YRC Worldwide Inc.
Form 10-Q
October 27, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016
OR
o 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: 0-12255

YRC Worldwide Inc.
(Exact name of registrant as specified in its charter)

Delaware	48-0948788
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10990 Roe Avenue, Overland Park, Kansas	66211
(Address of principal executive offices)	(Zip Code)

(913) 696-6100
(Registrant’s telephone number, including area code)
None
(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 ý 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 o Accelerated filer ý

Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 21, 2016
Common Stock, $0.01 par value per share	33,274,012 shares

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED BALANCE SHEETS
YRC Worldwide Inc. and Subsidiaries
(Amounts in millions except share and per share data)

	September 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	$ 276.4	$ 173.8
Restricted amounts held in escrow	43.0	58.8
Accounts receivable, net	477.8	427.4
Prepaid expenses and other	75.3	74.4
Total current assets	872.5	734.4
Property and Equipment:		
Cost	2,815.7	2,822.8
Less – accumulated depreciation	(1,927.9)	(1,885.5)
Net property and equipment	887.8	937.3
Intangibles, net	30.7	40.4
Restricted amounts held in escrow	—	63.4
Deferred income taxes, net	23.0	23.0
Other assets	56.6	80.9
Total Assets	$ 1,870.6	$ 1,879.4
Liabilities and Shareholders' Deficit		
Current Liabilities:		
Accounts payable	$ 163.9	$ 161.1
Wages, vacations and employee benefits	203.6	195.1
Deferred income taxes, net	23.0	23.0
Claims and insurance accruals	122.8	125.0
Other accrued taxes	27.6	29.8
Other current and accrued liabilities	24.9	23.6
Current maturities of long-term debt	16.6	15.9
Total current liabilities	582.4	573.5
Other Liabilities:		
Long-term debt, less current portion	1,023.9	1,046.5
Deferred income taxes, net	3.8	3.7
Pension and postretirement	311.4	339.9
Claims and other liabilities	291.3	295.2
Commitments and contingencies		
Shareholders' Deficit:		
Preferred stock, $1 par value per share	—	—
Common stock, $0.01 par value per share	0.3	0.3
Capital surplus	2,317.9	2,312.6
Accumulated deficit	(2,210.3)	(2,239.3)
Accumulated other comprehensive loss	(357.4)	(360.3)
Treasury stock, at cost (410 shares)	(92.7)	(92.7)
Total shareholders' deficit	(342.2)	(379.4)
Total Liabilities and Shareholders' Deficit	$ 1,870.6	$ 1,879.4

The accompanying notes are an integral part of these statements.

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STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
YRC Worldwide Inc. and Subsidiaries
For the Three and Nine Months Ended September 30
(Amounts in millions except per share data, shares in thousands)
(Unaudited)

	Three Months		Nine Months	
	2016	2015	2016	2015
Operating Revenue	$1,221.3	$1,244.9	$3,549.2	$3,689.7
Operating Expenses:				
Salaries, wages and employee benefits	715.8	725.8	2,132.6	2,148.6
Operating expenses and supplies	206.9	217.1	595.7	678.1
Purchased transportation	156.8	149.6	409.0	431.0
Depreciation and amortization	40.3	40.7	119.5	123.6
Other operating expenses	62.5	63.1	194.2	198.6
(Gains) losses on property disposals, net	0.2	0.9	(11.2)	1.5
Total operating expenses	1,182.5	1,197.2	3,439.8	3,581.4
Operating Income	38.8	47.7	109.4	108.3
Nonoperating Expenses:				
Interest expense	25.6	25.7	77.9	81.2
Loss on extinguishment of debt	—	—	—	0.6
Other, net	(1.2)	(4.5)	(0.9)	(8.1)
Nonoperating expenses, net	24.4	21.2	77.0	73.7
Income before income taxes	14.4	26.5	32.4	34.6
Income tax expense	0.5	6.7	3.4	10.4
Net Income	13.9	19.8	29.0	24.2
Other comprehensive income (loss), net of tax	2.3	(1.9)	2.9	2.9
Comprehensive Income Attributable to YRC Worldwide Inc.	$16.2	$17.9	$31.9	$27.1
Average Common Shares Outstanding – Basic	32,466	32,065	32,398	31,602
Average Common Shares Outstanding – Diluted	33,194	32,621	32,915	32,569
Income Per Share – Basic	$0.43	$0.62	$0.89	$0.76
Income Per Share – Diluted	$0.42	$0.61	$0.88	$0.74

The accompanying notes are an integral part of these statements.

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STATEMENTS OF CONSOLIDATED CASH FLOWS
YRC Worldwide Inc. and Subsidiaries
For the Nine Months Ended September 30
(Amounts in millions)
(Unaudited)

	2016	2015
Operating Activities:		
Net Income	$29.0	$24.2
Noncash items included in net income:		
Depreciation and amortization	119.5	123.6
Noncash equity-based compensation and employee benefits expense	16.2	18.5
(Gains) losses on property disposals, net	(11.2)	1.5
Gain on disposal of equity method investment	(2.3)	—
Other noncash items, net	7.6	0.7
Changes in assets and liabilities, net:		
Accounts receivable	(49.7)	(29.4)
Accounts payable	0.8	10.0
Other operating assets	4.1	(7.3)
Other operating liabilities	(28.0)	(50.3)
Net cash provided by operating activities	86.0	91.5
Investing Activities:		
Acquisition of property and equipment	(75.4)	(71.8)
Proceeds from disposal of property and equipment	26.5	15.7
Restricted escrow receipts	112.1	41.9
Restricted escrow deposits	(32.9)	(25.0)
Proceeds from disposal of equity method investment, net	14.6	—
Other, net	—	0.4
Net cash provided by (used in) investing activities	44.9	(38.8)
Financing Activities:		
Repayments of long-term debt	(26.5)	(13.1)
Debt issuance costs	(1.8)	—
Net cash used in financing activities	(28.3)	(13.1)
Net Increase In Cash and Cash Equivalents	102.6	39.6
Cash and Cash Equivalents, Beginning of Period	173.8	171.1
Cash and Cash Equivalents, End of Period	$276.4	$210.7
Supplemental Cash Flow Information:		
Interest paid	$(68.5)	$(79.3)
Income tax payments, net	(4.1)	(1.6)
Debt redeemed for equity consideration	—	17.9

The accompanying notes are an integral part of these statements.

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STATEMENT OF CONSOLIDATED SHAREHOLDERS' DEFICIT
YRC Worldwide Inc. and Subsidiaries
For the Nine Months Ended September 30, 2016
(Amounts in millions)
(Unaudited)

Preferred Stock:	
Beginning and ending balance	$—
Common Stock:	
Beginning and ending balance	$0.3
Capital Surplus:	
Beginning balance	$2,312.6
Equity-based compensation	5.3
Ending balance	$2,317.9
Accumulated Deficit:	
Beginning balance	$(2,239.3)
Net income	29.0
Ending balance	$(2,210.3)
Accumulated Other Comprehensive Loss:	
Beginning balance	$(360.3)
Reclassification of net pension actuarial losses to net income, net of tax	10.3
Foreign currency translation adjustments	3.0
Reclassification of foreign currency translation gains to net income	(10.4)
Ending balance	$(357.4)
Treasury Stock, At Cost:	
Beginning and ending balance	$(92.7)
Total Shareholders' Deficit	$(342.2)

The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YRC Worldwide Inc. and Subsidiaries
(Unaudited)

Certain of these Notes to Consolidated Financial Statements contain forward-looking statements, as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Cautionary Note Regarding Forward-Looking Statements."

1. Description of Business

YRC Worldwide Inc. (also referred to as "YRC Worldwide," the "Company," "we," "us" or "our") is a holding company that, through wholly owned operating subsidiaries, offers its customers a wide range of transportation services. We have one of the largest, most comprehensive less-than-truckload ("LTL") networks in North America with local, regional, national and international capabilities. Through our team of experienced service professionals, we offer expertise in LTL shipments and flexible supply chain solutions, ensuring customers can ship industrial, commercial and retail goods with confidence. Our reporting segments include the following:

- YRC Freight is the reporting segment that focuses on longer haul business opportunities with national, regional and international services. YRC Freight provides for the movement of industrial, commercial and retail goods, primarily through centralized management. This reporting segment includes YRC Inc. ("YRC Freight"), a U.S. LTL subsidiary, and Reimer Express ("YRC Reimer"), a subsidiary located in Canada that specializes in shipments into, across and out of Canada. In addition to the United States and Canada, YRC Freight also serves parts of Mexico, Puerto Rico and Guam.

- Regional Transportation is the reporting segment for our transportation service providers focused on business opportunities in the regional and next-day delivery markets. Regional Transportation is comprised of USF Holland LLC ("Holland"), New Penn Motor Express LLC ("New Penn") and USF Reddaway Inc. ("Reddaway"). These companies each provide regional, next-day ground services in their respective regions through a network of facilities located across the United States, Canada, Mexico and Puerto Rico.

At September 30, 2016, approximately 78% of our labor force is subject to collective bargaining agreements, which predominantly expire in March 2019.

2. Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of YRC Worldwide and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. We report on a calendar year basis. The quarters of the Regional Transportation companies (with the exception of New Penn) consist of thirteen weeks that end on a Saturday either before or after the end of March, June and September, whereas all other operating segment quarters end on the natural calendar quarter end. For ease of reference, the calendar quarter end dates are used herein. Our investment in our Chinese joint venture, a non-majority owned affiliate, was sold in March 2016 and was accounted for on the equity method.

We make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and notes. Actual results could differ from those estimates. We have prepared the Consolidated Financial Statements, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In our opinion, we have made all normal recurring adjustments necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods included in these financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (“GAAP”) have been condensed or omitted from these statements pursuant to SEC rules and regulations. Accordingly, the accompanying Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2015.

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Fair Value of Financial Instruments

The following table summarizes the fair value hierarchy of our financial assets and liabilities carried at fair value on a recurring basis as of September 30, 2016:

		Fair Value Measurement Hierarchy		
(in millions)	Total Carrying Value	Quoted prices in active market (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Restricted amounts held in escrow-current	$ 43.0	$ 43.0	$ —	$ —
Total assets at fair value	$ 43.0	$ 43.0	$ —	$ —

Restricted amounts held in escrow are invested in money market accounts and are recorded at fair value based on quoted market prices. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate their fair value due to the short-term nature of these instruments.

Equity Method Investment

On October 23, 2015, the Company entered into a sale and purchase agreement to sell its fifty percent equity interest in its Chinese joint venture, JHJ International Transportation Co., Ltd. (“JHJ”), for a purchase price of $16.3 million, which subsequently closed on March 30, 2016. At closing, we received proceeds of $16.3 million and paid transaction fees of $1.7 million. As of March 30, 2016, the carrying value of the investment was $22.7 million with an offsetting cumulative foreign translation adjustment of $10.4 million, resulting in a net gain on the transaction of $2.3 million. The gain on the transaction is included in “Nonoperating expenses - Other, net” in the accompanying statement of consolidated comprehensive income for the nine months ended September 30, 2016.

Reclassifications Out of Accumulated Other Comprehensive Loss

For the three and nine months ended September 30, 2016, we reclassified the amortization of our net pension loss totaling $3.5 million and $10.3 million, respectively, net of tax, from accumulated other comprehensive loss to net income. For the three and nine months ended September 30, 2015, we reclassified the amortization of our net pension loss totaling $4.0 million and $12.0 million respectively, net of tax, from accumulated other comprehensive loss to net income. This reclassification is a component of net periodic pension cost and is discussed in the “Employee Benefits” footnote.

Impact of Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, statutory tax withholding requirements, and classification of related amounts within the statement of cash flows. The new standard will become effective for the Company beginning with the first quarter of 2017, with early adoption permitted. The Company is currently evaluating the impacts the adoption of this accounting guidance will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which requires lessees to recognize most leases, including operating leases, on-balance sheet via a right-of-use asset, and lease liability. Lessees are permitted to make an accounting policy election to not recognize an asset or liability for leases with a term of 12 months or fewer. Additional qualitative and quantitative disclosures will be required. The new standard will be effective for the

Company for its annual reporting period beginning January 1, 2019, including interim periods within that reporting period. Early application is permitted. The ASU requires a modified retrospective transition, which means the Company will be required to apply the new guidance at the beginning of the earliest period presented in the financial statements; however, companies may elect to apply certain practical expedients on transition. The Company is currently evaluating the impacts of this new standard to its consolidated balance sheets, results of operations and related disclosures.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers, Deferral of the Effective date, which defers the effective date of ASU 2014-9, Revenue from Contracts with Customers. The new standard will supersede much of the previous requirements in ASU-605, Revenue Recognition and most industry specific guidance and introduces a five-step model to determine when and how revenue is recognized. The premise of the new model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard will be effective for the Company for its annual reporting

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period beginning January 1, 2018, including interim periods within that reporting period. Early application is permitted for annual periods beginning January 1, 2017. Entities are allowed to transition to the new standard by either recasting prior periods or recognizing the cumulative effect. The Company continues to assess the method of application and impact, if any, on our consolidated balance sheets, results of operations and related disclosures.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest, which required debt issue costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the accounting treatment for debt discounts. The Company adopted the standard as of January 1, 2016 and applied it retrospectively. The December 31, 2015 consolidated balance sheet was adjusted to reflect the reclassification of $15.2 million in debt issuance costs from “Other assets” to “Long-term debt, less current portion.” There was no other impact as a result of the adoption of this standard.

3. Debt and Financing

Our outstanding debt as of September 30, 2016 consisted of the following:

As of September 30, 2016 (in millions)	Par Value	Discount	Debt Issuance Costs	Book Value	Stated Interest Rate	Average Effective Interest Rate
Term Loan	$680.8	$(3.2)	$(9.7)	$667.9	8.00 % [a]	8.20 %
ABL Facility	—	—	—	—	N/A	N/A
Secured Second A&R CDA	29.0	—	(0.2)	28.8	3.3-18.3%	7.3 %
Unsecured Second A&R CDA	73.2	—	(0.4)	72.8	3.3-18.3%	7.3 %
Lease financing obligations	272.4	—	(1.4)	271.0	9.0-18.2%	12.0 %
Total debt	$1,055.4	$(3.2)	$(11.7)	$1,040.5		
Current maturities of Term Loan	(7.0)	—	—	(7.0)		
Current maturities of lease financing obligations	(9.6)	—	—	(9.6)		
Long-term debt	$1,038.8	$(3.2)	$(11.7)	$1,023.9		

[a] Variable interest rate of 1, 3 or 6-month LIBOR, with a floor of 1.0% plus a fixed margin of 7.0%.

ABL Facility Amendment

On June 28, 2016, the Company entered into Amendment No. 2 to the asset based loan facility (the “ABL Facility”), which amended several key terms, to include: (1) a 50 bps reduction in interest spread from LIBOR plus 2.25%, to LIBOR plus 1.75%, (2) the option to extend maturity from February 13, 2019 to June 28, 2021, subject to the refinancing, replacement or extension beyond June 28, 2021 of the credit agreement (the “Term Loan Agreement”) governing our term loan facility (the “Term Loan”), and (3) increased flexibility to manage and optimize the amount of cash included in the borrowing base by (i) providing the Company more flexibility as to the timing of testing the eligible borrowing base cash and (ii) reducing the availability limits under our ABL Facility to 10% of the collateral line cap from 15%.

ABL Facility Availability

Our principal sources of liquidity are cash and cash equivalents, available borrowings under our ABL Facility and net cash flow from operations. As of September 30, 2016, we had cash and cash equivalents of $276.4 million and the borrowing base and maximum availability on our ABL Facility were $412.6 million and $55.0 million, respectively. The maximum availability is calculated in accordance with the terms of the ABL Facility and is derived by reducing the borrowing base by our $357.6 million of outstanding letters of credit. While our ABL Agreement permits us to access maximum availability subject to certain financial covenant restrictions (which restrictions did not limit our availability as of September 30, 2016), the maximum amount we expect to access on our ABL Facility at any time is maximum availability less the lower of 10% of the borrowing base ($41.3 million at September 30, 2016) or 10% of the facility size ($45.0 million at September 30, 2016). Thus, of the $55.0 million in maximum availability, we expected to access no more than $13.7 million as of September 30, 2016 (“Managed Accessibility”). As a result, we had cash and cash equivalents and Managed Accessibility of $290.1 million as of September 30, 2016.

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Credit Facility Covenants

The Term Loan Agreement governing our Term Loan has certain financial covenants, as amended in September 2014, that, among other things, restricts certain capital expenditures and requires us to not exceed a maximum total leverage ratio (defined as Consolidated Total Debt divided by Consolidated Adjusted EBITDA, each as defined below).

Our total maximum leverage ratio covenants are as follows:

Four Consecutive Fiscal Quarters Ending	Maximum Total Leverage Ratio	Four Consecutive Fiscal Quarters Ending	Maximum Total Leverage Ratio
September 30, 2016	3.75 to 1.00	June 30, 2017	3.25 to 1.00
December 31, 2016	3.50 to 1.00	September 30, 2017	3.25 to 1.00
March 31, 2017	3.25 to 1.00	December 31, 2017 and thereafter	3.00 to 1.00

Consolidated Adjusted EBITDA, defined in our Term Loan Agreement as "Consolidated EBITDA," is a measure that reflects our earnings before interest, taxes, depreciation, and amortization expense, and is further adjusted for, among other things, letter of credit fees, equity-based compensation expense, net gains or losses on property disposals, restructuring professional fees, non-recurring consulting fees, expenses associated with certain lump sum payments to our International Brotherhood of Teamsters ("IBT") employees and the gains or losses from permitted dispositions and discontinued operations. Consolidated Total Debt, as defined in our Term Loan Agreement, is the aggregate principal amount of indebtedness outstanding. Our total leverage ratio for the four consecutive fiscal quarters ending September 30, 2016 was 3.45 to 1.00.

To maintain compliance with the maximum total leverage ratio over the tenor of the Term Loan and satisfy our liquidity needs, we would have to achieve operating results that reflect significant improvement over our third quarter 2016 results. Means for improving our profitability may include ongoing successful implementation and realization of pricing, productivity and efficiency initiatives, as well as increased volume, some of which are outside of our control.

Although we are currently in compliance with the maximum total leverage ratio covenant under our Term Loan Agreement, the covenant levels tighten in the coming quarters. Our internal forecasts currently indicate that, absent one or more specific actions as described below, we could fail to comply with this covenant in one or more quarters over the next 12 months. As a result, we may decide to pay down a sufficient amount of the Term Loan to comply with the covenant. We currently believe that the results of our operations will be sufficient to allow us to make such payments and fund our operations for the next twelve months. However, we may also be required to pursue certain actions, including but not limited to reducing capital expenditures, curtailing actions relating to our planned revenue growth and/or seeking other cost reductions. Some of those actions might adversely affect our operations and financial performance over the long-term.

Alternatively, we may seek an amendment to the Term Loan that would modify the covenant or pursue some other corporate finance transaction that would reduce our total leverage so that we would remain in compliance. There can be no assurance that we will be successful in obtaining such relief.

Fair Value Measurement

The book value and estimated fair values of our long-term debt, including current maturities and other financial instruments, are summarized as follows:

	September 30, 2016		December 31, 2015	
(in millions)	Book Value	Fair value	Book Value	Fair value
Term Loan	$667.9	$655.5	$669.0	$ 594.6

Lease financing obligations	271.0	268.3	276.3	282.9
Second A&R CDA	101.6	98.4	117.1	102.1
Total debt	$1,040.5	$ 1,022.2	$1,062.4	$ 979.6

The fair values of the Term Loan and the Secured and Unsecured Second Amended and Restated Contribution Deferral Agreement (the "Second A&R CDA") were estimated based on observable prices (level two inputs for fair value measurements). The fair value of the lease financing obligations is estimated using a publicly traded secured loan with similar characteristics (level three input for fair value measurement).

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Leases

As of September 30, 2016, our operating lease payment obligations through 2030 totaled $323.8 million and are expected to increase as we lease additional revenue equipment. Additionally, for the nine months ended September 30, 2016, we entered into new operating leases for revenue equipment totaling $95.2 million in future lease payments, payable over an average lease term of five years.

Our capital expenditures for the nine months ended September 30, 2016 and 2015 were $75.4 million and $71.8 million, respectively. These amounts were principally used to pay capitalized costs for technology infrastructure, to refurbish engines for our revenue fleet, and to fund the purchase of used tractors and trailers.

4. Employee Benefits

Qualified and Nonqualified Defined Benefit Pension Plans

The following table presents the components of our Company-sponsored pension costs for the three and nine months ended September 30:

	Three Months		Nine Months	
(in millions)	2016	2015	2016	2015
Service cost	$1.6	$1.2	$4.8	$3.6
Interest cost	14.0	14.3	42.0	42.9
Expected return on plan assets	(14.2)	(15.0)	(42.4)	(45.0)
Amortization of net pension loss	3.5	4.0	10.3	12.0
Total periodic pension cost	$4.9	$4.5	$14.7	$13.5

We expect to contribute $45.4 million to our Company-sponsored pension plans in 2016 of which we have contributed $33.1 million through September 30, 2016.

Performance Incentive Awards

The Company granted performance stock units in February 2016 that, to the extent earned based on company performance, will be settled in cash as the stock units vest equally over the next three years, with the first vesting occurring in February 2017. The awards are liability classified and remeasured to fair value at each reporting date until settlement.

5. Income Taxes

Our effective tax rate for the three and nine months ended September 30, 2016 was 3.5% and 10.5%, compared to 25.3% and 30.1% for the three and nine months ended September 30, 2015. The significant items impacting the 2016 rate include a provision for federal alternative minimum tax, a refund from a prior year amended return, a net state and foreign tax provision, certain permanent items, and a change in the valuation allowance established for the net deferred tax asset balance projected for December 31, 2016. The significant items impacting the 2015 rate include a net state and foreign tax provision, certain permanent items, and a change in the valuation allowance established for the net deferred tax asset balance that had been projected for December 31, 2015. We recognize valuation allowances on deferred tax assets if, based on the weight of the evidence, we determine it is more likely than not such assets will not be realized. Changes in valuation allowances are included in our tax provision in the period of change. In determining whether a valuation allowance is warranted, we evaluate factors such as prior years' earnings history, expected future earnings, loss carry-back and carry-forward periods, reversals of existing deferred tax liabilities and tax planning strategies that potentially enhance the likelihood of the realization of a deferred tax asset. At September 30, 2016 and December 31, 2015, substantially all of our net deferred tax assets were subject to a valuation allowance.

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6. Shareholders’ Deficit

The following reflects the activity in the shares of our common stock for the nine months ended September 30, 2016:

(shares in thousands)	2016
Beginning balance	32,141
Issuance of equity awards	330
Ending balance	32,471

7. Earnings Per Share

We calculate basic earnings per share by dividing our net earnings by our weighted-average shares outstanding at the end of the period. The calculation for diluted earnings per share adjusts the weighted average shares outstanding for our dilutive unvested shares and stock units using the treasury stock method and for our convertible notes using the if-converted method. Our calculations for basic and dilutive earnings per share for the three and nine months ended September 30, 2016 and 2015 are as follows: