

POTBELLY CORP
Form 10-Q
August 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 26, 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: 001-36104

Potbelly Corporation

(Exact name of registrant as specified in its charter)

Delaware 36-4466837
(State or Other Jurisdiction of (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

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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 – 25,192,902 shares as of July 29, 2016

POTBELLY CORPORATION

QUARTERLY REPORT ON FORM 10-Q

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POTBELLY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

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

| | June 26, 2016 | December 27, 2015 |
|--|------------------|-------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$29,921 | \$32,006 |
| Accounts receivable, net of allowances of \$126 and \$14 as of June 26, 2016 and December 27, 2015, respectively | 4,554 | 4,461 |
| Inventories | 3,039 | 3,159 |
| Prepaid expenses and other current assets | 5,191 | 10,155 |
| Total current assets | 42,705 | 49,781 |
| Property and equipment, net | 95,812 | 97,434 |
| Indefinite-lived intangible assets | 3,404 | 3,404 |
| Goodwill | 2,222 | 1,428 |
| Deferred income taxes, non-current | 18,162 | 18,439 |
| Deferred expenses, net and other assets | 3,989 | 4,021 |
| Total assets | \$166,294 | \$174,507 |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$3,913 | \$5,762 |
| Accrued expenses | 18,090 | 19,277 |
| Accrued income taxes | 1,281 | 143 |
| Total current liabilities | 23,284 | 25,182 |
| Deferred rent and landlord allowances | 18,398 | 17,820 |
| Other long-term liabilities | 1,490 | 1,292 |
| Total liabilities | 43,172 | 44,294 |
| Equity | | |
| Common stock, \$0.01 par value—authorized, 200,000,000 shares; outstanding 25,357,542 and 26,304,261 shares as of June 26, 2016 and December 27, 2015, respectively | | |
| | 306 | 303 |
| Warrants | 909 | 909 |
| Additional paid-in-capital | 404,585 | 399,458 |
| Treasury stock, held at cost, 5,302,754 and 4,033,910 shares as of June 26, 2016, and December 27, 2015, respectively | (66,622) | (50,000) |
| Accumulated deficit | (216,785) | (221,246) |
| Total stockholders' equity | 122,393 | 129,424 |
| Non-controlling interest | 729 | 789 |
| Total equity | 123,122 | 130,213 |
| Total liabilities and equity | \$166,294 | \$174,507 |

See accompanying notes to the unaudited condensed consolidated financial statements.

POTBELLY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

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

| | For the 13 Weeks Ended | | For the 26 Weeks Ended | |
|--|------------------------|------------------|------------------------|------------------|
| | June 26, 2016 | June 28, 2015 | June 26, 2016 | June 28, 2015 |
| Revenues | | | | |
| Sandwich shop sales, net | \$ 104,466 | \$ 95,566 | \$ 199,892 | \$ 180,963 |
| Franchise royalties and fees | 570 | 383 | 1,099 | 754 |
| Total revenues | 105,036 | 95,949 | 200,991 | 181,717 |
| Expenses | | | | |
| Sandwich shop operating expenses | | | | |
| Cost of goods sold, excluding depreciation | 28,500 | 27,253 | 54,746 | 51,598 |
| Labor and related expenses | 29,935 | 27,152 | 58,097 | 51,752 |
| Occupancy expenses | 13,174 | 11,539 | 25,931 | 22,886 |
| Other operating expenses | 10,687 | 9,970 | 21,232 | 19,627 |
| General and administrative expenses | 10,305 | 9,643 | 20,828 | 18,474 |
| Depreciation expense | 5,676 | 5,288 | 11,340 | 10,439 |
| Pre-opening costs | 239 | 536 | 391 | 1,077 |
| Impairment and loss on disposal of property and equipment | 1,008 | 484 | 1,025 | 832 |
| Total expenses | 99,524 | 91,865 | 193,590 | 176,685 |
| Income from operations | 5,512 | 4,084 | 7,401 | 5,032 |
| Interest expense | 41 | 63 | 69 | 124 |
| Income before income taxes | 5,471 | 4,021 | 7,332 | 4,908 |
| Income tax expense | 2,039 | 1,563 | 2,772 | 1,914 |
| Net income | 3,432 | 2,458 | 4,560 | 2,994 |
| Net income (loss) attributable to non-controlling interest | 59 | (3) | 99 | 2 |
| Net income attributable to Potbelly Corporation | \$ 3,373 | \$ 2,461 | \$ 4,461 | \$ 2,992 |
| Net income per common share attributable to common stockholders: | | | | |
| Basic | \$0.13 | \$0.09 | \$0.17 | \$0.10 |
| Diluted | \$0.13 | \$0.08 | \$0.17 | \$0.10 |
| Weighted average shares outstanding: | | | | |
| Basic | 25,818,571 | 28,594,712 | 26,039,082 | 28,749,898 |
| Diluted | 26,459,087 | 29,364,689 | 26,597,012 | 29,520,163 |

See accompanying notes to the unaudited condensed consolidated financial statements.

POTBELLY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statement of Equity

(amounts in thousands, except share data, unaudited)

| | Common Shares | Stock Amount | Treasury Stock | Warrants | Additional Paid-In- Capital | Accumulated Deficit | Non-Controlling Interest | Total Equity |
|--|------------------|-----------------|-------------------|----------|-----------------------------------|------------------------|-----------------------------|--------------|
| Balance at December 28, 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 | | | | | | | | |
| associated with exercise | | | | | | | | |
| of stock options | — | — | — | — | 224 | — | — | 224 |
| Repurchases of common stock | (922,316) | — | (12,546) | — | — | — | — | (12,546) |
| Capital distribution to non-controlling interest | — | — | — | — | — | — | (8) | (8) |
| Contributions from non-controlling interest | — | — | — | — | — | — | 326 | 326 |
| Amortization of stock-based compensation | — | — | — | — | 1,127 | — | — | 1,127 |
| Balance at June 28, 2015 | 28,371,178 | \$ 301 | \$(22,792) | \$ 909 | \$ 396,385 | \$ (223,882) | \$ 586 | \$ 151,507 |
| Balance at December 27, 2015 | 26,304,261 | \$ 303 | \$(50,000) | \$ 909 | \$ 399,458 | \$ (221,246) | \$ 789 | \$ 130,213 |
| Net income | — | — | — | — | — | 4,461 | 99 | 4,560 |
| Exercise of stock options | 322,125 | 3 | — | — | 3,645 | — | — | 3,648 |
| Excess tax benefits | | | | | | | | |
| associated with exercise | | | | | | | | |
| of stock options | — | — | — | — | 16 | — | — | 16 |

Repurchases of
common

| | | | | | | | | |
|-------|--------------|---|----------|---|---|---|---|-----------|
| stock | (1,268,844) | — | (16,622) | — | — | — | — | (16,622) |
|-------|--------------|---|----------|---|---|---|---|-----------|

Capital distribution to
non-

| | | | | | | | | |
|----------------------|---|---|---|---|---|---|--------|--------|
| controlling interest | — | — | — | — | — | — | (159) | (159) |
|----------------------|---|---|---|---|---|---|--------|--------|

Amortization of

| | | | | | | | | |
|-----------------------------|---|---|---|---|-------|---|---|-------|
| stock-based compensation | — | — | — | — | 1,466 | — | — | 1,466 |
|-----------------------------|---|---|---|---|-------|---|---|-------|

| | | | | | | | | |
|-----------------------------|------------|--------|------------|--------|-----------|--------------|--------|------------|
| Balance at June 26, 2016 | 25,357,542 | \$ 306 | \$(66,622) | \$ 909 | \$404,585 | \$(216,785) | \$ 729 | \$ 123,122 |
|-----------------------------|------------|--------|------------|--------|-----------|--------------|--------|------------|

See accompanying notes to the unaudited condensed consolidated financial statements.

POTBELLY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(amounts in thousands, unaudited)

| | For the 26 Weeks Ended | |
|---|---------------------------|------------------|
| | June 26, 2016 | June 28, 2015 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$4,560 | \$2,994 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 11,340 | 10,439 |
| Deferred income tax | 293 | 190 |
| Deferred rent and landlord allowances | 579 | 1,769 |
| Amortization of stock compensation expense | 1,466 | 1,127 |
| Excess tax benefit from stock-based compensation | (16) | (224) |
| Asset impairment, store closure and disposal of property and equipment | 1,028 | 887 |
| Amortization of debt issuance costs | 16 | 35 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (93) | (1,018) |
| Inventories | 138 | (52) |
| Prepaid expenses and other assets | 4,616 | 904 |
| Accounts payable | (1,511) | (730) |
| Accrued and other liabilities | 1,902 | 2,641 |
| Net cash provided by operating activities | 24,318 | 18,962 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Acquisition of franchise shop | (1,108) | — |
| Purchases of property and equipment | (12,178) | (17,901) |
| Net cash used in investing activities | (13,286) | (17,901) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on note payable | — | (1,022) |
| Proceeds from exercise of stock options | 3,813 | 3,743 |
| Payment of payroll taxes related to stock-based compensation awards | (165) | (678) |
| Treasury stock repurchase | (16,622) | (12,546) |
| Excess tax benefit from stock-based compensation | 16 | 224 |
| Contributions from non-controlling interest | — | 326 |
| Distribution to non-controlling interest | (159) | (8) |
| Net cash used in financing activities | (13,117) | (9,961) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (2,085) | (8,900) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 32,006 | 63,005 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$29,921 | \$54,105 |
| Supplemental cash flow information: | | |
| Income taxes paid | \$714 | \$230 |
| Interest paid | 57 | 114 |
| Supplemental non-cash investing and financing activities: | | |
| Unpaid liability for purchases of property and equipment | \$1,580 | \$2,931 |

See accompanying notes to the unaudited condensed consolidated financial statements

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 or franchises Potbelly Sandwich Works sandwich shops in 29 states and the District of Columbia. 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. In July 2015, the Company opened its first franchise shop in the United Kingdom. Additionally, during April 2016, the Company transitioned a franchise shop to a company-operated shop for a purchase price of \$1.1 million. The Company recorded \$0.8 million of goodwill related to the transaction. The Company believes this acquisition is immaterial.

The table below sets forth a rollforward of company-operated and franchise-operated activities:

| | Company- Operated | Franchise-Operated | | Total | Total Company |
|--------------------------------|----------------------|--------------------|---------------|-------|------------------|
| | | Domestic | International | | |
| Shops as of December 28, 2014 | 334 | 17 | 12 | 29 | 363 |
| Shops opened | 17 | — | 1 | 1 | 18 |
| Shops closed | (2) | — | (1) | (1) | (3) |
| Shops as of June 28, 2015 | 349 | 17 | 12 | 29 | 378 |
| Shops as of December 27, 2015 | 372 | 24 | 12 | 36 | 408 |
| Shops opened | 9 | 4 | 1 | 5 | 14 |
| Shop purchased from franchisee | 1 | (1) | — | (1) | — |
| Shop closed | — | — | (1) | (1) | (1) |
| Shops as of June 26, 2016 | 382 | 27 | 12 | 39 | 421 |

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 27, 2015. 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 26, 2016 and December 27, 2015, its statement of operations for the 13 and 26 weeks ended June 26, 2016 and June 28, 2015 and its statement of cash flows for the 26 weeks ended June 26, 2016 and June 28, 2015 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 recorded within its consolidated financial statements, and, therefore, does not separately present a statement of comprehensive income 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”); 17 of LLC’s wholly owned subsidiaries and LLC’s five 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 five joint venture investments. The Company has ownership interests ranging from 51-80% in these consolidated joint ventures.

POTBELLY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

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 2016 and 2015 each consist of 52 weeks. The fiscal quarters ended June 26, 2016 and June 28, 2015 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 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.

New and Revised Financial Accounting Standards

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 beginning after December 15, 2017. In addition, the FASB issued ASU 2016-08, ASU 2016-10, and ASU 2016-12 in March 2016, April 2016, and May 2016, respectively, to help provide interpretive clarifications on the new guidance in ASC Topic 606. The Company is evaluating the effect this guidance will have on the Company's consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its financial statements and disclosures.

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 the Company's management to evaluate whether there is substantial doubt about the Company's 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 the Company's financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases", which will replace the existing guidance in ASC 840, "Leases". The pronouncement requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use asset and a corresponding lease liability. For finance leases, the lessee would recognize interest expense and amortization of the right-of-use asset, and for operating leases, the lessee would recognize a straight-line total lease expense. The pronouncement is effective for fiscal years beginning after December 15, 2018, including annual and interim periods thereafter. In addition, the pronouncement requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. The Company is evaluating the impact this standard will have on its financial statements and disclosures.

In March 2016, the FASB issued ASU No. 2016-04, “Recognition of Breakage for Certain Prepaid Stored-Value Products”. This pronouncement clarifies when it is acceptable to recognize the unredeemed portion of prepaid gift cards into income. This pronouncement is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is evaluating the impact this standard will have on its financial statements and disclosures.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation – Stock Compensation (Topic 718)”. The pronouncement simplifies the accounting for the taxes related to stock-based compensation, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification within the statement of cash flows. The pronouncement is effective for annual periods beginning after December 15, 2016, including annual and interim periods thereafter. The Company is evaluating the impact this standard will have on its financial statements and disclosures.

(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.

POTBELLY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

The Company assesses potential impairments to its long-lived assets, which includes property and equipment, on a quarterly basis or 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. The fair value of the shop assets is 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. After performing a periodic review of the Company's shops during each quarter of 2016, it was determined that indicators of impairment were present for certain shops during the 13 weeks ended June 26, 2016 as a result of continued underperformance. The Company performed an impairment analysis related to these shops and recorded an impairment charge of \$1.0 million for the 13 and 26 weeks ended June 26, 2016 related to the excess of the carrying amounts recorded on the balance sheet over the shops' estimated fair value. The Company recorded impairment charges of \$0.3 million and \$0.6 million for the 13 and 26 weeks ended June 28, 2015, respectively.

(3) Earnings per share

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

| | For the 13 Weeks Ended | | For the 26 Weeks Ended | |
|--|------------------------|------------------|------------------------|------------------|
| | June 26, 2016 | June 28, 2015 | June 26, 2016 | June 28, 2015 |
| Net income attributable to Potbelly Corporation | \$3,373 | \$2,461 | \$4,461 | \$2,992 |
| Weighted average common shares outstanding-basic | 25,818,571 | 28,594,712 | 26,039,082 | 28,749,898 |
| Plus: Effect of potential stock options exercise | 581,971 | 708,271 | 504,761 | 709,276 |
| Plus: Effect of potential warrant exercise | 58,545 | 61,706 | 53,169 | 60,989 |
| Weighted average common shares outstanding-diluted | 26,459,087 | 29,364,689 | 26,597,012 | 29,520,163 |
| Income per share available to common stockholders-basic | \$0.13 | \$0.09 | \$0.17 | \$0.10 |
| Income per share available to common stockholders-diluted | \$0.13 | \$0.08 | \$0.17 | \$0.10 |
| Potentially dilutive shares that are considered anti-dilutive: | | | | |
| Common share options | 1,003,718 | 491,494 | 1,238,252 | 609,084 |
| Warrants | — | — | — | — |

(4) Income Taxes

The Company recognized income tax expense of \$2.0 million on pre-tax income of \$5.5 million, or an effective tax rate of 37.3%, for the 13 weeks ended June 26, 2016, compared to income tax expense of \$1.6 million on pre-tax income of \$4.0 million, or an effective tax rate of 38.9%, for the 13 weeks ended June 28, 2015. The Company recognized income tax expense of \$2.8 million on pre-tax income of \$7.3 million, or an effective tax rate of 37.8%, for the 26 weeks ended June 26, 2016, compared to 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. The difference between the federal statutory rate and the effective tax rate for both the 13 and 26 weeks ended June 26, 2016 is primarily attributable to state income taxes offset by certain federal and state tax credits.

(5) Capital Stock

On September 8, 2015, the Company's Board of Directors authorized a share repurchase program of up to \$35.0 million of the Company's common stock. This program permits the Company, from time to time, to 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 26, 2016, the Company repurchased 1,268,844 shares of its common stock for approximately \$16.6 million, including cost and commission, in open market transactions. As of June 26, 2016, the remaining dollar value of authorization under the share repurchase program was \$3.4 million, which does not include commission. Repurchased shares are included as treasury stock in the condensed consolidated balance sheets and the condensed consolidated statement of equity.

POTBELLY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

(6) Stock-Based Compensation

Throughout the 26 weeks ended June 26, 2016, the Company issued 367,789 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 26, 2016 was \$7.05 per share, as estimated using the following weighted average assumptions: expected life of options – seven years; volatility – 49.41%; risk-free interest rate – 1.67%; and dividend yield – 0.0%. The Company used the simplified method for determining the expected life of the options. Beginning October 2015, expected volatility of the options was calculated using the Company’s historical data since its initial public offering. Prior to October 2015, the Company calculated expected volatility of the options based on historical data from selected peer public company restaurants.

A summary of activity for the 26 weeks ended June 26, 2016 is as follows:

| | | Weighted | | |
|-------------------------------|-------------|----------|-------------|-----------|
| | | Average | Aggregate | Average |
| | | | Intrinsic | Remaining |
| | Shares | Exercise | Value | Term |
| Options | (Thousands) | Price | (Thousands) | (Years) |
| Outstanding—December 27, 2015 | 4,368 | \$ 10.53 | \$ 9,742 | 5.10 |
| Granted | 368 | 13.65 | | |
| Exercised | (307) | 11.85 | | |
| Canceled | (103) | 14.42 | | |
| Outstanding—June 26, 2016 | 4,326 | 10.61 | \$ 10,461 | 5.15 |
| Exercisable—June 26, 2016 | 3,136 | 9.58 | \$ 9,860 | 3.86 |

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 26, 2016, the Company recognized stock-based compensation of \$0.8 million and \$1.5 million, respectively. For the 13 and 26 weeks ended June 28, 2015, the Company recorded stock-based compensation of \$0.6 million and \$1.1 million, respectively. As of June 26, 2016, the unrecognized stock-based compensation expense was \$7.0 million, which will be recognized through fiscal year 2020. 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 fair value 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. In August 2015, the Company issued 5,221 shares of RSUs to the new non-employee member of its Board of Directors. The RSUs had a grant-date fair value of \$11.88 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. In May 2016, the Company issued 52,558 shares of RSUs to certain non-employee members of its Board of Directors. The RSUs had a grant-date fair value of \$13.27 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.

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 27, 2015. 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," "goals," "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 27, 2015, 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.

13 Weeks Ended June 26, 2016 Compared to 13 Weeks Ended June 28, 2015

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

| | For the 13 Weeks Ended | | | | Increase | | Percent | |
|--|------------------------|----------|-------------|----------|------------|-----------|---------|--|
| | June 26, | % of | June 28, | % of | (Decrease) | Change | | |
| | 2016 | Revenues | 2015 | Revenues | | | | |
| Revenues | | | | | | | | |
| Sandwich shop sales, net | \$ 104,466 | 99.5 | % \$ 95,566 | 99.6 | % \$ 8,900 | 9.3 | % | |
| Franchise royalties and fees | 570 | 0.5 | 383 | 0.4 | 187 | 48.8 | | |
| Total revenues | 105,036 | 100.0 | 95,949 | 100.0 | 9,087 | 9.5 | | |
| Expenses | | | | | | | | |
| Sandwich shop operating expenses | | | | | | | | |
| Cost of goods sold, excluding | | | | | | | | |
| depreciation | 28,500 | 27.1 | 27,253 | 28.4 | 1,247 | 4.6 | | |
| Labor and related expenses | 29,935 | 28.5 | 27,152 | 28.3 | 2,783 | 10.2 | | |
| Occupancy expenses | 13,174 | 12.5 | 11,539 | 12.0 | 1,635 | 14.2 | | |
| Other operating expenses | 10,687 | 10.2 | 9,970 | 10.4 | 717 | 7.2 | | |
| General and administrative expenses | 10,305 | 9.8 | 9,643 | 10.1 | 662 | 6.9 | | |
| Depreciation expense | 5,676 | 5.4 | 5,288 | 5.5 | 388 | 7.3 | | |
| Pre-opening costs | 239 | 0.2 | 536 | 0.6 | (297) | (55.4) | | |
| Impairment and loss on disposal of | | | | | | | | |
| property and equipment | 1,008 | 1.0 | 484 | 0.5 | 524 | 108.3 | | |
| Total expenses | 99,524 | 94.8 | 91,865 | 95.7 | 7,659 | 8.3 | | |
| Income from operations | 5,512 | 5.2 | 4,084 | 4.3 | 1,428 | 35.0 | | |
| Interest expense, net | 41 | * | 63 | 0.1 | (22) | (34.9) | | |
| Income before income taxes | 5,471 | 5.2 | 4,021 | 4.2 | 1,450 | 36.1 | | |
| Income tax expense | 2,039 | 1.9 | 1,563 | 1.6 | 476 | 30.5 | | |
| Net income | 3,432 | 3.3 | 2,458 | 2.6 | 974 | 39.6 | | |
| Net income (loss) attributable to non- | | | | | | | | |
| controlling interests | 59 | * | (3) | *) | 62 | (2,066.7) | | |
| Net income attributable to | | | | | | | | |
| Potbelly Corporation | \$ 3,373 | 3.2 | % \$ 2,461 | 2.6 | % \$ 912 | 37.1 | % | |

* Amount is less than 0.1%

Revenues

Total revenues increased by \$9.1 million, or 9.5%, to \$105.0 million during the 13 weeks ended June 26, 2016, from \$95.9 million during the 13 weeks ended June 28, 2015. The net change in revenues primarily consisted of an increase of \$8.4 million in sales from shops not yet in our company-operated comparable store sales base, \$1.6 million (or 1.7%) increase in company-operated comparable store sales, \$0.2 million increase in franchise revenues as well as an offsetting decline of \$1.1 million for shops that have closed. The increase in company-operated comparable store sales

resulted primarily from increases in average check from certain menu price increases.

Cost of Goods Sold

Cost of goods sold increased by \$1.2 million, or 4.6%, to \$28.5 million during the 13 weeks ended June 26, 2016, compared to \$27.3 million during the 13 weeks ended June 28, 2015, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 27.1% during the 13 weeks ended June 26, 2016, from 28.4% during the 13 weeks ended June 28, 2015, primarily driven by sales price increases.

Labor and Related Expenses

Labor and related expenses increased by \$2.8 million, or 10.2%, to \$29.9 million during the 13 weeks ended June 26, 2016, from \$27.1 million during the 13 weeks ended June 28, 2015, primarily due to new shop openings and wage inflation in certain states as a result of statutory minimum wage increases. As a percentage of revenues, labor and related expenses increased to 28.5% during the 13 weeks ended June 26, 2016, from 28.3% during the 13 weeks ended June 28, 2015, primarily driven by wage inflation.

Occupancy Expenses

Occupancy expenses increased by \$1.7 million, or 14.2%, to \$13.2 million during the 13 weeks ended June 26, 2016, from \$11.5 million during the 13 weeks ended June 28, 2015, primarily due to new shop openings and increases in certain occupancy-related costs. As a percentage of revenues, occupancy expenses increased to 12.5% during the 13 weeks ended June 26, 2016, from 12.0% during the 13 weeks ended June 28, 2015, primarily due to certain occupancy-related costs.

Other Operating Expenses

Other operating expenses increased by \$0.7 million, or 7.2%, to \$10.7 million during the 13 weeks ended June 26, 2016, from \$10.0 million during the 13 weeks ended June 28, 2015. The increase is attributable to new shop openings as well as increases in fees associated with credit card usage in our shops. As a percentage of revenues, other operating expenses decreased to 10.2% during the 13 weeks ended June 26, 2016, from 10.4% during the 13 weeks ended June 28, 2015, primarily driven by lower utility and insurance costs.

General and Administrative Expenses

General and administrative expenses increased by \$0.7 million, or 6.9%, to \$10.3 million during the 13 weeks ended June 26, 2016, from \$9.6 million during the 13 weeks ended June 28, 2015. The increase is driven primarily by increased costs related to investments in field-based headcount that corresponds with shop count, stock-based compensation expense as well as various other expenses. As a percentage of revenues, general and administrative expenses decreased to 9.8% during the 13 weeks ended June 26, 2016, from 10.1% during the 13 weeks ended June 28, 2015, driven by sales leverage (i.e., the ability to spread certain expenses over a higher revenue basis).

Depreciation Expense

Depreciation expense increased by \$0.4 million, or 7.3%, to \$5.7 million during the 13 weeks ended June 26, 2016, from \$5.3 million during the 13 weeks ended June 28, 2015, primarily due to a higher depreciable base related to new shops and existing shop capital investments. As a percentage of revenues, depreciation decreased to 5.4% during the 13 weeks ended June 26, 2016, from 5.5% during the 13 weeks ended June 28, 2015, 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 decreased by \$0.3 million, or 55.4%, to \$0.2 million during the 13 weeks ended June 26, 2016, from \$0.5 million during the 13 weeks ended June 28, 2015, primarily due to timing of new shop openings during the 13 weeks ended June 26, 2016 compared to the 13 weeks ended June 28, 2015.

Impairment and Loss on Disposal of Property and Equipment

Impairment and loss on disposal of property and equipment increased to \$1.0 million during the 13 weeks ended June 26, 2016, compared to \$0.5 million during the 13 weeks ended June 28, 2015. After performing a periodic review of our shops during the second quarter of 2016, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance. We performed an impairment analysis related to these shops and recorded an impairment charge of \$1.0 million related to the excess of the carrying amounts recorded on our balance sheet over the shops' estimated fair values.

Interest Expense, net

Interest expense decreased by \$22 thousand, or 34.9%, to \$41 thousand during the 13 weeks ended June 26, 2016, from \$63 thousand during the 13 weeks ended June 28, 2015, primarily due to lower accretion of certain occupancy-related interest costs as well as having no outstanding notes payable. The final repayment of the previously held note was made on April 1, 2015. Interest expense for the 13 weeks ended June 26, 2016 is attributable to unused commitment fees, occupancy-related interest costs and deferred financing fees.

Income Tax Expense

Income tax expense increased by \$0.5 million to \$2.0 million for the 13 weeks ended June 26, 2016, from \$1.5 million for the 13 weeks ended June 28, 2015. For the 13 weeks ended June 26, 2016, our effective tax rate was 37.3%, compared to 38.9% for the 13

weeks ended June 28, 2015. The decrease in the effective tax rate primarily relates to the recognition of certain federal tax credits, which were not recognized in the comparable prior period.

26 Weeks Ended June 26, 2016 Compared to 26 Weeks Ended June 28, 2015

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

| | For the 26 Weeks Ended | | | | Increase | | Percent | |
|-------------------------------------|------------------------|----------|------------|----------|------------|---------|---------|--|
| | June 26, | % of | June 28, | % of | (Decrease) | Change | | |
| | 2016 | Revenues | 2015 | Revenues | | | | |
| Revenues | | | | | | | | |
| Sandwich shop sales, net | \$ 199,892 | 99.5 % | \$ 180,963 | 99.6 % | \$ 18,929 | 10.5 % | | |
| Franchise royalties and fees | 1,099 | 0.5 | 754 | 0.4 | 345 | 45.8 | | |
| Total revenues | 200,991 | 100.0 | 181,717 | 100.0 | 19,274 | 10.6 | | |
| Expenses | | | | | | | | |
| Sandwich shop operating expenses | | | | | | | | |
| Cost of goods sold, excluding | | | | | | | | |
| depreciation | 54,746 | 27.2 | 51,598 | 28.4 | 3,148 | 6.1 | | |
| Labor and related expenses | 58,097 | 28.9 | 51,752 | 28.5 | 6,345 | 12.3 | | |
| Occupancy expenses | 25,931 | 12.9 | 22,886 | 12.6 | 3,045 | 13.3 | | |
| Other operating expenses | 21,232 | 10.6 | 19,627 | 10.8 | 1,605 | 8.2 | | |
| General and administrative expenses | 20,828 | 10.4 | 18,474 | 10.2 | 2,354 | 12.7 | | |
| Depreciation expense | 11,340 | 5.6 | 10,439 | 5.7 | 901 | 8.6 | | |
| Pre-opening costs | 391 | 0.2 | 1,077 | 0.6 | (686) | (63.7) | | |
| Impairment and loss on disposal of | | | | | | | | |
| property and equipment | 1,025 | 0.5 | 832 | 0.5 | 193 | 23.2 | | |
| Total expenses | 193,590 | 96.3 | 176,685 | 97.2 | 16,905 | 9.6 | | |
| Income from operations | 7,401 | 3.7 | 5,032 | 2.8 | 2,369 | 47.1 | | |
| Interest expense, net | 69 | * | 124 | 0.1 | (55) | (44.4) | | |
| Income before income taxes | 7,332 | 3.6 | 4,908 | 2.7 | 2,424 | 49.4 | | |
| Income tax expense | 2,772 | 1.4 | 1,914 | 1.1 | 858 | 44.8 | | |
| Net income | 4,560 | 2.3 | 2,994 | 1.6 | 1,566 | 52.3 | | |
| Net income attributable to non- | | | | | | | | |
| controlling interests | 99 | * | 2 | * | 97 | 4,850.0 | | |
| Net income attributable to | | | | | | | | |
| Potbelly Corporation | \$4,461 | 2.2 % | \$2,992 | 1.6 % | \$ 1,469 | 49.1 % | | |

* Amount is less than 0.1%

Revenues

Total revenues increased by \$19.3 million, or 10.6%, to \$201.0 million during the 26 weeks ended June 26, 2016, from \$181.7 during the 26 weeks ended June 28, 2015. The net change in revenues primarily consisted of an increase

of \$17.4 million in sales from shops not yet in our company-operated comparable store sales base, \$4.6 million (or 2.6%) increase in company-operated comparable store sales, \$0.3 million increase in franchise revenues as well as an offsetting decline of \$3.0 million for shops that have closed. The increase in company-operated comparable store sales resulted from increases in average check from certain menu price increases and menu mix.

Cost of Goods Sold

Cost of goods sold increased \$3.1 million, or 6.1%, to \$54.7 million during the 26 weeks ended June 26, 2016, from \$51.6 million during the 26 weeks ended June 28, 2015, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 27.2% during the 26 weeks ended June 26, 2016, from 28.4% during the 26 weeks ended June 28, 2015, primarily driven by sales price increases.

Labor and Related Expenses

Labor and related expenses increased by \$6.3 million, or 12.3%, to \$58.1 million during the 26 weeks ended June 26, 2016, from \$51.8 million during the 26 weeks ended June 28, 2015, primarily due to new shop openings and wage inflation in certain states as a result of statutory minimum wage increases. As a percentage of revenues, labor and related expenses increased to 28.9% during the 26 weeks ended June 26, 2016, from 28.5% during the 26 weeks ended June 28, 2015, primarily driven by wage inflation.

Occupancy Expenses

Occupancy expenses increased by \$3.0 million, or 13.3%, to \$25.9 million during the 26 weeks ended June 26, 2016, from \$22.9 million during the 26 weeks ended June 28, 2015, primarily due to new shop openings and increases in certain occupancy-related costs. As a percentage of revenues, occupancy expenses increased to 12.9% during the 26 weeks ended June 26, 2016, from 12.6% during the 26 weeks ended June 28, 2015, primarily due to certain occupancy-related costs.

Other Operating Expenses

Other operating expenses increased by \$1.6 million, or 8.2%, to \$21.2 million during the 26 weeks ended June 26, 2016, from \$19.6 million during the 26 weeks ended June 28, 2015. The increase is attributable to new shop openings as well as increases in fees associated with credit card usage in our shops. As a percentage of revenues, other operating expenses decreased to 10.6% during the 26 weeks ended June 26, 2016, from 10.8% during the 26 weeks ended June 28, 2015, primarily driven by lower utility and insurance costs.

General and Administrative Expenses

General and administrative expenses increased by \$2.3 million, or 12.7%, to \$20.8 million during the 26 weeks ended June 26, 2016, from \$18.5 million during the 26 weeks ended June 28, 2015. The increase is driven primarily by a conference held for our General Managers, which was not held during the 26 weeks ended June 28, 2015. Additionally, we incurred increased costs related to investments in field-based headcount that corresponds with shop count, stock-based compensation expense as well as various other expenses. As a percentage of revenues, general and administrative expenses increased to 10.4% during the 26 weeks ended June 26, 2016, from 10.2% during the 26 weeks ended June 28, 2015, driven by the conference held for our General Managers.

Depreciation Expense

Depreciation expense increased by \$0.9 million, or 8.6%, to \$11.3 million during the 26 weeks ended June 26, 2016, from \$10.4 million during the 26 weeks ended June 28, 2015, primarily due to a higher depreciable base related to new shops and existing shop capital investments. As a percentage of revenues, depreciation decreased to 5.6% during the 26 weeks ended June 26, 2016, from 5.7% during the 26 weeks ended June 28, 2015, 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 decreased by \$0.7 million, or 63.7%, to \$0.4 million during the 26 weeks ended June 26, 2016, from \$1.1 million during the 26 weeks ended June 28, 2015, primarily due to timing of new shop openings during the 26 weeks ended June 26, 2016 compared to the 26 weeks ended June 28, 2015.

Impairment and Loss on Disposal of Property and Equipment

Impairment and loss on disposal of property and equipment increased to \$1.0 million during the 26 weeks ended June 26, 2016, compared to \$0.8 million during the 26 weeks ended June 28, 2015. After performing a periodic review of our shops during the second quarter of 2016, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance. We performed an impairment analysis related to these shops and recorded an impairment charge of \$1.0 million related to the excess of the carrying amounts recorded on our balance sheet over the shops' estimated fair values.

Interest Expense, net

Interest expense decreased by \$55 thousand, or 44.4%, to \$69 thousand during the 26 weeks ended June 26, 2016, from \$124 thousand during the 26 weeks ended June 28, 2015, primarily due to lower accretion of certain occupancy-related interest costs as well

as having no outstanding notes payable. The final payment of the note was made on April 1, 2015. Interest expense for the 26 weeks ended June 26, 2016 is attributable to unused commitment fees, occupancy-related interest costs and deferred financing fees.

Income Tax Expense

Income tax expense increased by \$0.9 million to \$2.8 million for the 26 weeks ended June 26, 2016, from \$1.9 million for the 26 weeks ended June 28, 2015. For the 26 weeks ended June 26, 2016, our effective tax rate was 37.8%, compared to 39.0% for the 26 weeks ended June 28, 2015. The decrease in the effective tax rate primarily relates to the recognition of certain federal tax credits, which were not recognized in the comparable prior period.

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), repurchases of our common stock, lease obligations, principal and interest payments on our debt, purchases of existing franchise-operated shops, 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):

| | For the 26 Weeks Ended | |
|---------------------------------|---------------------------|------------------|
| | June 26, 2016 | June 28, 2015 |
| Net cash provided by (used in): | | |
| Operating activities | \$24,318 | \$18,962 |
| Investing activities | (13,286) | (17,901) |
| Financing activities | (13,117) | (9,961) |
| Net decrease in cash | \$(2,085) | \$(8,900) |

Operating Activities

Net cash provided by operating activities increased to \$24.3 million for the 26 weeks ended June 26, 2016, from \$19.0 million for the 26 weeks ended June 28, 2015. The \$5.3 million increase is primarily attributable to an increase of \$4.8 million in net shop-level profits.

Investing Activities

Net cash used in investing activities decreased to \$13.3 million for the 26 weeks ended June 26, 2016, from \$17.9 million for the 26 weeks ended June 28, 2015. The decrease was primarily due to timing of spend on capital expenditures for future shop openings, maintaining our existing shops, and certain other projects. This timing

difference is partially offset by the cost associated with the purchase of a franchise shop in April 2016 for a purchase price of \$1.1 million.

Financing Activities

Net cash used in financing activities was \$13.1 million for the 26 weeks ended June 26, 2016, compared to \$10.0 million for the 26 weeks ended June 28, 2015. The increase in net cash used was mainly driven by \$16.6 million of treasury stock repurchased during the 26 weeks ended June 26, 2016 compared to \$12.5 million during the 26 weeks ended June 28, 2015. The net increase of \$4.1 million in treasury stock repurchases is partially offset by \$1.0 million in payments on the note payable during the 26 weeks ended June 28, 2015 compared to no payments during the 26 weeks ended June 26, 2016. The final repayment of the previously held note was made on April 1, 2015.

Stock Repurchase Program

On September 8, 2015, our Board of Directors authorized a share repurchase program of up to \$35.0 million of the Company's common stock. This program permits the Company, from time to time, to 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 26, 2016, we repurchased 1,268,844 shares of our common stock for approximately \$16.6 million, including cost and commission, in open market transactions. As of June 26, 2016, the remaining dollar value of authorization under the share repurchase program was \$3.4 million, which does not include commission. Repurchased shares are included as treasury stock in the condensed consolidated balance sheets and the condensed consolidated statement of equity.

Credit Facility

On December 9, 2015, we entered into an amended and restated five-year revolving credit facility agreement that expires in November 2020. The credit agreement provides, among other things, for a revolving credit facility in a maximum principal amount of \$50 million, with possible future increases to \$75 million under an expansion feature. Borrowings under the credit facility generally bear interest at our option at either (i) a eurocurrency rate determined by reference to the applicable LIBOR rate plus a margin ranging from 1.00% to 1.75% or (ii) a prime rate as announced by JP Morgan Chase plus a margin ranging from 0.00% to 0.50%. The applicable margin is determined based upon our consolidated total leverage ratio. On the last day of each calendar quarter, we are required to pay a commitment fee ranging from 0.125% to 0.20% per annum in respect of any unused commitments under the credit facility, with the specific rate determined based upon our consolidated total leverage ratio. So long as certain total leverage ratios are met, there is no limit on the “restricted payments” (primarily distributions and equity repurchases) that we may make. As of and for the 26 weeks ended June 26, 2016, 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 26, 2016, 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.

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 27, 2015. Our exposures to market risk have not changed materially since December 27, 2015.

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 26, 2016. Based upon that evaluation, our Chief Executive Officer and Chief

Financial Officer have concluded that, as of June 26, 2016, 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 26, 2016 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.

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 27, 2015. 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 26, 2016:

| Period | Total Number of | | Total Number of Shares | | Maximum Value of |
|---------------------------------|-----------------|--------------------|------------------------|--------------------|---------------------|
| | Purchased | Average Price Paid | Purchased as Part of | Publicly Announced | Shares that May Yet |
| | Shares | | | | be Purchased Under |
| | | per Share (1) | | Program (2) | the Program (2) |
| March 28, 2016 – April 24, 2016 | 225,900 | \$ 13.43 | | 225,900 | \$ 12,640,178 |
| April 25, 2016 – May 22, 2016 | 156,592 | \$ 13.38 | | 156,592 | \$ 10,545,046 |
| May 23, 2016 – June 26, 2016 | 552,402 | \$ 12.88 | | 552,402 | \$ 3,429,495 |
| Total: | 934,894 | | | 934,894 | |

(1) Average price paid per share excludes commissions.

(2) On September 8, 2015, we announced that our Board of Directors approved a share repurchase program, authorizing us to repurchase up to \$35.0 million of our common stock. This program permits the Company, from time to time, to 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. No time limit has been set for the completion of the repurchase program, and the program may be suspended or discontinued at any time.

ITEM 6. EXHIBITS

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

Exhibit

| No. | Description |
|---------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

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 3, 2016 By: /s/ Michael Coyne
Michael Coyne
Chief Financial Officer
(Principal Financial Officer)