Marcus & Millichap, Inc.
Form 10-Q
November 07, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **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

¨ **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: 001-36155

MARCUS & MILLICHAP, INC.

(Exact name of registrant as specified in its Charter)

Delaware **(State or Other Jurisdiction of** **Incorporation or Organization)**	**35-2478370** **(I.R.S. Employer** **Identification No.)**
23975 Park Sorrento, Suite 400 **Calabasas, California** **(Address of Principal Executive Offices)**	**91302** **(Zip Code)**

(818) 212-2250

(Registrant s telephone number, including area code)

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

Indicate by checkmark 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 time period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Number of shares of common stock, par value $0.0001 per share, of the registrant issued and outstanding as of November 2, 2016 was 37,616,243 shares.

MARCUS & MILLICHAP, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARCUS & MILLICHAP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollar amounts in thousands, except per share amounts)

	September 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 121,953	$ 96,185
Commissions receivable	4,501	3,342
Prepaid expenses	6,987	7,542
Income tax receivable		4,049
Marketable securities, available-for-sale	48,377	79,860
Other assets, net	3,826	5,136
Total current assets	185,644	196,114
Prepaid rent	12,628	9,075
Property and equipment, net	15,585	11,579
Marketable securities, available-for-sale	94,279	54,395
Assets held in rabbi trust	7,309	5,661
Deferred tax assets, net	35,495	35,285
Other assets	9,056	9,116
Total assets	$ 359,996	$ 321,225
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 9,865	$ 9,135
Notes payable to former stockholders	986	939
Deferred compensation and commissions	29,644	34,091
Income tax payable	4,181	
Accrued bonuses and other employee related expenses	20,152	30,846
Total current liabilities	64,828	75,011
Deferred compensation and commissions	40,278	43,678
Notes payable to former stockholders	8,686	9,671
Deferred rent and other liabilities	4,291	3,875
Total liabilities	118,083	132,235

Commitments and contingencies				
Stockholders equity:				
Preferred stock, $0.0001 par value:				
Authorized shares 25,000,000; issued and outstanding shares none at September 30, 2016, and December 31, 2015, respectively				
Common stock, $0.0001 par value:				
Authorized shares 150,000,000; issued and outstanding shares 37,616,243 and 37,396,456 at September 30, 2016, and December 31, 2015, respectively		4		4
Additional paid-in capital		84,949		80,591
Stock notes receivable from employees		(4)		(4)
Retained earnings		155,425		107,942
Accumulated other comprehensive income		1,539		457
Total stockholders equity		241,913		188,990
Total liabilities and stockholders equity	$	359,996	$	321,225

See accompanying notes to condensed consolidated financial statements.

MARCUS & MILLICHAP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF NET AND COMPREHENSIVE INCOME

(dollar and share amounts in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Revenues:				
Real estate brokerage commissions	$ 165,695	$ 151,942	$ 489,477	$ 446,356
Financing fees	11,320	10,865	30,779	30,046
Other revenues	3,619	3,069	8,037	9,497
Total revenues	180,634	165,876	528,293	485,899
Operating expenses:				
Cost of services	113,852	102,010	323,131	293,725
Selling, general, and administrative expense	40,728	35,646	123,403	109,064
Depreciation and amortization expense	1,149	802	3,164	2,389
Total operating expenses	155,729	138,458	449,698	405,178
Operating income	24,905	27,418	78,595	80,721
Other income (expense), net	719	(464)	1,567	23
Interest expense	(380)	(380)	(1,155)	(1,349)
Income before provision for income taxes	25,244	26,574	79,007	79,395
Provision for income taxes	10,100	11,398	31,524	32,994
Net income	15,144	15,176	47,483	46,401
Other comprehensive (loss) income:				
Unrealized (loss) gain on marketable securities, net of tax of $(37), $47, $684 and $(159) for the three months ended September 30, 2016, and 2015 and the nine months ended September 30, 2016 and 2015, respectively	(56)	56	1,050	(249)
Foreign currency translation (loss) gain, net of tax of $0, $140, $0 and $226 for the three months ended September 30, 2016, and 2015 and the nine months ended September 30, 2016 and 2015, respectively	(3)	234	32	361
Total other comprehensive (loss) income	(59)	290	1,082	112
Comprehensive income	$ 15,085	$ 15,466	$ 48,565	$ 46,513

Earnings per share:

Basic	$	0.39	$	0.39	$	1.22	$	1.19
Diluted	$	0.39	$	0.39	$	1.22	$	1.19
Weighted average common shares outstanding:								
Basic		38,939		38,890		38,916		38,868
Diluted		39,122		39,160		39,034		39,051

See accompanying notes to condensed consolidated financial statements.

MARCUS & MILLICHAP, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(dollar amounts in thousands)

(Unaudited)

	Preferred Stock		Common Stock						
	Shares	**Amount**	**Shares**	**Amount**	**Additional Paid-In Capital**	**Stock Notes Receivable From Employees**	**Retained Earnings**	**Accumulated Other Comprehensive Income**	**Total**
Balance as of December 31, 2015		$	37,396,456	$ 4	$ 80,591	$ (4)	$ 107,942	$ 457	$ 188,990
Net and comprehensive income							47,483	1,082	48,565
Stock-based award activity									
Stock-based compensation					4,933				4,933
Shares issued pursuant to employee stock purchase plan			17,940		402				402
Issuance of common stock for unvested restricted stock awards			14,742						
Issuance of common stock for vesting of restricted stock units			228,398						
Shares withheld related to net share settlement of stock-based awards			(41,293)		(1,134)				(1,134)
Windfall tax benefit from stock-based award activity					157				157
Balance as of September 30, 2016		$	37,616,243	$ 4	$ 84,949	$ (4)	$ 155,425	$ 1,539	$ 241,913

See accompanying notes to condensed consolidated financial statements.

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MARCUS & MILLICHAP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollar amounts in thousands)

(Unaudited)

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Cash flows from operating activities		
Net income	$ 47,483	$ 46,401
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	3,164	2,389
Provision for bad debt expense	15	127
Stock-based compensation	4,933	6,750
Deferred taxes, net	(894)	(3,160)
Net realized losses (gains) on marketable securities, available-for-sale	119	(130)
Tax benefit from stock-based award activity	157	4,844
Excess tax benefit from stock-based award activity	(157)	(4,844)
Other non-cash items	359	295
Changes in operating assets and liabilities:		
Commissions receivable	(1,159)	(470)
Prepaid expenses	555	1,144
Prepaid rent	(3,553)	(4,538)
Contributions to rabbi trust	(1,263)	(1,448)
Other assets	1,544	(3,993)
Accounts payable and accrued expenses	309	(2,650)
Income tax receivable/payable	8,230	4,939
Accrued bonuses and other employee related expenses	(10,495)	(4,885)
Deferred compensation and commissions	(8,245)	(3,191)
Deferred rent obligation and other liabilities	416	1,002
Net cash provided by operating activities	41,518	38,582
Cash flows from investing activities		
Purchases of marketable securities, available-for-sale	(97,311)	(130,500)
Proceeds from sales and maturities of marketable securities, available-for-sale	90,476	10,608
Payments received on employee notes receivable	3	15
Issuances of employee notes receivable	(381)	(175)
Purchase of property and equipment	(7,049)	(3,753)
Proceeds from sale of property and equipment	25	
Net cash used in investing activities	(14,237)	(123,805)
Cash flows from financing activities		
Proceeds from issuance of shares pursuant to employee stock purchase plan	402	502
Taxes paid related to net share settlement of stock-based awards	(1,134)	(756)
Excess tax benefit from stock-based award activity	157	4,844

Principal payments on notes payable to former stockholders	(938)	(894)
Net cash (used in) provided by financing activities	(1,513)	3,696
Net increase (decrease) in cash and cash equivalents	25,768	(81,527)
Cash and cash equivalents at beginning of period	96,185	149,159
Cash and cash equivalents at end of period	$ 121,953	$ 67,632

MARCUS & MILLICHAP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(dollar amounts in thousands)

(Unaudited)

	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Supplemental disclosures of cash flow information		
Interest paid during the period	$ 613	$ 853
Income taxes paid, net	$ 24,032	$ 26,370
Supplemental disclosures of noncash investing and financing activities		
Reduction of accrued bonuses and other employee related expenses in settlement of employee notes receivable	$ 199	$ 208
Change in property and equipment included in accounts payable and accrued expenses	$ 421	$ 729
Settlements of deferred compensation obligation with trust assets	$	$ 28

See accompanying notes to condensed consolidated financial statements.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of business, basis of presentation and recent accounting pronouncements

Description of Business

Marcus & Millichap, Inc., (the Company , Marcus & Millichap , or MMI), a Delaware corporation, is a brokerage firm specializing in commercial real estate investment sales, financing, research and advisory services. As of September 30, 2016, MMI operates 81 offices in the United States and Canada through its wholly-owned subsidiary, Marcus & Millichap Real Estate Investment Services, Inc. (MMREIS), which includes the operations of Marcus & Millichap Capital Corporation (MMCC).

Reorganization and Initial Public Offering

MMI was formed in June 2013 in preparation for Marcus & Millichap Company (MMC) to spin-off its majority owned subsidiary, MMREIS (Spin-Off). Prior to the initial public offering (IPO) of MMI, all of the preferred and common stockholders of MMREIS (including MMC and employees of MMREIS) contributed all of their outstanding shares to MMI, in exchange for new MMI common stock. As a result, MMREIS became a wholly-owned subsidiary of MMI. Thereafter, MMC distributed 80.0% of the shares of MMI common stock to MMC s shareholders and exchanged the remaining portion of its shares of MMI common stock for cancellation of indebtedness of MMC. MMI completed its IPO on October 30, 2013.

Basis of Presentation

The financial information presented in the accompanying unaudited condensed consolidated financial statements, has been prepared in accordance with rules and regulations of the U.S. Securities and Exchange Commission (SEC) for quarterly reports on Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements and notes include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the periods presented. These unaudited condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and notes thereto for the year ended December 31, 2015 included in the Company s Annual Report on Form 10-K filed on March 15, 2016 with the SEC. The results of the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2016, or for other interim periods or future years.

Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Reclassifications

Certain prior-period amounts have been reclassified to conform to the current period presentation. These changes had no impact on the previously reported condensed consolidated results of operations, financial condition, stockholders equity or on cash flows subtotals.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash and cash equivalents, due from independent contractors (included under other assets, net current and other assets non-current captions), investments in marketable securities, available-for-sale, security deposits (included under other assets, non-current caption) and commissions receivables. Cash is placed with high-credit quality financial institutions and invested high-credit quality money market funds.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

To reduce its credit risk, the Company monitors the credit standing of the financial institutions that hold the Company s cash and cash equivalents. The Company historically has not experienced any losses related to cash and cash equivalents.

The Company derives its revenues from a broad range of real estate investors, owners and users in the United States and Canada, none of which individually represents a significant concentration of credit risk. The Company performs credit evaluations of its customers and debtors and requires collateral on a case-by-case basis. The Company maintains allowances, as needed, for estimated credit losses based on management s assessment of the likelihood of collection. For the three and nine months ended September 30, 2016 and 2015, no transaction represented 10% or more of total revenues. Further, while one or more transactions may represent 10% or more of commissions receivable at any reporting date, amounts due are typically collected within 10 days of settlement and therefore do not expose the Company to significant credit risk.

The Company s Canadian operations represented less than 1.0% of total revenues in each period presented.

For the three and nine months ended September 30, 2016, one office represented approximately 10.9% and 10.1% of real estate brokerage commissions revenue, respectively. No office represented 10% or more of real estate brokerage commissions revenue during the three and nine months ended September 30, 2015.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which supersedes virtually all of the current revenue recognition guidance under U.S. GAAP, and requires entities to recognize revenue for transfer to customer of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled to receive in exchange for those goods or services. Subsequent to the issuance of ASU 2014-09, the FASB issued ASU No. 2015-14 *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, ASU No. 2016-08, *Revenue from Contacts with Customers: Principal Versus Agent Considerations*, ASU No. 2016-10, *Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing*, ASU No. 2016-12, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*. The additional ASU s clarified certain provisions of ASU 2014-09 in response to recommendations from the Transition Resources Group established by the FASB and extended the required adoption of ASU 2014-09 which is now effective for reporting periods beginning after December 15, 2017 and early adoption is permitted as of the original effective date.

ASU 2014-09 permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. For the Company, the new standard will be effective January 1, 2018. The Company does not have multiple-element arrangements, variable consideration, licenses and long-term contracts with customers. Accordingly, the Company does not expect this standard to have a significant effect in the manner or timing of its revenue recognition. The Company is in the process of completing the evaluation of the impact of this new standard and will select a transition method when the effect is determined.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). Currently, there is no guidance under U.S. GAAP regarding management s responsibility to assess whether there is substantial doubt about an entity s ability to continue as a going concern. Under ASU 2014-15, the Company will be required to assess its ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about the entity s ability to continue as a going concern, including management s plan to alleviate the substantial doubt. ASU 2014-15 is effective for reporting periods ending after December 15, 2016 and early adoption is permitted. For the Company, the new standard will be effective December 31, 2016. The Company does not anticipate that the adoption will have an impact on the Company s condensed consolidated financial position or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases, to increase transparency and comparability by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The Company is still evaluating the impact of the new standard. The Company will be required to adopt the new standard in 2019 and the Company s condensed consolidated balance sheets will be impacted by the recording of a lease liability and right of use asset for virtually all of its current operating leases, the amount of which and potential impact on the condensed consolidated statements of net and comprehensive income and condensed consolidated statements of cash flows has yet to be determined. As of September 30, 2016, the Company has remaining contractual obligations for operating leases (autos and office), which aggregate approximately $77.1 million. Accordingly, we anticipate that the adoption of the new standard will have a material impact on the Company s condensed consolidated balance sheet.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). The ASU changes the accounting for share-based payment awards issued to employees in the following areas:

1. Accounting for income taxes upon vesting or settlement of awards
2. Presentation of excess tax benefits on the statement of cash flows
3. Accounting for forfeitures
4. Minimum statutory withholding requirements
5. Presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet minimum statutory withholding requirements
6. Private company practical expedients

ASU 2016-09 is effective for reporting periods beginning after December 15, 2016 and early adoption is permitted. For the Company, the new standard will be effective on January 1, 2017. The Company is finalizing its evaluation of the impact of ASU 2016-09. The Company intends to adopt the provisions of ASU 2016-09 as of January 1, 2017. Since the Company issues stock-based awards to its employees and independent contractors and has recognized windfall tax benefits in additional paid in capital, it is anticipated that the ASU, when adopted, will impact (i) the Company s provision for income taxes, and therefore net and comprehensive income and related earnings per share amounts, (ii) amounts presented in the condensed consolidated statement of stockholders equity and condensed consolidated statements of cash flows and (iii) to a lesser extent the timing of our stock-based compensation expense. In accordance with the provision of ASU 2016-09, the Company intends to change its accounting for forfeitures from awards that are not expected to vest to when forfeitures occur. The Company anticipates adopting the majority of the provision of ASU 2016-09 on a prospective basis except for the change in the accounting for forfeitures, where the Company anticipates adopting the provision on a modified retrospective basis with a cumulative-effect adjustment as of January 1, 2017. Since the impact of the adoption of ASU 2016-09 is dependent on the future share price of the Company s stock, the Company cannot determine what the future impact will be for the forfeitures; however, based on the closing stock price on September 30, 2016, the cumulative-effect adjustment as of January 1, 2017 is not expected to be material. See Note 9 Stock-Based Compensation Plans for additional information.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses* (ASU 2016-13). ASU 2016-13 is effective for reporting periods beginning after December 15, 2019 and early adoption is permitted. For the Company, the new standard will be effective January 1, 2020. Under ASU 2016-13, the Company will be required to use an expected-loss model for its marketable securities, available-for sale, which requires that credit losses be presented as an allowance rather than as a write-down. Reversals of credit losses (in situations in which the estimate of credit losses declines) is permitted in the reporting period the change occurs. Current U.S. GAAP prohibits reflecting reversals of credit losses in current period earnings. The Company is currently evaluating the impact of this new standard.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15), to reduce diversity in practice in the classification of cash activity related to eight specific areas. ASU 2016-15 is effective for reporting periods beginning after December 15, 2017 and interim periods within those years and early adoption is permitted. The Company adopted ASU 2016-15 during the nine months ended September 30, 2016. The Company evaluated the impact of this new standard and determined its historical classifications, where applicable, were in accordance with ASU 2016-15. Accordingly, the adoption did not have an impact on the Company s condensed consolidated financial position or results of operations.

2. Property and Equipment

Property and equipment, net consist of the following (in thousands):

	September 30, 2016	**December 31, 2015**
Computer software and hardware equipment	$ 13,502	$ 10,973
Furniture, fixtures, and equipment	19,252	17,047
Less: accumulated depreciation and amortization	(17,169)	(16,441)
	$ 15,585	$ 11,579

During the nine months ended September 30, 2016 and 2015, the Company wrote off approximately $2.7 million and $2.6 million, respectively, of fully depreciated computer software and hardware and furniture, fixtures and equipment.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company leases all of its facilities under operating lease agreements. Lease agreements may contain periods of free rent or reduced rent or contain predetermined fixed increases in the minimum rent. The Company recognizes the minimum lease payments as rent expense on a straight-line basis over the noncancellable term of the lease. The Company records the difference between the amount charged to rent expense and the rent paid as a deferred rent obligation. The Company typically leases general purpose built-out office space, which reverts to the lessor upon termination of the lease. Any payments for improvements, net of incentives received, are recorded as prepaid rent. Prepaid rent is amortized using the straight-line method over the expected lease term as a charge to rent expense.

3. Selected Balance Sheet Data

Other Assets

Other assets consisted of the following (in thousands):

	Current		Non-Current	
	September 30, 2016	**December 31, 2015**	**September 30, 2016**	**December 31, 2015**
Due from independent contractors, net [1] [2]	$ 1,783	$ 2,545	$ 7,678	$ 7,358
Security deposits			1,054	1,425
Employee notes receivable [3]	434	224	112	158
Customer trust accounts and other	1,609	2,367	212	175
	$ 3,826	$ 5,136	$ 9,056	$ 9,116

(1) Represents amounts advanced, notes receivable and other receivables due from the Company s investment sales and financing professionals. The notes receivable along with interest, are typically collected from future commissions and are generally due in one to five years.

(2) Includes allowance for doubtful accounts related to current receivables of $303 and $359 as of September 30, 2016 and December 31, 2015, respectively. The Company recorded a provision for bad debt expense of $12 and $48 and wrote off $6 and $24 of these receivables for the three months ended September 30, 2016 and 2015, respectively. The Company recorded a provision for bad debt expense of $15 and $127 and wrote off $71 and $59 of these receivables for the nine months ended September 30, 2016 and 2015, respectively.

(3) See Note 6 Related-Party Transactions for additional information.

Deferred Compensation and Commissions

Deferred compensation and commissions consisted of the following (in thousands):

	Current		Non-Current	
	September 30, 2016	December 31, 2015	September 30, 2016	December 31, 2015
SARs liability [1]	$ 1,366	$	$ 20,719	$ 21,399
Commissions payable to investment sales and financing professionals	28,140	34,091	12,755	17,015
Deferred compensation liability [1]	138		6,804	5,264
	$ 29,644	$ 34,091	$ 40,278	$ 43,678

(1) The SARs and deferred compensation liability become subject to payout as a result of a participant no longer being considered as an employee service provider. As a result of the retirement of certain participants, estimated amounts to be paid to the participants within the next 12 months has been classified as current.

SARs Liability

Prior to the IPO, certain employees of the Company were granted stock appreciation rights (SARs) under a stock-based compensation program assumed by MMC. In connection with the IPO, the SARs agreements were revised, the MMC liability of $20.0 million for the SARs was frozen at March 31, 2013, and was transferred to MMI through a capital distribution. The SARs liability will be settled with each participant in ten annual installments in January of each year upon retirement or termination from service. Under the revised agreements, MMI is required to accrue interest on the outstanding balance beginning on January 1, 2014 at a rate based on the 10-year treasury note plus 2%. The rate resets annually. The rates at January 1, 2016 and 2015 were 4.273% and 4.173%, respectively. MMI recorded interest expense related to this liability of $229,000 and $214,000, for the three months ended September 30, 2016 and 2015, respectively and $686,000 and $642,000 for the nine months ended September 30, 2016 and 2015, respectively.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Estimated payouts within the next twelve months for participants that have separated from service have been classified as current.

Commissions Payable

Certain investment sales professionals have the ability to earn additional commissions after meeting certain annual revenue thresholds. These commissions are recognized as cost of services in the period in which they are earned. The Company has the ability to defer payment of certain commissions, at its election, for up to three years. Commissions payable that are not expected to be paid within twelve months are classified as long-term.

Deferred Compensation Liability

A select group of management is eligible to participate in a Deferred Compensation Plan. The plan is a 409A plan and permits the participant to defer compensation up to limits as determined by the plan. Amounts are paid out generally when the participant is no longer a service provider; however, an in-service payout election is available to participants. Participants may elect to receive payouts as a lump sum or quarterly over a two to fifteen year period. The Company elected to fund the Deferred Compensation Plan through company owned variable life insurance policies. The Deferred Compensation Plan is managed by a third-party institutional fund manager, and the deferred compensation and investment earnings are held as a Company asset in a rabbi trust, which is recorded in assets held in rabbi trust in the accompanying condensed consolidated balance sheets. The assets in the trust are restricted unless the Company becomes insolvent, as defined in the Deferred Compensation Plan, in which case the trust assets are subject to the claims of MMI s creditors. The Company may also, in its sole and absolute discretion, elect to withdraw at any time a portion of the trust assets by an amount by which the fair market value of the trust assets exceeds 110% of the aggregate deferred compensation liability represented by the participants accounts. Estimated payouts within the next twelve months for participants that have separated from service have been classified as current.

The net change in the carrying value of the assets held in the rabbi trust and the net change in the carrying value of the deferred compensation liability, each exclusive of additional contributions, distributions and trust expenses consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Increase (decrease) in the carrying value of the assets held in the rabbi trust (1)	$ 229	$ (351)	$ 413	$ (340)
Increase (decrease) in the carrying value of the deferred compensation obligation (2)	$ 209	$ (307)	$ 397	$ (248)

(1)

Recorded in other income (expense), net in the condensed consolidated statements of net and comprehensive income.

(2) Recorded in selling, general and administrative expense in the condensed consolidated statements of net and comprehensive income.

MARCUS & MILLICHAP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Investments in Marketable Securities

Amortized cost and fair value of marketable securities, available-for-sale, by type of security consisted of the following (in thousands):

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term investments:								
U.S. treasuries	$ 24,864	$ 15	$ (1)	$ 24,878	$ 62,343	$	$ (71)	$ 62,272
U.S. government sponsored entities	11,508	5		11,513	17,571		(12)	17,559
Corporate debt securities	11,982	4		11,986				
Asset-backed securities and other					29			29
	$ 48,354	$ 24	$ (1)	$ 48,377	$ 79,943	$	$ (83)	$ 79,860
Long-term investments:								
U.S. treasuries	$ 50,535	$ 172	$ (9)	$ 50,698	$ 15,283	$	$ (112)	$ 15,171
U.S. government sponsored entities	15,989	25		16,014	12,107		(85)	12,022
Corporate debt securities	18,261	529	(21)	18,769	17,219	5	(519)	16,705
Asset-backed securities and other	8,729	118	(49)	8,798	10,649		(152)	10,497
	$ 93,514	$ 844	$ (79)	$ 94,279	$ 55,258	$ 5	$ (868)	$ 54,395

The amortized cost and fair value of the Company s investments in available-for-sale securities that have been in a continuous unrealized loss position consisted of the following (in thousands):

	September 30, 2016		December 31, 2015	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Less than 12 months	$ (33)	$ 39,367	$ (951)	$ 129,117
12 months or longer	$ (47)	$ 2,747	$	$

Gross realized gains and gross realized losses from the sales of the Company s available-for-sale securities consisted of the following (in thousands):

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Gross realized gain [(1)]	$ 16	$	$ 36	$ 133
Gross realized loss [(1)]	$	$	$ (155)	$ (3)

(1) Recorded in other income (expense), net in the condensed consolidated statements of net and comprehensive income. The cost basis of securities sold were determined on the specific identification method.

The Company may sell certain of its marketable securities, available-for-sale prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration, duration management and when a security no longer meets the criteria of the Company s investment policy. During the nine months ended September 30, 2016, the Company sold one security, which no longer met the requirements of its investment policy for a loss of $152,000.

As of September 30, 2016, the Company considers the declines in market value of its marketable securities, available-for-sale to be temporary in nature and does not consider any of its investments other-than-temporarily impaired. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss and matching long-term liabilities. When evaluating an investment for other-than-temporary impairment the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates and the Company s intent to sell, or whether it is more likely than not it will be required to sell the investment before recovery of the investment s cost basis.

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Amortized cost and fair value of marketable securities, available-for-sale, by contractual maturity consisted of the following (in thousands):

	September 30, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 48,354	$ 48,377	$ 79,943	$ 79,860
Due after one year through five years	70,627	70,758	28,634	28,465
Due after five years through ten years	14,998	15,537	18,020	17,466
Due after ten years	7,889	7,984	8,604	8,464
	$ 141,868	$ 142,656	$ 135,201	$ 134,255
Weighted average contractual maturity	3.2 years		3.3 years	

Actual maturities may differ from contractual maturities because certain borrowers have the right to prepay certain obligations with or without prepayment penalties.

5. Notes Payable to Former Stockholders

In conjunction with the Spin-Off and IPO, notes payable to certain former stockholders of MMREIS were issued in settlement of restricted stock and SARs awards that were redeemed by MMREIS upon the termination of employment by these former stockholders (the Notes), which had been previously assumed by MMC, and were transferred to the Company. The Notes are unsecured and bear interest at 5% with annual principal and interest installments and a final principal payment due during the second quarter of 2020. During each of the nine months ended September 30, 2016 and 2015, the Company made total payments on the Notes of $1.5 million.

Accrued interest pertaining to the Notes consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Accrued interest [1]	$ 216	$ 367

[1] Recorded in accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

Interest expense pertaining to the Notes consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest expense	$ 122	$ 133	$ 381	$ 414

6. Related-Party Transactions

Shared and Transition Services

Prior to October 2013, the Company operated under a shared services arrangement with MMC whereby the Company was charged for actual costs specifically incurred on behalf of the Company or allocated to the Company on a pro rata basis. Beginning in October 2013, certain services are provided to the Company under a Transition Services Agreement (TSA) between MMC and the Company, which replaced the pre-IPO shared services arrangement. The TSA is intended to provide certain services until the Company acquires the services separately. During the three months ended September 30, 2016 and 2015, the Company incurred $61,000 and $56,000 under the TSA. During the nine months ended September 30, 2016 and 2015, the Company incurred $185,000 and $165,000 under the TSA. These amounts are included in selling, general and administrative expense in the accompanying condensed consolidated statements of net and comprehensive income.

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Accounts Payable and Accrued Expenses with MMC

As of September 30, 2016 and December 31, 2015, $661,000 and $96,000, respectively, remains unpaid and is included in accounts payable and accrued expenses in the accompanying condensed consolidated balance sheets.

Brokerage and Financing Services with the Subsidiaries of MMC

MMC has wholly or majority owned subsidiaries that buy and sell commercial real estate properties. The Company performs certain brokerage and financing services related to transactions of the subsidiaries of MMC. For the three months ended September 30, 2016 and 2015, the Company generated real estate brokerage commissions and financing fees of $1.1 million and $305,000, respectively, from subsidiaries of MMC. The Company incurred cost of services of $674,000 and $173,000, respectively, related to these revenues. For the nine months ended September 30, 2016 and 2015, the Company generated real estate brokerage commissions and financing fees of $3.5 million and $1.6 million, respectively, from subsidiaries of MMCs. The Company incurred cost of services of $2.1 million and $943,000, respectively, related to these revenues.

Operating Lease with MMC

The Company has an operating lease with MMC for a single story office building located in Palo Alto, California, which was amended in 2016 to extend the expiration date to May 31, 2022. Rent expense for this lease aggregated $253,000 and $219,000 for the three months ended September 30, 2016 and 2015, respectively. Rent expense for this lease aggregated $759,000 and $474,500 for the nine months ended September 30, 2016 and 2015, respectively. Rent expense is included in selling, general and administrative expense in the accompanying condensed consolidated statements of net and comprehensive income.

Other

The Company makes advances to non-executive employees from time-to-time. At September 30, 2016 and December 31, 2015, the aggregate principal amount for employee loans outstanding was $546,000 and $382,000, respectively, which is included in other assets, net current and other assets non-current captions in the accompanying condensed consolidated balance sheets.

As of September 30, 2016, George M. Marcus, the Company s founder and Co-Chairman, beneficially owned 55.2% of the Company s issued and outstanding common stock, including shares owned by Phoenix Investments Holdings, LLC (Phoenix) and the George and Judy Marcus Family Foundation.

7. Fair Value Measurements

U.S. GAAP defines the fair value of a financial instrument as the amount that would be received from the sale of an asset in an orderly transaction between market participants at the measurement date. The Company is responsible for the determination of the value of the investment carried and fair value and the supporting methodologies and assumptions. The Company uses various pricing sources to validate the values utilized.

The degree of judgment used in measuring the fair value of financial instruments is generally inversely correlates with the level of observable valuation inputs. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgment is used in measuring fair value. Financial instruments for which no quoted prices are available have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgment.

Assets recorded at fair value are measured and classified in accordance with a fair value hierarchy consisting of the three levels based on the observability of inputs available in the marketplace used to measure the fair values as discussed below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; or

Level 3: Inputs reflect management s best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

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Recurring Fair Value Measurements

The Company values its investments including assets held in rabbi trust, money market funds and investments in marketable securities, available-for-sale at fair value on a recurring basis.

Investments carried at fair value are categorized into one of the three categories described above and consisted of the following (in thousands):

	September 30, 2016				December 31, 2015			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Assets held in rabbi trust	$ 7,309	$	$ 7,309	$	$ 5,661	$	$ 5,661	$
Money market funds [1]	$ 60,513	$ 60,513	$	$	$ 5,987	$ 5,987	$	$
Marketable securities, available-for-sale:								
Short-term investments:								
U.S. Treasuries	$ 24,878	$ 24,878	$	$	$ 62,272	$ 62,272	$	$
U.S. Government Sponsored Entities	11,513		11,513		17,559		17,559	
Corporate debt securities	11,986		11,986					
Asset-backed securities and other					29		29	
	$ 48,377	$ 24,878	$ 23,499	$	$ 79,860	$ 62,272	$ 17,588	$
Long-term investments:								
U.S. Treasuries	$ 50,698	$ 50,698	$	$	$ 15,171	$ 15,171	$	$
U.S. Government Sponsored Entities	16,014		16,014		12,022		12,022	
Corporate debt securities	18,769		18,769		16,705		16,705	
Asset-backed securities and other	8,798		8,798		10,497		10,497	
	$ 94,279	$ 50,698	$ 43,581	$	$ 54,395	$ 15,171	$ 39,224	$

[1] Included in cash and cash equivalents.

There were no transfers in or out of Level 1 and Level 2 during the three and nine months ended September 30, 2016.

Assets and Liabilities not Measured at Fair Value

The Company s cash and cash equivalents, commissions receivable, amounts due from employees (included in other assets, net current and other assets non-current captions) and investment sales and financing professionals (included in other assets, net current caption), accounts payable and accrued expenses and commissions payable are carried at cost, which approximates fair value based on their immediate or short-term maturities and terms which approximate current market rates and are considered to be in the Level 1 classification.

As the Company s obligations under notes payable to former stockholders bear fixed interest rates that approximate current interest rates for debt instruments with similar terms and maturities, the Company has determined that the carrying value on these instruments approximates fair value. As the Company s obligations under SARs liability (included in deferred compensation and commission s caption) bear interest at a variable rate based on U.S. Treasuries, the Company has determined that the carrying value approximates the fair value. These are considered to be in the Level 2 classification.

8. Stockholders Equity
Common Stock

As of September 30, 2016 and December 31, 2015, there were 37,616,243 and 37,396,456 shares of common stock, $0.0001 par value, issued and outstanding, which includes unvested restricted stock awards issued to non-employee directors, respectively. See Note 11 Earnings per Share for additional information.

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The Company currently does not intend to pay a regular dividend. The Company will evaluate its dividend policy in the future. Any declaration and payment of future dividends to holders of the Company s common stock will be at the discretion of the board of directors and will depend on many factors, including the Company s financial condition, earnings, cash flows, capital requirements, level of indebtedness, statutory and contractual restrictions applicable to the payment of dividends and other considerations that the board of directors deems relevant.

Preferred Stock

The Company has 25,000,000 authorized shares of preferred stock with a par value $0.0001 per share. At September 30, 2016 and December 31, 2015, there were no preferred shares issued or outstanding.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income as of September 30, 2016, by component, net of income taxes consisted of the following (in thousands):

	Unrealized gains and (losses) of available-for-sale securities	Foreign currency translation (2)	Total
Beginning balance, December 31, 2015	$ (568)	$ 1,025	$ 457
Other comprehensive income before reclassifications	1,152	32	1,184
Amounts reclassified from accumulated other comprehensive income (1)	(102)		(102)
Net current-period other comprehensive income	1,050	32	1,082
Ending balance, September 30, 2016	$ 482	$ 1,057	$ 1,539

(1) Included as a component of other income (expense), net in the condensed consolidated statements of net and comprehensive income. The reclassifications were determined on a specific identification basis.

(2) The Company has not provided for U.S. taxes on unremitted earnings of its foreign subsidiary as it is operating at a loss and has no earnings and profits to remit. As a result, deferred taxes were not provided related to the cumulative foreign currency translation adjustments.

9. Stock-Based Compensation Plans

2013 Omnibus Equity Incentive Plan

In October 2013, the board of directors adopted the 2013 Plan, which became effective upon the Company s IPO. The 2013 Plan, in general, authorizes for the granting of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards (RSAs), restricted stock units (RSUs), performance units and performance shares to the Company s and subsidiary corporations employees, independent contractors, directors and consultants. Grants are made from time to time by the Company s board of directors at its discretion subject to certain restrictions as to the number and value of shares that may be granted to any individual.

Upon adoption of the 2013 Plan, 5,500,000 shares of common stock were reserved for the issuance of awards under the 2013 Plan. Pursuant to the automatic increase provided for in the 2013 Plan, the board of directors have approved share reserve increases aggregating 2,200,000. At September 30, 2016, there were 4,352,735 shares available for future grants under the Plan.

Awards Granted in Connection with the IPO

In November 2013, MMI issued the following equity awards under the 2013 Plan: (i) Deferred stock units (DSUs) for an aggregate of 2,192,413 shares granted as replacement awards related to the prior SARs program to the MMREIS managing directors and (ii) DSUs for 83,334 shares granted to the Company s Co-chairman of the board of directors, William A. Millichap. The DSU s are fully vested and shares will be issued ratably over 5 years (see Amendments to Restricted Stock and SARs section below). In addition, 30,000 shares, in the form of RSAs, were granted to the Company s non-employee directors. The shares vest ratably over 3 years. All the above awards were granted based on the IPO price of $12.00.

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Awards Granted and Settled Subsequent to the IPO

Under the 2013 Plan, the Company has issued RSA s to non-employee directors and RSU s to employees and independent contractors. All RSAs vest in equal annual installments over a three year period from the date of grant. All RSUs vest in equal annual installments over a five year period from the date of grant. Any unvested awards are canceled upon termination of service. Awards accelerate upon death subject to approval by the compensation committee.

During the nine months ended September 30, 2016, 239,396 shares of stock-based awards vested and 41,293 shares of common stock were withheld to pay applicable required employee statutory withholding taxes based on the market value of the shares on the vesting date. The amount remitted to the tax authorities for the employees tax obligation was reflected in the taxes paid related to net share settlement of stock-based awards caption in the financing section of the condensed consolidated statements of cash flows. The shares withheld for taxes were returned to the share reserve and are available for future issuance in accordance with provisions of the 2013 Plan.

During the nine months ended September 30, 2016, the Company recorded windfall tax benefits, net in the amount of $157,000 resulting from settlement of stock-based award activity. Such windfall tax benefits, net are excluded from the provision for income taxes, and included as a component of additional paid-in capital in the accompanying condensed consolidated balance sheets and in cash flows provided by (used in) financing activities in the accompanying condensed consolidated statement of cash flows.

Outstanding Awards

Activity under the 2013 Plan consisted of the following (dollars in thousands, except per share data):

	RSA Grants to Non-employee Directors	RSU Grants to Employees	RSU Grants to Independent Contractors	Total	Weighted-Average Grant Date Fair Value Per Share
Nonvested shares at December 31, 2015	35,364	468,969	521,780	1,026,113	$ 21.17
Granted					
February 2016		*172,496*	*8,856*	*181,352*	
March 2016		*30,000*		*30,000*	
May 2016	*14,742*	*11,051*	*8,188*	*33,981*	
August 2016		*12,781*	*49,608*	*62,389*	
Total Granted	14,742	226,328	66,652	307,722	23.79
Vested	(10,998)	(103,428)	(124,970)	(239,396)	20.03
Forfeited/canceled		(37,299)	(4,135)	(41,434)	21.64

Nonvested shares at September 30, 2016 [1]	39,108	554,570	459,327	1,053,005	$ 22.18
Unrecognized stock-based compensation expense as of September 30, 2016 [2]	$ 584	$ 10,836	$ 9,183	$ 20,603	
Weighted average remaining vesting period (years) as of September 30, 2016	1.97	3.60	2.86	3.22	

(1) Nonvested RSU s will be settled through the issuance of new shares of common stock.

(2) The total unrecognized compensation expense is expected to be recognized over a weighted-average period of approximately 3.22 years.

As of September 30, 2016, 1,365,445 fully vested DSUs remained outstanding.

Employee Stock Purchase Plan

In 2013, the Company adopted the 2013 Employee Stock Purchase Plan (ESPP Plan). The ESPP Plan qualifies under Section 423 of the IRS Code and provides for consecutive, non-overlapping 6-month offering periods. The offering periods generally start on the first trading day on or after May 15 and November 15 of each year. The first offering period began on May 15, 2014. Qualifying employees may purchase shares of the Company s stock at a 10% discount based on the lower of the market price at the beginning or end of the offering period, subject to IRS limitations. The Company determined that the ESPP Plan was a compensatory plan and is required to expense the fair value of the awards over each 6-month offering period.

The ESPP Plan has 366,667 shares of common stock reserved and 289,244 shares of common stock available for issuance as of September 30, 2016. The ESPP Plan provides for annual increases in the number of shares available for issuance under the ESPP. Pursuant to the provisions of the ESPP Plan, the board of directors determined a share reserve increase was not needed in 2015. At September 30, 2016, total unrecognized compensation cost related to the ESPP Plan was $27,000 and is expected to be recognized over a weighted average period of 0.13 years.

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Amendments to Restricted Stock and SARs

Restricted Stock

In connection with the IPO, the formula settlement value of all outstanding shares of stock held by the plan participants was removed, and all such shares of stock are subject to sales restrictions that lapse at a rate of 20% per year for five years if the participant remains employed by the Company. In the event of death or termination of employment after reaching the age of 67, 100% of the shares of stock will be released from the resale restriction. 100% of the shares of stock will be released from the resale restriction upon the consummation of a change of control of the Company.

SARs

Prior to the IPO, certain employees were granted SARs. As of March 31, 2013, the outstanding SARs were frozen at the liability amount, and will be paid out to each participant in installments upon retirement or departure under the terms of the revised SARs agreements. To replace beneficial ownership in the SARs, the difference between the book value liability and the fair value of the awards was granted to plan participants in the form of DSUs, which were fully vested upon receipt and will be settled in actual stock at a rate of 20% per year if the participant remains employed by the Company during that period (otherwise all unsettled shares of stock upon termination from service will be settled five years from the termination date). In the event of death or termination of service after reaching the age of 67, 100% of the DSUs will be settled.

Summary of Stock-Based Compensation

Components of stock-based compensation included in selling, general and administrative expense in the condensed consolidated statements of net and comprehensive income consisted of the following (in thousands, except common stock price):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Employee stock purchase plan	$ 54	$ 56	$ 162	$ 184
RSAs non-employee directors	121	91	319	228
RSUs employees	734	547	2,210	1,626
RSUs independent contractors [(1)]	924	1,474	2,242	4,712
	$ 1,833	$ 2,168	$ 4,933	$ 6,750