

POTBELLY CORP  
Form 10-Q  
August 05, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the Quarterly Period Ended June 28, 2015**

**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: 001-36104**

**Potbelly Corporation**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or Other Jurisdiction of**

**36-4466837**  
**(IRS Employer**

**Incorporation)**

**Identification Number)**

**111 N. Canal Street, Suite 850**

**Chicago, Illinois 60606**

**(Address, including Zip Code, of Principal Executive Offices)**

**Registrant's telephone number, including area code: (312) 951-0600**

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  No

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  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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common stock, \$0.01 Par Value 30,213,562 shares as of July 31, 2015

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**POTBELLY CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**

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**Table of Contents****POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(amounts in thousands, except share and par value data, unaudited)

|  | June 28,<br>2015  | December 28,<br>2014 |
|--|-------------------|----------------------|
| <b>ASSETS</b>  |                   |                      |
| Current assets   |                   |                      |
| Cash and cash equivalents  | \$ 54,105         | \$ 63,005            |
| Accounts receivable, net of allowances of \$43 and \$19 as of June 28, 2015 and December 28, 2014, respectively  | 5,034             | 4,016                |
| Inventories  | 2,820             | 2,768                |
| Deferred income taxes, current   | 541               | 507                  |
| Prepaid expenses and other current assets  | 8,529             | 9,922                |
| <b>Total current assets</b>  | <b>71,029</b>     | <b>80,218</b>        |
| Property and equipment, net  | 92,615            | 85,704               |
| Indefinite-lived intangible assets   | 3,404             | 3,404                |
| Goodwill   | 1,428             | 1,428                |
| Deferred income taxes, non-current   | 17,860            | 17,860               |
| Deferred expenses, net and other assets  | 3,673             | 3,333                |
| <b>Total assets</b>  | <b>\$ 190,009</b> | <b>\$ 191,947</b>    |
| <b>LIABILITIES AND EQUITY</b>  |                   |                      |
| Current liabilities  |                   |                      |
| Accounts payable   | \$ 2,228          | \$ 3,301             |
| Accrued expenses   | 19,694            | 16,349               |
| Accrued income taxes   | 100               | 226                  |
| Current portion of long-term debt  |                   | 1,008                |
| <b>Total current liabilities</b>   | <b>22,022</b>     | <b>20,884</b>        |
| Deferred rent and landlord allowances  | 15,781            | 14,012               |
| Other long-term liabilities  | 699               | 726                  |
| <b>Total liabilities</b>   | <b>38,502</b>     | <b>35,622</b>        |
| Equity   |                   |                      |
| Common stock, \$0.01 par value authorized, 200,000,000 shares; outstanding 28,371,178 and 28,934,700 shares as of June 28, 2015, and December 28, 2014, respectively | 301               | 298                  |
| Warrants   | 909               | 909                  |

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|   |                   |                   |
|---|-------------------|-------------------|
| Additional paid-in-capital  | 396,385           | 391,972           |
| Treasury stock, held at cost, 1,749,406 and 827,090 shares as of June 28, 2015, and December 28, 2014, respectively | (22,792)          | (10,246)          |
| Accumulated deficit   | (223,882)         | (226,874)         |
| <b>Total stockholders' equity</b>   | <b>150,921</b>    | <b>156,059</b>    |
| Non-controlling interest  | 586               | 266               |
| <b>Total equity</b>   | <b>151,507</b>    | <b>156,325</b>    |
| <b>Total liabilities and equity</b>   | <b>\$ 190,009</b> | <b>\$ 191,947</b> |

*See accompanying notes to the unaudited condensed consolidated financial statements.*

**Table of Contents****POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations**

(amounts in thousands, except share and per share data, unaudited)

|   | <b>For the 13 Weeks Ended</b> |                 | <b>For the 26 Weeks Ended</b> |                 |
|---|-------------------------------|-----------------|-------------------------------|-----------------|
|   | <b>June 28,</b>               | <b>June 29,</b> | <b>June 28,</b>               | <b>June 29,</b> |
|   | <b>2015</b>                   | <b>2014</b>     | <b>2015</b>                   | <b>2014</b>     |
| <b>Revenues</b>   |                               |                 |                               |                 |
| Sandwich shop sales, net  | \$ 95,566                     | \$ 83,268       | \$ 180,963                    | \$ 156,791      |
| Franchise royalties and fees  | 383                           | 352             | 754                           | 710             |
| <b>Total revenues</b>   | <b>95,949</b>                 | <b>83,620</b>   | <b>181,717</b>                | <b>157,501</b>  |
| <b>Expenses</b>   |                               |                 |                               |                 |
| Sandwich shop operating expenses  |                               |                 |                               |                 |
| Cost of goods sold, excluding depreciation                              | 27,253                        | 23,936          | 51,598                        | 45,022          |
| Labor and related expenses  | 27,152                        | 23,405          | 51,752                        | 44,865          |
| Occupancy expenses  | 11,539                        | 10,183          | 22,886                        | 20,162          |
| Other operating expenses  | 9,970                         | 8,691           | 19,627                        | 16,849          |
| General and administrative expenses                                     | 9,643                         | 8,865           | 18,474                        | 16,687          |
| Depreciation expense  | 5,288                         | 4,784           | 10,439                        | 9,501           |
| Pre-opening costs   | 536                           | 273             | 1,077                         | 525             |
| Impairment and loss on disposal of property and equipment               | 484                           | 29              | 832                           | 877             |
| <b>Total expenses</b>   | <b>91,865</b>                 | <b>80,166</b>   | <b>176,685</b>                | <b>154,488</b>  |
| Income from operations  | 4,084                         | 3,454           | 5,032                         | 3,013           |
| Interest expense  | 63                            | 40              | 124                           | 82              |
| Income before income taxes  | 4,021                         | 3,414           | 4,908                         | 2,931           |
| Income tax expense  | 1,563                         | 1,407           | 1,914                         | 1,216           |
| Net income  | 2,458                         | 2,007           | 2,994                         | 1,715           |
| Net (loss) income attributable to non-controlling interest              | (3)                           | (3)             | 2                             | 6               |
| Net income attributable to Potbelly Corporation                         | 2,461                         | 2,010           | 2,992                         | 1,709           |
| <b>Net income per common share attributable to common stockholders:</b> |                               |                 |                               |                 |
| Basic   | \$ 0.09                       | \$ 0.07         | \$ 0.10                       | \$ 0.06         |
| Diluted   | \$ 0.08                       | \$ 0.07         | \$ 0.10                       | \$ 0.06         |

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Weighted average shares outstanding:

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 28,594,712 | 29,342,528 | 28,749,898 | 29,246,676 |
| Diluted | 29,364,689 | 30,509,553 | 29,520,163 | 30,642,892 |

*See accompanying notes to the unaudited condensed consolidated financial statements.*

Table of Contents**POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statement of Equity**

(amounts in thousands, except share data, unaudited)

|   | <b>Common Stock<br/>Shares</b> | <b>Common Stock<br/>Amount</b> | <b>Treasury<br/>Stock</b> | <b>Warrant</b> | <b>Additional Paid-In-Capital</b> | <b>Accumulated<br/>Deficit</b> | <b>Non-Controlling<br/>Interest</b> | <b>Total Equity</b> |
|---|--------------------------------|--------------------------------|---------------------------|----------------|-----------------------------------|--------------------------------|-------------------------------------|---------------------|
| Balance at December 29,<br>2013                                     | 29,148,029                     | \$ 291                         | \$                        | \$ 909         | \$ 383,077                        | \$ (231,232)                   | \$ 228                              | \$ 153,273          |
| Net income  |                                |                                |                           |                |                                   | 1,709                          | 6                                   | 1,715               |
| Issuance of unrestricted<br>common stock                            | 25,663                         |                                |                           |                | 400                               |                                |                                     | 400                 |
| Exercise of stock options   | 297,002                        | 4                              |                           |                | 2,624                             |                                |                                     | 2,628               |
| Distribution to<br>non-controlling interest                         |                                |                                |                           |                |                                   |                                | (26)                                | (26)                |
| Amortization of<br>stock-based<br>compensation                      |                                |                                |                           |                | 1,041                             |                                |                                     | 1,041               |
| <b>Balance at June 29,<br/>2014</b>                                 | <b>29,470,694</b>              | <b>\$ 295</b>                  | <b>\$</b>                 | <b>\$ 909</b>  | <b>\$ 387,142</b>                 | <b>\$ (229,523)</b>            | <b>\$ 208</b>                       | <b>\$ 159,031</b>   |
| Balance at December 28,<br>2014                                     | 28,934,700                     | \$ 298                         | \$ (10,246)               | \$ 909         | \$ 391,972                        | \$ (226,874)                   | \$ 266                              | \$ 156,325          |
| Net income  |                                |                                |                           |                |                                   | 2,992                          | 2                                   | 2,994               |
| Exercise of stock options   | 358,794                        | 3                              |                           |                | 3,062                             |                                |                                     | 3,065               |
| Excess tax benefits<br>associated with exercise<br>of stock options |                                |                                |                           |                | 224                               |                                |                                     | 224                 |
| Repurchases of common<br>stock                                      | (922,316)                      |                                | (12,546)                  |                |                                   |                                |                                     | (12,546)            |
| Capital distribution to<br>non-controlling interest                 |                                |                                |                           |                |                                   |                                | (8)                                 | (8)                 |
| Contributions from<br>non-controlling interest                      |                                |                                |                           |                |                                   |                                | 326                                 | 326                 |
| Amortization of<br>stock-based<br>compensation                      |                                |                                |                           |                | 1,127                             |                                |                                     | 1,127               |
| <b>Balance at June 28,<br/>2015</b>                                 | <b>28,371,178</b>              | <b>\$ 301</b>                  | <b>\$ (22,792)</b>        | <b>\$ 909</b>  | <b>\$ 396,385</b>                 | <b>\$ (223,882)</b>            | <b>\$ 586</b>                       | <b>\$ 151,507</b>   |

*See accompanying notes to the unaudited condensed consolidated financial statements.*





**Table of Contents****POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows****(amounts in thousands, unaudited)**

|   | <b>For the 26 Weeks Ended</b> |                          |
|---|-------------------------------|--------------------------|
|   | <b>June 28,<br/>2015</b>      | <b>June 29,<br/>2014</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                               |                          |
| Net income  | \$ 2,994                      | \$ 1,715                 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                               |                          |
| Depreciation  | 10,439                        | 9,501                    |
| Deferred income tax   | 190                           | 121                      |
| Deferred rent and landlord allowances   | 1,769                         | 723                      |
| Amortization of stock compensation expense  | 1,127                         | 1,441                    |
| Excess tax benefit from stock-based compensation                                  | (224)                         |                          |
| Asset impairment, store closure and disposal of property and equipment            | 887                           | 877                      |
| Amortization of debt issuance costs   | 35                            | 35                       |
| Changes in operating assets and liabilities:                                      |                               |                          |
| Accounts receivable, net  | (1,018)                       | (958)                    |
| Inventories   | (52)                          | (90)                     |
| Prepaid expenses and other assets   | 904                           | (2,035)                  |
| Accounts payable  | (730)                         | 1,351                    |
| Accrued and other liabilities   | 2,641                         | (910)                    |
| Net cash provided by operating activities   | 18,962                        | 11,771                   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                               |                          |
| Purchases of property and equipment   | (17,901)                      | (13,386)                 |
| Net cash (used in) investing activities   | (17,901)                      | (13,386)                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                               |                          |
| Payments on note payable  | (1,022)                       | (42)                     |
| Proceeds from exercise of stock options   | 3,743                         | 3,337                    |
| Payment of payroll taxes related to stock-based compensation awards               | (678)                         | (709)                    |
| Treasury stock repurchase   | (12,546)                      |                          |
| Excess tax benefit from stock-based compensation                                  | 224                           |                          |
| Contributions from non-controlling interest                                       | 326                           |                          |
| Distribution to non-controlling interest  | (8)                           | (26)                     |
| Net cash (used in) provided by financing activities                               | (9,961)                       | 2,560                    |

|  |           |           |
|--|-----------|-----------|
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (8,900)   | 945       |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD     | 63,005    | 69,579    |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD           | \$ 54,105 | \$ 70,524 |

Supplemental cash flow information:

|                   |        |        |
|-------------------|--------|--------|
| Income taxes paid | \$ 230 | \$ 700 |
| Interest paid     | 114    | 84     |

Supplemental non-cash investing and financing activities:

|  |          |          |
|--|----------|----------|
| Unpaid liability for purchases of property and equipment | \$ 2,931 | \$ 2,424 |
|--|----------|----------|

*See accompanying notes to the unaudited condensed consolidated financial statements*

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**POTBELLY CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**(1) Organization and Other Matters**

***Business***

Potbelly Corporation (the Company or Potbelly), through its wholly-owned subsidiaries, operates Potbelly Sandwich Works sandwich shops in 27 states and the District of Columbia. As of June 28, 2015 and June 29, 2014, the Company had 349 and 312 company-operated shops, respectively. During the 26 weeks ended June 28, 2015, the Company opened 17 new company-operated shops and closed 2 shops. During the 26 weeks ended June 29, 2014, the Company opened 16 new company-operated shops and closed no shops.

The Company also sells and administers franchises of Potbelly Sandwich Works sandwich shops. The first domestic and international franchise locations administered by the Company opened during February 2011. As of June 28, 2015, 17 franchised shops were in operation domestically and 12 franchised shops were in operation internationally. During the 26 weeks ended June 28, 2015, the Company opened one franchised shop and closed one franchised shop. During the 26 weeks ended June 29, 2014, the Company opened three franchised shops and closed no franchised shops.

***Basis of Presentation***

The unaudited condensed consolidated financial statements and notes herein should be read in conjunction with the audited consolidated financial statements of Potbelly Corporation and its subsidiaries and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 28, 2014. The unaudited condensed consolidated financial statements included herein have been prepared by the Company without audit, pursuant to the rules and regulations of the SEC regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the SEC's rules and regulations. In the opinion of management, all adjustments, which are of a normal and recurring nature (except as otherwise noted), that are necessary to present fairly the Company's financial position as of June 28, 2015 and December 28, 2014, its statement of operations for the 13 and 26 weeks ended June 28, 2015 and June 29, 2014 and its statement of cash flows for the 26 weeks ended June 28, 2015 and June 29, 2014 have been included. The consolidated statements of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the full year.

The Company does not have any components of other comprehensive income (loss) recorded within its consolidated financial statements, and, therefore, does not separately present a statement of comprehensive income (loss) in its consolidated financial statements.

***Principles of Consolidation***

The unaudited condensed consolidated financial statements include the accounts of Potbelly Corporation; its wholly owned subsidiary, Potbelly Illinois, Inc. (PII); PII's wholly owned subsidiaries, Potbelly Franchising, LLC and Potbelly Sandwich Works LLC (LLC) and 17 of LLC's wholly owned subsidiaries and the LLC's 4 joint ventures, collectively, the Company. All significant intercompany balances and transactions have been eliminated in consolidation. For consolidated joint ventures, non-controlling interest represents a non-controlling partner's share of

the assets, liabilities and operations related to the 4 joint venture investments. The Company has ownership interests ranging from 65-80% in these consolidated joint ventures.

***Fiscal Year***

The Company uses a 52/53-week fiscal year that ends on the last Sunday of the calendar period. Approximately every five or six years a 53rd week is added. Fiscal years 2015 and 2014 each consist of 52 weeks. The fiscal quarters ended June 28, 2015 and June 29, 2014 each consisted of 13 weeks.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, primarily related to the long-lived assets and income taxes, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**POTBELLY CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Condensed Consolidated Financial Statements**

***New and Revised Financial Accounting Standards***

We qualify as an emerging growth company pursuant to the provisions of the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, enacted on April 5, 2012. Section 102 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. However, we have chosen to opt out of such extended transition period, and as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Our decision to opt out of the extended transition period is irrevocable.

In April 2014, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The pronouncement changes the criteria for reporting discontinued operations while enhancing disclosures in this area. Pursuant to ASU 2014-08, only disposals representing a strategic shift, such as a major line of business, a major geographical area or a major equity investment, which were not expected to have continuing cash flows should be presented as a discontinued operation. If the disposal does qualify as a discontinued operation under ASU 2014-08, the entity will be required to provide expanded disclosures. ASU 2014-08 is effective for fiscal and interim periods beginning on or after December 15, 2014. Early adoption is permitted. The adoption of ASU 2014-08 is not expected to have a significant impact on our consolidated financial statements or disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The pronouncement was issued to clarify the principles for recognizing revenue and to develop a common revenue standard and disclosure requirements for U.S. GAAP and IFRS. The FASB has approved a one-year deferral of the effective date of ASU 2014-09, such that it will become effective for the annual period ending after December 15, 2017. We are evaluating the expected adoption method of ASU 2014-09 and the adoption is not expected to have a significant impact on our consolidated balance sheet or consolidated statement of operations.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The pronouncement requires our management to evaluate whether there is substantial doubt about our ability to continue as a going concern. The pronouncement is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early adoption is permitted. The adoption of ASU 2014-15 is not expected to have a material effect on our consolidated balance sheet or consolidated statement of operations.

**(2) Fair Value Measurement**

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate fair values due to the short maturities of these balances.

The Company assesses potential impairments to its long-lived assets, which includes property and equipment, whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Shop-level

assets are grouped at the individual shop-level for the purpose of the impairment assessment. Recoverability of an asset is measured by a comparison of the carrying amount of an asset to its estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset. After performing a periodic review of our shops during the first and second fiscal quarter of 2015, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance of shop profitability. We performed an impairment analysis related to these shops and recorded impairment charges of \$0.3 million and \$0.6 million for the 13 weeks and 26 weeks ended June 28, 2015, respectively, related to the excess of the carrying amounts recorded on our balance sheet over the identified shops estimated fair values. The fair value of the shop assets was determined using the discounted future cash flow method of anticipated cash flows through the shop's lease-end date using fair value measurement inputs classified as Level 3. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

In fiscal 2014, the Company established a non-qualified deferred compensation plan, Potbelly Non-Qualified Deferred Compensation Plan, which allows highly compensated employees to defer a portion of their base salary and variable compensation each plan year. The Company maintains a rabbi trust to fund obligations under the deferred compensation plan. Amounts in the rabbi trust are invested in mutual funds. The investments in the rabbi trust are designated as trading securities and carried at fair value. Fair market value of investments in the rabbi trust is measured using Level 1 inputs (quoted prices for identical assets in active markets). As of June 28, 2015, the fair value of the investments in the rabbi trust was \$71 thousand, which is included in other assets in the

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condensed consolidated balance sheet. The associated liability is recorded within other long-term liabilities in the condensed consolidated balance sheet. The Company records trading gains and losses in general and administrative expenses in the condensed consolidated statement of operations, along with the offsetting amount related to the increase or decrease in deferred compensation to reflect its exposure to liabilities for payment under the deferred plan. For the three months ended June 28, 2015, the Company recorded an immaterial amount of unrealized losses on investments held in the rabbi trust.

**(3) Earnings per share**

Basic and diluted income (loss) per share are calculated using the weighted average number of shares outstanding for the period as follows:

|   | <b>For the 13 Weeks Ended</b> |                          | <b>For the 26 Weeks Ended</b> |                          |
|---|-------------------------------|--------------------------|-------------------------------|--------------------------|
|   | <b>June 28,<br/>2015</b>      | <b>June 29,<br/>2014</b> | <b>June 28,<br/>2015</b>      | <b>June 29,<br/>2014</b> |
| Net income attributable to Potbelly Corporation                       | \$ 2,461                      | \$ 2,010                 | \$ 2,992                      | \$ 1,709                 |
| Weighted average common shares outstanding-basic                      | 28,594,712                    | 29,342,528               | 28,749,898                    | 29,246,676               |
| Plus: Effect of potential stock options exercise                      | 708,271                       | 1,046,198                | 709,276                       | 1,258,203                |
| Plus: Effect of potential warrant exercise                            | 61,706                        | 120,827                  | 60,989                        | 138,013                  |
| Weighted average common shares outstanding-diluted                    | 29,364,689                    | 30,509,553               | 29,520,163                    | 30,642,892               |
| Income per share available to common stockholders-basic               | \$ 0.09                       | \$ 0.07                  | \$ 0.10                       | \$ 0.06                  |
| Income per share available to common stockholders-diluted             | \$ 0.08                       | \$ 0.07                  | \$ 0.10                       | \$ 0.06                  |
| <u>Potentially dilutive shares that are considered anti-dilutive:</u> |                               |                          |                               |                          |
| Common share options  | 491,494                       | 242,636                  | 609,084                       | 242,636                  |
| Warrants  |                               |                          |                               |                          |

**(4) Income Taxes**

The Company recognized income tax expense of \$1.9 million on pre-tax income of \$4.9 million, or an effective tax rate of 39.0%, for the 26 weeks ended June 28, 2015, compared to income tax expense of \$1.2 million on pre-tax



income of \$2.9 million, or an effective tax rate of 41.5%, for the 26 weeks ended June 29, 2014. The difference between the statutory rate and the effective tax rate is primarily attributable to state income taxes offset by certain federal and state tax credits.

#### **(5) Capital Stock**

On August 1, 2014, the Company's Board of Directors authorized a share repurchase program of up to \$35.0 million of the Company's common stock. Under this program, the Company may, from time to time, purchase shares in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934, as amended) or in privately negotiated transactions. During the 26 weeks ended June 28, 2015, the Company repurchased 922,316 shares of its common stock for approximately \$12.5 million in open market transactions. As of June 28, 2015, the remaining dollar value of authorization under the share repurchase program was \$12.2 million. Repurchased shares are included as treasury stock in the condensed consolidated balance sheets and the condensed consolidated statement of equity.

#### **(6) Stock-Based Compensation**

Throughout the 26 weeks ending June 28, 2015, the Company issued 498,479 stock options under the 2013 Long-Term Incentive Plan to eligible employees and key executives. The fair value of the options was determined using the Black-Scholes option pricing model. The weighted average fair value of options granted during the 26 weeks ended June 28, 2015 was \$6.65 per share, as estimated using the following weighted average assumptions: expected life of options seven years; volatility- 45.47%; risk-free interest rate 1.90%; and dividend yield 0.00%. The Company used the simplified method for determining the expected life of the options. Due to the lack of historical data as a newly public company, the Company calculated the specific stock price volatility using a blended volatility rate based on comparable publicly traded companies.

Table of Contents**POTBELLY CORPORATION AND SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements**

A summary of activity for the 26 weeks ended June 28, 2015 is as follows:

| <b>Options</b> |                   | <b>Shares<br/>(Thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(Thousands)</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Term<br/>(Years)</b> |
|----------------|-------------------|-------------------------------|--|--|--|
| Outstanding    | December 28, 2014 | 4,613                         | \$ 10.10   | \$ 12,731  | 5.62   |
| Granted        |                   | 498                           | 13.59  |  |  |
| Exercised      |                   | (359)                         | 8.54   |  |  |
| Canceled       |                   | (141)                         | 14.18  |  |  |
| Outstanding    | June 28, 2015     | 4,611                         | 10.47  | \$ 12,653  | 5.61   |
| Exercisable    | June 28, 2015     | 3,337                         | 6.79   | \$ 11,549  | 3.19   |

In accordance with ASC Topic 718, *Compensation - Stock Compensation*, stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period, which is generally the vesting period of the grant, with a corresponding increase to additional paid-in-capital. For the 13 and 26 weeks ended June 28, 2015, the Company recognized \$0.6 million and \$1.1 million, respectively. For the 13 and 26 weeks ended June 29, 2014, the Company recognized \$1.0 million and \$1.4 million, respectively, which includes \$0.4 million related to the May 2014 unrestricted common stock grants. As of June 28, 2015, the unrecognized stock-based compensation expense was \$7.2 million, which will be recognized through fiscal year 2019. The Company records stock-based compensation expense within general and administrative expenses in the consolidated statements of operations.

In May 2015, the Company issued 30,856 shares of restricted stock units ( RSUs ) to certain non-employee members of its Board of Directors. The RSUs had a grant-date share price of \$14.26 upon issuance and have a vesting schedule of 50% on the first anniversary of the grant date and 50% on the second anniversary of the grant date. The Company recorded an immaterial amount of stock-based compensation expense related to the issuance of the RSUs.

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**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.****Forward-Looking Statements**

*The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 28, 2014. This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and involves numerous risks and uncertainties. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and generally contain words such as believes, expects, may, will, should, seeks, intends, plans, strives, goal, estimates, forecasts, projects or anticipates or similar expressions. Our forward-looking statements are subject to risks and uncertainties, which may cause actual results to differ materially from those projected or implied by the forward-looking statement. Forward-looking statements are based on current expectations and assumptions and currently available data and are neither predictions nor guarantees of future events or performance. You should not place undue reliance on forward-looking statements, which speak only as of the date hereof. See Risk Factors and Cautionary Note Regarding Forward-Looking Statements included in our Annual Report on Form 10-K for the fiscal year ended December 28, 2014, for a discussion of factors that could cause our actual results to differ from those expressed or implied by forward-looking statements.*

**Overview**

Potbelly is a fast-growing neighborhood sandwich concept offering toasty warm sandwiches, signature salads and other fresh menu items served by engaging people in an environment that reflects the Potbelly brand. Our combination of product, people and place is how we deliver on our passion to be The Best Place for Lunch. Our sandwiches, salads and hand-dipped milkshakes are all made fresh to order and our cookies are baked fresh each day. Our employees are trained to engage with our customers in a genuine way to provide a personalized experience. Our shops feature vintage design elements and locally-themed décor inspired by the neighborhood that we believe create a lively atmosphere. Through this combination, we believe we are creating a devoted base of Potbelly fans that return again and again and that we are expanding one sandwich shop at a time.

We believe that a key to our past and future success is our culture. It is embodied in *The Potbelly Advantage*, which is an expression of our Vision, Mission, Passion and Values, and the foundation of everything we do. Our Vision is for our customers to feel that we are their Neighborhood Sandwich Shop and to tell others about their great experience. Our Mission is to make people really happy, to make more money and to improve every day. Our Passion is to be The Best Place for Lunch. Our Values embody both how we lead and how we behave, and form the cornerstone of our culture. We use simple language that resonates from the frontline associate to the most senior levels of the organization, creating shared expectations and accountabilities in how we approach our day-to-day activities. We strive to be a fun, friendly and hardworking group of people who enjoy taking care of our customers, while at the same time taking care of each other.

**Table of Contents****13 Weeks Ended June 28, 2015 Compared to 13 Weeks Ended June 29, 2014**

The following table presents information comparing the components of net income (loss) for the periods indicated (dollars in thousands):

|   | For the 13 Weeks Ended |                  |                  |                  |                        |                   |
|---|------------------------|------------------|------------------|------------------|------------------------|-------------------|
|   | June 28,<br>2015       | % of<br>Revenues | June 29,<br>2014 | % of<br>Revenues | Increase<br>(Decrease) | Percent<br>Change |
| <b>Revenues</b>   |                        |                  |                  |                  |                        |                   |
| Sandwich shop sales, net                                  | \$ 95,566              | 99.6%            | \$ 83,268        | 99.6%            | \$ 12,298              | 14.8%             |
| Franchise royalties and fees                              | 383                    | 0.4              | 352              | 0.4              | 31                     | 8.8               |
| Total revenues  | 95,949                 | 100.0            | 83,620           | 100.0            | 12,329                 | 14.7              |
| <b>Expenses</b>   |                        |                  |                  |                  |                        |                   |
| Sandwich shop operating expenses                          |                        |                  |                  |                  |                        |                   |
| Cost of goods sold, excluding depreciation                | 27,253                 | 28.4             | 23,936           | 28.6             | 3,317                  | 13.9              |
| Labor and related expenses                                | 27,152                 | 28.3             | 23,405           | 28.0             | 3,747                  | 16.0              |
| Occupancy expenses  | 11,539                 | 12.0             | 10,183           | 12.2             | 1,356                  | 13.3              |
| Other operating expenses                                  | 9,970                  | 10.4             | 8,691            | 10.4             | 1,279                  | 14.7              |
| General and administrative expenses                       | 9,643                  | 10.1             | 8,865            | 10.6             | 778                    | 8.8               |
| Depreciation expense                                      | 5,288                  | 5.5              | 4,784            | 5.7              | 504                    | 10.5              |
| Pre-opening costs   | 536                    | 0.6              | 273              | 0.3              | 263                    | 96.3              |
| Impairment and loss on disposal of property and equipment | 484                    | 0.5              | 29               | *                | 455                    | 1569.0            |
| Total expenses  | 91,865                 | 95.7             | 80,166           | 95.9             | 11,699                 | 14.6              |
| Income from operations                                    | 4,084                  | 4.3              | 3,454            | 4.1              | 630                    | 18.2              |
| Interest expense, net                                     | 63                     | 0.1              | 40               | *                | 23                     | 57.5              |
| Income before income taxes                                | 4,021                  | 4.2              | 3,414            | 4.1              | 607                    | 17.8              |
| Income tax expense  | 1,563                  | 1.6              | 1,407            | 1.7              | 156                    | 11.1              |
| Net income  | 2,458                  | 2.6              | 2,007            | 2.4              | 451                    | 22.5              |
| Net loss attributable to non-controlling interests        | (3)                    | *                | (3)              | *                |                        | 0.0               |
| Net income attributable to Potbelly Corporation           | \$ 2,461               | 2.6%             | \$ 2,010         | 2.4%             | \$ 451                 | 22.4%             |

\* Amount is less than 0.1%

**Revenues**

Total revenues increased by \$12.3 million, or 14.7%, to \$95.9 million during the 13 weeks ended June 28, 2015, from \$83.6 million during the 13 weeks ended June 29, 2014. The increase in revenues primarily consisted of an increase of \$8.3 million in sales from shops not yet in our company-operated comparable store sales base and a \$4.0 million, or 4.9%, increase in company-operated comparable store sales. The increase in company-operated comparable store sales resulted from increases in average check from certain menu price increases and menu mix, as well as traffic.

***Cost of Goods Sold***

Cost of goods sold increased by \$3.3 million, or 13.9%, to \$27.2 million during the 13 weeks ended June 28, 2015, compared to \$23.9 million during the 13 weeks ended June 29, 2014, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 28.4% during the 13 weeks ended June 28, 2015, from 28.6% during the 13 weeks ended June 29, 2014, primarily driven by certain menu price increases, partially offset by inflation on dairy and certain proteins.

***Labor and Related Expenses***

Labor and related expenses increased by \$3.7 million, or 16.0%, to \$27.1 million during the 13 weeks ended June 28, 2015, from \$23.4 million during the 13 weeks ended June 29, 2014, primarily due to new shop openings. As a percentage of revenues, labor and related expenses increased to 28.3% during the 13 weeks ended June 28, 2015, from 28.0% during the 13 weeks ended June 29, 2014, primarily driven by higher labor costs, performance-based manager bonuses and an additional incentive program to reward employees for tenure and development.

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**Table of Contents*****Occupancy Expenses***

Occupancy expenses increased by \$1.4 million, or 13.3%, to \$11.6 million during the 13 weeks ended June 28, 2015, from \$10.2 million during the 13 weeks ended June 29, 2014, primarily due to new shop openings. As a percentage of revenues, occupancy expenses decreased to 12.0% during the 13 weeks ended June 28, 2015, from 12.2% during the 13 weeks ended June 29, 2014, primarily due to sales leverage (*i.e.*, the ability to spread certain expenses over a higher revenue base).

***Other Operating Expenses***

Other operating expenses increased by \$1.3 million, or 14.7%, to \$10.0 million during the 13 weeks ended June 28, 2015, from \$8.7 million during the 13 weeks ended June 29, 2014. The increase is attributable to new shop openings, as well as increased fees associated with credit card usage in our shops, and other operating expense increases in line with revenue growth. As a percentage of revenues, other operating expenses remained consistent at 10.4% during the 13 weeks ended June 28, 2015 and June 29, 2014.

***General and Administrative Expenses***

General and administrative expenses increased by \$0.7 million, or 8.8%, to \$9.6 million during the 13 weeks ended June 28, 2015, from \$8.9 million during the 13 weeks ended June 29, 2014. The net increase is driven primarily by increased spending on advertising, partially offset by lower stock-based compensation expense. As a percentage of revenues, general and administrative expenses decreased to 10.1% during the 13 weeks ended June 28, 2015, from 10.6% during the 13 weeks ended June 29, 2014, driven by lower stock-based compensation expense, coupled with sales leverage (*i.e.*, the ability to spread certain costs over a higher revenue base).

***Depreciation Expense***

Depreciation expense increased by \$0.5 million, or 10.5%, to \$5.3 million during the 13 weeks ended June 28, 2015, from \$4.8 million during the 13 weeks ended June 29, 2014, primarily due to a higher depreciable base related to new shops and existing shop capital investments. As a percentage of revenues, depreciation decreased to 5.5% during the 13 weeks ended June 28, 2015, from 5.7% during the 13 weeks ended June 29, 2014, driven by lower depreciation associated with new shops with lower build-out costs and longer expected useful lives for leasehold improvements, as well as leasehold improvements at legacy shops with higher build-out costs and shorter expected useful lives being fully depreciated.

***Pre-Opening Costs***

Pre-opening costs increased by \$0.2 million, or 96.3%, to \$0.5 million during the 13 weeks ended June 28, 2015, from \$0.3 million during the 13 weeks ended June 29, 2014, primarily due to timing of new shop openings during the 13 weeks ended June 28, 2015 compared to the 13 weeks ended June 29, 2014.

***Impairment and Loss on Disposal of Property and Equipment***

Impairment and loss on disposal of property and equipment increased to \$0.5 million during the 13 weeks ended June 28, 2015, from \$29 thousand during the 13 weeks ended June 29, 2014. After performing a periodic review of our shops during the second quarter of 2015, it was determined that indicators of impairment were present for a certain shop as a result of continued underperformance of shop profitability. We performed an impairment analysis related to this shop and recorded an impairment charge of \$0.3 million related to the excess of the carrying amounts

recorded on our balance sheet over the identified shop's estimated fair values.

***Interest Expense, net***

Interest expense increased by \$23 thousand, or 57.5%, to \$63 thousand during the 13 weeks ended June 28, 2015, from \$40 thousand during the 13 weeks ended June 29, 2014, primarily due to the accretion of certain occupancy-related interest costs. Interest expense for the 13 weeks ended June 28, 2015 is attributable to interest on the note payable, unused commitment fees, occupancy-related interest costs and deferred financing fees, partially offset by interest income related to money market funds.

***Income Tax Expense***

Income tax expense increased by \$0.2 million to \$1.6 million for the 13 weeks ended June 28, 2015, from \$1.4 million for the 13 weeks ended June 29, 2014. For the 13 weeks ended June 28, 2015, our effective tax rate was 38.9%, compared to 41.2% for the 13 weeks ended June 29, 2014. The decrease in the effective tax rate primarily relates to the Company recognizing certain federal tax credits, which were not recognized in the comparable prior period.

**Table of Contents****26 Weeks Ended June 28, 2015 Compared to 26 Weeks Ended June 29, 2014**

The following table presents information comparing the components of net income (loss) for the periods indicated (dollars in thousands):

|   | For the 26 Weeks Ended |                  |                  |                  | Increase<br>(Decrease) | Percent<br>Change |
|---|------------------------|------------------|------------------|------------------|------------------------|-------------------|
|   | June 28,<br>2015       | % of<br>Revenues | June 29,<br>2014 | % of<br>Revenues |                        |                   |
| <b>Revenues</b>   |                        |                  |                  |                  |                        |                   |
| Sandwich shop sales, net                                  | \$ 180,963             | 99.6%            | \$ 156,791       | 99.5%            | \$ 24,172              | 15.4%             |
| Franchise royalties and fees                              | 754                    | 0.4              | 710              | 0.5              | 44                     | 6.2               |
| Total revenues  | 181,717                | 100.0            | 157,501          | 100.0            | 24,216                 | 15.4              |
| <b>Expenses</b>   |                        |                  |                  |                  |                        |                   |
| Sandwich shop operating expenses                          |                        |                  |                  |                  |                        |                   |
| Cost of goods sold, excluding depreciation                | 51,598                 | 28.4             | 45,022           | 28.6             | 6,576                  | 14.6              |
| Labor and related expenses                                | 51,752                 | 28.5             | 44,865           | 28.5             | 6,887                  | 15.4              |
| Occupancy expenses  | 22,886                 | 12.6             | 20,162           | 12.8             | 2,724                  | 13.5              |
| Other operating expenses                                  | 19,627                 | 10.8             | 16,849           | 10.7             | 2,778                  | 16.5              |
| General and administrative expenses                       | 18,474                 | 10.2             | 16,687           | 10.6             | 1,787                  | 10.7              |
| Depreciation expense                                      | 10,439                 | 5.7              | 9,501            | 6.0              | 938                    | 9.9               |
| Pre-opening costs   | 1,077                  | 0.6              | 525              | 0.3              | 552                    | 105.1             |
| Impairment and loss on disposal of property and equipment | 832                    | 0.5              | 877              | 0.6              | (45)                   | (5.1)             |
| Total expenses  | 176,685                | 97.2             | 154,488          | 98.1             | 22,197                 | 14.4              |
| Income from operations                                    | 5,032                  | 2.8              | 3,013            | 1.9              | 2,019                  | 67.0              |
| Interest expense, net                                     | 124                    | 0.1              | 82               | 0.1              | 42                     | 51.2              |
| Income before income taxes                                | 4,908                  | 2.7              | 2,931            | 1.9              | 1,977                  | 67.5              |
| Income tax expense  | 1,914                  | 1.1              | 1,216            | 0.8              | 698                    | 57.4              |
| Net income  | 2,994                  | 1.6              | 1,715            | 1.1              | 1,279                  | 74.6              |
| Net income attributable to non-controlling interests      | 2                      | *                | 6                | *                | (4)                    | (66.7)            |
| Net income attributable to Potbelly Corporation           | \$ 2,992               | 1.6%             | \$ 1,709         | 1.1%             | \$ 1,283               | 75.1%             |

\* Amount is less than 0.1%

**Revenues**



Total revenues increased by \$24.2 million, or 15.4%, to \$181.7 million during the 26 weeks ended June 28, 2015, from \$157.5 million during the 26 weeks ended June 29, 2014. The increase in revenues primarily consisted of an increase of \$16.3 million in sales from shops not yet in our company-operated comparable store sales base and a \$7.8 million, or 5.1%, increase in company-operated comparable store sales. The increase in company-operated comparable store sales resulted from increases in average check from certain menu price increases and menu mix, as well as traffic.

***Cost of Goods Sold***

Cost of goods sold increased by \$6.6 million, or 14.6%, to \$51.6 million during the 26 weeks ended June 28, 2015, compared to \$45.0 million during the 26 weeks ended June 29, 2014, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 28.4% during the 26 weeks ended June 28, 2015, from 28.6% during the 26 weeks ended June 29, 2014, primarily driven by certain menu price increases.

***Labor and Related Expenses***

Labor and related expenses increased by \$6.9 million, or 15.4%, to \$51.8 million during the 26 weeks ended June 28, 2015, from \$44.9 million during the 26 weeks ended June 29, 2014, primarily due to new shop openings. As a percentage of revenues, labor and related expenses remained consistent at 28.5% during the 26 weeks ended June 28, 2015 and June 29, 2014.

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**Table of Contents*****Occupancy Expenses***

Occupancy expenses increased by \$2.7 million, or 13.5%, to \$22.9 million during the 26 weeks ended June 28, 2015, from \$20.2 million during the 26 weeks ended June 29, 2014, primarily due to new shop openings. As a percentage of revenues, occupancy expenses decreased to 12.6% during the 26 weeks ended June 28, 2015, from 12.8% during the 26 weeks ended June 29, 2014, primarily due to sales leverage (*i.e.*, the ability to spread certain expenses over a higher revenue base).

***Other Operating Expenses***

Other operating expenses increased by \$2.8 million, or 16.5%, to \$19.6 million during the 26 weeks ended June 28, 2015, from \$16.8 million during the 26 weeks ended June 29, 2014. The increase is attributable to new shop openings, increased marketing spend as well as increased fees associated with credit card usage in our shops. As a percentage of revenues, other operating expenses increased to 10.8% during the 26 weeks ended June 28, 2015, from 10.7% during the 26 weeks ended June 29, 2014, primarily due to increased marketing spend.

***General and Administrative Expenses***

General and administrative expenses increased by \$1.8 million, or 10.7%, to \$18.5 million during the 26 weeks ended June 28, 2015, from \$16.7 million during the 26 weeks ended June 29, 2014. The net increase is driven primarily by an increase in our performance-based incentives, as well as increased spending on advertising, partially offset by lower stock-based compensation expense. As a percentage of revenues, general and administrative expenses decreased to 10.2% during the 26 weeks ended June 28, 2015, from 10.6% during the 26 weeks ended June 29, 2014, driven by lower stock-based compensation expense, coupled with sales leverage (*i.e.*, the ability to spread certain costs over a higher revenue base).

***Depreciation Expense***

Depreciation expense increased by \$0.9 million, or 9.9%, to \$10.4 million during the 26 weeks ended June 28, 2015, from \$9.5 million during the 26 weeks ended June 29, 2014, primarily due to a higher depreciable base related to new shops and existing shop capital investments. As a percentage of revenues, depreciation decreased to 5.7% during the 26 weeks ended June 28, 2015, from 6.0% during the 26 weeks ended June 29, 2014, driven by lower depreciation associated with new shops with lower build-out costs and longer expected useful lives for leasehold improvements, as well as leasehold improvements at legacy shops with higher build-out costs and shorter expected useful lives being fully depreciated.

***Pre-Opening Costs***

Pre-opening costs increased by \$0.6 million, or 105.1%, to \$1.1 million during the 26 weeks ended June 28, 2015, from \$0.5 million during the 26 weeks ended June 29, 2014, primarily due to timing of new shop openings during the 26 weeks ended June 28, 2015 compared to the 26 weeks ended June 29, 2014.

***Impairment and Loss on Disposal of Property and Equipment***

Impairment and loss on disposal of property and equipment decreased to \$0.8 million during the 26 weeks ended June 28, 2015, from \$0.9 million during the 26 weeks ended June 29, 2014. After performing a periodic review of our shops during the first and second quarters of 2015, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance of shop profitability. We performed an impairment analysis

related to these shops and recorded an impairment charge of \$0.6 million related to the excess of the carrying amounts recorded on our balance sheet over the identified shops' estimated fair values.

***Interest Expense, net***

Interest expense increased by \$42 thousand, or 51.2%, to \$124 thousand during the 26 weeks ended June 28, 2015, from \$82 thousand during the 26 weeks ended June 29, 2014, primarily due to the accretion of certain occupancy-related interest costs. Interest expense for the 26 weeks ended June 28, 2015 is attributable to interest on the note payable, unused commitment fees, occupancy-related interest costs and deferred financing fees, partially offset by interest income related to money market funds.

***Income Tax Expense***

Income tax expense increased by \$0.7 million to \$1.9 million for the 26 weeks ended June 28, 2015, from \$1.2 million for the 26 weeks ended June 29, 2014. For the 26 weeks ended June 28, 2015, our effective tax rate was 39.0%, compared to 41.5% for the 26 weeks ended June 29, 2014. The decrease in the effective tax rate primarily relates to the Company recognizing certain federal tax credits, which were not recognized in the comparable prior period.

**Table of Contents****Liquidity and Capital Resources*****General***

Our primary sources of liquidity and capital resources are cash provided from operating activities, existing cash and cash equivalents and our credit facility. Our primary requirements for liquidity and capital are new shop openings, existing shop capital investments (maintenance and improvements), principal and interest payments on our debt, lease obligations, repurchases of our common stock and working capital and general corporate needs. Our requirement for working capital is not significant since our customers pay for their food and beverage purchases in cash or payment cards (credit or debit) at the time of sale. Thus, we are able to sell certain inventory items before we have to pay our suppliers for such items. Our shops do not require significant inventories or receivables. We believe that these sources of liquidity and capital will be sufficient to finance our continued operations and expansion plans for at least the next twelve months.

The following table presents summary cash flow information for the periods indicated (in thousands):

|                                 | <b>For the 26 Weeks<br/>Ended</b> |                          |
|---------------------------------|-----------------------------------|--------------------------|
|                                 | <b>June 28,<br/>2015</b>          | <b>June 29,<br/>2014</b> |
| Net cash provided by (used in): |                                   |                          |
| Operating activities            | \$ 18,962                         | \$ 11,771                |
| Investing activities            | (17,901)                          | (13,386)                 |
| Financing activities            | (9,961)                           | 2,560                    |
| Net (decrease) increase in cash | \$ (8,900)                        | \$ 945                   |

***Operating Activities***

Net cash provided by operating activities increased to \$19.0 million for the 26 weeks ended June 28, 2015, from \$11.8 million for the 26 weeks ended June 29, 2014. The \$7.2 million increase is primarily attributable to an increase of \$5.2 million in net shop-level profits, increases in non-cash items such as depreciation and deferred rent and landlord allowances as well as timing of the payment of working capital accounts.

***Investing Activities***

Net cash used in investing activities increased to \$17.9 million for the 26 weeks ended June 28, 2015, from \$13.4 million for the 26 weeks ended June 29, 2014. The increase was primarily due to capital expenditures for future shop openings, maintaining our existing shops and certain other projects, including costs associated with the move of our Company headquarters during the 26 weeks ended June 28, 2015 as compared to the same period in 2014.

***Financing Activities***

Net cash used in financing activities was \$10.0 million for the 26 weeks ended June 28, 2015, compared to net cash provided by financing activities of \$2.6 million for the 26 weeks ended June 29, 2014. The increase in net cash used was driven by the \$12.5 million of treasury stock repurchased during the 26 weeks ended June 28, 2015, with no

comparable transactions during the 26 weeks ended June 29, 2014, offset by \$3.1 million in cash proceeds received by us related to the exercise of stock options, net of payroll taxes paid, during the 26 weeks ended June 28, 2015, compared to \$2.6 million in cash proceeds received during the 26 weeks ended June 29, 2014.

***Stock Repurchase Program***

On August 1, 2014, our Board of Directors authorized a share repurchase program of up to \$35.0 million of the Company's common stock. Under this program, we may, from time to time, purchase shares in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Exchange Act) or in privately negotiated transactions. During the 26 weeks ended June 28, 2015, we repurchased 922,316 shares of common stock for approximately \$12.5 million in open market transactions. At June 28, 2015, the remaining dollar value of authorization under the share repurchase program was \$12.2 million.

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**Table of Contents*****Credit Facility***

On September 21, 2012, we entered into a five-year revolving credit facility agreement with JPMorgan Chase Bank, N.A. that expires in September 2017 and provides for borrowings up to \$35.0 million to fund capital expenditures for new shops, renovations and maintenance of existing shops, and to provide ongoing working capital for other general and corporate purposes. We will be entitled to incur additional incremental increases in the revolving credit facility of up to \$25.0 million that will be included in the credit facility if no event of default exists and certain other requirements are met. The credit facility contains customary representations, warranties, negative and affirmative covenants, including a requirement to maintain a maximum leverage ratio, as defined, of 2.25:1 and a minimum debt service coverage ratio, as defined, of 1.5:1. The credit facility also limits the restricted payments (primarily distributions and equity repurchases) that we may make, unless we obtain certain waivers or amendments from our lender. We were in compliance with these restrictions and conditions as of June 28, 2015. The credit facility is secured by substantially all assets of the Company. Borrowings under the credit facility bear interest at our option at either (i) a Eurocurrency rate determined by reference to the applicable LIBOR rate plus an applicable margin or (ii) a prime rate as announced by JPMorgan Chase plus an applicable margin. As of June 28, 2015, we had no amounts outstanding under the credit facility.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Critical accounting policies are those that management believes are both most important to the portrayal of our financial condition and operating results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We base our estimates on historical experience and other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Judgments and uncertainties affecting the application of those policies may result in materially different amounts being reported under different conditions or using different assumptions. We had no significant changes in our critical accounting estimates since our last annual report. Our critical accounting estimates are identified and described in our annual consolidated financial statements and related notes.

**Off-Balance Sheet Arrangements**

As of June 28, 2015, we do not have any off-balance sheet arrangements, synthetic leases, investments in special purpose entities or undisclosed borrowings or debt that would be required to be disclosed pursuant to Item 303 of Regulation S-K under the Exchange Act.

**New and Revised Financial Accounting Standards**

For a description of recently issued Financial Accounting Standards, see Note 1 – Organization and Other Matters of the Notes to Unaudited Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For quantitative and qualitative disclosures about market risk, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014. Our exposures to market risk have not changed materially since December 28, 2014.

**ITEM 4. CONTROLS AND PROCEDURES**

*Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ( Exchange Act )) as of June 28, 2015. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 28, 2015, our disclosure controls and procedures were effective in ensuring that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (the SEC ) and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our fiscal quarter ended June 28, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits 31.1 and 31.2 to this Quarterly Report on Form 10-Q.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

We are subject to legal proceedings, claims and liabilities, such as employment-related claims and slip and fall cases, which arise in the ordinary course of business and are generally covered by insurance. In the opinion of management, the amount of ultimate liability with respect to those actions should not have a material adverse impact on our financial position or results of operations and cash flows.

**ITEM 1A. RISK FACTORS**

A description of the risk factors associated with our business is contained in Item 1A, Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014. There have been no material changes to our Risk Factors as previously reported.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table contains information regarding purchases of our common stock made by or on behalf of Potbelly Corporation during the 13 weeks ended June 28, 2015:

| <b>Period</b>                   | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share (1)</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Program (2)</b> | <b>Maximum Value of Shares that May Yet be Purchased Under the Program (2)</b> |
|---------------------------------|---|---|---|--|
| March 30, 2015 – April 26, 2015 | 200,940                                 | \$ 13.89                                | 200,940   | \$ 17,586,629  |
| April 27, 2015 – May 24, 2015   | 79,604                                  | \$ 13.93                                | 79,604  | \$ 16,475,799  |
| May 25, 2015 – June 28, 2015    | 307,086                                 | \$ 13.83                                | 307,086   | \$ 12,242,638  |
| <b>Total:</b>                   | <b>587,630</b>                          |   | <b>587,630</b>  |  |

(1) Average price paid per share excludes commissions.

(2) On August 5, 2014, we announced that our Board of Directors approved a new share repurchase program, authorizing us to repurchase up to \$35.0 million of our common stock. Such repurchases may take place from time to time in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Exchange Act) or in privately negotiated transactions.

**ITEM 6. EXHIBITS**

The following exhibits are either provided with this Quarterly Report on Form 10-Q or are incorporated herein by reference.



| <b>Exhibit<br/>No.</b> | <b>Description</b>  |
|------------------------|---|
| <b>10.22</b>           | Director Compensation Plan, adopted May 14, 2015  |
| <b>31.1</b>            | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                             |
| <b>31.2</b>            | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                             |
| <b>32.1</b>            | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| <b>101.INS</b>         | XBRL Instance Document  |
| <b>101.SCH</b>         | XBRL Taxonomy Extension Schema Document   |
| <b>101.CAL</b>         | XBRL Taxonomy Extension Calculation Linkbase Document   |
| <b>101.LAB</b>         | XBRL Taxonomy Extension Label Linkbase Document   |
| <b>101.PRE</b>         | XBRL Taxonomy Extension Presentation Linkbase Document  |
| <b>101.DEF</b>         | XBRL Taxonomy Extension Definition Linkbase Document  |

Management contract or compensatory plan

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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.

POTBELLY CORPORATION

Date: August 5, 2015

By: /s/ Michael Coyne  
Michael Coyne  
Chief Financial Officer  
(Principal Financial Officer)