marketplace, improve our margin profile, and accelerate revenue growth for certain industry groups. We also reviewed all service lines and investments to assess whether ABM was positioned to continue to competitively offer value-added services to clients over the long term.

From the inception of our 2020 Vision in the fourth quarter of 2015, we have incurred cumulative restructuring and related charges of $31.9 million, consisting of external support fees of $14.3 million, employee severance costs of $12.0 million, lease exit and other costs of $3.1 million, and asset impairment costs of $2.6 million. The results by segment exclude these costs, consistent with the manner in which our management evaluates the performance of each reportable segment based on its respective operating profit results. As such, restructuring and related costs are included within Corporate expenses. See Note 15, "Segment Information," for more information.

Reconciliation of Restructuring and Related Cost Accrual

(in millions)	External Support Fees	Employee Severance	Lease Exit and Other	Total
Balance, November 1, 2015	$ 2.1	$ 4.3	$ 0.2	$ 6.6
Costs recognized	9.8	7.2	2.3	19.3
Payments	(11.5)	(7.0)	(2.0)	(20.4)
Balance, July 31, 2016	$ 0.4	$ 4.6	$ 0.5	$ 5.5

4. DISCONTINUED OPERATIONS

On October 26, 2015, in connection with our 2020 Vision, we sold substantially all of the assets of our Security business to Universal Protection Service, LP ("UPS") for cash proceeds of $131.0 million, subject to a working capital adjustment. In the second quarter of 2016, the working capital adjustment related to the sale was finalized, resulting in a payment to UPS of $3.1 million. We reduced the gain on sale recorded in the fourth quarter of 2015 by the amount of this adjustment.

Our discontinued operations is comprised of amounts that were directly related to the operations of this former business, including certain costs that were previously recorded in Corporate expenses. In addition, certain general corporate expenses that were previously allocated to the former Security business are now allocated to Corporate expenses and to the Janitorial segment. Discontinued operations also includes both costs related to ongoing legal cases and insurance reserves associated with the former Security business. We will continue to reflect these types of costs within discontinued operations in future periods. Refer to Note 15, "Segment Information," for further information.

Summarized Results of Operations and Cash Flows from Discontinued Operations

	Three Months Ended July 31,		Nine Months Ended July 31,	
(in millions)	2016	2015	2016	2015
Revenues	$—	$98.9	$—	$287.5
Expenses	2.9	98.6	4.7	281.2
Working capital adjustment to previously recorded gain	—	—	3.1	—
(Loss) income from discontinued operations before income taxes	(2.9)	0.3	(7.8)	6.3
Income tax benefit (provision)[1]	1.1	—	3.9	(0.3)
Net (loss) income from discontinued operations	$(1.8)	$0.3	$(3.9)	$6.0
Net cash used in operating activities of discontinued operations[2]			$(25.6)	$(3.5)

[1] For the nine months ended July 31, 2016, the income tax benefit includes the retroactive reinstatement of the Work Opportunity Tax Credits ("WOTC").

[2] During the first quarter of 2016, we paid $20.6 million in taxes in connection with the sale of our Security business.

5. ACQUISITIONS

2016 Acquisition

Effective December 1, 2015, we acquired all of the outstanding stock of Westway Services Holdings (2014) Ltd. ("Westway"), a provider of technical engineering services to clients in the United Kingdom, for a purchase price of $81.0 million. This acquisition allowed us to expand our higher margin technical services business to new and existing clients in the United Kingdom, resulting in the allocation of a significant portion of the purchase price to goodwill. As such, we recorded goodwill and intangible assets of $50.0 million and $22.2 million, respectively, which are subject to adjustments within one year from the acquisition date. The goodwill associated with this acquisition is not deductible for tax purposes. As of December 1, 2015, the operations of Westway are included in our Building & Energy Solutions segment.

2015 Acquisition

Effective May 1, 2015, we acquired certain assets and assumed certain liabilities of CTS Services/Facility Support Services ("CTS"), a provider of HVAC services and energy solutions in government, commercial, and industrial buildings, for a purchase price of $18.8 million. The purchase price includes $3.8 million of contingent consideration that is based on the expected achievement of certain pre-established revenue goals. See Note 7, "Fair Value of Financial Instruments," regarding the valuation of the contingent consideration liability. As of May 1, 2015, the operations of CTS are included in our Building & Energy Solutions segment.

Pro Forma and Other Supplemental Financial Information

Pro forma and other supplemental financial information is not presented for these acquisitions, as they are not considered material business combinations.

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6. NET INCOME PER COMMON SHARE

Basic and Diluted Net Income Per Common Share Calculations

(in millions, except per share amounts)	Three Months Ended July 31, 2016	2015	Nine Months Ended July 31, 2016	2015
Income from continuing operations	$32.9	$1.2	$53.3	$31.5
Net (loss) income from discontinued operations	(1.8)	0.3	(3.9)	6.0
Net income	$31.1	$1.5	$49.4	$37.5
Weighted-average common and common equivalent shares outstanding — Basic	56.2	56.8	56.4	56.7
Effect of dilutive securities:				
Restricted stock units	0.3	0.4	0.2	0.3
Stock options	0.2	0.2	0.2	0.3
Performance shares	0.1	0.1	0.1	0.1
Weighted-average common and common equivalent shares outstanding — Diluted	56.8	57.5	56.9	57.4
Net income per common share — Basic:				
Income from continuing operations	$0.58	$0.02	$0.94	$0.56
(Loss) income from discontinued operations	(0.03)	0.01	(0.06)	0.10
Net income	$0.55	$0.03	$0.88	$0.66
Net income per common share — Diluted:				
Income from continuing operations	$0.58	$0.02	$0.94	$0.55
(Loss) income from discontinued operations	(0.03)	0.01	(0.07)	0.10
Net income	$0.55	$0.03	$0.87	$0.65

Anti-Dilutive Outstanding Stock Awards Issued Under Share-Based Compensation Plans:

(in millions)	Three Months Ended July 31, 2016	2015	Nine Months Ended July 31, 2016	2015
Anti-dilutive	—	0.1	0.1	0.2

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7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Hierarchy of Our Financial Instruments

(in millions)	Fair Value Hierarchy	Fair Value July 31, 2016	Fair Value October 31, 2015
Financial assets measured at fair value on a recurring basis			
Assets held in funded deferred compensation plan[1]	1	$4.9	$ 5.3
Investments in auction rate securities[2]	3	8.0	13.0
Other select financial assets			
Cash and cash equivalents[3]	1	51.6	55.5
Insurance deposits[4]	1	11.2	11.4
Financial liabilities measured at fair value on a recurring basis			
Interest rate swaps[5]	2	1.0	0.1
Contingent consideration liability[6]	3	5.2	5.2
Other select financial liability			
Line of credit[7]	2	224.3	158.0

(1) Represents investments held in a Rabbi trust associated with one of our deferred compensation plans, which we include in "Other noncurrent assets" on the accompanying unaudited consolidated balance sheets. The fair value of the assets held in the funded deferred compensation plan is based on quoted market prices.

(2) For investments in auction rate securities, the fair value was based on discounted cash flow valuation models, primarily utilizing unobservable inputs. These amounts are included in "Other investments" on the accompanying unaudited consolidated balance sheets. See Note 9, "Auction Rate Securities," for further information.

(3) Cash and cash equivalents are stated at nominal value, which equals fair value.

(4) Represents restricted insurance deposits that are used to collateralize our insurance obligations and are stated at nominal value, which equals fair value. These insurance deposits are included in "Other noncurrent assets" on the accompanying unaudited consolidated balance sheets. See Note 10, "Insurance," for further information.

(5) Represents interest rate swap derivatives designated as cash flow hedges. The fair values of the interest rate swaps are estimated based on the present value of the difference between expected cash flows calculated at the contracted interest rates and the expected cash flows at current market interest rates using observable benchmarks for LIBOR forward rates at the end of the period. For 2016 the interest rate swaps were included in "Other noncurrent liabilities," and for 2015 the interest rate swaps were included in "Other accrued liabilities" on the accompanying unaudited consolidated balance sheets. See Note 11, "Line of Credit," for more information.

(6) Certain of our acquisitions involve the payment of contingent consideration. Depending on the structure of the contingent consideration arrangement, the fair value of the liability is based on either (i) the expected achievement of certain pre-established revenue goals or (ii) pre-defined forecasted adjusted income from operations using a probability weighted income approach. Our contingent consideration liabilities are included in "Other accrued liabilities" on the accompanying unaudited consolidated balance sheets.

(7) Represents outstanding borrowings under our syndicated line of credit. Due to variable interest rates, the carrying value of outstanding borrowings under our line of credit approximates the fair value. See Note 11, "Line of Credit," for further information.

Our non-financial assets, which include goodwill and long-lived assets held and used, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required, we would evaluate the non-financial assets for impairment. If an impairment were to occur, the asset would be recorded at the estimated fair value, which is determined using discounted future cash flows for goodwill or undiscounted future cash flows for long-lived assets.

During the nine months ended July 31, 2016, we had no transfers of assets or liabilities between any of the above hierarchy levels.

8. ADVANCES TO JOINT VENTURES

We make various advances to our unconsolidated joint ventures to provide working capital for the joint ventures' operations, which are not collateralized, do not carry interest, and have no specific repayment terms. At each of July 31, 2016 and October 31, 2015, the aggregate amount of these advances were $1.1 million. These amounts are included in "Other noncurrent assets" on the accompanying unaudited consolidated balance sheets.

9. AUCTION RATE SECURITIES

At October 31, 2015, we held investments in auction rate securities from three different issuers that had an aggregate original principal amount of $15.0 million and an amortized cost and fair value of $13.0 million. During the second quarter of 2016, one of our auction rate securities was redeemed by the issuer at its par value of $5.0 million. No gain or loss was recognized upon its redemption.

At July 31, 2016, the two remaining auction rate securities had an aggregate original principal amount of $10.0 million and an amortized cost and fair value of $8.0 million. These two auction rate securities are debt instruments with stated maturities in 2036 and 2050. The interest rates for these securities are designed to be reset through Dutch auctions approximately every thirty days, but auctions for these securities have not occurred since August 2007.

At July 31, 2016 and October 31, 2015, there were no unrealized gains or losses on our auction rate securities included in accumulated other comprehensive loss, net of taxes ("AOCL"), and the total amount of other-than-temporary impairment credit loss on our auction rate security investments included in our retained earnings was $2.0 million.

Significant Assumptions Used to Determine the Fair Values of Our Auction Rate Securities

Assumption	July 31, 2016	October 31, 2015
Discount rates	L + 0.53% and L + 1.44%	L + 0.38% – L + 2.13%
Yields	2.15%, L + 2.00%	2.15%, L + 2.00%
Average expected lives	4 – 10 years	4 – 10 years

L – One Month LIBOR

10. INSURANCE
We use a combination of insured and self-insurance programs to cover workers’ compensation, general liability, automobile liability, property damage, and other insurable risks. For the majority of these insurance programs, we retain the initial $1.0 million of exposure on a per-occurrence basis, either through deductibles or self-insured retentions. Beyond the retained exposures, we have varying primary policy limits ranging between $1.0 million and $5.0 million per occurrence. To cover general liability and automobile liability losses above these primary limits, we maintain commercial umbrella insurance policies that provide aggregate limits of $200.0 million. Our insurance policies generally cover workers’ compensation losses to the full extent of statutory requirements. Additionally, to cover property damage risks above our retained limits, we maintain policies that provide per occurrence limits of $75.0 million. We are also self-insured for certain employee medical and dental plans. We retain up to $0.4 million of exposure on a per participant per-year basis with respect to claims under our medical plan.
The adequacy of our reserves for workers’ compensation, general liability, automobile liability, and property damage insurance claims is based upon known trends and events and the actuarial estimates of required reserves considering the most recently completed actuarial reports. We use all available information to develop our best estimate of insurance claims reserves as information is obtained. The results of actuarial studies are used to estimate our insurance rates and insurance reserves for future periods and to adjust reserves, if appropriate, for prior years. During 2016, we performed both our annual actuarial evaluation and an actuarial review. As a result of these studies, we increased our reserves for claims related to prior periods by $31.8 million during the nine months ended July 31, 2016, as described below.
Annual Actuarial Evaluations Performed During the Third Quarter of 2016
During the three months ended July 31, 2016, annual actuarial evaluations were performed for the majority of our casualty insurance programs. These evaluations excluded claims relating to certain previously acquired businesses. We expect to complete the evaluation of those claims in the fourth quarter of 2016. These evaluations considered all changes made to claims reserves and claim payment activity for the period commencing May 1, 2015 and ending April 30, 2016 (the “Evaluation Period”). We performed these evaluations for all policy years in which open claims existed.
The annual actuarial evaluations completed to date show unfavorable developments in our estimate of ultimate losses related to general liability, workers’ compensation, and automobile liability claims, as explained below. While we have made significant improvements in our risk management programs, the actuarial evaluation demonstrates these improvements have had a modest impact on prior years and that the impact is not occurring at the pace originally forecasted by the actuaries.
The actuarial evaluations related to our general liability program showed that the total number of claims has remained relatively stable for prior years. However, we experienced adverse developments in prior year claims, which are largely attributable to adjustments on certain property damage claims, in addition to losses for alleged bodily injuries. These fact patterns developed subsequent to the actuarial review performed in the first quarter of 2016 and resulted in increases to our estimate of ultimate losses. Also contributing to the increase in projected cost estimates was a higher than expected average incurred cost for our less severe claims observed during the Evaluation Period.
Our workers’ compensation estimate of ultimate losses was negatively impacted by increases in projected costs for a significant number of prior year claims in California and New York. These claims have been impacted by statutory, regulatory, and legal implications. In California, we also experienced increases in severity of claims and in frequency of claims beyond that previously projected in the actuarial review performed in the first quarter of 2016.
Our automobile liability program covers our fleet of passenger vehicles, service vans, and shuttle buses, which are associated with our various transportation service contracts. Claim frequency and severity associated with our fleet operations developed unfavorably versus actuarial expectations. The adverse development was primarily attributable to claims in 2013 through 2015.
After analyzing the recent loss development patterns, comparing the loss development against benchmarks, and applying actuarial projection methods to determine the estimate of ultimate losses, we increased our total reserves by $19.8 million during the third quarter of 2016.

Actuarial Review Performed During the First Quarter of 2016

During the three months ended January 31, 2016, an actuarial review was performed for the majority of our casualty insurance programs that indicated unfavorable developments in our estimates of ultimate losses related to certain general liability, workers' compensation, and automobile liability claims, as described below. This review considered all changes made to claims reserves and claim payment activity for the period commencing May 1, 2015 and ending October 31, 2015 (the "Review Period"). We performed this review for all policy years in which open claims existed.

For our general liability program, claim frequency was generally consistent with our expectations. However, the actuarial review identified adverse developments in prior year claims. The adverse developments can be largely attributed to increases in the projected costs to resolve several high exposure claims within our retained limits. Also contributing to the increase in projected cost estimates was a higher than expected average incurred cost for our less severe claims observed during the Review Period.

Our workers' compensation estimate of ultimate losses was negatively impacted by increases in projected costs for a significant number of prior year claims in New York. These claims have been impacted by increases in statutory benefits and a slowing of claims closures observed during the Review Period. In California, we experienced increases in severity of claims and in frequency of claims beyond that previously projected.

For our automobile liability program, the increase in the projected cost estimates was primarily associated with significant claim reserve adjustments for a small population of high exposure claims within the 2013 policy year. Also contributing to the increase in projected estimates was an increase in claims frequency in the 2015 policy year observed during the Review Period.

As a result of these developments in our casualty insurance programs, we increased our reserves for known claims as well as our estimate of the loss amounts associated with incurred but not reported claims. As a result of this actuarial review, we increased our reserves for claims related to prior periods by $6.0 million at January 31, 2016. As we continued to see a similar trend in adverse developments, we increased our reserves by an additional $6.0 million, resulting in a total increase to our reserves for claims related to prior periods of $12.0 million at April 30, 2016.

At July 31, 2016 and October 31, 2015, we had insurance claim reserves totaling $422.6 million and $387.4 million, respectively, which included $6.7 million and $8.1 million in reserves, respectively, related to our medical and dental self-insured plans. At July 31, 2016 and October 31, 2015, we also had insurance recoverables, which we include in "Other current assets" and "Other noncurrent assets" on the accompanying unaudited consolidated balance sheets, totaling $69.9 million and $65.9 million, respectively.

Instruments Used to Collateralize Our Insurance Obligations

(in millions)	July 31, 2016	October 31, 2015
Standby letters of credit	$ 120.1	$ 105.4
Surety bonds	57.2	55.9
Restricted insurance deposits	11.2	11.4
Total	$ 188.5	$ 172.7

11. LINE OF CREDIT

On November 30, 2010, we entered into a syndicated credit agreement pursuant to which we obtained an unsecured revolving credit facility (the "Facility"). This credit agreement, as amended from time to time, is referred to as the "Credit Agreement." We can borrow up to $800.0 million under our Credit Agreement, and we have the option to increase the size of the Facility to $1.0 billion at any time prior to the December 11, 2018 expiration date (subject to receipt of commitments for the increased amount from existing and new lenders).

Borrowings under the Facility bear interest at a rate equal to an applicable margin plus, at our option, either a (i) eurodollar rate (generally LIBOR) or (ii) base rate determined by reference to the highest of (1) the federal funds rate plus 0.50%, (2) the prime rate published by Bank of America, N.A. from time to time, and (3) the eurodollar rate plus 1.00%. The applicable margin is a percentage per annum varying from zero to 0.75% for base rate loans and 1.00% to 1.75% for eurodollar loans, based upon our leverage ratio. We also pay a commitment fee, based on the leverage ratio, payable quarterly in arrears, ranging from 0.200% to 0.275% on the average daily unused portion of the Facility. For purposes of this calculation, irrevocable standby letters of credit, which are issued primarily in conjunction with our insurance programs, and cash borrowings are included as outstanding under the Facility.

The Credit Agreement contains certain financial covenants that include a maximum leverage ratio of 3.25 to 1.0 (except as described below) and a minimum fixed charge coverage ratio of 1.50 to 1.0. In addition, we are required to maintain a consolidated net worth in an amount not less than the sum of (i) $570.0 million, (ii) 50% of our consolidated net income (with no deduction for net loss), and (iii) 100% of our aggregate increases in stockholders' equity beginning on November 30, 2010. In the event of a material acquisition, as defined in the Credit Agreement, we may elect to increase the leverage ratio to 3.50 to 1.0 for a total of four fiscal quarters. As of July 31, 2016, we were in compliance with these covenants.

If an event of default occurs under the Credit Agreement, including certain cross-defaults, insolvency, change in control, or violation of specific covenants, the lenders can terminate or suspend our access to the Facility, declare all amounts outstanding under the Facility (including all accrued interest and unpaid fees) to be immediately due and payable, and require that we cash collateralize the outstanding standby letters of credit.

The Facility is available for working capital, the issuance of up to $300.0 million for standby letters of credit, the issuance of up to $50.0 million in swing line advances, the financing of capital expenditures, and other general corporate purposes, including acquisitions and investments in subsidiaries, subject to certain limitations, where applicable, as set forth in the Credit Agreement. The availability of our borrowing capacity is subject to, and limited by, compliance with the covenants described above.

Facility Information

(in millions)	July 31, 2016	October 31, 2015
Cash borrowings	$224.3	$158.0
Standby letters of credit	132.7	112.9
Borrowing capacity	443.0	529.1

Interest Rate Swaps

We enter into interest rate swaps to manage the interest rate risk associated with our floating-rate, LIBOR-based borrowings under our Facility. Under these arrangements, we typically pay a fixed interest rate in exchange for LIBOR-based variable interest throughout the life of the agreement.

During the second quarter of 2016, several interest rate swaps matured that had an underlying aggregate notional amount of $155.0 million. During April and May 2016, we entered into three new interest rate swap agreements with an underlying aggregate notional amount of $105.0 million, a fixed interest rate of 1.05%, and effective dates of April 7, 2016 and May 11, 2016. These swaps were designated and accounted for as cash flow hedges from inception and mature on April 7, 2021 and May 11, 2021.

We recognize interest rate swaps on the accompanying unaudited consolidated balance sheets at fair value. The fair value of our interest rate swaps are estimated based on the present value of the difference between expected cash flows calculated at the contracted interest rates and the expected cash flows at current market interest rates

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using observable benchmarks for LIBOR forward rates at the end of the period. See Note 7, “Fair Value of Financial Instruments,” for more information.

The effective portion of the derivative’s mark-to-market gain or loss is initially reported as a component of AOCL and subsequently reclassified into earnings when the hedged transactions occur and affect earnings. The ineffective portion of the gain or loss is reported in earnings immediately. Interest payables and receivables under the swap agreements are accrued and recorded as adjustments to interest expense.

At July 31, 2016 and October 31, 2015, the amounts recorded in AOCL were $0.5 million and $0.1 million, respectively. At July 31, 2016, the amount expected to be reclassified from AOCL to earnings during the next twelve months was $0.2 million.

12. COMMITMENTS AND CONTINGENCIES

Letters of Credit and Surety Bonds

We use letters of credit and surety bonds to secure certain commitments related to insurance programs and for other purposes. As of July 31, 2016, these letters of credit and surety bonds totaled $132.7 million and $392.8 million, respectively.

Guarantees

In some instances, we offer certain clients guaranteed energy savings under certain energy savings contracts. At July 31, 2016 and October 31, 2015, total guarantees were $91.9 million and $90.5 million, respectively, and these guarantees extend through 2031 and 2030, respectively. We accrue for the estimated cost of guarantees when it is probable that a liability has been incurred and the amount can be reasonably estimated. Historically, we have not incurred any material losses in connection with these guarantees.

In connection with an unconsolidated joint venture in which one of our subsidiaries has a 33% ownership interest, that subsidiary and the other joint venture partners have each jointly and severally guaranteed the obligations of the joint venture to perform under certain contracts extending through 2018. Annual revenues relating to the underlying contracts are approximately $35.0 million. Should the joint venture be unable to perform under these contracts, the joint venture partners would be jointly and severally liable for any losses incurred by the client due to the failure to perform.

Legal Matters

We are a party to a number of lawsuits, claims, and proceedings incident to the operation of our business, including those pertaining to labor and employment, contracts, personal injury, and other matters, some of which allege substantial monetary damages. Some of these actions may be brought as class actions on behalf of a class or purported class of employees.

At July 31, 2016, the total amount accrued for all probable litigation losses where a reasonable estimate of the loss could be made was $9.2 million. This $9.2 million includes the accrual of $4.8 million in connection with the settlement of certain cases alleging wage and hour violations. Litigation outcomes are difficult to predict and the estimation of probable losses requires the analysis of multiple possible outcomes that often depend on judgments about potential actions by third parties. There is the potential for a material adverse effect on our financial statements if one or more matters are resolved in a particular period in an amount materially in excess of what we anticipated.

We do not accrue for contingent losses that, in our judgment, are considered to be reasonably possible but not probable. The estimation of reasonably possible losses also requires the analysis of multiple possible outcomes that often depend on judgments about potential actions by third parties. Our management currently estimates the range of loss for all reasonably possible losses for which a reasonable estimate of the loss can be made is between zero and $15 million, which excludes the Augustus and Bucio cases discussed below. Factors underlying this estimated range of loss may change from time to time, and actual results may vary significantly from this estimate.

In some cases, although a loss is probable or reasonably possible, we cannot reasonably estimate the maximum potential losses for probable matters or the range of losses for reasonably possible matters. Therefore, our accrual for probable losses and our estimated range of loss for reasonably possible losses do not represent our maximum possible exposure.

While the results of these proceedings, claims, and inquiries cannot be predicted with any certainty, our management believes that the final outcome of these matters will not have a material adverse effect on our consolidated financial statements, results of operations, or cash flows.

Certain Legal Proceedings

Certain pending lawsuits to which we are a party are discussed below. In determining whether to include any particular lawsuit or other proceeding, we consider both quantitative and qualitative factors. These factors include, but are not limited to: the amount of damages and the nature of any other relief sought in the proceeding; if such damages and other relief are specified, our view of the merits of the claims; whether the action is or purports to be a class action, and our view of the likelihood that a class will be certified by the court; the jurisdiction in which the proceeding is pending; and the potential impact of the proceeding on our reputation.

The Consolidated Cases of Augustus, Hall, and Davis v. American Commercial Security Services, filed July 12, 2005, in the Superior Court of California, Los Angeles County (the "Augustus case")

The Augustus case is a certified class action involving alleged violations of certain California state laws relating to rest breaks. The case centers on whether requiring security guards to remain on call during rest breaks violated Section 226.7 of the California Labor Code. On February 8, 2012, the plaintiffs filed a motion for summary judgment on the rest break claim, and on July 31, 2012, the Superior Court of California, Los Angeles County (the "Superior Court"), entered judgment in favor of plaintiffs in the amount of approximately $89.7 million (the "common fund"). Subsequently, the Superior Court also awarded plaintiffs' attorneys' fees of approximately $4.5 million in addition to approximately 30% of the common fund. We appealed the Superior Court's rulings to the Court of Appeals of the State of California, Second Appellate District (the "Appeals Court"). On December 31, 2014, the Appeals Court issued its opinion, reversing the judgment in favor of the plaintiffs and vacating the award of $89.7 million in damages and the attorneys' fees award. Plaintiffs requested rehearing of the Appeals Court's decision to reverse the judgment in favor of plaintiffs and vacate the damages award. On January 29, 2015, the Appeals Court denied the plaintiffs' request for rehearing, modified its December 31, 2014 opinion, and certified the opinion for publication. The Appeals Court opinion held that "on-call rest breaks are permissible" and remaining on call during rest breaks does not render the rest breaks invalid under California law. The Appeals Court explained that "although on-call hours constitute 'hours worked,' remaining available to work is not the same as performing work.... Section 226.7 proscribes only work on a rest break." The plaintiffs filed a petition for review with the California Supreme Court on March 4, 2015, and on April 29, 2015, the California Supreme Court granted the plaintiffs' petition. Oral argument has been scheduled for September 29, 2016. We believe that the Appeals Court correctly ruled in our favor, and we look forward to presenting our arguments to the California Supreme Court.

The Consolidated Cases of Bucio and Martinez v. ABM Janitorial Services filed on April 7, 2006, in the Superior Court of California, County of San Francisco (the "Bucio case")

The Bucio case is a purported class action involving allegations that we failed to track work time and provide breaks. On April 19, 2011, the trial court held a hearing on plaintiffs' motion to certify the class. At the conclusion of that hearing, the trial court denied plaintiffs' motion to certify the class. On May 11, 2011, the plaintiffs filed a motion to reconsider, which was denied. The plaintiffs have appealed the class certification issues. The trial court stayed the underlying lawsuit pending the decision in the appeal. On August 30, 2012, the plaintiffs filed their appellate brief on the class certification issues. We filed our responsive brief on November 15, 2012. Oral argument relating to the appeal has not been scheduled.

Other

During October 2011, we began an internal investigation into matters relating to compliance with the U.S. Foreign Corrupt Practices Act and our internal policies in connection with services provided by a foreign entity affiliated with a former joint venture partner of The Linc Group, LLC ("Linc"). Such services commenced prior to the acquisition of Linc. As a result of the investigation, we caused Linc to terminate its association with the arrangement. In December 2011, we contacted the U.S. Department of Justice and the Securities and Exchange Commission to voluntarily disclose the results of our internal investigation to date, and we are cooperating with the government's investigation.

We cannot reasonably estimate the potential liability, if any, related to these matters. However, based on the facts currently known, we do not believe that these matters will have a material adverse effect on our business, financial position, results of operations, or cash flows.

13. COMMON STOCK

On September 2, 2015, our Board of Directors authorized the repurchase of up to $200.0 million shares of our common stock under a new share repurchase program, which replaced a previously authorized repurchase program. Purchases may take place on the open market or otherwise, and all or part of the repurchases may be made pursuant to Rule 10b5-1 plans or in privately negotiated transactions. The timing of repurchases is at our discretion and will depend upon several factors, including market and business conditions, share price, and share availability. Repurchased shares are retired and returned to an authorized but unissued status. The repurchase program may be suspended or discontinued at any time without prior notice. At July 31, 2016, authorization for $157.3 million of repurchases remained under our share repurchase program.

Repurchase Activity

	Nine Months Ended July 31,	
(in millions, except per share amounts)	2016	2015
Total number of shares repurchased	1.0	0.6
Average price paid per share	$31.42	$32.23
Total cash paid for share repurchases	$31.2	$20.0

14. INCOME TAXES

Our quarterly provision for income taxes is calculated using an estimated annual effective income tax rate, which is adjusted for discrete items that occur during the reporting period.

Our income taxes for the three and nine months ended July 31, 2016 were favorably impacted by a benefit of $19.0 million, including interest of $1.0 million, related to expiring statutes of limitations, $1.8 million in benefits resulting from the adoption of ASU 2016-09, and the positive impact of the 2016 WOTC. In addition, the nine months ended July 31, 2016 also benefited from $4.9 million of WOTC from the retroactive reinstatement of the WOTC for calendar year 2015 and $1.2 million of tax deductions for energy efficient government buildings.

Our income taxes for the three and nine months ended July 31, 2015 were favorably impacted by a benefit of $3.4 million related to expiring statutes of limitations and $1.8 million of tax deductions for energy efficient government buildings. In addition, the nine months ended July 31, 2015 also benefited from $3.6 million of WOTC from the retroactive reinstatement of the WOTC for calendar year 2014 and $1.8 million of state employment-based tax credits.

15. SEGMENT INFORMATION

During the fourth quarter of 2015, we sold our Security business, which was previously a separate reportable segment. This business is now included within discontinued operations for all periods presented, and we have revised our segment results accordingly. Refer to Note 4, “Discontinued Operations,” for further information. We currently have five reportable segments: Janitorial, Facility Services, Parking, Building & Energy Solutions, and Other.

The accounting policies for our segments are the same as those disclosed within our significant accounting policies in Note 2, “Basis of Presentation and Significant Accounting Policies.” Our management evaluates the performance of each reportable segment based on its respective operating profit results, which include the allocation of certain centrally incurred costs. Corporate expenses not allocated to segments include:

- certain CEO and other finance and human resource departmental costs;
- certain information technology costs;
- share-based compensation costs;
- certain legal costs and settlements;
- restructuring and related costs;
- certain adjustments resulting from actuarial developments of self-insurance reserves; and
- direct acquisition costs.

Financial Information by Reportable Segment

	Three Months Ended July 31,		Nine Months Ended July 31,	
(in millions)	2016	2015	2016	2015
Revenues:				
Janitorial	$691.8	$678.5	$2,063.9	$2,004.0
Facility Services	146.2	147.3	447.6	449.3
Parking	167.7	162.0	494.4	471.2
Building & Energy Solutions	167.8	149.1	470.7	390.0
Other	123.5	113.0	345.8	306.3
	$1,296.9	$1,249.9	$3,822.4	$3,620.8
Operating profit (loss):[1]				
Janitorial	$43.8	$32.9	$112.3	$106.6
Facility Services	7.9	6.0	19.9	18.5
Parking	7.6	7.8	19.0	21.0
Building & Energy Solutions	10.5	8.1	19.9	12.5
Other	5.8	4.5	11.1	10.1
Corporate	(55.8)	(62.5)	(132.4)	(124.2)
Adjustment for income from unconsolidated affiliates, net, included in Building & Energy Solutions	(1.3)	(2.6)	(4.6)	(6.3)
Adjustment for tax deductions for energy efficient government buildings, included in Building & Energy Solutions	(0.1)	(1.8)	(1.2)	(1.8)
	18.5	(7.6)	44.0	36.4
Income from unconsolidated affiliates, net	2.1	2.6	5.3	6.3
Interest expense	(2.6)	(2.4)	(7.7)	(7.6)
Income (loss) from continuing operations before income taxes	$18.0	$(7.4)	$41.6	$35.1

[1] In connection with the sale of our Security business, certain general corporate expenses that were previously allocated to Security are now allocated to Corporate expenses and to the Janitorial segment. In addition, certain Corporate expenses that were directly related to the operations of our former Security business have been allocated to discontinued operations. The net impact of these changes is as follows:

(in millions)	Three Months Ended	Nine Months Ended

	July 31, 2015	July 31, 2015
Janitorial	(0.5)	(1.6)
Corporate	3.2	2.8

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to facilitate an understanding of the results of operations and financial condition of ABM Industries Incorporated and its subsidiaries (collectively referred to as "ABM," "we," "us," "our," or the "Company"). This MD&A is provided as a supplement to, and should be read in conjunction with, our unaudited consolidated financial statements and the accompanying notes ("Financial Statements") and our Annual Report on Form 10-K for the year ended October 31, 2015 ("Annual Report"), which has been filed with the Securities and Exchange Commission ("SEC"). This MD&A contains forward-looking statements about our business, operations, and industry that involve risks and uncertainties, such as statements regarding our plans, objectives, expectations, and intentions. Our future results and financial condition may be materially different from those we currently anticipate. See "Forward-Looking Statements" for more information. Throughout the MD&A, amounts and percentages may not recalculate due to rounding. Unless otherwise noted, all information in the MD&A and references to years are based on our fiscal year, which ends on October 31. Our MD&A is comprised of the following sections:

- Business Overview
- Results of Operations
- Liquidity and Capital Resources
- Contingencies
- Critical Accounting Policies and Estimates
- Recent Accounting Pronouncements

Business Overview

ABM is a leading provider of integrated facility solutions, customized by industry, that enable our clients to deliver exceptional facilities experiences. In September 2015, following a comprehensive strategic review, we announced a transformation initiative (our "2020 Vision"), which we expect will drive long-term profitable growth and enhance shareholder value. During the fourth quarter of 2015, we launched our 2020 Vision and began to reorganize how we deliver services. We are pursuing an industry-based, go-to-market strategy that focuses on five groups: Aviation, Business and Industry, Education, Healthcare, and High Tech. Our technical services business complements these industry groups and supports our initiative to deliver value-added solutions through the ability to supply mechanical, electrical, and core services. In addition, we divested our Security business during the fourth quarter of 2015. The Security business is now included within discontinued operations for all periods presented, and we have revised our segment results accordingly.

In 2016, we will continue to execute our multi-phased 2020 Vision by focusing on organizational realignment, consistent excellence, cost optimization, and talent development. The elements of this strategy are described below.

- Organizational Realignment: Aligning our business operations for specific industries and developing custom client solutions will transform us into an integrated, industry-focused company, with a simplified organizational structure and a consolidated shared services model.
- Consistent Excellence: Implementing best practices in account management and labor management across the organization, and developing a more integrated approach for continuous improvement in our risk and safety programs.
- Cost Optimization: Leveraging our scale to manage costs more efficiently and effectively through enhanced procurement management.
- Talent Development: Creating greater opportunities and career paths for our employees, thereby laying the foundation for our future growth.

See "2016 Highlights—2020 Vision Restructuring" below for additional details on these initiatives.

2016 Highlights
2020 Vision Restructuring
In connection with the execution of our 2020 Vision, we anticipate total pre-tax restructuring and related charges will range from $45 million to $60 million. We expect these costs to consist of employee severance from $17 million to $20 million, external support fees from $14 million to $19 million, other project fees from $7 million to $8 million, lease exit costs related to real estate consolidation from $5 million to $10 million, and the write-down of certain investments from $2 million to $3 million. We anticipate that the majority of these charges will be incurred through the end of 2016. The following table represents costs incurred during the three and nine months ended July 31, 2016, and cumulative costs incurred from inception of our 2020 Vision in the fourth quarter of 2015.

(in millions)	Three Months Ended July 31, 2016	Nine Months Ended July 31, 2016	Cumulative
External Support Fees	$ 0.7	$ 9.8	$ 14.3
Employee Severance	1.7	7.2	12.0
Lease Exit and Other	0.9	2.3	3.1
Asset Impairment	—	—	2.6
Total	$ 3.3	$ 19.3	$ 31.9

Our 2020 Vision is expected to be fully implemented by the second half of 2017. We are anticipating an annualized run-rate for operational benefits in the range of $40 million to $50 million by the end of 2017. During the nine months ended July 31, 2016, we realized $12.9 million of savings in connection with this initiative.
In connection with our 2020 Vision, we are aligning our business operations to support specific industries through the creation of a new organizational structure. As part of this reorganization, we have eliminated several of our traditional personnel roles that existed under our service line structure, and we are in the process of selecting talent to fill newly created roles under our new organization. As such, we are benefiting from the timing of several investments in headcount that have not yet been made. While we expect to incur these personnel-related expenses in the future as these open positions are filled, it is difficult to predict the timing of when these hirings will occur. As such, we may continue to see this benefit in future months.
Insurance
During 2016, we performed both our annual actuarial evaluation and an actuarial review, as described below. As a result of these studies, we increased our reserves for claims related to prior periods by $31.8 million during the nine months ended July 31, 2016. Due to the actuarial evaluation completed during 2015, we increased our reserves for claims related to prior periods by $35.8 million during the three and nine months ended July 31, 2015. As such, on a year-over-year basis, there was a decrease in self-insurance expense related to prior year claims.
Annual Actuarial Evaluations Performed During the Third Quarter of 2016. During the three months ended July 31, 2016, annual actuarial evaluations were performed for the majority of our casualty insurance programs. These evaluations excluded claims relating to certain previously acquired businesses. We expect to complete the evaluation of those claims in the fourth quarter of 2016. These evaluations considered all changes made to claims reserves and claim payment activity for the period commencing May 1, 2015 and ending April 30, 2016 (the “Evaluation Period”). We performed these evaluations for all policy years in which open claims existed.
While we have made significant improvements in our risk management programs, the actuarial evaluation demonstrates these improvements have had a modest impact on prior years and that the impact is not occurring at the pace originally forecasted by the actuaries. The average claim cost was also unfavorably impacted by increases in legal fees, medical costs, and other claim management expenses necessary to adjudicate the claims with dates of loss prior to 2016.
The actuarial evaluations related to our general liability program showed that the total number of claims has remained relatively stable for prior years. However, we experienced adverse developments in prior year claims, which are largely attributable to adjustments on certain property damage claims, in addition to losses for alleged bodily injuries. These fact patterns developed subsequent to the actuarial review performed in the first quarter of 2016 and resulted in

increases to our estimate of ultimate losses. Also contributing to the increase in projected cost estimates was a higher than expected average incurred cost for our less severe claims observed during the Evaluation Period. The actuarial analysis also showed the total number of general liability claims improved in 2016. However, this trend data is not yet fully mature, therefore the ultimate claim and severity projections are subject to significant volatility.

Our workers' compensation estimate of ultimate losses was negatively impacted by increases in projected costs for a significant number of prior year claims in California and New York. These claims have been impacted by statutory, regulatory, and legal implications. In California, we also experienced increases in severity of claims and in frequency of claims beyond that previously projected in the actuarial review performed in the first quarter of 2016. Our claims data in 2016 is showing improvements with a reduction in the number of lost time cases, however ultimate claim count and severity projections are subject to volatility.

Our automobile liability program covers our fleet of passenger vehicles, service vans, and shuttle buses, which are associated with our various transportation service contracts. Claim frequency and severity associated with our fleet operations developed unfavorably versus actuarial expectations. The adverse development was primarily attributable to claims in 2013 through 2015.

After analyzing the recent loss development patterns, comparing the loss development against benchmarks, and applying actuarial projection methods to determine the estimate of ultimate losses, we increased our total reserves by $19.8 million during the third quarter of 2016.

Actuarial Review Performed During the First Quarter of 2016. During the three months ended January 31, 2016, an actuarial review was performed for the majority of our casualty insurance programs that indicated unfavorable developments in our estimates of ultimate losses related to certain general liability, workers' compensation, and automobile liability claims, as described below. This review considered all changes made to claims reserves and claim payment activity for the period commencing May 1, 2015 and ending October 31, 2015 (the "Review Period"). We performed this review for all policy years in which open claims existed.

For our general liability program, claim frequency was generally consistent with our expectations. However, the actuarial review identified adverse developments in prior year claims. The adverse developments can be largely attributed to increases in the projected costs to resolve several high exposure claims within our retained limits. Also contributing to the increase in projected cost estimates was a higher than expected average incurred cost for our less severe claims observed during the Review Period.

Our workers' compensation estimate of ultimate losses was negatively impacted by increases in projected costs for a significant number of prior year claims in New York. These claims have been impacted by increases in statutory benefits and a slowing of claims closures observed during the Review Period. In California, we experienced increases in severity of claims and in frequency of claims beyond that previously projected.

For our automobile liability program, the increase in the projected cost estimates was primarily associated with significant claim reserve adjustments for a small population of high exposure claims within the 2013 policy year. Also contributing to the increase in projected estimates was an increase in claims frequency in the 2015 policy year observed during the Review Period.

As a result of these developments in our casualty insurance programs, we increased our reserves for known claims as well as our estimate of the loss amounts associated with incurred but not reported claims. As a result of this actuarial review, we increased our reserves for claims related to prior periods by $6.0 million at January 31, 2016. As we continued to see a similar trend in adverse developments, we increased our reserves by an additional $6.0 million, resulting in a total increase to our reserves for claims related to prior periods of $12.0 million at April 30, 2016.

Annual Actuarial Evaluations Performed During the Third Quarter of 2015. During the third quarter of 2015, our actuarial evaluations showed unfavorable developments in our estimate of ultimate losses related to certain general liability, workers' compensation, and automobile liability claims. These evaluations indicated that previously estimated decreases in our average claim cost and the anticipated reduction in the total number of claims had not occurred at the pace contemplated in the 2014 actuarial evaluations. As a result, in the third quarter of 2015, we increased our insurance reserves for years prior to 2015 by $35.8 million. In addition, we increased the rate used to record our insurance reserves in 2016, which resulted in higher insurance expense related to current year claims for the nine months ended July 31, 2016.

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Taxes

Our income taxes for the three and nine months ended July 31, 2016 were favorably impacted by a benefit of $19.0 million, including interest of $1.0 million, related to expiring statutes of limitations and the Work Opportunity Tax Credits (“WOTC”). The WOTC program is a federal tax credit that provides financial incentives to hire individuals from certain target groups who have faced significant barriers to employment. In December 2015, the U.S. Congress retroactively reinstated and extended WOTC for the five-year period commencing January 1, 2015 and extending through December 31, 2019. During the first quarter of 2016, we benefited from the retroactive reinstatement for ten months of our fiscal year 2015, as it reduced our tax expense by $4.9 million for continuing operations. The WOTC benefit related to new hires during 2016 is expected to result in a reduction of tax expense of approximately $7 million during the fiscal year.

Westway Acquisition

During the first quarter of 2016, we acquired Westway Services Holdings (2014) Ltd. (“Westway”), a provider of technical engineering services to clients in the United Kingdom. This acquisition complements ABM’s existing technical services business and supports our initiative to deliver value-added solutions through the ability to supply mechanical, electrical, and core service lines to our current client base in the United Kingdom. In addition, this acquisition provides the opportunity to cross sell ABM’s services to existing Westway clients. Further, this acquisition is in line with our long-term strategic vision as we believe we can achieve higher margins and deliver greater value to our shareholders through our technical services business.

Financial and Operating Summary

- Revenues increased by $47.0 million, or 3.8%, during the three months ended July 31, 2016, as compared to the three months ended July 31, 2015. Organic revenue increased 2.2%.
- Operating profit increased by $26.1 million during the three months ended July 31, 2016, as compared to the three months ended July 31, 2015. The increase in operating profit is primarily attributable to a lower self-insurance adjustment. Also benefiting the quarter were higher margin revenues, savings from our 2020 Vision initiatives, and one less working day.
- Our income from continuing operations for the three and nine months ended July 31, 2016 were favorably impacted by a tax benefit of $19.0 million related to expiring statutes of limitations, including $1.0 million of related interest.
- Net cash provided by operating activities of continuing operations was $98.5 million during the nine months ended July 31, 2016.
- During the three months ended July 31, 2016

Weighted average shares outstanding	21,591	23,268	21,855	23,685
Dilutive effect of outstanding equity awards	493	453	526	422
Diluted weighted average shares outstanding	22,084	23,721	22,381	24,107
Earnings per common share - assuming dilution	$ 0.65	$ 0.55	$ 2.27	$ 1.84

The Company grants time-based restricted shares, which are participating securities. The Company evaluated earnings per common share under the two class method and determined there were no material differences from the amounts disclosed.

Shares subject to options to purchase common stock with an exercise price greater than the average market price are not included in the computation of earnings per common share assuming dilution because the effect would be antidilutive. The weighted average number of shares subject to antidilutive options was 24,000 and 129,000 for the three and nine months ended September 29, 2013, respectively (none for the three and nine months ended September 23, 2012).

6. Litigation

The Company is involved in a number of lawsuits, claims, investigations and proceedings, including those specifically identified below, consisting of intellectual property, employment, consumer, commercial and other matters arising in the ordinary course of business. In accordance with ASC 450 Contingencies, the Company has made accruals with respect to these matters, where appropriate, which are reflected in the Company s condensed consolidated financial statements. We review these provisions at least quarterly and adjust these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case.

Agne v. Papa John s International, Inc. et al. is a class action filed on May 28, 2010 in the United States District Court for the Western District of Washington seeking damages for violations of the Telephone Consumer Protection Act and Washington State telemarketing laws alleging, among other things that several Papa John s franchisees retained a vendor to send unsolicited commercial text message offers primarily in Washington and Oregon. The court granted plaintiff s motion for class certification in November 2012; we filed a petition for permission to appeal the court s ruling on class certification to the United States Court of Appeals for the Ninth Circuit.

In February 2013, the parties tentatively agreed to the financial terms of a settlement of the litigation. The court preliminarily approved the terms in June 2013 and granted final approval of the settlement and fee award in October 2013, following the close of the claims period. Due to a lower claimant participation rate, the actual settlement cost of $2.9 million was less than our original estimate at December 30, 2012 of $3.3 million, a decrease of approximately $400,000. We expect all settlement and fee payments to be made in 2013.

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Perrin v. Papa John s International, Inc. and Papa John s USA, Inc. is a conditionally certified collective action filed in August 2009 in the United States District Court, Eastern District of Missouri, alleging that delivery drivers were reimbursed for mileage and expenses in violation of the Fair Labor Standards Act. Approximately 3,900 drivers out of a potential class size of 28,800 have opted into the action. A motion to certify five additional state classes is pending and could result in another 14,000 plaintiffs if granted.

We intend to vigorously defend against all claims in this lawsuit. However, given the inherent uncertainties of litigation, the outcome of this case cannot be predicted and the amount of any potential loss cannot be reasonably estimated. A negative outcome in this case could have a material adverse effect on the Company.

7. Segment Information

We have defined five reportable segments: domestic Company-owned restaurants, domestic commissaries, North America franchising, international operations, and all other units.

The domestic Company-owned restaurant segment consists of the operations of all domestic (domestic is defined as contiguous United States) Company-owned restaurants and derives its revenues principally from retail sales of pizza and side items, such as breadsticks, cheesesticks, chicken poppers, chicken wings, dessert pizza, and soft drinks to the general public. The domestic commissary segment consists of the operations of our regional dough production and product distribution centers and derives its revenues principally from the sale and distribution of food and paper products to domestic Company-owned and franchised restaurants. The North America franchising segment consists of our franchise sales and support activities and derives its revenues from sales of franchise and development rights and collection of royalties from our franchisees located in the United States and Canada. The international operations segment principally consists of our Company-owned restaurants and distribution sales to franchised Papa John s restaurants located in the United Kingdom, Mexico and China and our franchise sales and support activities, which derive revenues from sales of franchise and development rights and the collection of royalties from our international franchisees. International franchisees are defined as all franchise operations outside of the United States and Canada. All other business units that do not meet the quantitative thresholds for determining reportable segments, which are not operating segments, we refer to as our all other segment, which consists of operations that derive revenues from the sale, principally to Company-owned and franchised restaurants, of printing and promotional items, risk management services, and information systems and related services used in restaurant operations, including our online and other technology-based ordering platforms.

Generally, we evaluate performance and allocate resources based on profit or loss from operations before income taxes and intercompany eliminations. Certain administrative and capital costs are allocated to segments based upon predetermined rates or actual estimated resource usage. We account for intercompany sales and transfers as if the sales or transfers were to third parties and eliminate the activity in consolidation.

Our reportable segments are business units that provide different products or services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies. No single external customer accounted for 10% or more of our consolidated revenues.

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Our segment information is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	Sept. 29, 2013	Sept. 23, 2012	Sept. 29, 2013	Sept. 23, 2012
Revenues from external customers:				
Domestic Company-owned restaurants	$ 152,662	$ 143,299	$ 465,713	$ 430,641
Domestic commissaries	138,044	132,666	421,941	396,869
North America franchising	19,682	18,937	61,410	58,984
International	22,388	18,031	63,451	52,265
All others	13,566	12,581	38,617	36,610
Total revenues from external customers	$ 346,342	$ 325,514	$ 1,051,132	$ 975,369
Intersegment revenues:				
Domestic commissaries	$ 46,408	$ 42,313	$ 139,320	$ 123,802
North America franchising	530	546	1,635	1,656
International	69	60	209	171
All others	3,718	2,758	10,204	8,443
Total intersegment revenues	$ 50,725	$ 45,677	$ 151,368	$ 134,072
Income (loss) before income taxes:				
Domestic Company-owned restaurants	$ 5,535	$ 5,549	$ 24,666	$ 27,228
Domestic commissaries	6,473	6,846	26,278	25,990
North America franchising	16,516	16,070	52,134	50,829
International	945	625	2,152	1,217
All others	590	732	2,402	1,598
Unallocated corporate expenses	(8,544)	(9,201)	(28,475)	(34,784)
Elimination of intersegment profits	(252)	242	(989)	(229)
Total income before income taxes	$ 21,263	$ 20,863	$ 78,168	$ 71,849
Property and equipment:				
Domestic Company-owned restaurants	$ 191,839			
Domestic commissaries	103,362			
International	25,832			
All others	39,753			
Unallocated corporate assets	153,186			
Accumulated depreciation and amortization	(306,557)			
Net property and equipment	$ 207,415			

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

Papa John s International, Inc. (referred to as the Company, Papa John s or in the first person notations of we, us and our) began operations 1985. At September 29, 2013, there were 4,296 Papa John s restaurants (711 Company-owned and 3,585 franchised) operating in all 50 states and 35 countries. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, risk management services, and information systems and related services used in their operations.

The results of operations are based on the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP). The preparation of consolidated financial statements requires management to select accounting policies for critical accounting areas and make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions in our critical accounting policies could materially impact the operating results. See Notes 1 and 2 of Notes to Condensed Consolidated Financial Statements for a discussion of the basis of presentation and the significant accounting policies.

Non-GAAP Measures

In connection with a 2012 multi-year supplier agreement, the Company received a $5.0 million supplier marketing payment in the first quarter of 2012, which the Company then contributed to the Papa John s Marketing Fund (PJMF), an unconsolidated, non-profit corporation, for the benefit of domestic restaurants. The Company s contribution to PJMF was fully expensed in the first quarter of 2012. The Company is recognizing the supplier marketing payment evenly as income over the five-year term of the agreement ($250,000 per quarter).

PJMF elected to distribute the $5.0 million supplier marketing payment to the domestic system as advertising credits in the first quarter of 2012. Our domestic Company-owned restaurants portion of the 2012 advertising credits resulted in an increase in income before income taxes of approximately $1.0 million.

The overall impact of the two transactions described above, which are collectively defined as the Incentive Contribution, increased income before income taxes for the three and nine months ended September 29, 2013, by $250,000 and $750,000, respectively, increased income before income taxes by $250,000 for the three months ended September 23, 2012, and reduced income before income taxes by $3.2 million for the nine months ended September 23, 2012.

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The following table reconciles our GAAP financial results to the adjusted financial results, excluding the impact of the Incentive Contribution, for the three and nine months ended September 29, 2013 and September 23, 2012:

	Three Months Ended			Nine Months Ended		
(In thousands, except per share amounts)	Sept. 29, 2013	Sept. 23, 2012	Increase (Decrease)	Sept. 29, 2013	Sept. 23, 2012	Increase (Decrease)
Income before income taxes, as reported	$ 21,263	$ 20,863	$ 400	$ 78,168	$ 71,849	$ 6,319
Incentive Contribution	(250)	(250)		(750)	3,221	(3,971)
Income before income taxes, excluding Incentive Contribution	$ 21,013	$ 20,613	$ 400	$ 77,418	$ 75,070	$ 2,348
Net income, as reported	$ 14,276	$ 13,031	$ 1,245	$ 50,732	$ 44,301	$ 6,431
Incentive Contribution	(165)	(159)	(6)	(494)	2,116	(2,610)
Net income, excluding Incentive Contribution	$ 14,111	$ 12,872	$ 1,239	$ 50,238	$ 46,417	$ 3,821
Earnings per diluted share, as reported	$ 0.65	$ 0.55	$ 0.10	$ 2.27	$ 1.84	$ 0.43
Incentive Contribution	(0.01)	(0.01)		(0.03)	0.09	(0.12)
Earnings per diluted share, excluding Incentive Contribution	$ 0.64	$ 0.54	$ 0.10	$ 2.24	$ 1.93	$ 0.31

The financial measures we present in this report, which exclude the Incentive Contribution, are non-GAAP measures and should not be construed as a substitute for or a better indicator of the Company s performance than the Company s GAAP measures. Management believes presenting the financial information excluding the impact of the Incentive Contribution is important for purposes of comparison to prior year results. In addition, management uses these non-GAAP measures to allocate resources, and analyze trends and underlying operating performance. Annual cash bonuses, and certain long-term incentive programs for various levels of management, were based on financial measures that excluded the Incentive Contribution. The presentation of the non-GAAP measures in this report is made alongside the most directly comparable GAAP measures. See Discussion of Operating Results below for further analysis regarding the impact of the Incentive Contribution.

In addition, we present free cash flow in this report, which is a non-GAAP measure. We define free cash flow as net cash provided by operating activities (from the consolidated statements of cash flows) less the purchases of property and equipment. We view free cash flow as an important measure because it is one factor that management uses in determining the amount of cash available for discretionary investment. Free cash flow is not a term defined by GAAP and as a result our measure of free cash flow might not be comparable to similarly titled measures used by other companies. Free cash flow should not be construed as a substitute for or a better indicator of our performance than the Company s GAAP measures. See Liquidity and Capital Resources for a reconciliation of free cash flow to the most directly comparable GAAP measure.

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Restaurant Progression

	Three Months Ended		Nine Months Ended	
	Sept. 29, 2013	Sept. 23, 2012	Sept. 29, 2013	Sept. 23, 2012
North America Company-owned:				
Beginning of period	654	643	648	598
Opened	2	2	8	2
Closed				(3)
Acquired from franchisees		1		57
Sold to franchisees		(3)		(11)
End of period	656	643	656	643
International Company-owned:				
Beginning of period	51	33	48	30
Opened	4	5	7	9
Closed		(1)		(2)
End of period	55	37	55	37
North America franchised:				
Beginning of period	2,588	2,475	2,556	2,463
Opened	48	45	111	127
Closed	(41)	(9)	(72)	(31)
Acquired from Company		3		11
Sold to Company		(1)		(57)
End of period	2,595	2,513	2,595	2,513
International franchised:				
Beginning of period	959	822	911	792
Opened	36	23	105	74
Closed	(5)	(9)	(26)	(30)
End of period	990	836	990	836
Total restaurants - end of period	4,296	4,029	4,296	4,029

Results of Operations

Summary of Operating Results - Segment Review

Discussion of Revenues

Consolidated revenues were $346.3 million for the three months ended September 29, 2013, an increase of $20.8 million, or 6.4%, over the corresponding 2012 period. For the nine months ended September 29, 2013, total revenues were $1.05 billion, an increase of $75.8 million, or 7.8%, over the corresponding 2012 period. The increases in revenues for the three and nine months ended September 29, 2013, were primarily due to the following:

- Domestic Company-owned restaurant sales increased \$9.4 million, or 6.5%, and \$35.1 million, or 8.1%, for the three and nine months ended September 29, 2013, respectively, primarily due to increases in comparable sales of 5.1% and 5.0%. Comparable sales represents the change in year-over-year sales for the same base of restaurants for the same fiscal periods. The increase for the nine-month period was also due to the net acquisition of 50 restaurants in the Denver and Minneapolis markets from a franchisee in the second quarter of 2012.

- North America franchise royalty revenue increased approximately \$600,000, or 3.4%, and \$2.0 million, or 3.4%, for the three and nine months ended September 29, 2013, respectively, primarily due to the increase in net franchise units over the prior year and increases in comparable sales of 0.6% and 1.3%,

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partially offset by third quarter royalty incentives offered to franchisees for meeting certain sales targets. The increase for the nine-month period was partially offset by reduced royalties attributable to the Company s net acquisition of the 50 restaurants noted above.

- Domestic commissary sales increased $5.4 million, or 4.1%, and $25.1 million, or 6.3%, for the three and nine months ended September 29, 2013, respectively, primarily due to increases in sales volumes as well as increases in the prices of commodities.

- International revenues increased $4.4 million, or 24.2%, and increased $11.2 million, or 21.4%, for the three and nine months ended September 29, 2013, respectively, primarily due to increases in the number of restaurants and increases in comparable sales of 8.1% and 7.7%, calculated on a constant dollar basis.

Discussion of Operating Results

Third quarter 2013 income before income taxes was $21.3 million compared to $20.9 million in the prior year, or a 1.9% increase. Income before income taxes was $78.2 million for the nine months ended September 29, 2013, compared to $71.8 million for the prior year, or an 8.8% increase. The Incentive Contribution (see Non-GAAP Measures above) increased income before income taxes by $250,000 and $750,000 for the three and nine months ended September 29, 2013 and increased income before income taxes by $250,000 for the three-month period in 2012 and reduced income before income taxes by $3.2 million for the nine-month period in 2012. Excluding the net impact of the Incentive Contribution, income before income taxes was $21.0 million for the third quarter of 2013, an increase of $400,000 or 1.9%, from $20.6 million in the same period in the prior year and was $77.4 million for the nine-month period in 2013, an increase of $2.3 million or 3.1%, from $75.1 million in the same period in the prior year. Income before income taxes is summarized in the following table on a reporting segment basis (in thousands):

	Three Months Ended			Nine Months Ended		
	Sept. 29, 2013	Sept. 23, 2012	Increase (Decrease)	Sept. 29, 2013	Sept. 23, 2012	Increase (Decrease)
Domestic Company-owned restaurants (a)	$ 5,535	$ 5,549	$ (14)	$ 24,666	$ 27,228	$ (2,562)
Domestic commissaries	6,473	6,846	(373)	26,278	25,990	288
North America franchising	16,516	16,070	446	52,134	50,829	1,305
International	945	625	320	2,152	1,217	935
All others	590	732	(142)	2,402	1,598	804
Unallocated corporate expenses (b)	(8,544)	(9,201)	657	(28,475)	(34,784)	6,309
Elimination of intersegment (profits) losses	(252)	242	(494)	(989)	(229)	(760)
Total income before income taxes	$ 21,263	$ 20,863	$ 400	$ 78,168	$ 71,849	$ 6,319

(a) Includes the benefit of a $1.0 million advertising credit from PJMF related to the Incentive Contribution for the nine months ended September 23, 2012.

(b) Includes the impact of the Incentive Contribution in 2013 ($250,000 increase and $750,000 increase for the three and nine months ended September 29, 2013) and 2012 ($250,000 increase and a $4.3 million reduction for the three and nine months ended September 23, 2012).

Income before income taxes increased $400,000 and $6.3 million for the three and nine months ended September 29, 2013, respectively ($400,000 and $2.3 million, respectively, excluding the net impact of the Incentive Contribution). The changes in income before income taxes were due to the following:

- **Domestic Company-owned Restaurant Segment.** Domestic Company-owned restaurants income before income taxes decreased $14,000 and $1.5 million for the three and nine months ended September 29, 2013, respectively, excluding the $1.0 million advertising credit from PJMF in 2012. For the three-month period, the incremental profits associated with higher comparable sales of 5.1% were offset by a lower gross margin. The decrease for the nine-month period was primarily due to higher commodity costs, somewhat

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offset by incremental profits associated with higher comparable sales of 5.0%. Additionally, the nine-month period of 2012 benefited from various supplier incentives.

- **Domestic Commissary Segment.** Domestic commissaries income before income taxes decreased approximately $400,000 and increased approximately $300,000 for the three and nine months ended September 29, 2013, respectively. The decrease for the three-month period was primarily due to higher distribution costs that more than offset the incremental profits associated with higher sales. The increase for the nine-month period was due to incremental profits from higher sales, partially offset by higher distribution and other costs, including dough production start up costs at our New Jersey commissary. We manage commissary results on a full year basis and anticipate the 2013 full year pre-tax income margin will approximate 2012.

- **North America Franchising Segment.** North America Franchising income before income taxes increased approximately $400,000 and $1.3 million for the three and nine months ended September 29, 2013, respectively. The increases were due to the previously mentioned royalty revenue increases, partially offset by third quarter 2013 royalty incentives offered to franchisees for meeting certain sales targets and an increase in development incentive costs. The increase for the nine-month period was partially offset by reduced royalties attributable to the Company s acquisition of the Denver and Minneapolis restaurants.

- **International Segment.** Income before income taxes increased approximately $300,000 and $900,000 for the three and nine months ended September 29, 2013, respectively. The increases were primarily due to higher royalties attributable to the 8.1% and 7.7% comparable sales increases and net unit growth and improvements in our United Kingdom results. These improvements were partially offset by higher operating losses in our Company-owned China market.

- **All Others Segment.** The All Others reporting segment income before income taxes decreased approximately $100,000 and increased approximately $800,000 for the three- and nine-month periods, respectively, as compared to the corresponding 2012 periods. Our online operating results improved for both the three- and nine-month periods due to higher online sales volumes. For the three months ended, the increased online income was more than offset by lower results at our printing subsidiary, Preferred Marketing Solutions, primarily due to a reduced cost direct mail campaign offered to our domestic franchised restaurants.

- **Unallocated corporate expenses.** Unallocated corporate expenses decreased approximately $700,000 and $6.3 million for the three and nine months ended September 29, 2013, respectively, compared to the corresponding 2012 periods. The components of unallocated corporate expenses were as follows (in thousands):

	Three Months Ended			Nine Months Ended		
	Sept. 29, 2013	**Sept. 23, 2012**	**Increase (Decrease)**	**Sept. 29, 2013**	**Sept. 23, 2012**	**Increase (Decrease)**
General and administrative (a)	$ 7,470	$ 7,589	$ (119)	$ 24,515	$ 24,289	$ 226
Supplier marketing (income) expense (b)	(250)	(250)		(750)	4,250	(5,000)
Net interest expense (income) (c)	176	348	(172)	(107)	978	(1,085)

Depreciation	1,629	1,829	(200)	5,020	5,382	(362)
Other expense (income)	(481)	(315)	(166)	(203)	(115)	(88)
Total unallocated corporate expenses	$ 8,544	$ 9,201	$ (657)	$ 28,475	$ 34,784	$ (6,309)

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(a) The three- and nine-month periods of 2013, include a favorable adjustment for lower class action settlement costs than previously estimated (see Note 6 of Notes to Condensed Consolidated Financial Statements for additional information).

(b) See Non-GAAP Measures above for further information about the Incentive Contribution.

(c) The decrease in net interest was primarily due to a decrease in the change in the redemption value of a mandatorily redeemable noncontrolling interest in a joint venture, partially offset by a higher average outstanding debt balance and a higher effective interest rate.

Diluted earnings per share were $0.65 and $0.55 for the three months ended September 29, 2013 and September 23, 2012, respectively ($0.64 and $0.54 for the three-month periods, excluding the impact of the Incentive Contribution, or an increase of $0.10 or 18.5%). For the nine months ended September 29, 2013 and September 23, 2012, diluted earnings per share were $2.27 and $1.84, respectively ($2.24 and $1.93 per share for the nine-month periods, excluding the impact of the Incentive Contribution, or an increase of $0.31 or 16.1%). Diluted weighted average shares outstanding decreased 6.9% and 7.2% for the three and nine months ended September 29, 2013, respectively, from the prior year comparable periods, primarily due to share repurchases under the Company s share repurchase program. Diluted earnings per share increased $0.05 and $0.17 for the three- and nine-month periods, respectively, due to the reduction in shares outstanding.

Review of Consolidated Operating Results

Revenues. Domestic Company-owned restaurant sales were $152.7 million for the three months ended September 29, 2013, compared to $143.3 million for the same period in 2012, and $465.7 million for the nine months ended September 29, 2013, compared to $430.6 million for the same period in 2012. The increases of $9.4 million and $35.1 million were primarily due to the previously mentioned increases of 5.1% and 5.0% in comparable sales during the three and nine months ended September 29, 2013, respectively. The increase for the nine-month period was also due to the net acquisition of 50 restaurants in the Denver and Minneapolis markets from a franchisee in the second quarter of 2012.

North America franchise sales, which are not included in the Company s revenues, were $450.0 million for the three months ended September 29, 2013, compared to $434.6 million for the same period in 2012, and $1.396 billion for the nine months ended September 29, 2013, compared to $1.352 billion for the same period in 2012. Domestic franchise comparable sales increased 0.6% for the third quarter and increased 1.3% for the nine months ended September 29, 2013, and equivalent units increased 3.7% and 3.3%, respectively, for the comparable periods. Equivalent units represents the number of restaurants open at the beginning of a given period, adjusted for restaurants opened, closed, acquired or sold during the period on a weighted average basis. North America franchise royalties were $19.4 million and $60.4 million for the three and nine months ended September 29, 2013, respectively, representing increases of 3.4% for both comparable periods in the prior year. The increases in royalties were primarily due to the previously noted increases in franchise sales.

Average weekly sales for comparable units include restaurants that were open throughout the periods presented below. The comparable sales base for domestic Company-owned and North America franchised restaurants, respectively, includes restaurants acquired by the Company or divested to franchisees during the previous twelve months. Average weekly sales for non-comparable units include restaurants that were not open throughout the periods presented below and include non-traditional sites. Average weekly sales for non-traditional units not subject to continuous operations are calculated based upon actual days open.

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The comparable sales base and average weekly sales for 2013 and 2012 for domestic Company-owned and North America franchised restaurants consisted of the following:

	Three Months Ended			
	September 29, 2013		September 23, 2012	
	Company	Franchised	Company	Franchised
Total domestic units (end of period)	656	2,595	643	2,513
Equivalent units	650	2,479	638	2,391
Comparable sales base units	633	2,264	631	2,187
Comparable sales base percentage	97.40%	91.30%	98.90%	91.50%
Average weekly sales - comparable units	$ 18,241	$ 14,385	$ 17,329	$ 14,353
Average weekly sales - total non-comparable units (a)	$ 11,666	$ 9,494	$ 12,519	$ 9,980
Average weekly sales - all units	$ 18,071	$ 13,962	$ 17,274	$ 13,980

	Nine Months Ended			
	September 29, 2013		September 23, 2012	
	Company	Franchised	Company	Franchised
Total domestic units (end of period)	656	2,595	643	2,513
Equivalent units	647	2,483	618	2,403
Comparable sales base units	633	2,257	609	2,186
Comparable sales base percentage	97.8%	90.9%	98.5%	91.0%
Average weekly sales - comparable units	$ 18,610	$ 14,885	$ 17,943	$ 14,839
Average weekly sales - total non-comparable units (a)	$ 11,564	$ 9,769	$ 12,179	$ 10,316
Average weekly sales - all units	$ 18,458	$ 14,419	$ 17,856	$ 14,431

(a) Includes 193 traditional and 178 nontraditional units as of September 29, 2013 and 188 traditional and 151 nontraditional units as of September 23, 2012.

Domestic commissary sales increased 4.1% to $138.0 million for the three months ended September 29, 2013, from $132.7 million in the comparable 2012 period and increased 6.3% to $421.9 million for the nine months ended September 29, 2013, from $396.9 million in the comparable 2012 period. The increases were primarily due to increases in the volume of sales as well as increases in the prices of commodities.

Other sales increased approximately $1.0 million, or 7.8%, and $2.0 million, or 5.5%, for the three and nine months ended September 29, 2013, respectively, primarily due to increased online revenue from higher online sales.

International franchise sales were $116.6 million for the three months ended September 29, 2013, compared to $96.5 million for the same period in 2012, and $334.9 million for the nine months ended September 29, 2013, compared to $279.1 million for the same period in 2012. International franchise sales are not included in Company revenues; however, our international royalty revenue is derived from these sales. Total international revenues increased 24.2% to $22.4 million for the three months ended September 29, 2013, from $18.0 million in the prior comparable period, and increased 21.4% to $63.5 million for the nine months ended September 29, 2013, from $52.3 million in the prior comparable period. The increases are due to an increase in the number of restaurants in addition to increases of 8.1% and 7.7% in comparable sales, calculated on a constant dollar basis, for the three- and nine-month periods, respectively.

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Costs and expenses. The restaurant operating margin for domestic Company-owned units was 16.8% for the three months ended September 29, 2013, compared to 17.5% for the same period in 2012, and 18.5% for the nine months ended September 29, 2013, compared to 19.7% (19.4% excluding the $1.0 million advertising credit from PJMF) for the same period in 2012. The restaurant operating margin decreases of 0.7% and 1.2% for the three and nine months ended September 29, 2013, respectively, consisted of the following differences:

- Cost of sales was 1.3% and 1.2% higher for the three and nine months ended September 29, 2013, as compared to the same periods in 2012. The increase for the three-month period was due to both higher commodity costs and higher food costs associated with changes in sales mix. The increase for the nine-month period was primarily due to higher commodity costs. The nine-month period benefited from various supplier incentives in 2012.

- Salaries and benefits were 0.3% and 0.2% lower as a percentage of sales for the three and nine months ended September 29, 2013, as compared to the same periods in 2012, primarily due to leverage from increased sales.

- Advertising and related costs as a percentage of sales were 0.3% lower and 0.2% higher for the three and nine months ended September 29, 2013, respectively. The nine-month period of 2012 included a $1.0 million advertising credit received from PJMF. The lower costs as a percentage of sales, excluding the advertising credit from PJMF, reflect leverage from increased sales.

- Occupancy costs and other operating costs, on a combined basis, were relatively consistent (21.4% for both the three months ended September 29, 2013 and September 23, 2012, and 20.5% for both the nine months ended September 29, 2013 and September 23, 2012).

Domestic commissary and other margin was 6.4% for the three months ended September 29, 2013, compared to 7.2% for the corresponding 2012 period, and 7.5% for the nine months ended September 29, 2013, compared to 8.2% for the corresponding period in 2012. Changes in operating costs for the three- and nine-month periods were as follows:

- Cost of sales was 0.3% lower as a percentage of revenues for both the three and nine months ended September 29, 2013 due to pricing changes.

- Salaries and benefits were 0.2% higher as a percentage of revenues for both the three- and nine-month periods. The increases were primarily due to additional commissary staffing to support higher volumes.

- Other operating expenses were 0.8% and 0.7% higher as a percentage of revenues for the three and nine months ended September 29, 2013, respectively, as compared to the same periods in 2012, primarily due to higher distribution costs.

International restaurant and commissary expenses were 84.9% of international restaurant and commissary sales for the three months ended September 29, 2013, compared to 84.7% for the same period in 2012, and 84.2% of international restaurant and commissary sales for the nine months ended September 29, 2013, compared to 85.1% for the same period in 2012. Operating expenses were higher for the three months ended due to higher food and other operating costs in China. For the nine months ended the losses in China were more than offset by improved commissary operating costs in the United Kingdom due to sales leverage.

General and administrative costs were $31.8 million, or 9.2%, of revenues for the three months ended September 29, 2013, compared to $30.4 million, or 9.3%, of revenues for the same period in 2012, and $98.1 million, or 9.3%, of revenues for the nine months ended September 29, 2013, compared to $93.5 million, or 9.6%, of revenues for the same period in 2012. The decreases as a percentage of sales were primarily the result of leverage from higher sales as well as lower class action settlement costs than previously estimated.

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Other general expenses reflected net expense of $1.3 million for the three months ended September 29, 2013, compared to $1.2 million for the comparable period in 2012, and $4.0 million, for the nine months ended September 29, 2013 compared to $8.0 million for the comparable period in 2012, as detailed below (in thousands):

	Three Months Ended Sept. 29, 2013	Three Months Ended Sept. 23, 2012	Increase (Decrease)	Nine Months Ended Sept. 29, 2013	Nine Months Ended Sept. 23, 2012	Increase (Decrease)
Supplier marketing (income) expense (a)	$ (250)	$ (250)	$	$ (750)	$ 4,250	$ (5,000)
Disposition and valuation-related losses	168	344	(176)	546	460	86
Franchise and development incentives (b)	1,121	929	192	3,232	2,403	829
Other	221	188	33	1,014	907	107
Total other general expenses	$ 1,260	$ 1,211	$ 49	$ 4,042	$ 8,020	$ (3,978)

(a) See the discussion of the Incentive Contribution included in Non-GAAP Measures above for further information.

(b) Includes incentives provided to domestic franchisees for opening restaurants.

Depreciation and amortization was $8.6 million (2.5% of revenues) for the three months ended September 29, 2013, compared to $8.2 million (2.5% of revenues) for the same 2012 period, and $25.7 million (2.4% of revenues) for the nine months ended September 29, 2013, compared to $24.2 million (2.5% of revenues) for the 2012 period.

Net interest (expense) income. Net interest (expense) income consisted of the following for the three and nine months ended September 29, 2013 and September 23, 2012 (in thousands):

	Three Months Ended Sept. 29, 2013	Three Months Ended Sept. 23, 2012	(Increase) Decrease	Nine Months Ended Sept. 29, 2013	Nine Months Ended Sept. 23, 2012	(Increase) Decrease
Interest expense - line of credit (a)	$ (646)	$ (284)	$ (362)	$ (1,425)	$ (854)	$ (571)
Investment income	87	136	(49)	425	501	(76)
Change in redemption value of mandatorily redeemable noncontrolling interest in a joint venture	374	(194)	568	1,147	(586)	1,733
Net interest (expense) income	$ (185)	$ (342)	$ 157	$ 147	$ (939)	$ 1,086

(a) The increase in interest expense for both the three and nine months ended September 29, 2013, was due to a higher average outstanding debt balance and a higher effective interest rate.

Income tax expense. Our effective income tax rates were 30.0% and 31.9% for the three and nine months ended September 29, 2013, representing decreases of 3.7% and 1.9% from the prior year rates. The lower effective rates were primarily due to various credits earned and the settlement or resolution of specific tax issues in 2013.

Liquidity and Capital Resources

Our debt at September 29, 2013 was comprised of a $120 million outstanding principal balance on our $300 million unsecured revolving credit facility with a maturity date of April 30, 2018. The interest rate charged on outstanding balances is LIBOR (London Interbank Offered Rate) plus 75 to 175 basis points. The commitment fee on the unused balance ranges from 15 to 25 basis points. The increment over LIBOR and the commitment fee are determined quarterly based upon the ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (EBITDA), as defined by the revolving credit facility. The remaining availability under the revolving credit facility, reduced for outstanding letters of credit, was approximately $160.3 million as of September 29, 2013.

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We use interest rate swaps to hedge against the effects of potential interest rate increases on borrowings under our revolving credit facility. At September 29, 2013, we had an interest rate swap agreement that resulted in a fixed rate of 1.42%, instead of the variable rate of LIBOR, with a notional amount of $75.0 million and a maturity date of April 30, 2018, which coincides with the maturity date of our revolving credit facility. We previously had a $50.0 million interest rate swap that resulted in a fixed rate of 0.56% until its termination on July 30, 2013. The termination of the swap did not have a material impact on our third quarter results. See the notes to condensed consolidated financial statements for additional information.

Our revolving credit facility contains affirmative and negative covenants, including the following financial covenants, as defined:

	Permitted Ratio	**Actual Ratio for the Quarter Ended Sept. 29, 2013**
Leverage Ratio	Not to exceed 3.0 to 1.0	0.96 to 1.0
Interest Coverage Ratio	Not less than 3.5 to 1.0	5.11 to 1.0

Our leverage ratio is defined as outstanding debt divided by consolidated EBITDA for the most recent four fiscal quarters. Our interest coverage ratio is defined as the sum of consolidated EBITDA and consolidated rental expense for the most recent four fiscal quarters divided by the sum of consolidated interest expense and consolidated rental expense for the most recent four fiscal quarters. We were in compliance with all covenants at September 29, 2013.

Cash flow provided by operating activities was $74.8 million for the nine months ended September 29, 2013, compared to $94.8 million for the same period in 2012. The decrease of approximately $19.9 million was primarily due to unfavorable changes in working capital, including the timing of income tax and other payments, partially offset by an increase in net income.

Our free cash flow, a non-GAAP financial measure, for the nine months ended September 29, 2013 and September 23, 2012 was as follows (in thousands):

	Nine Months Ended			
		Sept. 29, 2013		**Sept. 23, 2012**
Net cash provided by operating activities	$	74,833	$	94,773
Purchases of property and equipment		(38,537)		(26,425)
Free cash flow (a)	$	36,296	$	68,348

(a) Free cash flow is defined as net cash provided by operating activities (from the consolidated statements of cash flows) less the purchases of property and equipment. We believe free cash flow is an important measure because it is one factor that management uses in determining the amount of cash available for discretionary investment. See previous Non-GAAP Measures for discussion about this non-GAAP measure, its limitations and why we present free cash flow alongside the most directly comparable GAAP measure.

We require capital primarily for the development, acquisition, renovation and maintenance of restaurants and commissaries and the enhancement of corporate systems and facilities, including technological enhancements. We also require capital for share repurchases and the payment of cash dividends.

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Capital expenditures were $38.5 million for the nine months ended September 29, 2013, compared to $26.4 million for the nine months ended September 23, 2012. The increased purchases of property and equipment primarily relate to expenditures on equipment for New Jersey dough production as well as technology investments.

Additionally, we had common stock repurchases of $69.1 million (1.1 million shares at an average price of $61.25 per share) which were funded by cash flow from operations as well as borrowings on our revolving credit facility. Subsequent to September 29, 2013, through October 28, 2013, we repurchased an additional 74,000 shares with an aggregate cost of $5.3 million and an average cost of $70.73 per share. As of October 28, 2013, $66.0 million remained available for repurchase of common stock under our Board of Directors authorization.

A cash dividend of $0.25 per common share, or $5.4 million, was paid on September 20, 2013 to shareholders of record as of the close of business on September 6, 2013. Subsequent to third quarter, on October 29, 2013, our Board of Directors declared a fourth quarter cash dividend of $0.25 per common share (approximately $5.4 million based on current shareholders of record). The dividend will be paid on November 22, 2013 to shareholders of record as of the close of business on November 11, 2013. While future dividends will be subject to Board declaration, the Company is initially targeting a dividend payout of $0.25 per quarter, or $0.125 adjusted for the two-for-one stock split. The declaration and payment of any future dividends will be at the discretion of the Board of Directors, subject to the Company s financial results, cash requirements, and other factors deemed relevant by the Board of Directors. This quarterly dividend is not a guarantee that a dividend will be declared or paid in any particular period in the future.

Forward-Looking Statements

Certain matters discussed in this report, including information within Management s Discussion and Analysis of Financial Condition and Results of Operations constitute forward-looking statements within the meaning of the federal securities laws. Generally, the use of words such as expect, estimate, believe, anticipate, will, forecast, plan, project, or similar words identify forward-looking statements that we inten included within the safe harbor protections provided by the federal securities laws. Such forward-looking statements may relate to projections or guidance concerning business performance, revenue, earnings, contingent liabilities, resolution of litigation, commodity costs, profit margins, unit growth, capital expenditures, and other financial and operational measures. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are beyond our control. Therefore, actual outcomes and results may differ materially from those matters expressed or implied in such forward-looking statements. The risks, uncertainties and assumptions that are involved in our forward-looking statements include, but are not limited to:

- aggressive changes in pricing or other marketing or promotional strategies by competitors which may adversely affect sales; and new product and concept developments by food industry competitors;
- changes in consumer preferences and adverse general economic and political conditions, including increasing tax rates, and their resulting impact on consumer buying habits;
- the impact that product recalls, food quality or safety issues, and general public health concerns could have on our restaurants;
- failure to maintain our brand strength and quality reputation;
- the ability of the company and its franchisees to meet planned growth targets and to operate new and existing restaurants profitably;

- increases in or sustained high costs of food ingredients and other commodities;

- disruption of our supply chain or our commissary operations due to sole or limited source of suppliers or weather, drought, disease or other disruption beyond our control;

- increased risks associated with our international operations, including economic and political conditions in our international markets and difficulty in meeting planned sales targets and new store growth for our international operations;

- increased employee compensation, benefits, insurance, regulatory compliance and similar costs, including increased costs resulting from federal health care legislation;
- the credit performance of our franchise loan program;
- the impact of the resolution of current or future claims and litigation, and current or proposed legislation impacting our business;
- currency exchange or interest rates;
- failure to effectively execute succession planning, and our reliance on the services of our Founder and CEO, who also serves as our brand spokesperson; and
- disruption of critical business or information technology systems, and risks associated with security breaches, including theft of company and customer information.

For a discussion of these and other risks that may cause actual results to differ from expectations, refer to Part I. Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 30, 2012, as well as subsequent filings. We undertake no obligation to update publicly any forward-looking statements, whether as a result of future events, new information or otherwise, except as required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our debt at September 29, 2013 was comprised of a $120 million outstanding principal balance on our $300 million unsecured revolving credit facility with a maturity date of April 30, 2018. The interest rate charged on outstanding balances is LIBOR (London Interbank Offered Rate) plus 75 to 175 basis points.

At September 29, 2013, we had an interest rate swap agreement that provided for a fixed rate of 1.42%, as compared to LIBOR, with a notional amount of $75.0 million and a maturity date of April 30, 2018, which coincides with the maturity date of our revolving credit facility. We previously had a $50.0 million interest rate swap that provided for a fixed rate of 0.56% until its termination on July 30, 2013.

The effective interest rate on the revolving credit facility, including the impact of the interest rate swap agreement, was 2.0% as of September 29, 2013. An increase in the present market interest rate of 100 basis points on the revolving credit facility balance outstanding as of September 29, 2013 would increase interest expense by approximately $450,000.

We do not enter into financial instruments to manage foreign currency exchange rates since only 6.0% of our total revenues are derived from sales to customers and royalties outside the United States.

In the ordinary course of business, the food and paper products we purchase, including cheese (historically representing 35% to 40% of our food cost), are subject to seasonal fluctuations, weather, availability, demand and other factors that are beyond our control. We have pricing agreements with some of our vendors, including forward pricing agreements for a portion of our cheese purchases for our domestic Company-owned restaurants, which are accounted for as normal purchases; however, we still remain exposed to on-going commodity volatility.

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The following table presents the actual average block price for cheese by quarter through the third quarter of 2013 and the projected average block price for cheese by quarter through 2014 (based on the October 28, 2013 Chicago Mercantile Exchange cheese futures market prices).

	2014 Projected Block Price	2013 Projected Block Price	2012 Actual Block Price
Quarter 1	$ 1.673*	$ 1.662	$ 1.522
Quarter 2	1.666*	1.784	1.539
Quarter 3	1.728*	1.740	1.750
Quarter 4	1.728*	1.806*	1.939
Full Year	$ 1.699*	$ 1.748*	$ 1.692

* Amounts are estimates based on futures prices.

Item 4. Controls and Procedures

Under the supervision and with the participation of the Company s management, including its chief executive officer and chief financial officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)). Based upon this evaluation, the chief executive officer and chief financial officer have concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective.

During the most recently completed fiscal quarter, there was no change made in the Company s internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information contained in Note 6 of Notes to Condensed Consolidated Financial Statements is incorporated by reference into this Item 1. We are party to various legal proceedings arising in the ordinary course of business, but except as set forth herein, are not currently a party to any legal proceedings that management believes could have a material adverse effect on the Company.

Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in the Company s Form 10-K for the fiscal year ended December 30, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Our Board of Directors has authorized the repurchase of up to $1.1 billion of common stock under a share repurchase program that began on December 9, 1999 and expires on March 30, 2014. Through September 29, 2013, a total of 50.9 million shares with an aggregate cost of $1.0 billion and an average price of $20.22 per share have been repurchased under this program. Subsequent to September 29, 2013, through October 28, 2013, we acquired an additional 74,000 shares at an aggregate cost of $5.3 million. As of October 28, 2013, approximately $66.0 million remained available for repurchase of common stock under this authorization.

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The following table summarizes our repurchases by fiscal period during the three months ended September 29, 2013 (in thousands, except per-share amounts):

Fiscal Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
07/01/2013 - 07/28/2013	23	$ 65.41	50,750	$ 80,135
07/29/2013 - 08/25/2013	37	$ 69.54	50,787	$ 77,570
08/26/2013 - 09/29/2013	90	$ 69.53	50,877	$ 71,306

The Company utilizes a written trading plan under Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, from time to time to facilitate the repurchase of shares of our common stock under this share repurchase program. There can be no assurance that we will repurchase shares of our common stock either through a Rule 10b5-1 trading plan or otherwise.

Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Financial statements from the quarterly report on Form 10-Q of Papa John s International, Inc. for the quarter ended September 29, 2013, filed on November 5, 2013, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Condensed Consolidated Financial Statements.

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SIGNATURE

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 thereunto duly authorized.

	PAPA JOHN S INTERNATIONAL, INC.
	(Registrant)
Date: November 5, 2013	/s/ Lance F. Tucker Lance F. Tucker Senior Vice President, Chief Financial Officer, Chief Administrative Officer and Treasurer