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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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

For the Quarterly Period Ended June 29, 2014

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

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**Potbelly Corporation**

(Exact name of registrant as specified in its charter)

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

**36-4466837**  
(IRS Employer  
Identification Number)

**222 Merchandise Mart Plaza, 23rd Floor**  
**Chicago, Illinois 60654**  
(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	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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 – 29,477,677 shares as of August 1, 2014

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POTBELLY CORPORATION  
QUARTERLY REPORT ON FORM 10-Q  
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**PART I. FINANCIAL INFORMATION.**

## ITEM 1. FINANCIAL STATEMENTS.

**POTBELLY CORPORATION AND SUBSIDIARIES**  
**Condensed Consolidated Balance Sheets**  
**(amounts in thousands, except share and par value data, unaudited)**

	June 29, 2014	December 29, 2013
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 70,524	\$ 69,579
Accounts receivable, net of allowances of \$3 and \$6 as of June 29, 2014 and December 29, 2013, respectively	3,949	2,991
Inventories	2,353	2,263
Prepaid expenses and other current assets	8,872	6,965
Total current assets	85,698	81,798
Property and equipment, net	81,901	78,983
Intangible assets, net	3,404	3,404
Goodwill	1,428	1,428
Deferred income taxes	17,176	17,297
Deferred expenses, net and other assets	3,139	3,170
<b>Total assets</b>	<b>\$ 192,746</b>	<b>\$ 186,080</b>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Accounts payable	\$ 3,451	\$ 2,078
Accrued expenses	14,977	16,337
Accrued income taxes	490	216
Current portion of long-term debt	74	74
Total current liabilities	18,992	18,705
Long-term debt, net of current portion	976	1,018
Deferred rent and landlord allowances	13,011	12,288
Other long-term liabilities	736	796
Total liabilities	33,715	32,807
Equity		
Common stock, \$0.01 par value—authorized, 200,000,000 shares; issued and outstanding 29,470,694 and 29,148,029 shares as of June 29, 2014, and December 29, 2013, respectively	295	291
Warrants	909	909
Additional paid-in-capital	387,142	383,077
Accumulated deficit	(229,523)	(231,232)
Total stockholders' equity	158,823	153,045
Non-controlling interest	208	228
Total equity	159,031	153,273
<b>Total liabilities and equity</b>	<b>\$ 192,746</b>	<b>\$ 186,080</b>

*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 29, 2014	June 30, 2013	June 29, 2014	June 30, 2013
<b>Revenues</b>				
Sandwich shop sales, net	\$ 83,268	\$ 77,926	\$ 156,791	\$ 146,467
Franchise royalties and fees	352	260	710	463
Total revenues	<u>83,620</u>	<u>78,186</u>	<u>157,501</u>	<u>146,930</u>
<b>Expenses</b>				
Sandwich shop operating expenses				
Cost of goods sold, excluding depreciation	23,936	22,760	45,022	42,753
Labor and related expenses	23,405	21,204	44,865	40,995
Occupancy expenses	10,183	8,811	20,162	17,530
Other operating expenses	8,691	7,901	16,849	15,112
General and administrative expenses	8,865	7,823	16,687	16,005
Depreciation expense	4,784	4,444	9,501	8,824
Pre-opening costs	273	429	525	719
Impairment and loss on disposal of property and equipment	29	53	877	79
Total expenses	<u>80,166</u>	<u>73,425</u>	<u>154,488</u>	<u>142,017</u>
Income from operations	3,454	4,761	3,013	4,913
Interest expense	40	122	82	233
Other expense	—	—	—	2
Income before income taxes	3,414	4,639	2,931	4,678
Income tax expense	1,407	1,869	1,216	1,886
Net income	2,007	2,770	1,715	2,792
Net (loss) income attributable to non-controlling interest	(3)	11	6	15
Net income attributable to Potbelly Corporation	2,010	2,759	1,709	2,777
Accretion of redeemable convertible preferred stock to maximum redemption value	—	(2,905)	—	(10,301)
Net income (loss) attributable to common stockholders	<u>\$ 2,010</u>	<u>\$ (146)</u>	<u>\$ 1,709</u>	<u>\$ (7,524)</u>
Net income (loss) per common share attributable to common stockholders:				
Basic	\$ 0.07	\$ (0.03)	\$ 0.06	\$ (1.77)
Diluted	\$ 0.07	\$ (0.03)	\$ 0.06	\$ (1.77)
Weighted average shares outstanding:				
Basic	29,342,528	4,244,879	29,246,676	4,241,752
Diluted	30,509,553	4,244,879	30,642,892	4,241,752

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

**POTBELLY CORPORATION AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Redeemable Convertible Preferred Stock and Equity (Deficit)**  
**(amounts in thousands, except share data, unaudited)**

	Redeemable Convertible Preferred Stock														Equity (Deficit)					Total Equity (Deficit)	
	Series A		Series B		Series C		Series D		Series E		Series F		Total		Common Stock		Warrants	Additional Paid-In-Capital	Accumulated Deficit		Non-Controlling Interest
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Balance at December 30, 2012	3,697,377	\$52,796	3,290,294	\$46,983	1,646,595	\$23,715	1,250,000	\$18,319	4,194,366	\$79,861	2,007,743	\$28,669	16,086,375	\$250,343	4,233,977	\$ 42	\$ 1,552	\$ —	\$ (170,518)	\$ 196	\$(168,728)
Net income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	2,777	15	2,792
Beneficial Conversion Charge	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	50	(50)	—	—
Exercise of stock warrants	—	—	—	—	—	—	—	—	—	—	—	—	—	—	14,383	—	(78)	78	—	—	—
Changes in redemption value of preferred stock	—	2,097	—	1,866	—	942	—	735	—	3,523	—	1,138	—	10,301	—	—	—	(1,270)	(9,031)	—	(10,301)
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1,142	—	—	1,142
<b>Balance at June 30, 2013</b>	<b>3,697,377</b>	<b>\$54,893</b>	<b>3,290,294</b>	<b>\$48,849</b>	<b>1,646,595</b>	<b>\$24,657</b>	<b>1,250,000</b>	<b>\$19,054</b>	<b>4,194,366</b>	<b>\$83,384</b>	<b>2,007,743</b>	<b>\$29,807</b>	<b>16,086,375</b>	<b>\$260,644</b>	<b>4,248,360</b>	<b>\$ 42</b>	<b>\$ 1,474</b>	<b>\$ —</b>	<b>\$ (176,822)</b>	<b>\$ 211</b>	<b>\$(175,095)</b>
Balance at December 29, 2013	—	—	—	—	—	—	—	—	—	—	—	—	—	—	29,148,029	\$ 291	\$ 909	\$383,077	\$ (231,232)	\$ 228	\$ 153,273
Net income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1,709	6	1,715
Issuance of unrestricted common stock	—	—	—	—	—	—	—	—	—	—	—	—	—	—	25,663	—	—	400	—	—	400
Exercise of stock options	—	—	—	—	—	—	—	—	—	—	—	—	—	—	297,002	4	—	2,624	—	—	2,628
Distribution to non-controlling interest	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	(26)	(26)
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1,041	—	—	1,041
<b>Balance at June 29, 2014</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>29,470,694</b>	<b>\$ 295</b>	<b>\$ 909</b>	<b>\$387,142</b>	<b>\$ (229,523)</b>	<b>\$ 208</b>	<b>\$ 159,031</b>

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

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

	<b>For the 26 Weeks Ended</b>	
	<b>June 29, 2014</b>	<b>June 30, 2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 1,715	\$ 2,792
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,501	8,824
Deferred income tax	121	1,134
Deferred rent and landlord allowances	723	90
Stock compensation expense	1,441	1,142
Asset impairment and disposal of property and equipment	877	79
Amortization of debt issuance costs	35	29
Changes in operating assets and liabilities:		
Accounts receivable, net	(958)	(781)
Inventories	(90)	(150)
Prepaid expenses and other assets	(2,035)	(1,453)
Accounts payable	1,351	831
Accrued and other liabilities	(910)	1,218
Net cash provided by operating activities	<u>11,771</u>	<u>13,755</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(13,386)	(14,411)
Net cash (used in) investing activities	<u>(13,386)</u>	<u>(14,411)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	3,337	—
Payment of payroll taxes related to stock-based compensation awards	(709)	—
Payment of costs associated with initial public offering	—	(160)
Distribution to non-controlling interest	(26)	—
Payments on note payable	(42)	(33)
Net cash provided by (used in) financing activities	<u>2,560</u>	<u>(193)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>945</b>	<b>(849)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>69,579</b>	<b>22,595</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b><u>\$ 70,524</u></b>	<b><u>\$ 21,746</u></b>
<b>Supplemental cash flow information:</b>		
Income taxes paid	\$ 700	\$ 397
Interest paid	84	197
<b>Supplemental non-cash investing and financing activities:</b>		
Unpaid liability for purchases of property and equipment	\$ 2,424	\$ 2,076
Accretion of redeemable convertible preferred stock to maximum redemption value	—	10,301

*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 Potbelly Sandwich Works sandwich shops in 22 states and the District of Columbia. As of June 29, 2014, the Company had 312 company-operated 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 new Potbelly Sandwich Works sandwich shops. The first domestic and international franchise locations administered by the Company opened during February 2011. As of June 29, 2014, 13 franchised shops were in operation in domestic locations and 13 franchised shops were in operation internationally.

***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 29, 2013. 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 December 29, 2013 and June 29, 2014, its statement of operations for the 13 and 26 weeks ended June 30, 2013 and June 29, 2014 and its statement of cash flows for the 26 weeks ended June 30, 2013 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, Potbelly Sandwich Works, LLC (“LLC”) and 17 of LLC’s wholly owned subsidiaries, collectively, the “Company.” All significant intercompany balances and transactions have been eliminated in consolidation. For the Company’s consolidated joint venture, non-controlling interest represents the non-controlling partner’s share of the assets, liabilities and operations related to the joint venture investment in Potbelly Airport II Boston, LLC, related to one shop located in the Boston Logan International Airport. The Company owns a seventy-five percent interest in this consolidated joint venture.

***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, income taxes, stock-based compensation and common stock equity valuations, 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.

***Fiscal Year***

The Company uses a 52/53-week fiscal year that ends on the last Sunday of the calendar year. Approximately every five or six years a 53rd week is added. Fiscal 2013 and 2014 each consist of 52 weeks. The fiscal quarters ended June 30, 2013 and June 29, 2014 each consisted of 13 weeks.

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

**(2) Fair Value Measurements**

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. 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. After performing a periodic review of our shops during the first fiscal quarter of 2014, 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 \$0.8 million related to the excess of the carrying amounts recorded on our balance sheet over the identified shops' estimated fair values as of March 30, 2014. As of June 29, 2014, no additional indicators of impairment were noted.

**(3) Earnings per share**

Basic income (loss) per common share attributable to common stockholders is calculated using the weighted average number of common shares outstanding for the period. For the 13 and 26 weeks ended June 30, 2013, diluted (loss) per common share attributable to common stockholders was computed by dividing the (loss) allocated to common stockholders utilizing the two-class method by the weighted average number of fully diluted common shares outstanding. In periods with net income attributable to common stockholders, the Company's redeemable convertible preferred stock were all considered participating securities requiring the two-class method to calculate basic and diluted earnings per share. However, in periods of a net (loss) attributable to common stockholders, the redeemable convertible preferred stock were excluded from the computation of basic earnings per share due to the fact that they are not required to fund losses and the redemption amount is not reduced as a result of losses. For the 13 and 26 weeks ended June 30, 2013, the dilutive securities did not include stock options awarded to employees that had a performance condition requiring the completion of an initial public offering of common stock, as that performance condition was not satisfied at the reporting date and the holders of these options had no rights in our undistributed earnings until that time. On October 9, 2013, the Company completed an initial public offering. Effective upon the closing of such offering, all of the shares of preferred stock and non-voting common stock converted into common stock. As a result of the conversion, for subsequent reporting periods, the Company no longer utilized the two-class method in its calculation of diluted income (loss) per common share attributable to common stockholders. For the 13 and 26 weeks ended June 29, 2014, diluted income (loss) per common share attributable to common stockholders was calculated using income available to common shareholders divided by diluted weighted-average shares of common stock outstanding during the period.

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

	<u>For the 13 Weeks Ended</u>		<u>For the 26 Weeks Ended</u>	
	<u>June 29, 2014</u>	<u>June 30, 2013</u>	<u>June 29, 2014</u>	<u>June 30, 2013</u>
<u>Calculation of undistributed income (loss) for basic and diluted shares:</u>				
Net income attributable to Potbelly Corporation	\$ 2,010	\$ 2,759	\$ 1,709	\$ 2,777
Less: Accretion of redeemable convertible preferred stock to maximum redemption value	—	(2,905)	—	(10,301)
Undistributed income (loss) for basic and diluted shares	<u>\$ 2,010</u>	<u>\$ (146)</u>	<u>\$ 1,709</u>	<u>\$ (7,524)</u>
<u>Allocation of undistributed income (loss) to participating securities:</u>				
Common shares	\$ 2,010	\$ (146)	\$ 1,709	\$ (7,524)
Redeemable convertible preferred shares	—	—	—	—
Undistributed income (loss)	<u>\$ 2,010</u>	<u>\$ (146)</u>	<u>\$ 1,709</u>	<u>\$ (7,524)</u>
Weighted average common shares outstanding-basic	29,342,528	4,244,879	29,246,676	4,241,752
Plus: Effect of potential stock options exercise	1,046,198	—	1,258,203	—
Plus: Effect of potential warrant exercise	120,827	—	138,013	—
Weighted average common shares outstanding-diluted	<u>30,509,553</u>	<u>4,244,879</u>	<u>30,642,892</u>	<u>4,241,752</u>
Income (loss) per share available to common stockholders-basic	\$ 0.07	\$ (0.03)	\$ 0.06	\$ (1.77)
Income (loss) per share available to common stockholders-diluted	\$ 0.07	\$ (0.03)	\$ 0.06	\$ (1.77)
<u>Potentially dilutive shares that are considered anti-dilutive:</u>				
Common share options	242,636	4,399,773	242,636	4,399,773
Warrants	—	345,213	—	345,213

For the 13 and 26 weeks ended June 30, 2013, the Company's potential common stock instruments such as common share options and warrants were not included in the computation of diluted (loss) per common share as the effect of including these shares in the calculation would have been anti-dilutive. For the 13 and 26 weeks ended June 29, 2014, 242,636 common share options were not included in the computation of diluted income per common share for the respective periods, as the effect of including these shares in the calculation would have been anti-dilutive.

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

**(4) Income Taxes**

The Company recognized 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, compared to income tax expense of \$1.9 million on pre-tax income of \$4.7 million or an effective tax rate of 40.3%, for the 26 weeks ended June 30, 2013. 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. The increase in the effective tax rate primarily relates to the expiration of certain federal income tax credits for 2014 that were available in prior years.

**(5) Capital Stock**

On October 9, 2013, the Company completed an initial public offering. Effective upon the closing of such offering, all shares of preferred stock and non-voting common stock converted into common stock. The terms of the non-voting common stock provided that all shares of non-voting common stock would convert into voting common stock on a 1:1 basis immediately prior to the closing of an underwritten IPO or sale of the Company. The redeemable convertible preferred stock included down-round provisions which would adjust the conversion price for any additional stock issued without consideration or for a consideration per share less than the respective conversion price for one or more of the series of preferred stock in effect immediately prior to the issuance of such additional stock. Each share of common stock has the same relative rights and was identical in all respects to each other share of common stock. Each holder of shares of common stock is entitled to one vote for each share held by such holder at all meetings of stockholders.

**(6) Stock-Based Compensation**

During the first quarter of 2014, the Company issued 247,767 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 Company used the following assumptions for purposes of valuing these option grants: common stock fair value of \$20.53 per share; expected life of options – seven years; volatility- 49.61%; risk-free interest rate – 1.13%; 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.

A summary of activity for the 26 weeks ended June 29, 2014 is as follows:

<b>Options</b>	<b>Shares (Thousands)</b>	<b>Weighted Average Exercise Price</b>	<b>Aggregate Intrinsic Value (Thousands)</b>	<b>Weighted Average Remaining Term (Years)</b>
Outstanding—December 29, 2013	5,030	\$ 9.41	<u>\$ 78,575</u>	6.31
Granted	273	20.09		
Exercised	(297)	8.91		
Canceled	(57)	12.30		
Outstanding—June 29, 2014	<u>4,949</u>	9.99	<u>\$ 29,147</u>	6.05
Exercisable—June 29, 2014	<u>3,650</u>	9.73	<u>\$ 29,610</u>	5.74

In May 2014, the Company issued 25,663 shares of unrestricted common stock to certain non-employee members of its Board of Directors. The unrestricted stock had a weighted average grant-date share price of \$15.60 upon issuance. The Company recorded \$0.4 million in stock-based compensation expense, with a corresponding increase to additional paid-in capital, related to the issuance of common stock.

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

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 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. For the 13 and 26 weeks ended June 30, 2013, the Company recognized \$0.4 million and \$1.1 million, respectively. As of June 29, 2014, the unrecognized stock-based compensation expense was \$6.6 million, which will be recognized through fiscal year 2018. The Company records stock-based compensation expense within general and administrative expenses in the consolidated statements of operations.

**(7) Subsequent Events**

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. With this authorization, repurchases may be made at management's discretion from time to time on the open market.

**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 29, 2013. This discussion contains forward-looking statements within the meaning of Section 27A of 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 29, 2013, 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 29, 2014 Compared to 13 Weeks Ended June 30, 2013**

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

	For the 13 Weeks Ended				Increase (Decrease)	Percent Change
	June 29, 2014	% of Revenues	June 30, 2013	% of Revenues		
<b>Revenues</b>						
Sandwich shop sales, net	\$83,268	99.6%	\$77,926	99.7%	\$ 5,342	6.9%
Franchise royalties and fees	352	0.4	260	0.3	92	35.4
Total revenues	<u>83,620</u>	<u>100.0</u>	<u>78,186</u>	<u>100.0</u>	<u>5,434</u>	<u>7.0</u>
<b>Expenses</b>						
Sandwich shop operating expenses						
Cost of goods sold, excluding depreciation	23,936	28.6	22,760	29.1	1,176	5.2
Labor and related expenses	23,405	28.0	21,204	27.1	2,201	10.4
Occupancy expenses	10,183	12.2	8,811	11.3	1,372	15.6
Other operating expenses	8,691	10.4	7,901	10.1	790	10.0
General and administrative expenses	8,865	10.6	7,823	10.0	1,042	13.3
Depreciation expense	4,784	5.7	4,444	5.7	340	7.7
Pre-opening costs	273	0.3	429	0.5	(156)	(36.4)

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Impairment and loss on disposal of property and equipment	29	*	53	*	(24)	(45.3)
Total expenses	80,166	95.9	73,425	93.9	6,741	9.2
Income from operations	3,454	4.1	4,761	6.1	(1,307)	(27.5)
Interest expense	40	*	122	0.2	(82)	(67.2)
Other expense	—	—	—	—	—	—
Income before income taxes	3,414	4.1	4,639	5.9	(1,225)	(26.4)
Income tax expense	1,407	1.7	1,869	2.4	(462)	(24.7)
Net income	2,007	2.4	2,770	3.5	(763)	(27.5)
Net (loss) income attributable to non-controlling interests	(3)	*	11	*	(14)	(127.3)
Net income attributable to Potbelly Corporation	2,010	2.4	2,759	3.5	(749)	(27.1)
Accretion of redeemable convertible preferred stock to maximum redemption value	—	—	(2,905)	(3.7)	2,905	(100.0)
Net income (loss) attributable to common stockholders	\$ 2,010	2.4%	\$ (146)	(0.2)%	\$ 2,156	1,476.7

\* Amount is less than 0.1%

### Revenues

Total revenues increased by \$5.4 million, or 7.0%, to \$83.6 million during the 13 weeks ended June 29, 2014, from \$78.2 million during the 13 weeks ended June 30, 2013. The increase in revenues primarily consisted of an increase of \$6.5 million in sales from shops not yet in our company-operated comparable store sales base, \$0.1 million increase in franchise revenues, partially offset by a \$1.2 million, or 1.6%, decrease in company-operated comparable store sales. The decrease in company-operated comparable store sales resulted from a reduction in entrée counts, which were impacted by reduced traffic as well as a shift of the Easter holiday from the first fiscal quarter to the second fiscal quarter, partially offset by certain menu price increases and mix.

### Cost of Goods Sold

Cost of goods sold increased by \$1.2 million, or 5.2%, to \$23.9 million during the 13 weeks ended June 29, 2014, compared to \$22.8 million during the 13 weeks ended June 30, 2013, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 28.6% during the 13 weeks ended June 29, 2014, from 29.1% during the 13 weeks ended June 30, 2013, primarily driven by lower commodity costs.

### Labor and Related Expenses

Labor and related expenses increased by \$2.2 million, or 10.4%, to \$23.4 million during the 13 weeks ended June 29, 2014, from \$21.2 million during the 13 weeks ended June 30, 2013, primarily due to new shop openings. As a percentage of revenues, labor and related expenses increased to 28.0% during the 13 weeks ended June 29, 2014, from 27.1% during the 13 weeks ended June 30, 2013, primarily driven by deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales.

### Occupancy Expenses

Occupancy expenses increased by \$1.4 million, or 15.6%, to \$10.2 million during the 13 weeks ended June 29, 2014, from \$8.8 million during the 13 weeks ended June 30, 2013, primarily due to new shop openings. As a percentage of revenues, occupancy expenses increased to 12.2% during the 13 weeks ended June 29, 2014, from 11.3% during the 13 weeks ended June 30, 2013, due to deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales as well as increases in other occupancy-related costs.

### Other Operating Expenses

Other operating expenses increased by \$0.8 million, or 10.0%, to \$8.7 million during the 13 weeks ended June 29, 2014, from \$7.9 million during the 13 weeks ended June 30, 2013, primarily due to new shop openings and higher neighborhood marketing expense in our shops, among other costs. As a percentage of revenues, other operating expenses increased to 10.4% during the 13 weeks ended June 29, 2014, from 10.1% during the 13 weeks ended June 30, 2013, primarily due to deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales as well as increased marketing expenses, among other costs.

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### **General and Administrative Expenses**

General and administrative expenses increased by \$1.1 million, or 13.3%, to \$8.9 million during the 13 weeks ended June 29, 2014, from \$7.8 million during the 13 weeks ended June 30, 2013, driven by an increase in advertising expense of approximately \$0.4 million related to the launch of the new Flats platform in late May in addition to approximately \$0.8 million higher public company related expenses, which includes \$0.4 million related to the May 2014 unrestricted common stock grants. As a percentage of revenues, general and administrative expenses increased to 10.6% during the 13 weeks ended June 29, 2014, from 10.0% during the 13 weeks ended June 30, 2013, driven by public company related expenses and advertising expense during the 13 weeks ended June 29, 2014 as compared to the 13 weeks ended June 30, 2013.

### **Depreciation Expense**

Depreciation expense increased by \$0.3 million, or 7.7%, to \$4.8 million during the 13 weeks ended June 29, 2014, from \$4.5 million during the 13 weeks ended June 30, 2013, primarily due to a higher depreciable base related to new shops. As a percentage of revenues, depreciation remained consistent at 5.7% during the 13 weeks ended June 29, 2014 and June 30, 2013.

### **Pre-Opening Costs**

Pre-opening costs decreased by \$0.1 million, or 36.4%, to \$0.3 million during the 13 weeks ended June 29, 2014, from \$0.4 million during the 13 weeks ended June 30, 2013, primarily due to fewer new shops opened during the 13 weeks ended June 29, 2014 compared to the 13 weeks ended June 30, 2013.

### **Interest Expense**

Interest expense decreased by \$82 thousand, or 67.2%, to \$40 thousand during the 13 weeks ended June 29, 2014, from \$0.1 million during the 13 weeks ended June 30, 2013, primarily due to repaying the \$14.0 million outstanding under the senior credit facility on October 24, 2013. Interest expense for the thirteen weeks ended June 29, 2014 is attributable to interest on the note payable, unused commitment fees and deferred financing fees.

### **Income Tax Expense**

Income tax expense decreased by \$0.5 million, or 24.7%, to \$1.4 million for the 13 weeks ended June 29, 2014, from \$1.9 million during the 13 weeks ended June 30, 2013. For the 13 weeks ended June 29, 2014, our effective tax rate was 41.2%, compared to 40.3% for the 13 weeks ended June 30, 2013. The increase in the effective tax rate primarily relates to the expiration of certain federal income tax credits that were available in prior years.

## **26 Weeks Ended June 29, 2014 Compared to 26 Weeks Ended June 30, 2013**

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

	For the 26 Weeks Ended				Increase (Decrease)	Percent Change
	June 29, 2014	% of Revenues	June 30, 2013	% of Revenues		
<b>Revenues</b>						
Sandwich shop sales, net	\$156,791	99.5%	\$146,467	99.7%	\$ 10,324	7.0%
Franchise royalties and fees	710	0.5	463	0.3	247	53.3
Total revenues	<u>157,501</u>	<u>100.0</u>	<u>146,930</u>	<u>100.0</u>	<u>10,571</u>	<u>7.2</u>
<b>Expenses</b>						
<b>Sandwich shop operating expenses</b>						
Cost of goods sold, excluding depreciation	45,022	28.6	42,753	29.1	2,269	5.3
Labor and related expenses	44,865	28.5	40,995	27.9	3,870	9.4
Occupancy expenses	20,162	12.8	17,530	11.9	2,632	15.0
Other operating expenses	16,849	10.7	15,112	10.3	1,737	11.5
General and administrative expenses	16,687	10.6	16,005	10.9	682	4.3
Depreciation expense	9,501	6.0	8,824	6.0	677	7.7
Pre-opening costs	525	0.3	719	0.5	(194)	(27.0)
Impairment and loss on disposal of property and equipment	877	0.6	79	*	798	1,010.1
Total expenses	<u>154,488</u>	<u>98.1</u>	<u>142,017</u>	<u>96.7</u>	<u>12,471</u>	<u>8.8</u>
Income from operations	3,013	1.9	4,913	3.3	(1,900)	(38.7)

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Interest expense	82	0.1	233	0.2	(151)	(64.8)
Other expense	—	*	2	*	(2)	(100.0)
Income before income taxes	2,931	1.9	4,678	3.2	(1,747)	(37.3)
Income tax expense	1,216	0.8	1,886	1.3	(670)	(35.5)
Net income	1,715	1.1	2,792	1.9	(1,077)	(38.6)
Net income attributable to non-controlling interests	6	*	15	*	(9)	(60.0)
Net income attributable to Potbelly Corporation	1,709	1.1	2,777	1.9	(1,068)	(38.5)
Accretion of redeemable convertible preferred stock to maximum redemption value	—	*	(10,301)	(7.0)	10,301	(100.0)
Net income (loss) attributable to common stockholders	<u>\$1,709</u>	<u>1.1%</u>	<u>\$ (7,524)</u>	<u>(5.1)%</u>	<u>\$ 9,233</u>	<u>(122.7)</u>

\* Amount is less than 0.1%

### Revenues

Total revenues increased by \$10.6 million, or 7.2%, to \$157.5 million during the 26 weeks ended June 29, 2014, from \$146.9 million during the 26 weeks ended June 30, 2013. The increase in revenues primarily consisted of an increase of \$13.0 million in sales from shops not yet in our company-operated comparable store sales base, \$0.2 million increase in franchise revenues, partially offset by a \$2.7 million, or 1.9%, decrease in company-operated comparable store sales. The decrease in company-operated comparable store sales resulted from a reduction in entrée counts, which were impacted by reduced traffic as well as significantly adverse weather in the first quarter, partially offset by certain menu price increases and mix.

### Cost of Goods Sold

Cost of goods sold increased by \$2.3 million, or 5.3%, to \$45.0 million during the 26 weeks ended June 29, 2014, compared to \$42.8 million during the 26 weeks ended June 30, 2013, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold decreased to 28.6% during the 26 weeks ended June 29, 2014, from 29.1% during the 26 weeks ended June 30, 2013, primarily driven by lower commodity costs.

### Labor and Related Expenses

Labor and related expenses increased by \$3.9 million, or 9.4%, to \$44.9 million during the 26 weeks ended June 29, 2014, from \$41.0 million during the 26 weeks ended June 30, 2013, primarily due to new shop openings. As a percentage of revenues, labor and related expenses increased to 28.5% during the 26 weeks ended June 29, 2014, from 27.9% during the 26 weeks ended June 30, 2013, primarily driven by deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales.

### Occupancy Expenses

Occupancy expenses increased by \$2.6 million, or 15.0%, to \$20.2 million during the 26 weeks ended June 29, 2014, from \$17.5 million during the 26 weeks ended June 30, 2013, primarily due to new shop openings. As a percentage of revenues, occupancy expenses increased to 12.8% during the 26 weeks ended June 29, 2014, from 11.9% during the 26 weeks ended June 30, 2013, due to deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales as well as increases in other occupancy-related costs.

### Other Operating Expenses

Other operating expenses increased by \$1.7 million, or 11.5%, to \$16.8 million during the 26 weeks ended June 29, 2014, from \$15.1 million during the 26 weeks ended June 30, 2013, primarily due to new shop openings and increases in various other operating expenses. As a percentage of revenues, other operating expenses increased to 10.7% during the 26 weeks ended June 29, 2014, from 10.3% during the 26 weeks ended June 30, 2013, primarily due to deleveraging of the fixed component of these expenses as a result of lower company-operated comparable store sales as well as increases in various other operating expenses.

### General and Administrative Expenses

General and administrative expenses increased by \$0.7 million, or 4.3%, to \$16.7 million during the 26 weeks ended June 29, 2014, from \$16.0 million during the 26 weeks ended June 30, 2013 driven by an increase in advertising expense of approximately \$0.4 million related to the launch of the new Flats platform in late May in addition to approximately \$0.8 million higher public company

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related expenses, which includes \$0.4 million related to the May 2014 unrestricted common stock grants, and offset by lower labor-related expense. As a percentage of revenues, general and administrative expenses decreased to 10.6% during the 26 weeks ended June 29, 2014, from 10.9% during the 26 weeks ended June 30, 2013, primarily due to lower labor-related expense during the 26 weeks ended June 29, 2014 as compared to the 26 weeks ended June 30, 2013.

### **Depreciation Expense**

Depreciation expense increased by \$0.7 million, or 7.7%, to \$9.5 million during the 26 weeks ended June 29, 2014, from \$8.8 million during the 26 weeks ended June 30, 2013, primarily due to a higher depreciable base related to new shops. As a percentage of revenues, depreciation remained consistent at 6.0% during the 26 weeks ended June 29, 2014 and June 30, 2013.

### **Pre-Opening Costs**

Pre-opening costs decreased by \$0.2 million, or 27.0%, to \$0.5 million during the 26 weeks ended June 29, 2014, from \$0.7 million during the 26 weeks ended June 30, 2013, primarily due to fewer new shops opened in new markets that, on average, have higher pre-opening costs during the 26 weeks ended June 29, 2014 compared to the 26 weeks ended June 30, 2013.

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

Impairment and loss on disposal of property and equipment increased to \$0.9 million during the 26 weeks ended June 29, 2014, from \$79 thousand during the 26 weeks ended June 30, 2013. After performing a periodic review of our shops during the first quarter of 2014, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance of shop profitability. In the first fiscal quarter of 2014, we performed an impairment analysis related to these shops and recorded an impairment charge of \$0.8 million related to the excess of the carrying amounts recorded on our balance sheet over the identified shops' estimated fair values.

### **Interest Expense**

Interest expense decreased by \$0.1 million, or 64.8%, to \$0.1 million during the 26 weeks ended June 29, 2014, from \$0.2 million during the 26 weeks ended June 30, 2013, primarily due to repaying the \$14.0 million outstanding under the senior credit facility on October 24, 2013. Interest expense for the 13 weeks ended June 29, 2014 is attributable to interest on the note payable, unused commitment fees and deferred financing fees.

### **Income Tax Expense**

Income tax expense decreased by \$0.7 million, or 35.5%, to \$1.2 million during the 26 weeks ended June 29, 2014, from \$1.9 million during the 26 weeks ended June 30, 2013. For the 26 weeks ended June 29, 2014, our effective tax rate was 41.5%, compared to 40.3% for the 26 weeks ended June 30, 2013. The increase in the effective tax rate primarily relates to the expiration of certain federal income tax credits for 2014 that were available in prior years.

## **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, 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 Ended</b>	
	<b>June 29, 2014</b>	<b>June 30, 2013</b>
Net cash provided by (used in):		
Operating activities	\$ 11,771	\$ 13,755
Investing activities	(13,386)	(14,411)
Financing activities	2,560	(193)
Net increase (decrease) in cash	<u>\$ 945</u>	<u>\$ (849)</u>

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### ***Operating Activities***

Net cash provided by operating activities decreased to \$11.8 million for the 26 weeks ended June 29, 2014, from \$13.8 million for the 26 weeks ended June 30, 2013. Cash flows from operating activities include net income, adjusted for certain non-cash items, as well as changes in the balances of certain assets and liabilities. The decrease compared to the same period in 2013 was primarily due to lower net income and the timing of the payment of accrued expenses.

### ***Investing Activities***

Net cash used in investing activities decreased to \$13.4 million for the 26 weeks ended June 29, 2014, from \$14.4 million for the 26 weeks ended June 30, 2013. The decrease was primarily due to one less company-operated shop opened in the 26 weeks ended June 29, 2014 as compared to the same period in 2013 and lower average construction costs for new company-operated shops opened during the 26 weeks ended June 29, 2014 as compared to the same period in 2013.

### ***Financing Activities***

Net cash provided by financing activities was \$2.6 million for the 26 weeks ended June 29, 2014, compared net cash used of \$0.2 million for the 26 weeks ended June 30, 2013. The increase in net cash provided was driven by the \$2.6 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 29, 2014, with no comparable cash proceeds received during the 26 weeks ended June 30, 2013.

### ***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. With this authorization, repurchases may be made at management's discretion from time to time on the open market.

### ***Credit Facility***

On September 21, 2012, we entered into a new 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 29, 2014. 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 29, 2014, 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 29, 2014, 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**

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 are choosing 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 May 2014, the Financial Accounting Standards Board (“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 pronouncement is effective for reporting period beginning after December 15, 2016. The adoption of ASU 2014-09 is not expected to have a significant impact on the Company’s consolidated balance sheet or consolidated statement of operations.

### **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 29, 2013. Our exposures to market risk have not changed materially since December 29, 2013.

### **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 Exchange Act) as of June 29, 2014. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 29, 2014, 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 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 that occurred during our fiscal quarter ended June 29, 2014 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 29, 2013. There have been no material changes to our Risk Factors as previously reported.

**ITEM 6. EXHIBITS**

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

<u>Exhibit No.</u>	<u>Description</u>
<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

**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.

Date: August 6, 2014

POTBELLY CORPORATION

By: /s/ Charles Talbot  
Charles Talbot  
Chief Financial Officer  
(Principal Financial Officer)

Certification of Chief Executive Officer  
pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Aylwin Lewis, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Potbelly Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2014

By: /s/ Aylwin Lewis

Aylwin Lewis  
Chief Executive Officer and President  
(Principal Executive Officer)

Certification of Chief Financial Officer  
pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Charles Talbot, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Potbelly Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2014

By: /s/ Charles Talbot

Charles Talbot  
Chief Financial Officer  
(Principal Financial Officer)

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

In accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Aylwin Lewis, Chief Executive Officer and President of Potbelly Corporation (the "Registrant"), and Charles Talbot, Chief Financial Officer of the Registrant, each hereby certifies that, to the best of his knowledge on the date hereof:

1. the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 29, 2014, to which this Certification is attached as Exhibit 32.1 (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: August 6, 2014

By: /s/ Aylwin Lewis

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Aylwin Lewis  
Chief Executive Officer and President

Date: August 6, 2014

By: /s/ Charles Talbot

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Charles Talbot  
Chief Financial Officer

This certification accompanies the Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Registrant for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.