

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

**FORM S-1**  
REGISTRATION STATEMENT UNDER THE  
SECURITIES ACT OF 1933

**Potbelly Corporation**

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

**Delaware**  
*(State or other jurisdiction of incorporation or organization)*

**5812**  
*(Primary Standard Industrial  
Classification Code Number)*  
**222 Merchandise Mart Plaza, 23rd Floor**  
**Chicago, Illinois 60654**  
**(312) 951-0600**

**36-4466837**  
*(I.R.S. Employer  
Identification No.)*

*(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)*

**Matthew Revord**  
**Senior Vice President, General Counsel and Secretary**  
**Potbelly Corporation**  
**222 Merchandise Mart Plaza, 23rd Floor, Chicago, Illinois 60654**  
**(312) 951-0600**  
*(Name, address, including zip code, and telephone number, including area code, of agent for service)*

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

**CALCULATION OF REGISTRATION FEE**

Title of each class of securities to be registered	Proposed maximum aggregate offering price (1)(2)	Amount of registration fee
Common Stock, \$0.01 par value per share, offered by the Registrant	\$	\$
Common Stock, \$0.01 par value per share, offered by the selling stockholders	\$	\$

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.

(2) Includes shares of common stock that the underwriters have the option to purchase to cover over-allotments, if any.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion  
Preliminary Prospectus dated February 4, 2013

PROSPECTUS

Shares



**Potbelly Corporation**  
Common Stock

This is Potbelly Corporation's initial public offering. We are selling \_\_\_\_\_ shares of our common stock and the selling stockholders are selling \_\_\_\_\_ shares of our common stock. We will not receive any proceeds from the sale of shares to be offered by the selling stockholders.

We expect the public offering price to be between \$ \_\_\_\_\_ and \$ \_\_\_\_\_ per share. Currently, no public market exists for the shares. After pricing of the offering, we expect that the shares will trade on the Nasdaq Global Select Market under the symbol "\_\_\_\_\_".

We are an "emerging growth company" under applicable Securities and Exchange Commission rules and will be subject to reduced public company reporting requirements.

**Investing in the common stock involves risks that are described in the "[Risk Factors](#)" section beginning on page 11 of this prospectus.**

	<u>Per Share</u>	<u>Total</u>
Public offering price	\$ _____	\$ _____
Underwriting discount	\$ _____	\$ _____
Proceeds, before expenses, to us	\$ _____	\$ _____
Proceeds, before expenses, to the selling stockholders	\$ _____	\$ _____

The underwriters may also exercise their option to purchase up to an additional \_\_\_\_\_ shares from us, and up to an additional \_\_\_\_\_ shares from the selling stockholders, at the public offering price, less the underwriting discount, for 30 days after the date of this prospectus to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares will be ready for delivery on or about \_\_\_\_\_, \_\_\_\_\_.

**BofA Merrill Lynch**

**Baird**

**William Blair**

**Goldman, Sachs & Co.**

**Piper Jaffray**

The date of this prospectus is \_\_\_\_\_, \_\_\_\_\_.

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You should rely only on the information contained in this prospectus or in any free writing prospectus that we authorize to be distributed to you. We have not, and the underwriters have not, authorized anyone to provide you with additional or different information. This document may only be used where it is legal to sell these securities. You should assume that the information contained in this prospectus is accurate only as of the date of this prospectus.

No action is being taken in any jurisdiction outside the United States to permit a public offering of the common stock or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of the prospectus applicable to that jurisdiction.

## MARKET AND OTHER INDUSTRY DATA

In this prospectus, we rely on and refer to information regarding the restaurant industry and the limited-service restaurant and full-service restaurant segments of the restaurant industry, which has been sourced from Technomic Inc., a national consulting market research firm, and the National Restaurant Association, an industry trade group, or compiled from market research reports, analyst reports and other publicly available information. Other industry and market data included in this prospectus are from internal analyses based upon data available from known sources or other proprietary research and analysis. We believe these data to be reliable as of the date of this prospectus. You should carefully consider the inherent risks and uncertainties associated with the market and other industry data contained in this prospectus.

## TRADEMARKS, SERVICE MARKS AND COPYRIGHTS

We own or have rights to trademarks, service marks or trade names that we use in connection with the operation of our business, including our corporate names, logos and website names. Solely for convenience, some of the trademarks, service marks, trade names and copyrights referred to in this prospectus are listed without the ©, ® and ™ symbols, but we will assert, to the fullest extent permissible under applicable law, our rights to our copyrights, trademarks, service marks and trade names. All brand names or other trademarks appearing in this prospectus are the property of their respective owners, and their use or display should not be construed to imply a relationship with, or an endorsement or a sponsorship of us by, these other parties.

## PROSPECTUS SUMMARY

*This summary highlights information appearing elsewhere in this prospectus. This summary does not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including the financial data and related notes and the section entitled "Risk Factors," before deciding whether to invest in our common stock. Unless otherwise indicated or the context otherwise requires, references in this prospectus to the "company," "Potbelly," "we," "us" and "our" refer to Potbelly Corporation and its consolidated subsidiaries.*

### **The Neighborhood Sandwich Shop**

Potbelly is a fast-growing neighborhood sandwich concept offering toasty warm sandwiches, signature salads and other fresh menu items served by welcoming people in a unique environment. 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 creating 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 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.

We believe executing on *The Potbelly Advantage* at a high level creates a distinct competitive advantage and drives our operating and financial results, as illustrated by the following:

- As of September 23, 2012, we had a domestic base of 262 shops in 17 states and the District of Columbia, having grown 13.4% over the prior year;
- We achieved ten consecutive quarters of positive comparable store sales growth through our fiscal quarter ended September 23, 2012 (comparable store sales growth reflects the change in year-over-year sales of our existing shops);
- From 2010 to 2011, we increased our total revenue 7.9% to \$238.0 million, our adjusted EBITDA 27.1% to \$26.8 million, our adjusted EBITDA margin by 170 basis points to 11.2%, and our net income to \$7.2 million from a net loss of \$0.5 million; and
- From 2008 to 2011, we increased our shop-level profit margin each year and by a total of 610 basis points: with levels of 15.5%, 19.2%, 20.9% and 21.6% in 2008, 2009, 2010 and 2011, respectively (shop-level profit margin measures net shop sales less shop operating expenses as a percentage of net shop sales).

Shop-level profit margin is not required by, or presented in accordance with, U.S. generally accepted accounting principles ("GAAP"). See "Selected Consolidated Financial and Other Data" for a discussion of adjusted EBITDA, adjusted EBITDA margin and shop-level profit margin and a reconciliation of the differences between adjusted EBITDA and net income (loss) and shop-level profit and income (loss) from operations, as well as a calculation of shop-level profit margin. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a definition of comparable store sales.

### **Our History**

Potbelly started in 1977 as a small antique store on Lincoln Avenue in Chicago. To boost sales, the original owner began offering toasty warm sandwiches and homemade desserts to customers. As time passed,

Potbelly became a well-known neighborhood sandwich shop with a loyal following of regulars and frequent lines out the door. We opened our second shop in 1997 and continued to open shops in more neighborhoods throughout the country, reaching 100 shops in 2005 and 200 shops in 2008. Throughout our growth, each new shop has maintained the same look, vibe and experience that define the Potbelly brand.

#### **Industry Overview**

According to Technomic, Inc. (“Technomic”), a national consulting market research firm, the restaurant industry is divided into two primary segments, limited-service restaurants (“LSRs”) and full-service restaurants, and is generally categorized by price, quality of food, service and location. LSRs are defined as establishments with patrons who pay before eating and generate an average check between \$3 and \$12. The LSR segment is further divided into (i) quick-service restaurants, which are defined as traditional “fast food” restaurants, generally with check averages between \$3 and \$8, and (ii) fast-casual restaurants, which are establishments with limited service, check averages generally between \$8 and \$12, food prepared to order, fresh (or perceived as fresh) ingredients, innovative food suited to sophisticated tastes, and upscale or highly developed interior design.

Technomic reported that LSRs accounted for 72% of the sales of the Top 500 U.S. restaurant chains in 2011. We operate in the “Other Sandwich” category, which includes LSRs specializing in sandwiches and wraps, other than hamburgers. This category accounted for \$20.6 billion of sales in 2011 by the Top 500 chains. Sales in this category increased 4.7% from 2010 to 2011, outperforming the broader LSR growth rate of 3.7% over the same time period. We cannot provide assurance that the increases in sales in this category will continue or that we will benefit from any such increases.

#### **Our Competitive Strengths**

*Simple, Wholesome Food.* Our menu features wholesome food made from high quality ingredients such as fresh vegetables, artisanal-style hearth-baked bread and all-natural chicken (without preservatives or artificial flavors). Our sandwiches are made fresh to order, and many are based on the original recipes from 1977. They are served toasty warm on our signature multigrain wheat or regular bread. We slice our meats and cheeses daily in each shop to ensure freshness. We believe our sandwiches have the right balance of ingredients with the last bite tasting as good as the first. We believe our simple menu and freshly-made food offers ease of ordering and broad appeal and helps us create loyal Potbelly fans that return again and again.

*Differentiated Customer Experience That Delivers a Neighborhood Feel.* We strive to provide a positive customer experience that is driven by both our employees and the atmosphere of our shops. We look to hire employees that are outgoing people and train them to interact with our customers in a genuine way while providing fast service. To support the neighborhood feel of our shops, most of our managers live in the neighborhood where their shop is located. We believe this allows them to get to know their customers and understand the unique character of each neighborhood. Each of our shops features vintage décor and shared design elements, such as the use of wood, our signature Potbelly stove and locally-themed decorations. We also strive to enhance our atmosphere with live, local musicians that perform at least three times per week in the majority of our shops. We believe the unique Potbelly experience encourages repeat customer visits and drives increased sales.

*Attractive Shop Economics.* Our shop model is designed to generate, and has generated, strong cash flow, attractive shop-level financial results and high returns on investment. We operate our shops successfully in a wide range of geographic markets, population densities and real estate settings. We aim to generate average shop-level profit margins, a non-GAAP measure, above 20% and cash-on-cash returns above 25%. We have achieved these targets in 2010, 2011 and the 52 weeks ended September 23, 2012. Our ability to maintain such margins and returns depends on a number of factors. For example, we face increasing commodity costs, which we have partially offset by increasing menu prices. Although there is no guarantee that we will be able to maintain these returns, we believe our attractive shop economics support our ability to profitably grow our brand in new and existing markets.

*Management Team with Substantial Operating Experience.* Our senior management team has extensive operating experience, with an average of over 16 years in the restaurant industry. Our core senior team has been together since 2008, when we hired our President and CEO, Aylwin Lewis. Aylwin was previously with Yum! Brands, Inc. from 1991 to 2004, most recently as President and Chief Multibranding and Operating Officer, as well as with Sears Holdings from 2004 to 2008, most recently as President and CEO. We believe our experienced leadership team is a key driver of our success and positions us to execute our long-term growth strategy.

*Distinct, Deep-Rooted Culture: The Potbelly Advantage.* We believe our culture is a key to our success. It is embodied in *The Potbelly Advantage*, which is a written expression of our Vision, Mission, Passion and Values. Our Vision is for our customers to feel we are their “Neighborhood Sandwich Shop” and to become Potbelly fans and advocates. Our Mission is to make our customers and employees happy, to make more money and to improve our business every day. Our Passion is to be “The Best Place for Lunch.” We strive to emphasize our Values of integrity, teamwork, accountability, positive energy and coaching throughout all levels of our organization and believe our Values form a common language across our organization. We believe *The Potbelly Advantage* allows us to deliver operational excellence and grow our business and our base of Potbelly fans.

#### **Our Growth Strategy**

We strive to grow profitability and create value for our stockholders by working to achieve the goals listed below. While we cannot provide assurances that we will be able to achieve and maintain these objectives, we consider each of them to be a core strategy of our business.

*Run Great Shops.* We believe that continued excellence in shop-level execution is fundamental to our growth strategy. To maintain our operational standards we use a Balanced Scorecard approach to measure People, Customers, Sales and Profits at each of our shops. Hiring the right people and maintaining optimal staffing levels enable us to run efficient operations. We track metrics such as peak hour throughput, mystery shopper scores and neighborhood engagement activities, such as fundraisers for local causes. Shop sales and profitability are benchmarked against prior year periods and budget, and we focus on achieving targets on a shop-by-shop basis. To support our shop operators, we invest in systems and technology that can meaningfully improve shop-level execution.

*Find and Build Great Shops.* Our shops are successful in diverse markets in 17 states and the District of Columbia, and we intend to continue to build company-operated shops in both new and existing markets utilizing our careful site selection process. This process is overseen by senior management and focuses on, among other things, demographics, traffic patterns and information gathered from local employees. Our location-specific approach to development allows us to leverage our versatile shop format to achieve strong returns across a wide range of real estate settings. In 2011 and for the 39 weeks ended September 23, 2012 we opened 21 and 24 new shops, respectively, and expanded into New York, Seattle, Boston and Phoenix. In those same time periods, we closed five shops and one shop, respectively, due to under-performance. In 2013, we expect to open 25 to 35 new shops. Over the long term, we plan to grow the number of Potbelly shops 10% annually.

*Achieve High Margins and Terrific Returns.* Our approach to margin enhancement begins with continuous efforts to improve the financial results of our shops. We focus on cash-on-cash returns and look to grow shop-level profitability each year through sales growth and productivity improvements. Between 2008 and 2011, we increased our shop-level profit margin, a non-GAAP measure, from 15.5% to 21.6%. Our intention is to maintain average shop-level profit margins over 20% as we continue to grow. We believe we exercise strong financial discipline in managing expenses and by encouraging employee efficiency with the goal of achieving and maintaining general and administrative expenses under 10% of sales. However, we cannot provide assurances that we will be able to maintain our shop-level profit margin levels or that we will be able to achieve or maintain low levels of expenses.

*Become a Global Iconic Brand.* We believe that our premise of a “Neighborhood Sandwich Shop” has broad appeal across a wide range of market types and geographies. We find that Potbelly is now a recognized brand beyond the neighborhoods in which we currently operate. We believe a significant contributor to this success is word-of-mouth publicity by our customers who enjoy their Potbelly experience and tell others about it. We believe that our positive brand perception helps drive interest in our shops in both existing and new markets.

*Be a Great Franchisor.* In 2010, we initiated a program to franchise shops in selected markets in the U.S. and internationally. We intend to expand the number of franchise shops on a disciplined basis as we develop our franchise program. As of September 23, 2012, our franchisees operated five shops in the U.S. and seven shops in the Middle East. Although we do not expect franchise activities to result in significant revenue in the near term, we see the selective expansion of our franchising efforts to be a valuable potential growth opportunity over time.

#### **Risk Factors**

Before you invest in our common stock, you should carefully consider all of the information in this prospectus, including matters set forth under the heading “Risk Factors.” Risks relating to our business include the following, among others:

- we face significant competition for customers that could affect our results of operations;
- changes in economic conditions could materially affect our business;
- our operations and future development could be significantly disrupted if we lose key members of our management team;
- changes in food availability and costs could adversely affect our operating results;
- our inability to find and hire qualified employees could slow our growth or harm our current operations; and
- our long-term success is highly dependent on our ability to successfully identify new shop locations and develop and expand our operations.

#### **Company Information**

We were incorporated in Delaware in 2001 as Potbelly Sandwich Works, Inc. and changed our name to Potbelly Corporation in 2002. Our principal executive offices are located at 222 Merchandise Mart Plaza, 23rd Floor, Chicago, Illinois 60654, our telephone number at that address is (312) 951-0600 and our internet address is [www.potbelly.com](http://www.potbelly.com). Our website and the information contained on or accessible through our website are not part of this prospectus.

#### **Implications of Being an Emerging Growth Company**

As a company with less than \$1.0 billion in revenue during our last fiscal year, we qualify as an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act. As an emerging growth company, we may take advantage of specified reduced reporting requirements and are relieved from certain other significant requirements that are otherwise generally applicable to public companies. We may choose to take advantage of some but not all of these provisions for as long as we remain an emerging growth company. We will remain an emerging growth company until the earlier of (1) the last day of the fiscal year (a) following the fifth anniversary of the completion of this offering, (b) in which we have total annual gross revenue of at least \$1.0 billion, or (c) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30th, or (2) the date on which we have issued more than \$1.0 billion in non-convertible debt securities during the prior three-year period. See “Risk Factors—We are an ‘emerging growth company,’ and any decision on our part to comply only with certain reduced reporting and disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.”



**The Offering**

Common stock offered by us	shares
Common stock offered by the selling stockholders	shares
Common stock to be outstanding immediately after the completion of this offering	shares
Option to purchase additional shares	We, along with certain of the selling stockholders, have granted the underwriters a 30-day option to purchase up to an additional shares. If this option is exercised in full, we will issue and sell shares and the selling stockholders will sell shares.
Use of proceeds	We expect to receive net proceeds, after deducting estimated offering expenses and underwriting discounts and commissions payable by us, of approximately \$ million (or \$ million if the underwriters exercise their option to purchase additional shares in full), based on an assumed offering price of \$ per share (the midpoint of the price range set forth on the cover page of this prospectus). We intend to use the net proceeds from this offering for working capital and general corporate purposes. We will not receive any proceeds from the sale of shares of common stock by the selling stockholders. See "Use of Proceeds" and "Principal and Selling Stockholders."
Dividend policy	We do not currently pay cash dividends on our common stock and do not anticipate paying any dividends on our common stock in the foreseeable future. Any future determinations relating to our dividend policies will be made at the discretion of our board of directors and will depend on various factors. See "Dividend Policy."
Risk factors	You should read carefully the "Risk Factors" section of this prospectus for a discussion of factors that you should consider before deciding to invest in shares of our common stock.
Proposed Nasdaq Global Select Market symbol	

Unless otherwise indicated, all information in this prospectus relating to the number of shares of common stock to be outstanding immediately after the completion of this offering:

- assumes the conversion of all outstanding shares of all series of our preferred stock into, and the exercise of all outstanding warrants for, an aggregate of 16,897,088 shares of common stock immediately prior to the completion of this offering;
- assumes the effectiveness of our amended and restated certificate of incorporation and amended and restated by-laws, which we will adopt prior to the completion of this offering;
- excludes outstanding options to purchase 4,446,049 shares of our common stock at a weighted average exercise price of \$9.16 per share, of which options to purchase 3,032,113 shares at a weighted average exercise price of \$9.90 were vested as of September 23, 2012. See "Executive and Director Compensation;"

- excludes shares of our common stock reserved for future grants under our 2013 Long-Term Incentive Plan, which we intend to adopt in connection with this offering; and
- assumes no exercise by the underwriters of their option to purchase up to additional shares.

Except for pro forma and pro forma as adjusted data and as otherwise indicated, financial data does not give effect to the conversion of all outstanding shares of all series of our preferred stock and the exercise of all outstanding warrants.

**SUMMARY CONSOLIDATED FINANCIAL AND OTHER DATA**

The following table sets forth our summary consolidated financial and other data as of the dates and for the periods indicated. The summary consolidated financial data as of December 25, 2011 and December 26, 2010 and for each of the two fiscal years in the period ended December 25, 2011 presented in this table have been derived from the audited consolidated financial statements included elsewhere in this prospectus. The summary consolidated interim financial data as of and for the 39 weeks ended September 23, 2012 and for the 39 weeks ended September 25, 2011 have been derived from the unaudited condensed interim consolidated financial statements included elsewhere in this prospectus. The unaudited financial information for the 52 weeks ended September 23, 2012 has been derived by adding our financial information for the fiscal year ended December 25, 2011 to the unaudited financial information for the 39 weeks ended September 23, 2012 and subtracting the unaudited financial information for the 39 weeks ended September 25, 2011. We believe that presentation of unaudited financial information for these 52-week periods is useful to investors because it presents information about how our business has performed in the 52-week period immediately preceding the date of our most recent interim financial statements, which allows investors to review our current performance trends over a full 52-week period, and because it presents results for four consecutive quarters, which presentation compensates for seasonal factors that might influence results in a particular quarter within the year. Historical results are not necessarily indicative of the results to be expected for future periods, and our interim results are not necessarily indicative of the results to be expected for the full fiscal year.

Our fiscal year ends on the last Sunday of each year. The first three quarters of our fiscal year consist of 13 weeks and our fourth quarter consists of 13 weeks for 52-week fiscal years and 14 weeks for 53-week fiscal years. The fiscal years ended December 25, 2011 and December 26, 2010 each had 52 weeks. The fiscal year ending December 30, 2012 will have 53 weeks.

This summary consolidated financial and other data should be read in conjunction with the disclosures set forth under "Capitalization" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the related notes thereto appearing elsewhere in this prospectus.

	Fiscal Year Ended		39 Weeks Ended		52 Weeks
	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
(\$ in thousands, except per share data)					
<b>Consolidated Statements of Operations Data:</b>					
<b>Total revenues</b>	\$ 220,573	\$ 237,966	\$ 176,651	\$ 201,406	\$ 262,721
<b>Expenses:</b>					
Sandwich shop operating expenses:					
Cost of goods sold, excluding depreciation	63,009	68,491	50,784	58,389	76,096
Labor and related expenses	63,506	67,036	49,865	56,618	73,789
Occupancy expenses	25,238	26,511	19,493	22,885	29,903
Other operating expenses	22,620	24,095	17,899	20,767	26,963
General and administrative expenses	26,563	26,911	20,308	22,542	29,145
Depreciation expense	15,647	14,838	11,085	11,633	15,386
Pre-opening costs	267	1,521	1,046	1,760	2,235
Impairment and loss on disposal of property and equipment	2,952	365	29	78	414
Total expenses	219,802	229,768	170,509	194,672	253,931
Income from operations	771	8,198	6,142	6,734	8,790
Interest expense	519	495	359	427	563
Other expense (income)	9	1	(2)	6	9
Income before income taxes	243	7,702	5,785	6,301	8,218
Income tax expense	773	537	591	765	711
Net income (loss)	(530)	7,165	5,194	5,536	7,507
Net income (loss) attributable to non-controlling interests (1)	—	—	—	(35)	(35)
Net income (loss) attributable to Potbelly Corporation	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,571	\$ 7,542
Accretion of redeemable convertible preferred stock to maximum redemption value	(45,992)	(17,410)	(9,011)	(13,887)	(16,609)
Net loss attributable to common stockholders	\$ (46,522)	\$ (10,245)	\$ (3,817)	\$ (8,316)	\$ (9,067)
Net loss per common share attributable to common stockholders (2):					
Basic	\$ (9.34)	\$ (2.35)	\$ (0.85)	\$ (2.09)	\$ (2.29)
Diluted	(9.34)	(2.35)	(0.85)	(2.09)	(2.29)
Weighted average shares outstanding:					
Basic	4,978,621	4,359,930	4,503,982	3,972,873	3,962,294
Diluted	4,978,621	4,359,930	4,503,982	3,972,873	3,962,294
Unaudited pro forma net income per common share attributable to common stockholders (3):					
Basic		\$ 0.34		\$ 0.27	
Diluted		0.33		0.27	
Unaudited pro forma weighted average shares outstanding (3):					
Basic		21,386,375		20,787,320	
Diluted		21,437,590		20,855,416	
<b>Statement of Cash Flows Data:</b>					
Net cash provided by (used in):					
Operating activities	\$ 18,780	\$ 20,121	\$ 10,839	\$ 20,457	\$ 29,740
Investing activities	(6,243)	(17,758)	(13,070)	(19,700)	(24,388)
Financing activities	(4,382)	(7,197)	(7,659)	51	513
<b>Selected Other Data:</b>					
Total company-operated shops (end of period)	218	234	231	257	257
Total comparable stores (end of period)	211	211	211	221	221
Change in comparable store sales	1.8%	1.7%	1.3%	3.9%	3.7%
Operating income margin (4)	0.3%	3.4%	3.5%	3.3%	3.3%
Shop-level profit margin (5)	20.9%	21.6%	21.7%	21.0%	21.1%
Capital expenditures	\$ 6,243	\$ 17,758	\$ 13,070	\$ 19,700	\$ 24,388
Adjusted EBITDA (6)	\$ 21,051	\$ 26,752	\$ 19,670	\$ 22,741	\$ 29,823
Adjusted EBITDA margin (6)	9.5%	11.2%	11.1%	11.3%	11.4%

	December 26, 2010	December 25, 2011	September 23, 2012	
			Actual (\$ in thousands)	Pro Forma (7) Pro Forma As Adjusted (8)
<b>Balance Sheet Data:</b>				
Cash and cash equivalents	\$ 28,980	\$ 24,146	\$ 24,954	\$ 26,930
Working capital	14,764	16,490	15,204	16,880
Total assets	98,424	99,110	108,797	110,773
Total debt	9,313	15,243	15,409	15,409
Total redeemable convertible preferred stock	228,544	239,848	253,735	—
Total equity (deficit)	(169,643)	(185,302)	(191,103)	64,608

- (1) Non-controlling interests represent 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. We own a seventy-five percent interest in this consolidated joint venture.
- (2) Net loss per common share attributable to common stockholders is calculated under the two-class method, as our redeemable convertible preferred stock participates in the undistributed earnings of the company. Earnings of the company are allocated between the common and preferred stockholders to account for the accretion of the redeemable convertible preferred stock to its maximum redemption value, thereby reducing the earnings of the company attributable to common stockholders. For the periods presented, this resulted in net losses attributable to common stockholders, in total and on a per share basis, as the net income attributable to the company (if any) was exceeded by the change in maximum redemption value of the redeemable convertible preferred stock.
- (3) Pro forma net income per common share attributable to stockholders and the number of weighted average common shares used in computing pro forma net income per common share attributable to stockholders gives effect to the conversion of all of our outstanding redeemable convertible preferred stock into, and the exercise of all outstanding warrants for, common stock upon the closing of a qualified public offering as if such conversion had occurred as of the beginning of the fiscal year. See "Related Party Transactions—Arrangements with Our Investors."
- (4) Income (loss) from operations as a percentage of total revenues.
- (5) Shop-level profit is not required by, or presented in accordance with, GAAP, and is defined as income (loss) from operations less franchise royalties and fees, general and administrative expenses, depreciation expense, pre-opening costs and impairment and loss on disposal of property and equipment. Shop-level profit is a supplemental measure of operating performance of our shops and our calculation thereof may not be comparable to that reported by other companies. Shop-level profit margin represents shop-level profit expressed as a percentage of net company-operated sandwich shop sales. Shop-level profit and shop-level profit margin have limitations as analytical tools, and you should not consider them in isolation or as a substitute for analysis of our results as reported under GAAP. Management believes shop-level profit margin is an important tool for investors because it is a widely used metric within the restaurant industry to evaluate restaurant-level productivity, efficiency and performance. Management uses shop-level profit margin as a key metric to evaluate the profitability of incremental sales at our shops, to evaluate our shop performance across periods and to evaluate our shop financial performance compared with our competitors. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of shop-level profit margin and other key performance indicators.

A reconciliation of shop-level profit to income (loss) from operations and a calculation of shop-level profit margin is provided below:

	Fiscal Year Ended		39 Weeks Ended		52 Weeks Ended
	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
			(\$ in thousands)		
Income (loss) from operations	\$ 771	\$ 8,198	\$ 6,142	\$ 6,734	\$ 8,790
Less: Franchise royalties and fees	—	503	348	553	708
General and administrative expenses	26,563	26,911	20,308	22,542	29,145
Depreciation expense	15,647	14,838	11,085	11,633	15,386
Pre-opening costs	267	1,521	1,046	1,760	2,235
Impairment and loss on disposal of property and equipment	2,952	365	29	78	414
Shop-level profit [Y]	\$ 46,200	\$ 51,330	\$ 38,262	\$ 42,194	\$ 55,262
Total revenues	\$ 220,573	\$ 237,966	\$ 176,651	\$ 201,406	\$ 262,721
Less: Franchise royalties and fees	—	503	348	553	708
Sandwich shop sales, net [X]	\$ 220,573	\$ 237,463	\$ 176,303	\$ 200,853	\$ 262,013
Shop-level profit margin [Y=X]	20.9%	21.6%	21.7%	21.0%	21.1%

- (6) Adjusted EBITDA has been presented in this prospectus and is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted EBITDA as net income (loss) before depreciation and amortization expense, interest expense, provision for income taxes and pre-opening costs, adjusted to eliminate the impact of other items set forth in the reconciliation below, including certain non-cash as well as certain other items that we do not consider representative of our ongoing operating performance. Adjusted EBITDA margin is calculated by dividing adjusted EBITDA by total revenues. Adjusted EBITDA has limitations as an analytical tool and our calculation thereof may not be comparable to that reported by other companies; accordingly, you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Adjusted EBITDA is included in this prospectus because it is a key metric used by management. Additionally, adjusted EBITDA is frequently used by analysts, investors and other interested parties to evaluate companies in our industry. We use adjusted EBITDA, alongside other GAAP measures such as operating income (loss) and net income (loss), to measure profitability, as a key profitability target in our annual and other budgets, and to compare our performance against that of peer companies. We believe that adjusted EBITDA provides useful information facilitating operating performance comparisons from period to period and company to company.

A reconciliation of adjusted EBITDA to net income (loss) attributable to Potbelly Corporation is provided below:

	Fiscal Year Ended		39 Weeks Ended		52 Weeks Ended
	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
			(\$ in thousands)		
<b>Net income (loss) attributable to Potbelly Corporation</b>	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,571	\$ 7,542
Depreciation expense	15,647	14,838	11,085	11,633	15,386
Interest expense	519	495	359	427	563
Income tax expense	773	537	591	765	711
Impairment and closures (a)	3,344	672	299	265	638
Pre-opening costs (b)	267	1,521	1,046	1,760	2,235
Stock-based compensation (c)	1,031	1,524	1,096	2,320	2,748
<b>Adjusted EBITDA</b>	<u>\$ 21,051</u>	<u>\$ 26,752</u>	<u>\$ 19,670</u>	<u>\$ 22,741</u>	<u>\$ 29,823</u>

- (a) Includes costs related to impairment of long-lived assets, gain or loss on disposal of property and equipment and shop closure expenses.
- (b) Includes expenses directly associated with the opening of new shops and are incurred prior to the opening of the shop.
- (c) Includes non-cash stock-based compensation.
- (7) Assumes the conversion of all outstanding shares of all series of our preferred stock into, and the exercise of all outstanding warrants for, an aggregate of 16,897,088 shares of common stock immediately prior to the completion of this offering, and excludes outstanding options to purchase 4,446,049 shares of our common stock at a weighted average exercise price of \$9.16 per share, of which options to purchase 3,032,113 shares at a weighted average exercise price of \$9.90 were vested as of September 23, 2012.
- (8) Gives effect to the transactions described in footnote 7 and the sale of \_\_\_\_\_ shares of common stock in this offering by us at the estimated initial public offering price of \$ \_\_\_\_\_ per share (the midpoint of the price range set forth on the cover page of this prospectus), after deducting underwriting discounts and commissions and estimated expenses payable by us.

## RISK FACTORS

*An investment in our common stock involves various risks. You should carefully consider the following risks and all of the other information contained in this prospectus before investing in our common stock. The risks described below are those that we believe are the material risks that we face. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment in our common stock.*

### **Risks Related to Our Business and Industry**

*We face significant competition for customers and our inability to compete effectively may affect our traffic, sales and shop-level profit margins, which could adversely affect our business, financial condition and results of operations.*

The restaurant industry is intensely competitive with many well-established companies that compete directly and indirectly with us with respect to food quality, ambience, service, price and value and location. We compete in the restaurant industry with national, regional and locally-owned limited-service restaurants and full-service restaurants. Some of our competitors have significantly greater financial, marketing, personnel and other resources than we do, and many of our competitors are well established in markets in which we have existing shops or intend to locate new shops. In addition, many of our competitors have greater name recognition nationally or in some of the local markets in which we have shops. Any inability to successfully compete with the restaurants in our markets will place downward pressure on our customer traffic and may prevent us from increasing or sustaining our revenues and profitability. Consumer tastes, nutritional and dietary trends, traffic patterns and the type, number and location of competing restaurants often affect the restaurant business, and our competitors may react more efficiently and effectively to those conditions. Further, we face growing competition from the supermarket industry, with the improvement of their “convenient meals” in the deli section, and from limited-service and fast casual restaurants, as a result of higher-quality food and beverage offerings by those restaurants. In addition, some of our competitors have in the past implemented programs which provide price discounts on certain menu offerings, and they may continue to do so in the future. If we are unable to continue to compete effectively, our traffic, sales and shop-level profit margins could decline and our business, financial condition and results of operations would be adversely affected.

*Changes in economic conditions, including continuing effects from the recent recession, could materially affect our business, financial condition and results of operations.*

The restaurant industry depends on consumer discretionary spending. During the economic downturn starting in 2008, continuing disruptions in the overall economy, including the ongoing impacts of the housing crisis, high unemployment, and financial market volatility and unpredictability, caused a related reduction in consumer confidence, which negatively affected customer traffic and sales throughout our industry. These factors, as well as national, regional and local regulatory and economic conditions, gasoline prices, disposable consumer income and consumer confidence, affect discretionary consumer spending. If these economic conditions persist or worsen, customer traffic could be adversely impacted if our customers choose to dine out less frequently or reduce the amount they spend on meals while dining out. If current negative economic conditions persist for a long period of time or become more pervasive, consumer changes to their discretionary spending behavior, including the frequency with which they dine out, could be more permanent. The ability of the U.S. economy to continue to recover from these challenging economic conditions is likely to be affected by many national and international factors that are beyond our control. If sales decrease, our profitability could decline as we spread fixed costs across a lower level of sales. Prolonged negative trends in shop sales could cause us to, among other things, reduce the number and frequency of new shop openings, close shops or delay remodeling of our existing shops or take asset impairment charges.

***Our business operations and future development could be significantly disrupted if we lose key members of our management team.***

The success of our business continues to depend to a significant degree upon the continued contributions of our senior officers and key employees, both individually and as a group. Our future performance will be substantially dependent in particular on our ability to retain and motivate Aylwin Lewis, our Chief Executive Officer, Charlie Talbot, our Senior Vice President and Chief Financial Officer, John Morlock, our Senior Vice President of Operations, and other members of our senior leadership team. We currently have employment agreements in place with all of the members of our senior leadership team. The loss of the services of any of these executive officers or other key employees could have a material adverse effect on our business and plans for future development. In addition, we may have difficulty finding appropriate replacements and our business could suffer. We also do not maintain any key man life insurance policies for any of our employees.

***Increased commodity, energy and other costs could decrease our shop-level profit margins or cause us to limit or otherwise modify our menus, which could adversely affect our business.***

Our profitability depends in part on our ability to anticipate and react to changes in the price and availability of food commodities, including among other things beef, poultry, grains, dairy and produce. Prices may be affected due to market changes, increased competition, the general risk of inflation, shortages or interruptions in supply due to weather, disease or other conditions beyond our control, or other reasons. For example, certain regions of the U.S. experienced a significant drought in 2012, which may increase the price of certain food commodities, including beef and corn. Increased prices or shortages could affect the cost and quality of the items we buy or require us to raise prices or limit our menu options. These events, combined with other more general economic and demographic conditions, could impact our pricing and negatively affect our sales and shop-level profit margins. We enter into certain forward pricing arrangements with our suppliers from time to time, which may result in fixed or formula-based pricing with respect to certain food products. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Quantitative and Qualitative Disclosures of Market Risks—Commodity Price Risk.” However, these arrangements generally are relatively short in duration and may provide only limited protection from price changes, and the extent to which we use these arrangements varies substantially from time to time. In addition, the use of these arrangements may limit our ability to benefit from favorable price movements.

Our profitability is also adversely affected by increases in the price of utilities, such as natural gas, whether as a result of inflation, shortages or interruptions in supply, or otherwise. Our profitability is also affected by the costs of insurance, labor, marketing, taxes and real estate, all of which could increase due to inflation, changes in laws, competition or other events beyond our control. Our ability to respond to increased costs by increasing menu prices or by implementing alternative processes or products will depend on our ability to anticipate and react to such increases and other more general economic and demographic conditions, as well as the responses of our competitors and customers. All of these things may be difficult to predict and beyond our control. In this manner, increased costs could adversely affect our performance.

***Our inability to identify qualified individuals for our workforce could slow our growth and adversely impact our ability to operate our shops.***

Our success depends in part upon our ability to attract, motivate and retain a sufficient number of qualified managers and associates to meet the needs of our existing shops and to staff new shops. A sufficient number of qualified individuals to fill these positions may be in short supply in some communities. Competition in these communities for qualified staff could require us to pay higher wages and provide greater benefits. In addition, significant improvement in regional or national economic conditions could increase the difficulty of attracting and retaining qualified individuals and could result in the need to pay higher wages and provide greater benefits. We place a heavy emphasis on the qualification and training of our personnel and spend a significant amount of time and money on training our employees. Any inability to recruit and retain qualified individuals



may result in higher turnover and increased labor costs, and could compromise the quality of our service, all of which could adversely affect our business. Any such inability could also delay the planned openings of new shops and could adversely impact our existing shops. Any such inability to retain or recruit qualified employees, increased costs of attracting qualified employees or delays in shop openings could adversely affect our business and results of operations.

*Our long-term success is highly dependent on our ability to successfully identify appropriate sites and develop and expand our operations in existing and new markets.*

One of the key means of achieving our growth strategies will be through opening new shops and operating those shops on a profitable basis. We expect this to be the case for the foreseeable future. We opened 24 new shops in the 39 weeks ended September 23, 2012 and expect to open 25 to 35 new shops in 2013. There can be no assurance that any new shops that we open will have similar operating results to those of existing shops. We may not be able to open our planned new shops on a timely basis, if at all, and, if opened, these shops may not be operated profitably. For example, in 2011 and the 39 weeks ended September 23, 2012, we closed five shops and one shop, respectively, due to under-performance. The number and timing of new shops opened during any given period, and their associated contribution to operating growth, may be negatively impacted by a number of factors including, without limitation:

- the availability of attractive sites for new shops and the ability to negotiate suitable lease terms;
- the cost and availability of capital to fund construction costs and pre-opening expenses;
- our ability to control construction and development costs of new shops;
- recruitment and training of qualified operating personnel in the local market;
- our ability to obtain all required governmental permits, including zoning approvals, on a timely basis;
- our ability to predict and respond to consumer tastes in new geographic regions and acceptance or awareness of our concept;
- competition in new markets, including competition for appropriate sites;
- limitations under our current and future credit facilities; and
- unanticipated increases in costs, any of which could give rise to delays or cost overruns.

Our results have been, and in the future may continue to be, significantly impacted by the timing of new shop openings (often dictated by factors outside of our control), including associated shop pre-opening costs and operating inefficiencies, as well as changes in our geographic concentration due to the opening of new shops. We typically incur the most significant portion of pre-opening expenses associated with a given shop within the five months immediately preceding and the month of the opening of the shop. Our experience has been that labor and operating costs associated with a newly opened shop for the first several months of operation are materially greater than what can be expected after that time, both in aggregate dollars and as a percentage of revenues. Our new shops commonly take 10 to 13 weeks to reach planned operating levels due to inefficiencies typically associated with new shops, including the training of new personnel, lack of market awareness, inability to hire sufficient qualified staff and other factors. Accordingly, the volume and timing of new shop openings may have a meaningful impact on our profitability.

Although we target specified operating and financial metrics, new shops may not meet these targets or may take longer than anticipated to do so. Any new shops we open may not be profitable or achieve operating results similar to those of our existing shops. We may not be able to respond on a timely basis to all of the

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changing demands that our planned expansion will impose on management and on our existing infrastructure, or be able to hire or retain the necessary management and operating personnel. Our existing management systems, financial and management controls and information systems may not be adequate to support our planned expansion. Our ability to manage our growth effectively will require us to continue to enhance these systems, procedures and controls and to locate, hire, train and retain management and operating personnel.

We cannot assure you that we will be able to successfully expand or acquire critical market presence for our brand in new geographical markets, as we may encounter well-established competitors with substantially greater financial resources. We may be unable to find attractive locations, build name recognition, successfully market our brand or attract new customers. We may incur additional costs in new markets, particularly for transportation, distribution and training of new personnel, which may impact the profitability of those shops. Competitive circumstances and consumer characteristics and preferences in new market segments and new geographical markets may differ substantially from those in the market segments and geographical markets in which we have substantial experience. If we are unable to expand in existing markets or penetrate new markets, our ability to increase our revenues and profitability may be harmed.

***We are subject to risks associated with leasing property subject to long-term non-cancelable leases.***

We do not own any real property and all of our company-owned shops are located in leased premises. The leases for our shop locations generally have initial terms of 10 years and typically provide for two renewal options in five-year increments as well as for rent escalations. Generally, our leases are net leases that require us to pay our share of the costs of real estate taxes, utilities, building operating expenses, insurance and other charges in addition to rent. We generally cannot cancel these leases. Additional sites that we lease are likely to be subject to similar long-term non-cancelable leases. If we close a shop, we nonetheless may be obligated to perform our monetary obligations under the applicable lease, including, among other things, payment of the base rent for the balance of the lease term. In addition, as each of our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close shops in desirable locations.

***Damage to our reputation or lack of acceptance of our brand in existing or new markets could negatively impact our business, financial condition and results of operations.***

We believe we have built our reputation on the high quality of our food, service and staff, as well as on our unique culture and the ambience in our shops, and we must protect and grow the value of our brand to continue to be successful in the future. Any incident that erodes consumer affinity for our brand could significantly reduce its value and damage our business. For example, our brand value could suffer and our business could be adversely affected if customers perceive a reduction in the quality of our food, service or staff, or an adverse change in our culture or ambience, or otherwise believe we have failed to deliver a consistently positive experience.

We may be adversely affected by news reports or other negative publicity regardless of their accuracy, regarding food quality issues, public health concerns, illness, safety, injury or government or industry findings concerning our shops, restaurants operated by other foodservice providers, or others across the food industry supply chain. The risks associated with such negative publicity cannot be completely eliminated or mitigated and may materially harm our results of operations and result in damage to our brand.

Also, there has been a marked increase in the use of social media platforms and similar devices, including weblogs (blogs), social media websites and other forms of Internet-based communications which allow individuals access to a broad audience of consumers and other interested persons. The availability of information on social media platforms is virtually immediate as is its impact. Many social media platforms immediately publish the content their subscribers and participants can post, often without filters or checks on accuracy of the content posted. The opportunity for dissemination of information, including inaccurate information, is seemingly limitless and readily available. Information concerning our company may be posted on such platforms at any time. Information posted may be adverse to our interests or may be inaccurate, each of which may harm our

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performance, prospects or business. The harm may be immediate without affording us an opportunity for redress or correction. Such platforms also could be used for dissemination of trade secret information, compromising valuable company assets. In sum, the dissemination of information online could harm our business, prospects, financial condition and results of operations, regardless of the information's accuracy.

### ***Our marketing programs may not be successful.***

We incur costs and expend other resources in our marketing efforts to attract and retain customers. These initiatives may not be successful, resulting in expenses incurred without the benefit of higher revenues. Additionally, some of our competitors have greater financial resources, which enable them to spend significantly more on marketing and advertising than we are able to. Should our competitors increase spending on marketing and advertising or our marketing funds decrease for any reason, or should our advertising and promotions be less effective than our competitors, there could be a material adverse effect on our results of operations and financial condition.

### ***Our business is subject to seasonal fluctuations.***

Historically, customer spending patterns for our established shops are lowest in the first quarter of the year. Our quarterly results have been and will continue to be affected by the timing of new shop openings and their associated pre-opening costs. As a result of these and other factors, our financial results for any quarter may not be indicative of the results that may be achieved for a full fiscal year.

### ***Because many of our shops are concentrated in local or regional areas, we are susceptible to economic and other trends and developments, including adverse weather conditions, in these areas.***

Our financial performance is highly dependent on shops located in Illinois, Texas, Washington, D.C., Michigan, Minnesota and Ohio, which comprised approximately 73% of our total domestic shops as of September 23, 2012. Shops located in the Chicago metropolitan area comprised approximately 30% of our total domestic shops as of such date. As a result, adverse economic conditions in any of these areas could have a material adverse effect on our overall results of operations. In recent years, certain of these states have been more negatively impacted by the economic crisis than other geographic areas. In addition, given our geographic concentrations, negative publicity regarding any of our shops in these areas could have a material adverse effect on our business and operations, as could other regional occurrences such as local strikes, terrorist attacks, increases in energy prices, or natural or man-made disasters.

In particular, adverse weather conditions, such as regional winter storms, floods, severe thunderstorms and hurricanes, could negatively impact our results of operations. For example, we experienced substantial temporary shop closures in the Chicago metropolitan area following a severe blizzard in February 2011. More recently, we have experienced temporary shop closures on the east coast due to Hurricane Sandy. 37 shops were closed for at least one day, of which three shops were closed for a period of one to two weeks and three additional shops remain closed to date and are expected to re-open in the first quarter of 2013. By the end of fiscal 2012, a total of 260 full shop operating days will have been lost. Temporary or prolonged shop closures may occur and customer traffic may decline due to the actual or perceived effects of future weather-related events.

### ***Legislation and regulations requiring the display and provision of nutritional information for our menu offerings, and new information or attitudes regarding diet and health or adverse opinions about the health effects of consuming our menu offerings, could affect consumer preferences and negatively impact our results of operations.***

Government regulation and consumer eating habits may impact our business as a result of changes in attitudes regarding diet and health or new information regarding the health effects of consuming our menu offerings. These changes have resulted in, and may continue to result in, the enactment of laws and regulations that impact the ingredients and nutritional content of our menu offerings, or laws and regulations requiring us to disclose the nutritional content of our food offerings.

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For example, a number of states, counties and cities have enacted menu labeling laws requiring multi-unit restaurant operators to disclose certain nutritional information to customers, or have enacted legislation restricting the use of certain types of ingredients in restaurants. Furthermore, the Patient Protection and Affordable Care Act of 2010 (the "PPACA") establishes a uniform, federal requirement for certain restaurants to post certain nutritional information on their menus. Specifically, the PPACA amended the Federal Food, Drug and Cosmetic Act to require chain restaurants with 20 or more locations operating under the same name and offering substantially the same menus to publish the total number of calories of standard menu items on menus and menu boards, along with a statement that puts this calorie information in the context of a total daily calorie intake. The PPACA also requires covered restaurants to provide to consumers, upon request, a written summary of detailed nutritional information for each standard menu item, and to provide a statement on menus and menu boards about the availability of this information. The PPACA further permits the United States Food and Drug Administration (the "FDA") to require covered restaurants to make additional nutrient disclosures, such as disclosure of trans-fat content. An unfavorable report on, or reaction to, our menu ingredients, the size of our portions or the nutritional content of our menu items could negatively influence the demand for our offerings.

Compliance with current and future laws and regulations regarding the ingredients and nutritional content of our menu items may be costly and time-consuming. Additionally, if consumer health regulations or consumer eating habits change significantly, we may be required to modify or discontinue certain menu items, and we may experience higher costs associated with the implementation of those changes. Additionally, some government authorities are increasing regulations regarding trans-fats and sodium, which may require us to limit or eliminate trans-fats and sodium from our menu offerings, switch to higher cost ingredients or may hinder our ability to operate in certain markets. If we fail to comply with these laws or regulations, our business could experience a material adverse effect.

We cannot make any assurances regarding our ability to effectively respond to changes in consumer health perceptions or our ability to successfully implement the nutrient content disclosure requirements and to adapt our menu offerings to trends in eating habits. The imposition of menu-labeling laws could have an adverse effect on our results of operations and financial position, as well as the restaurant industry in general.

***We are subject to many federal, state and local laws with which compliance is both costly and complex.***

The restaurant industry is subject to extensive federal, state and local laws and regulations, including the recently enacted comprehensive health care reform legislation and those relating to building and zoning requirements and those relating to the preparation and sale of food. The development and operation of restaurants depend to a significant extent on the selection and acquisition of suitable sites, which are subject to zoning, land use, environmental, traffic and other regulations and requirements. We are also subject to licensing and regulation by state and local authorities relating to health, sanitation, safety and fire standards.

We are subject to federal and state laws governing our relationships with employees (including the Fair Labor Standards Act of 1938, the Immigration Reform and Control Act of 1986 and applicable requirements concerning the minimum wage, overtime, family leave, working conditions, safety standards, immigration status, unemployment tax rates, workers' compensation rates and state and local payroll taxes) and federal and state laws which prohibit discrimination. As significant numbers of our associates are paid at rates related to the applicable minimum wage, further increases in the minimum wage or other changes in these laws could increase our labor costs. Our ability to respond to minimum wage increases by increasing menu prices will depend on the responses of our competitors and customers.

In March 2010, the United States federal government enacted comprehensive health care reform legislation which, among other things, includes guaranteed coverage requirements, eliminates pre-existing condition exclusions and annual and lifetime maximum limits, restricts the extent to which policies can be rescinded and imposes new and significant taxes on health insurers and health care benefits. The legislation imposes implementation effective dates that began in 2010 and extend through 2020, and many of the changes

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require additional guidance from government agencies or federal regulations. To date, we have not experienced material costs related to such legislation. However, due to the phased-in nature of the implementation and the lack of interpretive guidance, it is difficult to determine at this time what impact the health care reform legislation will have on our financial results. Possible adverse effects could include increased costs, exposure to expanded liability and requirements for us to revise the ways in which we provide healthcare and other benefits to our employees.

There is also a potential for increased regulation of certain food establishments in the United States, where compliance with a Hazard Analysis and Critical Control Points (“HACCP”) approach may now be required. HACCP refers to a management system in which food safety is addressed through the analysis and control of potential hazards from production, procurement and handling, to manufacturing, distribution and consumption of the finished product. Many states have required restaurants to develop and implement HACCP Systems, and the United States government continues to expand the sectors of the food industry that must adopt and implement HACCP programs. For example, the Food Safety Modernization Act (the “FSMA”), signed into law in January 2011, granted the FDA new authority regarding the safety of the entire food system, including through increased inspections and mandatory food recalls. Although restaurants are specifically exempted from or not directly implicated by some of these new requirements, we anticipate that the new requirements may impact our industry. Additionally, our suppliers may initiate or otherwise be subject to food recalls that may impact the availability of certain products, result in adverse publicity or require us to take actions that could be costly for us or otherwise impact our business.

We are subject to the Americans with Disabilities Act (the “ADA”), which, among other things, requires our shops to meet federally mandated requirements for the disabled. The ADA prohibits discrimination in employment and public accommodations on the basis of disability. Under the ADA, we could be required to expend funds to modify our shops to provide service to, or make reasonable accommodations for the employment of, disabled persons. In addition, our employment practices are subject to the requirements of the Immigration and Naturalization Service relating to citizenship and residency. Government regulations could affect and change the items we procure for resale such as commodities.

In addition, our franchising activities are subject to laws enacted by a number of states, rules and regulations promulgated by the U.S. Federal Trade Commission and certain rules and requirements regulating franchising activities in foreign countries. Failure to comply with new or existing franchise laws, rules and regulations in any jurisdiction or to obtain required government approvals could negatively affect our franchise sales and our relationships with our franchisees.

The impact of current laws and regulations, the effect of future changes in laws or regulations that impose additional requirements and the consequences of litigation relating to current or future laws and regulations, or our inability to respond effectively to significant regulatory or public policy issues, could increase our compliance and other costs of doing business and, therefore, have an adverse effect on our results of operations. Failure to comply with the laws and regulatory requirements of federal, state and local authorities could result in, among other things, revocation of required licenses, administrative enforcement actions, fines and civil and criminal liability. In addition, certain laws, including the ADA, could require us to expend significant funds to make modifications to our shops if we failed to comply with applicable standards. Compliance with all of these laws and regulations can be costly and can increase our exposure to litigation or governmental investigations or proceedings.

***Food safety and food-borne illness concerns may have an adverse effect on our business by reducing demand and increasing costs.***

Food safety is a top priority, and we dedicate substantial resources to help ensure that our customers enjoy safe, quality food products. However, food-borne illnesses and food safety issues have occurred in the food industry in the past, and could occur in the future. Any report or publicity linking us to instances of food-borne

illness or other food safety issues, including food tampering or contamination, could adversely affect our brands and reputation as well as our revenues and profits. In addition, instances of food-borne illness, food tampering or food contamination occurring solely at restaurants of our competitors could result in negative publicity about the food service industry generally and adversely impact our sales.

Furthermore, our reliance on third-party food suppliers and distributors increases the risk that food-borne illness incidents could be caused by factors outside of our control and that multiple locations would be affected rather than a single shop. We cannot assure that all food items are properly maintained during transport throughout the supply chain and that our employees will identify all products that may be spoiled and should not be used in our shops. If our customers become ill from food-borne illnesses, we could be forced to temporarily close some shops. Furthermore, any instances of food contamination, whether or not at our shops, could subject us or our suppliers to a food recall pursuant to the recently enacted the Food and Drug Administration Food Safety Modernization Act.

***Shortages or interruptions in the supply or delivery of fresh food products could adversely affect our operating results.***

We are dependent on frequent deliveries of fresh food products that meet our specifications. Shortages or interruptions in the supply of fresh food products caused by problems in production or distribution, inclement weather, unanticipated demand or other conditions could adversely affect the availability, quality and cost of ingredients, which would adversely affect our operating results.

***We have a limited number of suppliers for our major products and rely on one custom distribution company for the majority of our national distribution program in the U.S. If our suppliers or distributors are unable to fulfill their obligations under their contracts, we could encounter supply shortages and incur higher costs.***

We have a limited number of suppliers for our major products, such as bread. In 2011, we purchased all of our bread from one supplier, Campagna-Turano Bakery, Inc., and more than 95% of our meat products from nine suppliers. In addition, we contract with Distribution Market Advantage, Inc., or DMA, a cooperative of multiple food distributors located throughout the nation to provide the majority of our food distribution services in the U.S. Although we believe that alternative supply and distribution sources are available, there can be no assurance that we will be able to identify or negotiate with such sources on terms that are commercially reasonable to us. If our suppliers or distributors are unable to fulfill their obligations under their contracts or we are unable to identify alternative sources, we could encounter supply shortages and incur higher costs. See “Business—Sourcing and Supply Chain.”

***Failure to obtain and maintain required licenses and permits or to comply with food control regulations could lead to the loss of our food service licenses and, thereby, harm our business.***

Restaurants are required under various federal, state and local government regulations to obtain and maintain licenses, permits and approvals to operate their businesses and such regulations are subject to change from time to time. The failure to obtain and maintain these licenses, permits and approvals could adversely affect our operating results. Typically, licenses must be renewed annually and may be revoked, suspended or denied renewal for cause at any time if governmental authorities determine that our conduct violates applicable regulations. Difficulties or failure to maintain or obtain the required licenses and approvals could adversely affect our existing shops and delay or result in our decision to cancel the opening of new shops, which would adversely affect our business.

***Information technology system failures or breaches of our network security could interrupt our operations and adversely affect our business.***

We rely on our computer systems and network infrastructure across our operations, including point-of-sale processing at our shops. Our operations depend upon our ability to protect our computer equipment

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and systems against damage from physical theft, fire, power loss, telecommunications failure or other catastrophic events, as well as from internal and external security breaches, viruses and other disruptive problems. Any damage or failure of our computer systems or network infrastructure that causes an interruption in our operations could have a material adverse effect on our business and subject us to litigation or actions by regulatory authorities.

***Security breaches of confidential customer information in connection with our electronic processing of credit and debit card transactions may adversely affect our business.***

The majority of our sales are by credit or debit cards. Other restaurants and retailers have experienced security breaches in which credit and debit card information of their customers has been stolen. We may in the future become subject to lawsuits or other proceedings for purportedly fraudulent transactions arising out of the actual or alleged theft of our customers' credit or debit card information. Any such claim or proceeding, or any adverse publicity resulting from these allegations, may have a material adverse effect on our business.

***Changes to estimates related to our property, fixtures and equipment or operating results that are lower than our current estimates at certain shop locations may cause us to incur impairment charges on certain long-lived assets, which may adversely affect our results of operations.***

In accordance with accounting guidance as it relates to the impairment of long-lived assets, we make certain estimates and projections with regard to individual shop operations, as well as our overall performance, in connection with our impairment analyses for long-lived assets. When impairment triggers are deemed to exist for any location, the estimated undiscounted future cash flows are compared to its carrying value. If the carrying value exceeds the undiscounted cash flows, an impairment charge equal to the difference between the carrying value and the sum of the discounted cash flows is recorded. The projections of future cash flows used in these analyses require the use of judgment and a number of estimates and projections of future operating results. If actual results differ from our estimates, additional charges for asset impairments may be required in the future. We have experienced significant impairment charges in past years. If future impairment charges are significant, our reported operating results would be adversely affected.

***We may not be able to adequately protect our intellectual property, which, in turn, could harm the value of our brands and adversely affect our business.***

Our ability to implement our business plan successfully depends in part on our ability to further build brand recognition using our trademarks, service marks and other proprietary intellectual property, including our name and logos and the unique ambiance of our shops. We have registered or applied to register a number of our trademarks. We cannot assure you that our trademark applications will be approved. Third parties may also oppose our trademark applications, or otherwise challenge our use of the trademarks. In the event that our trademarks are successfully challenged, we could be forced to rebrand our goods and services, which could result in loss of brand recognition, and could require us to devote resources to advertising and marketing new brands.

If our efforts to register, maintain and protect our intellectual property are inadequate, or if any third party misappropriates, dilutes or infringes on our intellectual property, the value of our brands may be harmed, which could have a material adverse effect on our business and might prevent our brands from achieving or maintaining market acceptance. We may also face the risk of claims that we have infringed third parties' intellectual property rights. If third parties claim that we infringe upon their intellectual property rights, our operating profits could be adversely affected. Any claims of intellectual property infringement, even those without merit, could be expensive and time consuming to defend, require us to rebrand our services, if feasible, divert management's attention and resources or require us to enter into royalty or licensing agreements in order to obtain the right to use a third party's intellectual property.

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*Restaurant companies have been the target of class action lawsuits and other proceedings alleging, among other things, violations of federal and state workplace and employment laws. Proceedings of this nature are costly, divert management attention and, if successful, could result in our payment of substantial damages or settlement costs.*

Our business is subject to the risk of litigation by employees, consumers, suppliers, stockholders or others through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The outcome of litigation, particularly class action and regulatory actions, is difficult to assess or quantify. In recent years, restaurant companies have been subject to lawsuits, including class action lawsuits, alleging violations of federal and state laws regarding workplace and employment matters, discrimination and similar matters. A number of these lawsuits have resulted in the payment of substantial damages by the defendants. Similar lawsuits have been instituted from time to time alleging violations of various federal and state wage and hour laws regarding, among other things, employee meal deductions, overtime eligibility of assistant managers and failure to pay for all hours worked. While we have not been a party to any of these types of lawsuits in the past, there can be no assurance that we will not be named in any such lawsuit in the future or that we would not be required to pay substantial expenses and/or damages.

Occasionally, our customers file complaints or lawsuits against us alleging that we are responsible for some illness or injury they suffered at or after a visit to one of our shops, including actions seeking damages resulting from food-borne illness or accidents in our shops. We are also subject to a variety of other claims from third parties arising in the ordinary course of our business, including contract claims. The restaurant industry has also been subject to a growing number of claims that the menus and actions of restaurant chains have led to the obesity of certain of their customers. We may also be subject to lawsuits from our employees, the U.S. Equal Employment Opportunity Commission or others alleging violations of federal and state laws regarding workplace and employment matters, discrimination and similar matters.

Regardless of whether any claims against us are valid or whether we are liable, claims may be expensive to defend and may divert time and money away from our operations. In addition, they may generate negative publicity, which could reduce customer traffic and sales. Although we maintain what we believe to be adequate levels of insurance, insurance may not be available at all or in sufficient amounts to cover any liabilities with respect to these or other matters. A judgment or other liability in excess of our insurance coverage for any claims or any adverse publicity resulting from claims could adversely affect our business and results of operations.

*Our insurance may not provide adequate levels of coverage against claims.*

We believe that we maintain insurance customary for businesses of our size and type. However, there are types of losses we may incur that cannot be insured against or that we believe are not economically reasonable to insure. Such losses could have a material adverse effect on our business and results of operations.

*We have limited control with respect to the operations of our franchisees which could have a negative impact on our business.*

Our franchisees are obligated to operate their shops according to the specific guidelines we set forth. We provide training opportunities to these franchisees to integrate them into our operating strategy. However, since we do not have control over these shops, we cannot give assurance that there will not be differences in product quality, operations, marketing or profitability or that there will be adherence to all of our guidelines at these shops. The failure of these shops to operate effectively could adversely affect our cash flows from those operations or have a negative impact on our reputation or our business.

### **Risks Related to this Offering and Our Common Stock**

*Our stock price could be extremely volatile and, as a result, you may not be able to resell your shares at or above the price you paid for them.*

Volatility in the market price of our common stock may prevent you from being able to sell your shares at or above the price you paid for your shares. The stock market in general has been highly volatile, and this may



be especially true for our common stock given our growth strategy and stage of development. As a result, the market price of our common stock is likely to be similarly volatile. You may experience a decrease, which could be substantial, in the value of your stock, including decreases unrelated to our operating performance or prospects, and could lose part or all of your investment. The price of our common stock could be subject to wide fluctuations in response to a number of factors, including those described elsewhere in this prospectus and others such as:

- actual or anticipated fluctuations in our quarterly or annual operating results and the performance of our competitors;
- publication of research reports by securities analysts about us, our competitors or our industry;
- our failure or the failure of our competitors to meet analysts' projections or guidance that we or our competitors may give to the market;
- additions and departures of key personnel;
- sales, or anticipated sales, of large blocks of our stock or of shares held by our stockholders, directors or executive officers;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- the passage of legislation or other regulatory developments affecting us or our industry;
- speculation in the press or investment community, whether or not correct, involving us, our suppliers or our competitors;
- changes in accounting principles;
- litigation and governmental investigations;
- terrorist acts, acts of war or periods of widespread civil unrest;
- a food-borne illness outbreak;
- natural disasters and other calamities; and
- changes in general market and economic conditions.

As we operate in a single industry, we are especially vulnerable to these factors to the extent that they affect our industry or our products. In the past, securities class action litigation has often been initiated against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs and divert our management's attention and resources, and could also require us to make substantial payments to satisfy judgments or to settle litigation.

***There is no existing market for our common stock, and we do not know if one will develop to provide you with adequate liquidity.***

Prior to this offering, there has not been a public market for our common stock. An active market for our common stock may not develop following the completion of this offering, or if it does develop, may not be maintained. If an active trading market does not develop, you may have difficulty selling any of our common

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stock that you buy. The initial public offering price for the shares of our common stock will be determined by negotiations between us and the representatives of the underwriters and may not be indicative of prices that will prevail in the open market following this offering. Consequently, you may not be able to sell shares of our common stock at prices equal to or greater than the price you paid in this offering.

***There may be sales of a substantial amount of our common stock after this offering by our current stockholders, and these sales could cause the price of our common stock to fall.***

After this offering, there will be \_\_\_\_\_ shares of common stock outstanding (\_\_\_\_\_ if the underwriters exercise their option to purchase additional shares from us in full). Of our issued and outstanding shares, all the common stock sold in this offering will be freely transferable, except for any shares held by our “affiliates,” as that term is defined in Rule 144 under the Securities Act of 1933, as amended. Following completion of this offering, \_\_\_\_\_ % of our outstanding common stock will be held by our pre-IPO stockholders, including our directors, members of our management and employees (or \_\_\_\_\_ % if the underwriters exercise their option to purchase additional shares from us and the selling stockholders in full).

Each of our directors and executive officers and all of our stockholders have entered into a lock-up agreement with the representatives of the underwriters which regulates their sales of our common stock for a period of at least 180 days after the date of this prospectus, subject to certain exceptions. See “Underwriting.”

Sales of substantial amounts of our common stock in the public market after this offering, or the perception that such sales will occur, could adversely affect the market price of our common stock and make it difficult for us to raise funds through securities offerings in the future. Of the shares to be outstanding after the offering, the shares offered by this prospectus will be eligible for immediate sale in the public market without restriction by persons other than our affiliates. Our remaining outstanding shares will become available for resale in the public market as shown in the chart below (less any shares sold as a result of the exercise of the underwriters’ option to purchase additional shares), subject to the provisions of Rule 144 and Rule 701.

<u>Number of Shares</u>	<u>Date Available for Resale</u>
	On the date of this offering ( _____ , _____ )
	180 days after this offering ( _____ , _____ ), subject to certain exceptions

Beginning 180 days after this offering, subject to certain exceptions, holders of shares of our common stock may require us to register their shares for resale under the federal securities laws, and holders of additional shares of our common stock would be entitled to have their shares included in any such registration statement, all subject to reduction upon the request of the underwriter of the offering, if any. See “Related Party Transactions—Arrangements With Our Investors.” Registration of those shares would allow the holders to immediately resell their shares in the public market. Any such sales or anticipation thereof could cause the market price of our common stock to decline.

In addition, after this offering, we intend to register shares of common stock that are reserved for issuance under our stock incentive plans. See “Executive and Director Compensation—Equity Incentive Plans.”

***Provisions in our certificate of incorporation and by-laws and Delaware law may discourage, delay or prevent a change of control of our company or changes in our management and, therefore, may depress the trading price of our stock.***

Our certificate of incorporation and by-laws include certain provisions that could have the effect of discouraging, delaying or preventing a change of control of our company or changes in our management, including, among other things:

- our board initially will be classified into three classes of directors with only one class subject to election each year, with a 3-year phase-out period beginning with our fifth annual meeting of stockholders following the completion of this offering;

- restrictions on the ability of our stockholders to fill a vacancy on the board of directors;
- our ability to issue preferred stock with terms that the board of directors may determine, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
- the inability of our stockholders to call a special meeting of stockholders;
- our directors may only be removed from the board of directors for cause by the affirmative vote of the holders of at least 66-2/3% of the voting power of outstanding shares of our capital stock entitled to vote generally in the election of directors;
- the absence of cumulative voting in the election of directors, which may limit the ability of minority stockholders to elect directors;
- advance notice requirements for stockholder proposals and nominations, which may discourage or deter a potential acquirer from soliciting proxies to elect a particular slate of directors or otherwise attempting to obtain control of us; and
- our by-laws may only be amended by the affirmative vote of the holders of at least 66-2/3% of the voting power of outstanding shares of our capital stock entitled to vote generally in the election of directors or by our board of directors.

Section 203 of the Delaware General Corporation Law may affect the ability of an “interested stockholder” to engage in certain business combinations, including mergers, consolidations or acquisitions of additional shares, for a period of three years following the time that the stockholder becomes an “interested stockholder.” An “interested stockholder” is defined to include persons owning directly or indirectly 15% or more of the outstanding voting stock of a corporation.

***We will incur increased costs and obligations as a result of being a public company.***

As a privately held company, we were not required to comply with certain corporate governance and financial reporting practices and policies required of a publicly-traded company. As a publicly-traded company, we will incur significant legal, accounting and other expenses that we were not required to incur in the recent past, particularly after we are no longer an “emerging growth company” as defined under the Jumpstart Our Business Startups Act of 2012, or the JOBS Act. In addition, new and changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and the rules and regulations promulgated and to be promulgated thereunder, as well as under the Sarbanes-Oxley Act of 2002, as amended (the “Sarbanes-Oxley Act”), and the rules and regulations of the Securities and Exchange Commission and the Nasdaq Stock Market, have created uncertainty for public companies and will increase our costs and the time that our board of directors and management must devote to complying with these rules and regulations. Furthermore, the need to establish the corporate infrastructure demanded of a public company may divert management’s attention from implementing our growth strategy, which could prevent us from improving our business, results of operations and financial condition.

***We are an “emerging growth company,” and any decision on our part to comply only with certain reduced reporting and disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.***

We are an “emerging growth company,” as defined in the JOBS Act, and, for as long as we continue to be an “emerging growth company,” we may choose to take advantage of exemptions from various reporting requirements applicable to other public companies but not to “emerging growth companies,” including, but not

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limited to, not being required to have our independent registered public accounting firm audit our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We may choose to take advantage of some but not all of these reduced burdens until we are no longer an “emerging growth company.” We will remain an emerging growth company until the earlier of (1) the last day of the fiscal year (a) following the fifth anniversary of the completion of this offering, (b) in which we have total annual gross revenue of at least \$1.0 billion, or (c) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30th, or (2) the date on which we have issued more than \$1.0 billion in non-convertible debt securities during the prior three-year period. We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and our stock price may be more volatile.

Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards, and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

***If you purchase shares in this offering, you will suffer immediate and substantial dilution.***

If you purchase shares of our common stock in this offering, you will incur immediate and substantial dilution in the book value of your stock, because the price that you pay will be substantially greater than the net tangible book value per share of the shares you acquire. The pro forma as adjusted net tangible book value per share, calculated as of \_\_\_\_\_, 2012 and after giving effect to the offering at an estimated initial public offering price of \$ \_\_\_\_\_ (the midpoint of the price range set forth on the cover page of this prospectus), is \$ \_\_\_\_\_, resulting in dilution of your shares of \$ \_\_\_\_\_ per share.

You will experience additional dilution upon the exercise of options and warrants to purchase our common stock, including those options currently outstanding and possibly those granted in the future, and the issuance of restricted stock or other equity awards under our stock incentive plans. To the extent we raise additional capital by issuing equity securities, our stockholders may experience substantial additional dilution. See “Dilution.”

***If securities analysts or industry analysts downgrade our stock, publish negative research or reports, or do not publish reports about our business, our stock price and trading volume could decline.***

We expect that the trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us, our business and our industry. If one or more analysts adversely change their recommendation regarding our stock or our competitors’ stock, our stock price would likely decline. If one or more analysts cease coverage of us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***Because we have no plans to pay cash dividends on our common stock for the foreseeable future, you may not receive any return on investment unless you sell your common stock for a price greater than that which you paid for it.***

We may retain future earnings, if any, for future operations, expansion and debt repayment and have no current plans to pay any cash dividends for the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our board of directors and will depend on, among other things, our results of operations, financial condition, cash requirements, contractual restrictions and other factors that our

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board of directors may deem relevant. In addition, our ability to pay dividends may be limited by covenants of any existing and future outstanding indebtedness we or our subsidiaries incur, including our credit facility. As a result, you may not receive any return on an investment in our common stock unless you sell our common stock for a price greater than that which you paid for it. See “Dividend Policy” and “Description of Credit Facility.”

*Our ability to raise capital in the future may be limited, which could make us unable to fund our capital requirements.*

Our business and operations may consume resources faster than we anticipate. In the future, we may need to raise additional funds through the issuance of new equity securities, debt or a combination of both. Additional financing may not be available on favorable terms or at all. If adequate funds are not available on acceptable terms, we may be unable to fund our capital requirements. If we issue new debt securities, the debt holders would have rights senior to common stockholders to make claims on our assets, and the terms of any debt could restrict our operations, including our ability to pay dividends on our common stock. If we issue additional equity securities, existing stockholders may experience dilution, and the new equity securities could have rights senior to those of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future securities offerings reducing the market price of our common stock and diluting their interest.

#### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes statements that express our opinions, expectations, beliefs, plans, objectives, assumptions or projections regarding future events or future results and therefore are, or may be deemed to be, “forward-looking statements.” These forward-looking statements can generally be identified by the use of forward-looking terminology, including the terms “believes,” “estimates,” “anticipates,” “expects,” “strives,” “goal,” “seeks,” “projects,” “intends,” “forecasts,” “plans,” “may,” “will” or “should” or, in each case, their negative or other variations or comparable terminology. They appear in a number of places throughout this prospectus and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industry in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We believe that these risks and uncertainties include, but are not limited to, those described in the “Risk Factors” section of this prospectus, which include, but are not limited to, the following:

- competition in the restaurant industry, which is highly competitive and includes many larger, more well-established companies;
- changes in economic conditions, including continuing effects from the recent recession, the effects of consumer confidence and discretionary spending; the future cost and availability of credit; and the liquidity or operations of our suppliers and other service providers;
- fluctuation in price and availability of commodities, including but not limited to items such as beef, poultry, grains, dairy and produce and energy supplies, where prices could increase or decrease more than we expect;
- our ability to identify new locations and expand our operations (which is dependent upon various factors such as the availability of attractive sites for new shops), negotiate suitable lease terms, obtain all required governmental permits including zoning approvals on a timely basis, control construction and development costs and obtain capital to fund such costs, and recruit, train and retain qualified operating personnel;
- changes in consumer tastes and lack of acceptance or awareness of our brand in existing or new markets; damage to our reputation caused by, for example, any perceived reduction in the quality of our food, service or staff or an adverse change in our culture, concerns regarding food safety and food-borne illness or adverse opinions about the health effects of our menu offerings;
- local, regional, national and international economic and political conditions; the seasonality of our business; demographic trends; traffic patterns and our ability to effectively respond in a timely manner to changes in traffic patterns; the cost of advertising and media; inflation or deflation; unemployment rates; interest rates; and increases in various costs, such as real estate and insurance costs;
- adverse weather conditions, local strikes, natural disasters and other disasters, especially in local or regional areas in which our shops are concentrated;
- litigation or legal complaints alleging, among other things, illness, injury or violations of federal and state workplace and employment laws and our ability to obtain and maintain required licenses and permits;
- government actions and policies; tax and other legislation; regulation of the restaurant industry; and accounting standards or pronouncements;

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- our reliance on a limited number of suppliers for our major products and on one distribution company for the majority of our national distribution program;
- security breaches of confidential customer information in connection with our electronic processing of credit and debit card transactions or the failure of our information technology system;
- our ability to adequately protect our intellectual property; and
- other factors discussed under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.”

Although we base these forward-looking statements on assumptions that we believe are reasonable when made, we caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and industry developments may differ materially from statements made in or suggested by the forward-looking statements contained in this prospectus. In addition, even if our results of operations, financial condition and liquidity, and industry developments are consistent with the forward-looking statements contained in this prospectus, those results or developments may not be indicative of results or developments in subsequent periods.

In light of these risks and uncertainties, we caution you not to place undue reliance on these forward-looking statements. Any forward-looking statement that we make in this prospectus speaks only as of the date of such statement, and we undertake no obligation to update any forward-looking statement or to publicly announce the results of any revision to any of those statements to reflect future events or developments. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless specifically expressed as such, and should only be viewed as historical data.

#### USE OF PROCEEDS

We estimate that the net proceeds we will receive from the sale of \_\_\_\_\_ shares of our common stock in this offering, after deducting underwriter discounts and commissions and estimated expenses payable by us, will be approximately \$ \_\_\_\_\_ million (approximately \$ \_\_\_\_\_ million if the underwriters exercise their option to purchase \_\_\_\_\_ additional shares in full). This estimate assumes an initial public offering price of \$ \_\_\_\_\_ per share, the midpoint of the price range set forth on the cover page of this prospectus.

A \$1.00 increase (decrease) in the assumed initial public offering price of \$ \_\_\_\_\_ per share would increase (decrease) the net proceeds to us from this offering by \$ \_\_\_\_\_ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and estimated expenses payable by us.

We intend to use the net proceeds from this offering for working capital and general corporate purposes, such as to continue to maintain our existing shops and to support our growth, primarily through opening new shops. Pending such use, we may use the net proceeds to temporarily reduce borrowings under our credit facility, which expires in September 2017. As of September 23, 2012, we had \$14.2 million outstanding under the credit facility with a weighted average interest rate of 1.35%. We may also invest the net proceeds in short- and intermediate-term interest-bearing obligations.

We will not receive any proceeds from the sale of shares of common stock by the selling stockholders. See “Principal and Selling Stockholders.”

#### DIVIDEND POLICY

We do not currently pay cash dividends on our common stock and do not anticipate paying any dividends on our common stock in the foreseeable future. Any future determinations relating to our dividend policies will be made at the discretion of our board of directors and will depend on conditions then existing, including our financial condition, results of operations, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant. In addition, our ability to pay dividends on our common stock is limited under the terms of our credit facility. See “Description of Credit Facility.”



**CAPITALIZATION**

The following table sets forth our cash and cash equivalents and our capitalization as of September 23, 2012:

- on an actual basis;
- on a pro forma basis to give effect to the conversion of all outstanding shares of all series of our preferred stock into, and the exercise of all outstanding warrants for, common stock immediately prior to this offering; and
- on a pro forma as adjusted basis to give effect to the transactions described in the bullet immediately above and (1) the sale of \_\_\_\_\_ shares of common stock in this offering by us at the estimated initial public offering price of \$ \_\_\_\_\_ per share (the midpoint of the price range set forth on the cover page of this prospectus), after deducting underwriting discounts and commissions and estimated expenses payable by us and (2) the application of the net proceeds of this offering as described under “Use of Proceeds,” as if the events had occurred on September 23, 2012.

This table should be read in conjunction with “Use of Proceeds,” “Selected Consolidated Financial and Other Data,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes appearing elsewhere in this prospectus.

	As of September 23, 2012		
	Actual	Pro Forma(1)	Pro Forma As Adjusted(1)
Cash and cash equivalents	\$ 24,954	<u>\$ 26,930</u>	<u>\$</u>
Long-term debt, including current portion:			
Credit facility	\$ 14,221	\$ 14,221	
Note payable	1,188	1,188	
Total long-term debt	<u>15,409</u>	<u>15,409</u>	
Redeemable convertible preferred stock, \$0.01 par value—17,183,632 shares authorized and 16,086,375 shares issued and outstanding on an actual basis; 17,183,632 shares authorized and no shares issued and outstanding on a pro forma basis; and no shares authorized or issued on a pro forma as adjusted basis	253,735	—	
Equity (deficit):			
Common stock, \$0.01 par value—35,500,000 shares authorized and 3,972,873 issued and outstanding on an actual basis; 35,500,000 shares authorized and 20,809,961 shares issued and outstanding on a pro forma basis; and _____ shares authorized and _____ shares issued and outstanding on a pro forma as adjusted basis	40	204	
Warrants	2,977	—	
Additional paid-in-capital	—	258,524	
Accumulated deficit	(194,315)	(194,315)	
Total stockholders’ equity (deficit)	(191,298)	64,413	
Non-controlling interests	195	195	
Total equity (deficit)	(191,103)	64,608	
Total capitalization	<u>\$ 78,041</u>	<u>\$ 80,017</u>	<u>\$</u>

(1) Assumes the conversion of all outstanding shares of all series of our preferred stock into, and the exercise of all outstanding warrants for, an aggregate of 16,897,088 shares of common stock immediately prior to the completion of this offering, and excludes outstanding options to purchase 4,446,049 shares of our common stock at a weighted average exercise price of \$9.16 per share, of which options to purchase 3,032,113 shares at a weighted average exercise price of \$9.90 were vested as of September 23, 2012. See “Executive and Director Compensation.”

## DILUTION

If you invest in our common stock, your ownership interest will experience immediate book value dilution to the extent of the difference between the initial public offering price per share of our common stock and the net tangible book value per share of our common stock after this offering. Dilution results from the fact that the initial public offering price per share of the common stock is substantially in excess of the net tangible book value per share of common stock attributable to the existing stockholders for the presently outstanding shares of common stock. Net tangible book value per share represents the amount of our total tangible assets less our total liabilities, divided by the number of shares of our common stock outstanding.

Our pro forma net tangible book value at September 23, 2012 was approximately \$       million, or \$       per share of our common stock, after taking into account the conversion of our outstanding shares of our preferred stock and the exercise of our outstanding warrants but before giving effect to this offering. Dilution in net tangible book value per share represents the difference between the amount per share that you pay in this offering and the net tangible book value per share immediately after this offering.

After giving effect to our sale of shares in this offering and the conversion of our outstanding shares of our preferred stock and the exercise of our outstanding warrants, assuming an initial public offering price of \$       per share (the midpoint of the price range set forth on the cover page of this prospectus), and the application of the estimated net proceeds as described under "Use of Proceeds," our pro forma as adjusted net tangible book value at September 23, 2012 would have been approximately \$       million, or \$       per share of common stock. This represents an immediate increase in net tangible book value per share of \$       to existing stockholders and an immediate and substantial dilution of \$       per share to new investors. The following table illustrates this dilution per share.

Assumed initial public offering price per share of common stock		\$
Pro forma net tangible book value per share at September 23, 2012	\$	
Increase per share attributable to new investors in the offering		
Pro forma as adjusted net tangible book value per share of common stock after this offering		\$
Dilution per share to new investors		\$

If the underwriters were to fully exercise their option to purchase additional shares of our common stock, the pro forma as adjusted net tangible book value per share of our common stock after giving effect to this offering would be \$       per share of our common stock. This represents an increase in net tangible book value of \$       per share of our common stock to existing stockholders and dilution of \$       per share of our common stock to new investors.

A \$1.00 increase (decrease) in the assumed initial public offering price of \$       per share of our common stock would increase (decrease) our net tangible book value after giving effect to the offering by \$       million, or by \$       per share of our common stock, assuming no change to the number of shares of our common stock offered by us as set forth on the cover page of this prospectus, and after deducting the estimated underwriting discounts and commissions and estimated expenses payable by us.

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The following table sets forth, as of September 23, 2012, the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid by existing stockholders and to be paid by new investors purchasing shares of common stock in this offering, before deducting underwriting discounts and commissions and estimated offering expenses payable by us.

	Shares Purchased			Total Consideration	Average price per share
	Number	Percent	Amount (in thousands)	Percent	
Existing stockholders		%	\$	%	\$
New investors					
Total		100.0%	\$	100.0%	

If the underwriters were to exercise in full their option to purchase additional shares of our common stock, the percentage of shares of our common stock held by existing stockholders would be %, and the percentage of shares of our common stock held by new investors would be %.

The discussion and tables above assume the conversion of all outstanding shares of our preferred stock into, and the exercise of all outstanding warrants for, an aggregate of 16,897,088 shares of common stock immediately prior to the completion of this offering and excludes, as of September 23, 2012:

- outstanding options to purchase 4,446,049 shares of our common stock at a weighted average exercise price of \$9.16 per share, of which options to purchase 3,032,113 shares at a weighted average exercise price of \$9.90 were vested as of September 23, 2012; and
- shares of our common stock reserved for future grants under our 2013 Long-Term Incentive Plan, which we intend to adopt in connection with this offering.

To the extent any outstanding options or other equity awards are exercised or become vested or any additional options or other equity awards are granted and exercised or become vested or other issuances of shares of our common stock are made, there may be further economic dilution to new investors.

**SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA**

The following table sets forth our selected consolidated financial and other data as of the dates and for the periods indicated. The selected consolidated financial data as of December 25, 2011 and December 26, 2010 and for each of the two fiscal years in the period ended December 25, 2011 presented in this table have been derived from our audited consolidated financial statements included elsewhere in this prospectus. The selected consolidated financial data as of December 27, 2009, December 28, 2008 and December 30, 2007 and for the fiscal years then ended have been derived from our unaudited consolidated financial statements for such years, which are not included in this prospectus. The selected consolidated interim financial data as of and for the 39 weeks ended September 23, 2012 and for the 39 weeks ended September 25, 2011 have been derived from the unaudited condensed interim consolidated financial statements included elsewhere in this prospectus. The unaudited financial information for the 52 weeks ended September 23, 2012 has been derived by adding our financial information for the fiscal year ended December 25, 2011 to the unaudited financial information for the 39 weeks ended September 23, 2012 and subtracting the unaudited financial information for the 39 weeks ended September 25, 2011. We believe that presentation of unaudited financial information for these 52-week periods is useful to investors because it presents information about how our business has performed in the 52-week period immediately preceding the date of our most recent interim financial statements, which allows investors to review our current performance trends over a full 52-week period, and because it presents results for four consecutive quarters, which presentation compensates for seasonal factors that might influence results in a particular quarter within the year. Historical results are not necessarily indicative of future results, and our interim results are not necessarily indicative of the results to be expected for the full fiscal year.

Our fiscal year ends on the last Sunday of each year. The first three quarters of our fiscal year consist of 13 weeks and our fourth quarter consists of 13 weeks for 52-week fiscal years and 14 weeks for 53-week fiscal years. The fiscal years ended December 25, 2011, December 26, 2010, December 27, 2009, December 28, 2008 and December 30, 2007 all had 52 weeks. The fiscal year ending December 30, 2012 will have 53 weeks.

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This selected consolidated financial and other data should be read in conjunction with the disclosure set forth under “Risk Factors,” “Capitalization,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and the related notes thereto appearing elsewhere in this prospectus.

	Fiscal Year Ended					39 Weeks Ended		52 Weeks Ended
	December 30, 2007	December 28, 2008	December 27, 2009	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
(\$ in thousands, except per share data)								
<b>Consolidated Statements of Operations Data:</b>								
<b>Total Revenues</b>	\$ 177,505	\$ 207,686	\$ 214,733	\$ 220,573	\$ 237,966	\$ 176,651	\$ 201,406	\$ 262,721
<b>Expenses:</b>								
Sandwich shop operating expenses:								
Cost of goods sold, excluding depreciation	52,499	62,612	61,700	63,009	68,491	50,784	58,389	76,096
Labor and related expenses	55,852	66,756	63,939	63,506	67,036	49,865	56,618	73,789
Occupancy expenses	17,612	23,429	25,574	25,238	26,511	19,493	22,885	29,903
Other operating expenses	17,615	22,752	22,373	22,620	24,095	17,899	20,767	26,963
General and administrative expenses	25,027	30,785	27,840	26,563	26,911	20,308	22,542	29,145
Depreciation expense	14,126	17,599	17,586	15,647	14,838	11,085	11,633	15,386
Pre-opening costs	2,532	1,887	95	267	1,521	1,046	1,760	2,235
Impairment and loss on disposal of property and equipment	60	2,852	5,511	2,952	365	29	78	414
Total expenses	185,323	228,672	224,618	219,802	229,768	170,509	194,672	253,931
Income (loss) from operations	(7,818)	(20,986)	(9,885)	771	8,198	6,142	6,734	8,790
Interest expense (income)	(573)	681	828	519	495	359	427	563
Other expense (income)	4	20	4	9	1	(2)	6	9
Income (loss) before income taxes	(7,249)	(21,687)	(10,717)	243	7,702	5,785	6,301	8,218
Income tax expense	206	121	219	773	537	591	765	711
Net income (loss)	(7,455)	(21,808)	(10,936)	(530)	7,165	5,194	5,536	7,507
Net income (loss) attributable to non-controlling interests (1)	—	—	—	—	—	—	(35)	(35)
Net income (loss) attributable to Potbelly Corporation	\$ (7,455)	\$ (21,808)	\$ (10,936)	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,571	\$ 7,542
Accretion of redeemable convertible preferred stock to maximum redemption value	21,968	8,814	(14,568)	(45,992)	(17,410)	(9,011)	(13,887)	(16,609)
Net loss attributable to common stockholders	\$ 14,513	\$ (12,994)	\$ (25,504)	\$ (46,522)	\$ (10,245)	\$ (3,817)	\$ (8,316)	\$ (9,067)
Net loss per common share attributable to common stockholders (2):								
Basic	\$ (1.52)	\$ (4.40)	\$ (5.13)	\$ (9.34)	\$ (2.35)	\$ (0.85)	\$ (2.09)	\$ (2.29)
Diluted	\$ (1.52)	\$ (4.40)	\$ (5.13)	\$ (9.34)	\$ (2.35)	\$ (0.85)	\$ (2.09)	\$ (2.29)
Weighted average shares outstanding:								
Basic	4,896,891	4,960,984	4,975,511	4,978,621	4,359,930	4,503,982	3,972,873	3,962,294
Diluted	4,896,891	4,960,984	4,975,511	4,978,621	4,359,930	4,503,982	3,972,873	3,962,294

	Fiscal Year Ended					39 Weeks Ended		52 Weeks Ended
	December 30, 2007	December 28, 2008	December 27, 2009	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
(\$ in thousands, except per share data)								
<b>Statement of Cash Flows Data:</b>								
Net cash provided by (used in):								
Operating activities	\$ 15,719	\$ 5,195	\$ 11,277	\$ 18,780	\$ 20,121	\$ 10,839	\$ 20,457	\$ 29,740
Investing activities	(36,110)	(24,856)	(4,385)	(6,243)	(17,758)	(13,070)	(19,700)	(24,388)
Financing activities	433	21,219	5,152	(4,382)	(7,197)	(7,659)	51	513
<b>Selected Other Data:</b>								
Total company-operated shops (end of period)	182	214	213	218	234	231	257	257
Total comparable stores (end of period)	122	165	205	211	211	211	221	221
Change in comparable store sales	5.4%	(4.3)%	(2.4)%	1.8%	1.7%	1.3%	3.9%	3.7%
Operating income margin (3)	(4.4)%	(10.1)%	(4.6)%	0.3%	3.4%	3.5%	3.3%	3.3%
Shop-level profit margin (4)	19.1%	15.5%	19.2%	20.9%	21.6%	21.7%	21.0%	21.1%
Capital expenditures	\$ 34,556	\$ 24,856	\$ 4,398	\$ 6,243	\$ 17,758	\$ 13,070	\$ 19,700	\$ 24,388
Adjusted EBITDA (5)	\$ 10,818	\$ 4,038	\$ 15,732	\$ 21,051	\$ 26,752	\$ 19,670	\$ 22,741	\$ 29,823
Adjusted EBITDA margin (5)	6.1%	1.9%	7.3%	9.5%	11.2%	11.1%	11.3%	11.4%

	December 30, 2007	December 28, 2008	December 27, 2009	December 26, 2010	December 25, 2011	September 23, 2012
	(\$ in thousands)					
<b>Balance Sheet Data:</b>						
Cash and cash equivalents	\$ 7,223	\$ 8,781	\$ 20,825	\$ 28,980	\$ 24,146	\$ 24,954
Working capital (deficit)	(5,050)	(4,142)	6,014	14,764	16,490	15,204
Total assets	104,054	107,440	101,976	98,424	99,110	108,797
Total debt	865	13,440	13,544	9,313	15,243	15,409
Total redeemable convertible preferred stock	176,797	167,983	182,551	228,544	239,848	253,735
Total equity (deficit)	(105,105)	(105,859)	(124,712)	(169,643)	(185,302)	(191,103)

- (1) Non-controlling interests represent 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. We own a seventy-five percent interest in this consolidated joint venture.
- (2) Net loss per common share attributable to common stockholders is calculated under the two-class method, as our redeemable convertible preferred stock participates in the undistributed earnings of the company. Earnings of the company are allocated between the common and preferred stockholders to account for the accretion of the redeemable convertible preferred stock to its maximum redemption value, thereby reducing the earnings of the company attributable to common stockholders. For the periods presented, this resulted in net losses attributable to common stockholders, in total and on a per share basis, as the net income attributable to the company (if any) was exceeded by the change in maximum redemption value of the redeemable convertible preferred stock.
- (3) Income (loss) from operations as a percentage of total revenues.
- (4) Shop-level profit is not required by, or presented in accordance with, U.S. generally accepted accounting principles, or GAAP, and is defined as income (loss) from operations less franchise royalties and fees, general and administrative expenses, depreciation expense, pre-opening costs and impairment and loss on disposal of property and equipment. Shop-level profit is a supplemental measure of operating performance of our shops and our calculation thereof may not be comparable to that reported by other companies. Shop-level profit margin represents shop-level profit expressed as a percentage of net company-operated sandwich shop sales. Shop-level profit and shop-level profit margin have limitations as analytical tools, and you should not consider them in isolation or as a substitute for analysis of our results as reported under GAAP. Management believes shop-level profit margin is an important tool for investors because it is a widely used metric within the restaurant industry to evaluate restaurant-level productivity, efficiency and performance. Management uses shop-level profit margin as a key metric to evaluate the profitability of incremental sales at our shops, to evaluate our shop performance across periods and to evaluate our shop financial performance compared with our competitors. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of shop-level profit margin and other key performance indicators.

A reconciliation of shop-level profit to income (loss) from operations and a calculation of shop-level profit margin is provided below:

	Fiscal Year Ended					39 Weeks Ended		52 Weeks Ended
	December 30, 2007	December 28, 2008	December 27, 2009	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
	(\$ in thousands)							
Income (loss) from operations	\$ (7,818)	\$ (20,986)	\$ (9,885)	\$ 771	\$ 8,198	\$ 6,142	\$ 6,734	\$ 8,790
Less: Franchise royalties and fees	—	—	—	—	503	348	553	708
General and administrative expenses	25,027	30,785	27,840	26,563	26,911	20,308	22,542	29,145
Depreciation expense	14,126	17,599	17,586	15,647	14,838	11,085	11,633	15,386
Pre-opening costs	2,532	1,887	95	267	1,521	1,046	1,760	2,235
Impairment and loss on disposal of property and equipment	60	2,852	5,511	2,952	365	29	78	414
Shop-level profit [Y]	<u>\$ 33,927</u>	<u>\$ 32,137</u>	<u>\$ 41,147</u>	<u>\$ 46,200</u>	<u>\$ 51,330</u>	<u>\$ 38,262</u>	<u>\$ 42,194</u>	<u>\$ 55,262</u>
Total revenues	\$ 177,505	\$ 207,686	\$ 214,733	\$ 220,573	\$ 237,966	\$ 176,651	\$ 201,406	\$ 262,721
Less: Franchise royalties and fees	—	—	—	—	503	348	553	708
Sandwich shop sales, net [X]	<u>177,505</u>	<u>207,686</u>	<u>214,733</u>	<u>220,573</u>	<u>237,463</u>	<u>176,303</u>	<u>200,853</u>	<u>262,013</u>
Shop-level profit margin [Y÷X]	19.1%	15.5%	19.2%	20.9%	21.6%	21.7%	21.0%	21.1%

- (5) Adjusted EBITDA has been presented in this prospectus and is a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We define adjusted EBITDA as net income (loss) before depreciation and amortization expense, interest expense, provision for income taxes and pre-opening costs, adjusted to eliminate the impact of other items set forth in the reconciliation below, including certain non-cash as well as certain other items that we do not consider representative of our ongoing operating performance. Adjusted EBITDA margin is calculated by dividing adjusted EBITDA by total revenues. Adjusted EBITDA has limitations as an analytical tool and our calculation thereof may not be comparable to that reported by other companies; accordingly, you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Adjusted EBITDA is included in this prospectus because it is a key metric used by management. Additionally, adjusted EBITDA is frequently used by analysts, investors and other interested parties to evaluate companies in our industry. We use adjusted EBITDA, alongside other GAAP measures such as operating income (loss) and net income (loss), to measure profitability, as a key profitability target in our annual and other budgets, and to compare our performance against that of peer companies. We believe that adjusted EBITDA provides useful information facilitating operating performance comparisons from period to period and company to company.

A reconciliation of adjusted EBITDA to net income (loss) attributable to Potbelly Corporation is provided below:

	Fiscal Year Ended					39 Weeks Ended		52 Weeks Ended
	December 30, 2007	December 28, 2008	December 27, 2009	December 26, 2010	December 25, 2011	September 25, 2011	September 23, 2012	September 23, 2012
	(\$ in thousands)							
<b>Net income (loss) attributable to Potbelly Corporation</b>	\$ (7,455)	\$ (21,809)	\$ (10,936)	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,571	\$ 7,542
Depreciation expense	14,126	17,599	17,586	15,647	14,838	11,085	11,633	15,386
Interest expense (income)	(573)	681	828	519	495	359	427	563
Income tax expense	206	121	219	773	537	591	765	711
Impairment and closures (a)	60	3,343	6,824	3,344	672	299	265	638
Pre-opening costs (b)	2,532	1,887	95	267	1,521	1,046	1,760	2,235
Stock-based compensation (c)	1,922	2,216	1,116	1,031	1,524	1,096	2,320	2,748
<b>Adjusted EBITDA</b>	<u>\$ 10,818</u>	<u>\$ 4,038</u>	<u>\$ 15,732</u>	<u>\$ 21,051</u>	<u>\$ 26,752</u>	<u>\$ 19,670</u>	<u>\$ 22,741</u>	<u>\$ 29,823</u>

- 
- (a) Includes costs related to impairment of long-lived assets, gain or loss on disposal of property and equipment and shop closure expenses.
  - (b) Includes expenses directly associated with the opening of new shops and are incurred prior to the opening of a new shop.
  - (c) Includes non-cash stock-based compensation.



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion of our financial condition and results of operations should be read in conjunction with the "Selected Consolidated Financial and Other Data" and the audited and unaudited historical consolidated financial statements and related notes. This discussion contains forward-looking statements about our markets, the demand for our products and services and our future results 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" for a discussion of factors that could cause our actual results to differ from those expressed or implied by forward-looking statements.

Operating results are reported on a 52-week fiscal year calendar, with a 53-week year occurring every seventh year. Our fiscal year ends on the last Sunday of each year. Fiscal years 2011 and 2010 were 52-week years. References to fiscal years 2011 and 2010 are references to fiscal years ended December 25, 2011 and December 26, 2010, respectively. Fiscal year 2012 will include a 53rd week. The first three quarters of our fiscal year consist of 13 weeks and our fourth quarter consists of 13 weeks for 52-week fiscal years and 14 weeks for 53-week fiscal years.

We own and operate Potbelly Sandwich Works sandwich shops in the United States. We also have domestic and international franchise operations of Potbelly Sandwich Works sandwich shops. Our chief operating decision maker is our Chief Executive Officer. Based on how our Chief Executive Officer reviews financial performance and allocates resources on a recurring basis, the company has one operating segment and one reportable segment.

**Overview**

Potbelly is a fast-growing neighborhood sandwich concept offering toasty warm sandwiches, signature salads and other fresh menu items served by welcoming people in a unique environment. 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 creating 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.

## Outlook

Potbelly operates in a highly competitive segment of the restaurant industry. We compete with sandwich concepts that have significant scale and presence, as well as with the multitude of locally-owned sandwich shops. Additionally, we compete with many non-sandwich concepts that fall into the limited-service restaurants category. However, we believe that we will continue to succeed in the marketplace based on our combination of excellent product, people and place. The following competitive strengths provide a platform for us to achieve continued growth:

- *Simple, Wholesome Food.* Our menu features wholesome food made from high quality ingredients such as fresh vegetables, artisanal-style hearth-baked bread, and all-natural chicken (without preservatives or artificial flavors). Our sandwiches are made fresh to order and served toasty warm on our signature multigrain wheat or regular bread. Our menu also features a variety of cookies baked fresh daily in each shop, and our hand-dipped shakes, malts and smoothies are made from real, wholesome ingredients. We believe the unique Potbelly experience encourages repeat customer visits and drives increased sales.
- *Differentiated Customer Experience That Delivers a Neighborhood Feel.* We strive to provide a positive customer experience that is driven by both our employees and the atmosphere of our shops. We look to hire employees that are outgoing people and train them to interact with our customers in a genuine way while providing fast service. We believe our atmosphere is enhanced by live, local musicians that perform at least three times per week in the majority of our shops. Every Potbelly location strives to the “The Neighborhood Sandwich Shop,” creating devoted fans who tell others about their experience.
- *Attractive Shop Economics.* Our shop model is designed to generate, and has generated, strong cash flow, with above 20% shop-level profit margins, a non-GAAP measure, and cash-on-cash returns exceeding 25%. We have achieved these targets in 2010, 2011 and the 52 weeks ended September 23, 2012. Our ability to maintain such margins and returns depends on a number of factors. For example, we face increasing commodity costs, which we have partially offset by increasing menu prices. Although there is no guarantee that we will be able to maintain these returns, we believe our shop economics support our ability to profitably grow our brand in new and existing markets.
- *Management Team with Substantial Operating Experience.* Our senior management team has extensive operating experience across disciplines in the restaurant and retail sectors. Our senior team, led by our CEO, Aylwin Lewis, averages over 16 years of restaurant industry experience and embraces the daily intensity needed to deliver growth in existing shops as well as growing the business in new neighborhoods. We believe our experienced leadership team is a key driver of our success and positions us to execute our long-term growth strategy.
- *Distinct, Deep-Rooted Culture: The Potbelly Advantage.* We believe our culture is a key to our success. It is embodied in *The Potbelly Advantage*, which is an expression of our Vision, Mission, Passion and Values. *The Potbelly Advantage* is a statement of our intentions and is the foundation of everything we do, including how we plan and manage our business. It allows us to deliver operational excellence and grow our business and our base of devoted fans.

We believe the combination of these strengths provides a competitive advantage in the marketplace. Continuing to execute at a high level across all aspects of our business is imperative to realize the growth potential for Potbelly. We are confident in our strategies, our people and the opportunity to make Potbelly a “Global Iconic Brand.”

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### **Key Performance Indicators**

In assessing the performance of our business, we consider a variety of performance and financial measures. The key measures for determining how our business is performing are comparable store sales growth, number of shop openings, shop-level profit margins and adjusted EBITDA.

#### *Comparable Store Sales Growth*

Comparable store sales growth reflects the change in year-over-year sales for the comparable company-operated store base. We define the comparable store base to include those shops open for 15 months or longer. As of the fiscal years ended December 26, 2010 and December 25, 2011 and the 39 weeks ended September 23, 2012, there were 211, 211 and 221 shops, respectively, in our comparable store base. Comparable store sales growth can be generated by an increase in entree counts and/or by increases in the average check amount resulting from a shift in menu mix and/or increase in price. This measure highlights performance of existing shops as the impact of new shop openings is excluded. Entree counts are defined as sandwiches, salads and bowls of soup.

#### *Number of Company-operated Shop Openings*

The number of company-operated shop openings reflects the number of shops opened during a particular reporting period. Before we open new shops, we incur pre-opening costs, which are defined below. Often, new shops open with an initial start-up period of higher than normal sales volumes, which subsequently decrease to stabilized levels. While sales volumes are generally higher during the initial opening period, new shops typically experience normal inefficiencies in the form of higher cost of sales, labor and other direct operating expenses and as a result, shop-level profit margins are generally lower during the start-up period of operation. The average start-up period is 10 to 13 weeks. The number and timing of shop openings has had, and is expected to continue to have, an impact on our results of operations.

#### *Shop-Level Profit Margin*

Shop-level profit margin is defined as net company-operated sandwich shop sales less company-operated sandwich shop operating expenses, including cost of goods sold, labor and related expenses, other operating expenses and occupancy expenses, as a percentage of net company-operated sandwich shop sales. Shop-level profit margin is not required by, or presented in accordance with, GAAP. We believe shop-level profit margin is important in evaluating shop-level productivity, efficiency and performance.

#### *Adjusted EBITDA*

We define adjusted EBITDA as net income (loss) before depreciation and amortization, interest expense and provision for income taxes, adjusted for the impact of the following items that we do not consider representative of our ongoing operating performance: stock-based compensation expense, impairment and shop closure expenses, gain or loss on disposal of property and equipment and pre-opening expenses. We believe that adjusted EBITDA is a more appropriate measure of operating performance, as it provides a clearer picture of operating results by eliminating expenses that are not reflective of underlying business performance.

### **Key Financial Definitions**

#### *Revenues*

We generate revenue from net company-operated sandwich shop sales and our franchise operations.

Net company-operated shop sales consist of food and beverage sales, net of promotional allowances and employee meals. Company-operated shop sales are influenced by new shop openings and comparable store sales.

Franchise royalties and fees consist of royalty income from the franchisee and a one-time upfront fee.

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### *Cost of Goods Sold*

Cost of goods sold consists primarily of food and beverage related costs. The components of cost of goods sold are variable in nature, change with sales volume, are influenced by menu mix and are subject to increases or decreases based on fluctuations in commodity costs.

### *Labor and Related Expenses*

Labor and related expenses include all shop-level management and hourly labor costs, including salaries, wages, benefits and performance incentives, labor taxes and other indirect labor costs.

### *Occupancy Expenses*

Occupancy expenses include fixed and variable portions of rent, common area maintenance and real estate taxes.

### *Other Operating Expenses*

Other operating expenses include all other shop-level operating costs, the major components of which are operating supplies, utilities, repair and maintenance costs, shop-level marketing costs, musician expense and credit card fees.

### *General and Administrative Expenses*

General and administrative expenses is comprised of expenses associated with corporate and administrative functions that support the development and operations of shops, including compensation and benefits, travel expenses, stock compensation costs, legal and professional fees, advertising costs, costs related to abandoned new shop development sites and other related corporate costs.

### *Depreciation Expense*

Depreciation expense includes the depreciation of fixed assets and capitalized leasehold improvements.

### *Pre-Opening Costs*

Pre-opening costs consist of costs incurred prior to opening a new shop and are made up primarily of manager salaries, travel, employee payroll and training costs incurred prior to the shop opening, as well as occupancy costs incurred from when we take site possession to shop opening. Shop pre-opening costs are expensed as incurred.

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

We review long-lived assets, such as property and equipment and intangibles, for impairment when events or circumstances indicate the carrying value of the assets may not be recoverable and record an impairment charge when appropriate. The impairment loss recognized is the excess of the carrying value of the asset over its fair value. Typically, the fair value of the asset is determined by estimating future cash flows associated with the asset.

Loss on disposal of property and equipment represents the net book value of property and equipment less proceeds received, if applicable, on assets abandoned or sold. These losses are related to normal disposals in the ordinary course of business, along with disposals related to shop closures and selected shop remodeling activities.

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*Interest Expense*

Interest expense consists primarily of interest expense related to our credit facility.

*Non-controlling Interests*

Non-controlling interests represent 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.

*Accretion of Redeemable Convertible Preferred Stock to Maximum Redemption Value*

Accretion of redeemable convertible preferred stock reflects the changes in measurement of the redeemable convertible preferred stock each reporting period to record the redeemable convertible preferred stock at its maximum redemption value at each reporting period.

**39 Weeks Ended September 23, 2012 Compared to 39 Weeks Ended September 25, 2011**

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

	39 Weeks Ended				Increase (Decrease)	Percent Change
	September 25, 2011	% of Revenues	September 23, 2012	% of Revenues		
<b>Revenues</b>						
Sandwich shop sales, net	\$ 176,303	99.8%	\$ 200,853	99.7%	\$ 24,550	13.9%
Franchise royalties and fees	348	0.2	553	0.3	205	58.9
<b>Total revenues</b>	<u>176,651</u>	<u>100.0</u>	<u>201,406</u>	<u>100.0</u>	<u>24,755</u>	<u>14.0</u>
<b>Expenses</b>						
Sandwich shop operating expenses						
Cost of goods sold, excluding depreciation	50,784	28.7	58,389	29.0	7,605	15.0
Labor and related expenses	49,865	28.2	56,618	28.1	6,753	13.5
Occupancy expenses	19,493	11.0	22,885	11.4	3,392	17.4
Other operating expenses	17,899	10.1	20,767	10.3	2,868	16.0
General and administrative expenses	20,308	11.5	22,542	11.2	2,234	11.0
Depreciation expense	11,085	6.3	11,633	5.8	548	4.9
Pre-opening costs	1,046	0.6	1,760	0.9	714	68.3
Impairment and loss on disposal of property and equipment	29	*	78	*	49	169.0
<b>Total expenses</b>	<u>170,509</u>	<u>96.5</u>	<u>194,672</u>	<u>96.7</u>	<u>24,163</u>	<u>14.2</u>
Income from operations	6,142	3.5	6,734	3.3	592	9.6
Interest expense	359	0.2	427	0.2	68	18.9
Other expense (income)	(2)	*	6	*	8	—
Income before income taxes	5,785	3.3	6,301	3.1	516	8.9
Income tax expense	591	0.3	765	0.4	174	29.4
Net income	5,194	2.9	5,536	2.7	342	6.6
Net income (loss) attributable to non-controlling interests	—	—	(35)	*	(35)	—
Net income attributable to Potbelly Corporation	5,194	2.9	5,571	2.8	377	7.3
Accretion of redeemable convertible preferred stock to maximum redemption value	(9,011)	(5.1)	(13,887)	(6.9)	(4,876)	(54.1)
<b>Net loss attributable to common stockholders</b>	<u>\$ (3,817)</u>	<u>(2.2)%</u>	<u>\$ (8,316)</u>	<u>(4.1)%</u>	<u>\$ (4,499)</u>	<u>(117.9)%</u>

\* Amount is less than 0.1%.

Percentages reflected may not compute to the percentages that precede them due to rounding adjustments.

*Revenues*

Revenues increased by \$24.8 million, or 14.0%, to \$201.4 million during the 39 weeks ended September 23, 2012, from \$176.7 million during the 39 weeks ended September 25, 2011. Company-operated non-comparable store sales

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contributed \$18.0 million, or 72.6%, of the total revenue increase, company-operated comparable store sales contributed \$6.6 million, or 26.6% of the total revenue increase, and franchise shops contributed \$0.2 million, or 0.8% of the total revenue increase. Comparable store sales increased 3.9% as a result of a 3.2% increase in average check, driven by price increases and a shift in menu mix, and a 0.7% increase in entree counts.

### *Cost of Goods Sold*

Cost of goods sold increased by \$7.6 million, or 15.0%, to \$58.4 million during the 39 weeks ended September 23, 2012, from \$50.8 million during the 39 weeks ended September 25, 2011, primarily due to the increase in revenues. As a percentage of revenues, cost of goods sold increased to 29.0% in the 39 weeks ended September 23, 2012, from 28.7% in the 39 weeks ended September 25, 2011. The increase in cost of goods sold as a percentage of revenues was primarily driven by higher commodity costs partially offset by menu price increases.

### *Labor and Related Expenses*

Labor and related expenses increased by \$6.8 million, or 13.5%, to \$56.6 million during the 39 weeks ended September 23, 2012, from \$49.9 million during the 39 weeks ended September 25, 2011, primarily due to additional labor costs associated with new shops. As a percentage of revenues, labor and related expenses decreased to 28.1% for the 39 weeks ended September 23, 2012, compared to 28.2% for the 39 weeks ended September 25, 2011, primarily driven by labor productivity improvements offset by higher payroll tax rates.

### *Occupancy Expenses*

Occupancy expenses increased by \$3.4 million, or 17.4%, to \$22.9 million during the 39 weeks ended September 23, 2012, from \$19.5 million during the 39 weeks ended September 25, 2011, primarily due to new shop openings. As a percentage of revenues, occupancy expenses increased to 11.4% in the 39 weeks ended September 23, 2012, from 11.0% in the 39 weeks ended September 25, 2011, due to more shop openings in higher rent markets, specifically New York City and Boston. There were 14 company-operated shops in New York City and Boston as of September 23, 2012, compared to three company-operated shops as of September 25, 2011.

### *Other Operating Expenses*

Other operating expenses increased by \$2.9 million, or 16.0%, to \$20.8 million during the 39 weeks ended September 23, 2012, from \$17.9 million during the 39 weeks ended September 25, 2011, mainly due to new shop openings as well as an increase in fees associated with higher credit card usage in our shops. As a percentage of revenues, operating expenses increased to 10.3% in the 39 weeks ended September 23, 2012, from 10.1% in the 39 weeks ended September 25, 2011, driven by the increase in credit card usage.

### *General and Administrative Expenses*

General and administrative expenses increased by \$2.2 million, or 11.0%, to \$22.5 million during the 39 weeks ended September 23, 2012, from \$20.3 million during the 39 weeks ended September 25, 2011, primarily due to \$0.9 million in stock-based compensation expense related to warrants, \$0.7 million increase in corporate personnel and \$0.4 million in initial public offering planning costs. As a percentage of revenues, general and administrative expenses decreased to 11.2% in the 39 weeks ended September 23, 2012, from 11.5% in the 39 weeks ended September 25, 2011, driven by sales leverage (i.e., the ability to spread certain expenses over a higher revenue base).

### *Depreciation Expense*

Depreciation expense increased by \$0.5 million, or 4.9%, to \$11.6 million for the 39 weeks ended September 23, 2012, from \$11.1 million for the 39 weeks ended September 25, 2011, primarily due to a higher depreciable base from newly opened shops. As a percentage of revenue, depreciation decreased to 5.8% from 6.3%, primarily driven by greater coverage of the depreciable asset base due to the increase in revenue.

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*Pre-Opening Costs*

Pre-opening costs increased by approximately \$0.8 million, or 68.3%, to \$1.8 million for the 39 weeks ended September 23, 2012, from \$1.0 million for the 39 weeks ended September 25, 2011, mainly due to an increase in the number of new shop openings and, notably, initial investments in new markets such as New York City, Boston and Phoenix. There were 24 new company-operated shop openings during the 39 weeks ended September 23, 2012, compared to 16 new company-operated shop openings during the 39 weeks ended September 25, 2011.

*Interest Expense*

Interest expense increased by \$0.1 million, or 18.9%, primarily due to additional debt incurred related to the repurchase of preferred and common shares in June of 2011. Outstanding debt was \$15.4 million as of September 23, 2012, as compared to \$15.2 million as of September 25, 2011.

*Income Tax Expense*

Income tax expense increased by \$0.2 million, or 29.4%, to \$0.8 million during the 39 weeks ended September 23, 2012, from \$0.6 million during the 39 weeks ended September 25, 2011, primarily due to higher pre-tax income and an increase in the effective income tax rate to 12.1% from 10.2%. We have a full valuation allowance against all deferred tax assets. As a result, our income tax expense primarily relates to current state income taxes payable and the increase in our effective tax rate is due to certain states suspending the utilization of net operating losses against taxable income, as well as changes in state statutory tax rates.

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**Fiscal Year 2011 Compared to Fiscal Year 2010**

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

	Fiscal Year				Increase (Decrease)	Percent Change
	2010	% of Revenues	2011	% of Revenues		
<b>Revenues</b>						
Sandwich shop sales, net	\$ 220,573	100.0%	\$ 237,463	99.8%	\$ 16,890	7.7%
Franchise royalties and fees	—	—	503	0.2	503	—
Total revenues	<u>220,573</u>	<u>100.0</u>	<u>237,966</u>	<u>100.0</u>	<u>17,393</u>	<u>7.9</u>
<b>Expenses</b>						
Sandwich shop operating expenses						
Cost of goods sold, excluding depreciation	63,009	28.6	68,491	28.8	5,482	8.7
Labor and related expenses	63,506	28.8	67,036	28.2	3,530	5.6
Occupancy expenses	25,238	11.4	26,511	11.1	1,273	5.0
Other operating expenses	22,620	10.3	24,095	10.1	1,475	6.5
General and administrative expenses						
Depreciation expense	15,647	7.1	14,838	6.2	(809)	(5.2)
Pre-opening costs	267	0.1	1,521	0.6	1,254	469.7
Impairment and loss on disposal of property and equipment	2,952	1.3	365	0.2	(2,587)	(87.6)
Total expenses	<u>219,802</u>	<u>99.7</u>	<u>229,768</u>	<u>96.6</u>	<u>9,966</u>	<u>4.5</u>
Income from operations	771	0.3	8,198	3.4	7,427	963.3
Interest expense	519	0.2	495	0.2	(24)	(4.6)
Other expense	9	*	1	*	(8)	(88.9)
Income before income taxes	243	0.1	7,702	3.2	7,459	3,069.5
Income tax expense	773	0.4	537	0.2	(236)	(30.5)
Net income (loss)	<u>(530)</u>	<u>(0.2)</u>	<u>7,165</u>	<u>3.0</u>	<u>7,695</u>	<u>—</u>
Net income (loss) attributable to non-controlling interest						
Net income (loss) attributable to Potbelly Corporation	(530)	(0.2)%	7,165	3.0	7,695	—
Accretion of redeemable convertible preferred stock to maximum redemption value	(45,992)	(20.9)	(17,410)	(7.3)	28,582	62.1
Net loss attributable to common stockholders	<u>\$ (46,522)</u>	<u>(21.1)%</u>	<u>\$ (10,245)</u>	<u>(4.3)%</u>	<u>\$ 36,277</u>	<u>78.0%</u>

\* Amount is less than 0.1%.

Percentages reflected may not compute to the percentages that precede them due to rounding adjustments.

*Revenues*

Revenues increased by \$17.4 million, or 7.9%, to \$238.0 million for fiscal year 2011, from \$220.6 million for fiscal year 2010. Company-operated non-comparable store sales contributed \$13.2 million, or 75.8%, of the total revenue increase, company-operated comparable store sales contributed \$3.7 million, or 21.3%, of the total revenue increase, and franchise shops contributed \$0.5 million, or 2.9%, of the total revenue increase. Comparable store sales increased 1.7% as a result of a 1.4% increase in average check, primarily due to a shift in menu mix, and a 0.3% increase in entree counts.



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### *Cost of Goods Sold*

Cost of goods sold increased by \$5.5 million, or 8.7%, to \$68.5 million for fiscal year 2011, compared to \$63.0 million for fiscal year 2010, due to the increase in revenues. As a percentage of revenues, cost of goods sold increased slightly to 28.8% for fiscal year 2011, from 28.6% for fiscal year 2010, primarily driven by higher commodity costs.

### *Labor and Related Expenses*

Labor and related expenses increased by \$3.5 million, or 5.6%, to \$67.0 million for fiscal year 2011, from \$63.5 million for fiscal year 2010, primarily due to new shop openings. As a percentage of revenues, labor and related expenses decreased to 28.2% for fiscal year 2011, from 28.8% for fiscal year 2010, primarily due to leverage of shop personnel and improved labor productivity.

### *Occupancy Expenses*

Occupancy expenses increased by \$1.3 million, or 5.0%, to \$26.5 million for fiscal year 2011, from \$25.2 million for fiscal year 2010, primarily due to new shop openings. As a percentage of revenues, occupancy expenses decreased to 11.1% for fiscal year 2011, from 11.4% for fiscal year 2010, primarily due to sales leverage.

### *Other Operating Expenses*

Other operating expenses increased by \$1.5 million, or 6.5%, to \$24.1 million for fiscal year 2011, from \$22.6 million for fiscal year 2010, primarily due to new shop openings. As a percentage of revenues, other operating expenses decreased to 10.1% for fiscal year 2011, from 10.3% for fiscal year 2010, primarily due to sales leverage and more efficient execution to drive lower operating expenses at our shops.

### *General and Administrative Expenses*

General and administrative expenses increased by \$0.3 million, or 1.3%, to \$26.9 million for fiscal year 2011, from \$26.6 million for fiscal year 2010. The increase was primarily due to an increase of \$0.5 million in stock compensation expense in addition to \$0.1 million for our General Manager conference in Chicago, offset by lower legal related expenses. As a percentage of revenues, general and administrative expenses decreased to 11.3% for fiscal year 2011, from 12.0% for fiscal year 2010, primarily due to sales leverage and effective cost containment at our corporate headquarters, which we refer to as the Support Center.

### *Depreciation Expense*

Depreciation expense decreased by \$0.8 million, or 5.2%, to \$14.8 million for fiscal year 2011, from \$15.6 million for fiscal year 2010, primarily due to certain fixed assets being fully depreciated. As a percentage of revenues, depreciation decreased to 6.2% for fiscal year 2011, from 7.1% for fiscal year 2010.

### *Pre-Opening Costs*

Pre-opening costs increased by approximately \$1.2 million to \$1.5 million for fiscal year 2011, from \$0.3 million for fiscal year 2010. The increase was due to 21 new company-operated shop openings during fiscal year 2011, compared to six new company-operated shop openings during fiscal year 2010, including one re-location.

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

Impairment and loss on disposal of property and equipment decreased by \$2.6 million to \$0.4 million for fiscal year 2011, from \$3.0 million for fiscal year 2010. Due to unfavorable operating results at certain shops, the related assets were assessed for impairment. A determination was made that certain shops had carrying amounts in excess of their fair value as of December 25, 2011 and December 26, 2010. An impairment charge of

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\$0.4 million and \$2.9 million was recorded in fiscal years 2011 and 2010, respectively. The reduction in expense is primarily driven by improved operating performance and lower levels of new shop development activities in the immediately preceding years.

### *Interest Expense*

Interest expense remained constant at \$0.5 million for fiscal years 2011 and 2010, respectively.

### *Income Tax Expense*

Income tax expense decreased approximately \$0.3 million to \$0.5 million in fiscal year 2011, from \$0.8 million in fiscal year 2010. We have a full valuation allowance against all deferred tax assets. Our income tax expense primarily relates to current state income taxes payable and the decrease in our effective tax rate is due to the impact of an adjustment in fiscal 2010, offset by changes in state statutory tax rates.

### **Quarterly Results and Seasonality**

The following table sets forth certain unaudited financial and operating data in each of the first three fiscal quarters during fiscal year 2012. The unaudited quarterly information includes all normal recurring adjustments that we consider necessary for a fair presentation of the information shown. This information should be read in conjunction with the audited consolidated and unaudited condensed consolidated financial statements and related notes thereto appearing elsewhere in this prospectus.

	For the 13 Weeks Ended		
	March 25, 2012	June 24, 2012	September 23, 2012
	(unaudited)		
Total Revenues	\$ 62,381	\$69,156	\$ 69,869
Income from operations	1,592	2,325	2,817
Net income attributable to Potbelly Corporation	1,274	1,749	2,548
Adjusted EBITDA (1)	\$ 6,545	\$ 8,251	\$ 7,945
Total company-operated shops (end of period)	239	248	257
Change in comparable store sales	6.4%	3.3%	2.2%

(1) The following table presents a reconciliation of net income (loss), the most directly comparable GAAP financial measure, to adjusted EBITDA for the periods indicated below. For further discussion of the use of adjusted EBITDA, see footnote 4 to the table included in "Selected Consolidated Financial and Other Data."

	For the 13 Weeks Ended		
	March 25, 2012	June 24, 2012	September 23, 2012
	(amount in thousands)		
<b>Net Income (loss) attributable to Potbelly Corporation</b>	\$ 1,274	\$ 1,749	\$ 2,548
Depreciation expense	3,837	3,716	4,080
Interest expense	128	123	176
Income tax expense	206	476	84
Impairment and closures	93	171	—
Pre-opening costs	537	593	630
Stock compensation	470	1,423	427
<b>Adjusted EBITDA</b>	<b>\$ 6,545</b>	<b>\$8,251</b>	<b>\$ 7,945</b>

Historically, customer spending patterns for our established shops are lowest in the first quarter of the year. Our quarterly results have been and will continue to be affected by the timing of new shop openings and their associated pre-opening costs. As a result of these and other factors, our financial results for any quarter may not be indicative of the results that may be achieved for a full fiscal year.

**Liquidity and Capital Resources***General*

Our primary sources of liquidity and capital resources have been cash provided from operating activities, 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, 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 many of our inventory items before we have to pay our suppliers for such items. Our shops do not require significant inventories or receivables. During the last three fiscal years and the 39 weeks ended September 23, 2012, net cash provided by operating activities exceeded cash used in investing activities. 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):

	2010	2011	39 Weeks Ended	
			September 25, 2011	September 23, 2012
Net cash provided by (used in):				
Operating activities	\$ 18,780	\$ 20,121	\$ 10,839	\$ 20,457
Investing activities	(6,243)	(17,758)	(13,070)	(19,700)
Financing activities	(4,382)	(7,197)	(7,659)	51
Net increase (decrease) in cash	\$ 8,155	\$ (4,834)	\$ (9,890)	\$ 808

*Operating Activities*

Net cash provided by operating activities increased to \$20.5 million for the 39 weeks ended September 23, 2012, from \$10.8 million for the 39 weeks ended September 25, 2011, primarily due to the increase in shop-level profits as a result of new shop openings and increased working capital.

Net cash provided by operating activities was \$20.1 million for fiscal year 2011, compared to \$18.8 million for fiscal year 2010. The increase was primarily due to an increase in shop-level profits as a result of new shop openings.

*Investing Activities*

Net cash used in investing activities increased to \$19.7 million for the 39 weeks ended September 23, 2012, from \$13.1 million for the 39 weeks ended September 25, 2011. The increase in the use of cash was primarily due to increased purchases of property and equipment related to new company-operated shop openings, which were funded primarily by cash provided by operating activities.

For fiscal years 2011 and 2010, purchases of property and equipment were \$17.8 million and \$6.2 million, respectively. Each year, new company-operated shop development accounted for the majority of the expenditures and the increase in 2011, as compared to 2010, is driven by an increase in the number of shop openings. We estimate that total capital expenditures for fiscal year 2012 will be approximately \$26 million to \$28 million, with 31 new company-operated shop openings planned. We estimate a similar range of capital expenditures for 2013, with 25 to 35 new company-operated shop openings planned.

*Financing Activities*

Net cash provided by (used in) financing activities was \$0.1 million for the 39 weeks ended September 23, 2012, compared to \$(7.7) million for the 39 weeks ended September 25, 2011. The variance was primarily due to the repurchase of preferred stock (\$5.0 million) and common stock (\$8.5 million) in June 2011. This was partially offset by \$6.0 million of net proceeds from borrowings under the credit facility.

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Net cash (used in) provided by financing activities was \$(7.2) million and \$(4.4) million during fiscal years 2011 and 2010, respectively. The increase in net cash used in fiscal year 2011 as compared to fiscal year 2010 was primarily due to the repurchase of preferred stock (\$5.0 million) and common stock (\$8.5 million) during 2011, which was partially offset by \$6.0 million of net proceeds from borrowings under the credit facility.

*Credit Facility*

On September 21, 2012, we entered into a new five-year revolving credit facility agreement 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. 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 company was in compliance with these restrictions and conditions as of September 23, 2012. 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 September 23, 2012, we had \$14.2 million outstanding under the credit facility with a weighted-average interest rate of 1.35%. Our previous credit facility, which we entered into in January 2008, would have expired in January 2013 and was repaid in full and terminated when we entered into our new credit facility. See "Description of Credit Facility."

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, 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 Securities Exchange Act of 1934. Additionally, we do not have any synthetic leases.

**Contractual Obligations**

The following table presents contractual obligations and commercial commitments as of December 25, 2011 (in thousands):

	Payments Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt (including current portion) (a)	\$ 15,443	\$ 259	\$ 14,178	\$ 1,006	\$ —
Operating leases (b)	124,333	22,716	40,328	31,117	30,172
Capital leases	297	42	126	126	3
Total	<u>\$ 140,073</u>	<u>\$ 23,017</u>	<u>\$ 54,632</u>	<u>\$ 32,249</u>	<u>\$ 30,175</u>

(a) On January 15, 2008, we entered into a five-year revolving credit facility agreement that would have expired in January 2013 and provided 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. Interest on the credit facility was variable and is included in the table above utilizing an interest rate of 1.32% that applied as of December 25, 2011. Interest expense on the credit facility in 2011 was \$0.4 million. The credit facility was repaid in full and terminated upon entering into a new credit facility on September 21, 2012, as described above under "Credit Facility." Long-term debt also includes a note payable with \$1.2 million outstanding as of September 23, 2012. As of December 25, 2011:

- scheduled principal payments on the previous revolving credit facility were \$14.0 million in fiscal year 2013; and
- scheduled principal payments on the note payable were \$0.1 million in fiscal year 2012, \$0.1 million in fiscal year 2013, \$0.1 million in fiscal year 2014 and \$1.0 million in fiscal year 2015. The above table excludes interest on the note, payable quarterly at an interest rate of 6%.

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- (b) Includes base lease terms and certain optional renewal periods that are included in the lease term in accordance with accounting guidance related to leases. Certain of these options are subject to escalation based on various market-based factors.

### **Impact of Inflation**

Our profitability is dependent, among other things, on our ability to anticipate and react to changes in the costs of key operating resources, including food and beverages, labor, energy and other services. Substantial increases in costs and expenses could impact our operating results to the extent such increases cannot be passed along to our customers. Apart from the commodity effects discussed above, in general, we have been able to substantially offset shop and operating cost increases resulting from inflation by altering our menu items, increasing menu prices, making productivity improvements or other adjustments. However, certain areas of costs, notably labor and utilities, can be significantly volatile or subject to significant changes due to changes in laws or regulations, such as the minimum wage laws. There can be no assurance that we will continue to generate increases in comparable store sales in amounts sufficient to offset inflationary or other cost pressures.

### **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 of 1933, as amended (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.

### **Critical Accounting Policies**

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. Our significant accounting policies can be found in Note 2 to our consolidated financial statements. We consider the following policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

#### *Impairment of Long-Lived Assets and Disposal of Property and Equipment*

We assess potential impairments to long-lived assets, which includes property and equipment, whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. 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 exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as the amount by which the carrying amount

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of the asset exceeds the fair value of the asset. Shop-level assets are grouped together for the purpose of the impairment assessment. Due to unfavorable operating results at certain shops, we assessed the related assets for impairment as of December 25, 2011 and December 26, 2010. 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. We used a weighted average cost of capital to discount the future cash flows. A 100 basis point change in weighted average cost of capital would not have a material impact on the calculation of an impairment charge. We recorded an impairment charge of \$0.4 million and \$2.9 million, included in impairment and loss on disposal of property and equipment in the consolidated statements of operations for the fiscal years 2011 and 2010, respectively.

### *Income Taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are attributable to differences between financial statement and income tax reporting. Deferred tax assets, net of any valuation allowances, represent the future tax return consequences of those differences and for operating loss and tax credit carryforwards, which will be deductible when the assets are recovered. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns. While management believes the company will be profitable in the future and will be able to utilize these deferred tax assets, in accordance with ASC 740, *Income Taxes*, the existing evidence of past operating losses is weighted more heavily than the forecast of future earnings; therefore, due to the uncertainty of future recoverability of the deferred tax assets, management has determined that a valuation allowance for the full amount of net deferred taxes is warranted. However, the company may re-evaluate the need for a full valuation allowance if forecasted results of operations indicate increased profitability and actual results demonstrate a sustained level of profitability.

### *Stock-Based Compensation*

Our 2001 and 2004 Equity Incentive Plans (the "Plans") permit the granting of awards to employees and nonemployee officers, consultants, agents, and independent contractors of the Company in the form of stock appreciation rights, stock awards, and stock options. We account for our stock-based employee compensation in accordance with ASC 718, *Stock Based Compensation*. Because our stock option plan contains a performance condition that restricts certain option holders' ability to exercise vested options until the consummation of an initial public offering (an "IPO") under the Securities Act or at the discretion of our board of directors, no compensation cost related to vested employee stock options with these performance conditions has been recognized through September 23, 2012. Since the probability and the date of an IPO cannot be determined, we have not estimated what the potential compensation cost associated with vested options would be as of September 23, 2012. We will recognize non-cash stock compensation expense with respect to these options in the period in which the offering is consummated. Based on an estimated initial public offering price of \$ (the midpoint of the price range set forth on the cover page of this prospectus), we estimate that this expense will be \$ million. For stock options granted without these performance conditions, we record stock compensation expense on a straight-line basis over the vesting period based on the grant-date fair value of the option, determined using the Black-Scholes option pricing valuation model. In addition to the grant date fair value of our common stock, the Black-Scholes model requires inputs for risk-free interest rate, volatility and expected lives of the options. Since we do not have a history of traded common stock activity, expected volatility of the options is based on historical data from selected peer public company restaurants. The expected life of options granted is derived from the average of the vesting period and the term of the option. The risk-free rate is based on U.S. Treasury rates in effect at the time of the grant with a similar duration of the expected life of the options.

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### *Common Stock Equity Valuations*

Our policy is to have all options granted to be exercisable at a price per share not less than the per-share fair value of our common stock underlying those options on the date of grant. The range of exercise prices of options granted as of September 23, 2012 is \$5 to \$14 per option, and the options vest over a five-year period from the date of grant. Also, we measure our redeemable convertible preferred stock at its maximum redemption value at each reporting period. The fair value of the company, used to calculate the maximum redemption value of the redeemable convertible preferred stock and to measure the value of the common stock as a key assumption in our stock options, was determined with assistance from an independent third-party valuation specialist. The valuations of the company and our common stock were determined based on valuation methodologies and assumptions selected in accordance with the guidelines outlined in the American Institute of Certified Public Accountants Practice Aid, *Valuation of Privately-Held-Companies Equity Securities Issued as Compensation*. In the absence of observable market data regarding the value of our stock, the valuation of the company and our common stock was estimated using multiple valuation approaches, primarily an income and market approach. The income approach is based on the present value of estimated future cash flows and relies upon significant assumptions and estimates, including those related to the selected discount rate and forecasted revenues and expenses. The market approach is based on a comparison to observed fair values of comparable peer companies and recent market transactions, adjusted for the relative size and profitability of these peer companies.

During the twelve months prior to September 23, 2012, 333,000 options were granted at a common stock fair value of \$8.16; the fair value of our common stock used as the grant price for these options was based on a concurrent valuation prepared by an independent valuation specialist as discussed in Note 9 to our consolidated financial statements.

### **Quantitative and Qualitative Disclosures of Market Risks**

#### *Interest Rate Risk*

We are subject to interest rate risk in connection with borrowings under our credit facility, which bear interest at variable rates. As of September 23, 2012, we had \$14.2 million outstanding under our credit facility. A 100 basis point change in the interest rate would not have a material impact on our financial condition or results of operations. We did not have any material exposure to interest rate market risks for fiscal year 2011 or for the 39 weeks ended September 23, 2012.

#### *Commodity Price Risk*

We are also exposed to commodity price risks. Many of the food products we purchase are subject to changes in the price and availability of food commodities, including among other things beef, poultry, grains, dairy and produce. Prices may be affected due to market changes, increased competition, the general risk of inflation, shortages or interruptions in supply due to weather, disease or other conditions beyond our control, or other reasons. For example, the drought conditions of 2012 may affect commodity prices. We work with our suppliers and use a mix of forward pricing protocols for certain items under which we agree with our supplier on fixed prices for deliveries at some time in the future, fixed pricing protocols under which we agree on a fixed price with our supplier for the duration of that protocol, and formula pricing protocols under which the prices we pay are based on a specified formula related to the prices of the goods, such as spot prices. Our use of any forward pricing arrangements varies substantially from time to time and these arrangements tend to cover relatively short periods (i.e., typically twelve months or less). We do not enter into futures contracts or other derivative instruments. Increased prices or shortages could generally affect the cost and quality of the items we buy or may require us to raise prices or limit our menu options. These events, combined with other general economic and demographic conditions, could impact our pricing and negatively affect our sales and profit margins.

**BUSINESS**



**The Neighborhood Sandwich Shop**

Potbelly is a fast-growing neighborhood sandwich concept offering toasty warm sandwiches, signature salads and other fresh menu items served by welcoming people in a unique environment. 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 creating 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.

We believe executing on *The Potbelly Advantage* at a high level creates a distinct competitive advantage and drives our operating and financial results, as illustrated by the following:

- As of September 23, 2012, we had a domestic base of 262 shops in 17 states and the District of Columbia, having grown 13.4% over the prior year;
- We achieved ten consecutive quarters of positive comparable store sales growth through our fiscal quarter ended September 23, 2012, due to a combination of an increase in traffic, price increases and shift in menu mix;
- From 2010 to 2011, we increased our total revenue 7.9% to \$238.0 million, our adjusted EBITDA 27.1% to \$26.8 million, our adjusted EBITDA margin by 170 basis points to 11.2%, and our net income to \$7.2 million from a net loss of \$0.5 million; and
- From 2008 to 2011, we increased our shop-level profit margin each year and by a total of 610 basis points: with levels of 15.5%, 19.2%, 20.9% and 21.6% in 2008, 2009, 2010 and 2011, respectively.

See “Selected Consolidated Financial and Other Data” for a discussion of adjusted EBITDA, adjusted EBITDA margin and shop-level profit margin and a reconciliation of the differences between adjusted EBITDA and net income (loss) and shop-level profit and income (loss) from operations, as well as a calculation of shop-level profit margin. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for a definition of comparable store sales.

**Our History**

Potbelly started in 1977 as a small antique store on Lincoln Avenue in Chicago. To boost sales, the original owner began offering toasty warm sandwiches to customers. Soon, people who had no interest in



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antiques were stopping by to enjoy the delicious sandwiches, homemade desserts and live music featured in the shop. As time passed, Potbelly became a well-known neighborhood destination with a loyal following of regulars and frequent lines out the door.

The original owner sold the Lincoln Avenue store to Bryant Keil in 1996. Bryant was the entrepreneur with the vision to expand Potbelly. We opened our second shop in 1997 and continued to open shops in more neighborhoods throughout the country, reaching 100 shops in 2005 and 200 shops in 2008. Throughout our growth, each new shop has maintained the same look, vibe and experience that defines the Potbelly brand. Though our shops vary in size and shape, we maintain core elements in each new location, such as fast and efficient line flow, vintage décor customized with local details and exceptional customer focus. Just like our first shop on Lincoln Avenue, we are committed to building deep community roots in all the neighborhoods we serve.

### **Industry Overview**

According to the National Restaurant Association (“NRA”), U.S. restaurant industry sales are projected to grow 3.5% to \$632 billion in 2012, representing approximately 4% of the U.S. gross domestic product. The NRA projects that 48% of total U.S. food expenditures will be spent at restaurants in 2012, up from 44% in 1996 and 25% in 1955.

According to Technomic, Inc. (“Technomic”), a national consulting market research firm, the restaurant industry is divided into two primary segments, limited-service restaurants (“LSRs”) and full-service restaurants (“FSRs”), and is generally categorized by price, quality of food, service and location. LSRs are defined as establishments with patrons who pay before eating and generate an average check between \$3 and \$12. The LSR segment is further divided into (i) quick-service restaurants, which are defined as traditional “fast food” restaurants, generally with check averages between \$3 and \$8, and (ii) fast-casual restaurants, which are establishments with limited service, check averages generally between \$8 and \$12, food prepared to order, fresh (or perceived as fresh) ingredients, innovative food suited to sophisticated tastes, and upscale or highly developed interior design.

Technomic reported that LSRs accounted for 72% of the sales of the Top 500 U.S. restaurant chains in 2011. We operate in the “Other Sandwich” category, which includes LSRs specializing in sandwiches and wraps, other than hamburgers. This category accounted for \$20.6 billion of sales in 2011 by the Top 500 chains. Sales in this category increased 4.7% from 2010 to 2011, outperforming the broader LSR growth rate of 3.7% over the same time period. We cannot provide assurance that the increases in sales in this category will continue or that we will benefit from any such increases.

### **Our Competitive Strengths**

We believe the following competitive strengths provide a platform for us to achieve continued growth:

*Simple, Wholesome Food.* Our menu features wholesome food made from high quality ingredients, such as fresh vegetables, artisanal-style hearth-baked bread and all-natural, breast meat chicken (without preservatives or artificial flavors). We also use whole muscle turkey, ham and roast beef, rather than chopped and formed deli meats. See “—Our Food—Our Menu” for more information on our ingredients. Our sandwiches are made fresh to order, and many are based on the original recipes from 1977. They are served toasty warm on our signature multigrain wheat or regular bread. We slice our meats and cheeses daily in each shop to ensure freshness. Our sandwiches can be customized with a variety of toppings, including our unique Potbelly hot peppers that are made with a combination of spices exclusively for us. We believe our sandwiches have the right balance of ingredients with the last bite tasting as good as the first. Our generously sized cookies are baked fresh daily in each shop, and our hand-dipped shakes, malts and smoothies are made from real, wholesome ingredients and come with our signature butter cookie on the straw. Our menu regularly evolves based on consumer trends and customer feedback. Among other things, we solicit customer feedback quarterly via in-person “Customer Advisories” in our major markets and conduct an annual customer survey to help determine trends. See “—Our Food—Customer Feedback” for more information about these surveys. For example, we now offer signature salads that are made to order and have recently introduced the all-veggie Mediterranean sandwich.

We believe our simple menu and freshly-made food offers ease of ordering and broad appeal and helps us create loyal Potbelly fans that return again and again. Based on the CREST® reports provided by the NPD Group, which tracks consumer reported eating share trends, on average our customers eat at our shops more than two times every four-week period. Additionally, based on our 2012 annual customer surveys, which we distributed by email, we believe 18% of our customers come to a Potbelly shop one or more times per week. See “—Our Food—Customer Feedback.”

*Differentiated Customer Experience That Delivers a Neighborhood Feel.* We strive to provide a positive customer experience that is driven by both our employees and the atmosphere of our shops. We look to hire employees that are outgoing people and train them to interact with our customers in a genuine way while providing fast service. To support the neighborhood feel of our shops, most of our managers live in the neighborhood where their shop is located. We believe this allows them to get to know their customers, understand the unique character of each neighborhood and form deep roots within the community. Each of our shops features vintage décor and shared design elements, such as the use of wood, wallpaper motifs and our signature Potbelly stove. In addition, our shops display locally-themed photos and other decorative items inspired by the neighborhood. We believe we enhance our atmosphere with live, local musicians that perform at least three times per week in the majority of our shops. Every Potbelly location strives to be “The Neighborhood Sandwich Shop,” creating devoted fans who tell others about their experience. We believe our shops are strongly integrated into the neighborhood through the use of local managers, musicians and locally-themed décor and engage with customers through initiatives such as fundraising for local causes and other promotions that cater to local interests. We believe the unique Potbelly experience encourages repeat customer visits and drives increased sales.

*Attractive Shop Economics.* Our shop model generates strong cash flow, attractive shop-level financial results and high returns on investment. We operate our shops successfully in a wide range of geographic markets, population densities and real estate settings. The broad appeal of our menu offerings and the moderate investment requirements of our shops allow us to generate average shop-level profit margins above 20% and cash-on-cash returns above 25%. We have achieved these targets in 2010, 2011 and the 52 weeks ended September 23, 2012. Shop-level profit margin is a financial measure which is not required by, or presented in accordance with, U.S. generally accepted accounting principles (“GAAP”). Our ability to maintain such margins and returns depends on a number of factors. For example, we face increasing commodity costs, which we have partially offset by increasing menu prices. Although there is no guarantee that we will be able to maintain these returns, we believe our attractive shop economics support our ability to profitably grow our brand in new and existing markets.

*Management Team with Substantial Operating Experience.* Our senior management team has extensive operating experience across disciplines in the restaurant and retail sectors, including store operations, marketing, human resources, innovation, real estate, supply chain and finance. This team has an average of over 16 years of restaurant industry experience, and many of our executives have experience at large public companies. Our core senior management team has been together since 2008, when we hired our President and CEO, Aylwin Lewis. Aylwin was previously with Yum! Brands, Inc. from 1991 to 2004, most recently as President and Chief Multibranding and Operating Officer, as well as with Sears Holdings from 2004 to 2008, most recently as President and CEO. We believe our experienced leadership team is a key driver of our success and positions us to execute our long-term growth strategy.

*Distinct, Deep-Rooted Culture: The Potbelly Advantage.* We believe our culture is a key to our success. It is embodied in *The Potbelly Advantage*, which is an expression of our Vision, Mission, Passion and Values. *The Potbelly Advantage* is the written mission statement for our company that is shared with everyone who works at our company, from our top executives to shop associates. We believe such mission statement serves as the foundation of everything we do, including how we plan and manage our business. Our Vision is to create Potbelly fans nationwide. We want our customers to feel we are their “Neighborhood Sandwich Shop” and to become Potbelly fans and advocates. Our Mission is to make our customers and employees happy, to make more money and to improve our business every day. Our Passion is to be “The Best Place for Lunch.” We strive to emphasize our Values of integrity, teamwork, accountability, positive energy and coaching throughout all levels

of our organization including in our hiring process and training programs. We also place importance on values for our leaders, such as delivering results through execution and building and inspiring teams. The Potbelly Values form a common language across our organization and make Potbelly a place our employees love to work. Through our Ethics Code of Conduct, ongoing training and evaluations, we encourage our employees to perform at their personal best and help them to work together as a team to make sure we deliver a positive experience to everyone who works here. See “—Our People.” Our culture helps us attract and retain employees and has contributed to our hourly employee turnover rate of 71% for the twelve months ended September 23, 2012. We believe *The Potbelly Advantage* allows us to deliver operational excellence and grow our business and our base of devoted Potbelly fans.

### **Our Growth Strategy**

We strive to grow profitability and create value for our stockholders by working to achieve the goals listed below. While we cannot provide assurances that we will be able to achieve and maintain these objectives, we consider each of them to be a core strategy of our business.

*Run Great Shops.* We believe that continued excellence in shop-level execution is fundamental to our growth strategy. To maintain our operational standards we use a Balanced Scorecard approach to measure People, Customers, Sales and Profits at each of our shops. Hiring the right people and maintaining optimal staffing levels enable us to run efficient operations. We track metrics such as peak hour throughput, mystery shopper scores and neighborhood engagement activities, such as fundraisers for local causes, to improve the customer experience. Shop sales and profitability are benchmarked against prior year periods and budget, and we focus on achieving targets on a shop-by-shop basis. To support our shop operators, we invest in systems and technology that can meaningfully improve shop-level execution. For example, we have enhanced capabilities around in-line order-taking by using a proprietary tablet system in approximately 41% of our shops as of September 23, 2012 to further increase throughput by increasing accuracy and speed of order taking. In addition, we are expanding our backline businesses, including catering, delivery and online ordering, which we view as additional growth drivers.

*Find and Build Great Shops.* Our shops are successful in diverse markets in 17 states and the District of Columbia, and we intend to continue to build company-operated shops in both new and existing markets utilizing our careful site selection process. We evaluate a number of metrics to assess the optimal sites for our new shops, including neighborhood daytime population, site visibility, traffic and accessibility, along with an on-the-ground qualitative assessment of the characteristics of each unique trade area. This location-specific approach to development allows us to leverage our versatile shop format, which does not have standardized requirements with respect to size, shape or location, to achieve strong returns across a wide range of real estate settings. See “—Site Selection and Expansion—Shop Design” for more information about our shop requirements. In 2011 and for the 39 weeks ended September 23, 2012, we opened 21 and 24 new shops, respectively, and expanded into New York, Seattle, Boston and Phoenix. In those same time periods, we closed five shops and one shop, respectively, due to under-performance. We expect to open 25 to 35 new shops in 2013. Over the long term, we plan to grow the number of Potbelly shops 10% annually.

*Achieve High Margins and Terrific Returns.* Our approach to margin enhancement begins with continuous efforts to improve the financial results of our shops. We focus on cash-on-cash returns and look to grow shop-level profitability each year through sales growth and productivity improvements. Between 2008 and 2011, we increased our shop-level profit margin, a non-GAAP measure, from 15.5% to 21.6%. We also focus on cash flow generation, which supports our self-funded development model of sourcing our liquidity and capital resource needs primarily from operating activities and cash and cash equivalents. We also have a credit facility to provide another source of liquidity and to manage cash flow timing. We believe we exercise strong financial discipline in managing expenses and by encouraging employee efficiency with the goal of achieving and maintaining general and administrative expenses under 10% of sales. In addition, we expect our sales and shop-level profit margin to grow faster than general and administrative expenses. Our intention is to maintain average shop-level profit margins over 20% as we continue to grow. However, we cannot provide assurances that we will be able to maintain our shop-level profit margin levels or that we will be able to achieve or maintain low levels of expenses.

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*Become a Global Iconic Brand.* We believe that our premise of a “Neighborhood Sandwich Shop” has broad appeal across a wide range of market types and geographies. We believe that Potbelly is a recognized brand beyond the neighborhoods in which we currently operate. Based on our management’s experience, we believe a significant contributor to this success is word-of-mouth publicity by our customers who enjoy their Potbelly experience and tell others about it. Customers at our shops in new markets report positive recommendations from friends and family members who live in regions with established Potbelly shops. We believe that our positive brand perception helps drive interest in our shops in both existing and new markets.

*Be a Great Franchisor.* In 2010, we initiated a program to franchise shops in selected markets in the U.S., including Indiana, Kentucky, Missouri, Ohio and Texas. As we develop our franchise program, we intend to expand the number of franchise shops on a disciplined basis. We perform a market analysis and focus on markets we believe have appropriate characteristics for our franchise shops and on franchisees that are compatible with the Potbelly culture. As of September 23, 2012, our franchisees operated five shops domestically. In addition, we have signed a franchise development agreement with the Alshaya Trading Company W.L.L. (“Alshaya”), a leading franchisee of retail brands, to develop shops in the Middle East. As of September 23, 2012, Alshaya operated seven shops in Kuwait, Dubai and Bahrain. See “—Franchising” for more information about our program and about Alshaya. Although we do not expect franchise activities to result in significant revenue in the near term, we see the selective expansion of our franchising efforts to be a valuable potential growth opportunity over time.

### **Our Food**

#### *Our Menu*

Each of our shops offers freshly-made food with high quality ingredients from a simple menu with sandwiches at a limited number of price points. The majority of our sales are generated during lunchtime hours, but dinner and breakfast (in locations with high early morning traffic) are also important to our business. Our menu currently includes toasty warm sandwiches, signature salads, soups, chili, sides, desserts and, in our breakfast locations, breakfast sandwiches and steel cut oatmeal.

Every toasty warm sandwich on the Potbelly menu is made-to-order and customizable and many are based on the original recipes from 1977. Sandwiches are made with our signature multigrain wheat or regular bread as “Originals” (our “regular” size), “Bigs” (30% bigger) and “Skinny’s” (less meat and cheese on thin cut bread with 20% less fat than Originals). We slice our meats and cheeses daily in each shop to ensure freshness, and each of our sandwiches can be customized with a variety of toppings, including our unique Potbelly hot peppers that are made with a combination of spices exclusively for us. We believe our sandwiches have the right balance of ingredients with the last bite tasting as good as the first.

Our core sandwich offerings include the following:



Customers can also order off-menu sandwiches and variations on our sandwiches, including the “Wrecking Ball” (A Wreck plus meatballs), the “Lucky Seven” (which includes all seven of our sliced meat choices) and the “Cheeseburger” (the Meatball with cheddar cheese and no marinara). These items are on what our loyal fans call the “Underground Menu,” which contributes to the special connection between Potbelly and our customers.

Our shops also offer salads which are made fresh to order with high quality ingredients. Our signature salads include the following:



Customers may order any of our salads without meat for a vegetarian option and may customize a salad as they desire. Salads come with a choice of dressing, including Potbelly Vinaigrette, Balsamic Vinaigrette, Buttermilk Ranch, Caesar and Non-Fat Vinaigrette. We believe our signature salads are key to diversifying our menu and help ensure that there is something for everyone at our shops.

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We also offer soups, chili and side dishes. Different soups are offered daily, including varieties such as Broccoli Cheddar, Chicken Noodle, Loaded Baked Potato, Southwestern Chicken and Spicy Southwest Veggie. We have multiple vegan soup options, including Garden Vegetable and Spicy Black Bean. Our chili is available seven days a week and is a hearty recipe of ground beef, kidney beans, onions and bell peppers sweetened with a touch of molasses. Additionally, customers can choose side dishes of coleslaw, macaroni salad, potato salad, potato chips or a whole dill pickle.

Our hand-dipped shakes and smoothies are made with real, wholesome ingredients and come with our signature butter cookie on the straw. Our classic shake flavors include vanilla, chocolate, strawberry, coffee and Oreo®, and our smoothies include real fruit, such as bananas and strawberries. Our varieties of cookies are baked fresh in each shop daily and include Oatmeal Chocolate Chip, Sugar, Chocolate Brownie and Chocolate Cherry Granola cookies. Customers can also order an ice cream sandwich, with their choice of cookies and ice cream, or our signature chocolate and caramel Dream Bar.

Certain of our shops in areas with high early morning traffic also offer breakfast selections. Our breakfast menu includes made-to-order breakfast sandwiches on our signature multigrain wheat or regular bread and include Egg & Cheddar Cheese; Bacon, Egg & Cheddar Cheese; Sausage, Egg & Cheddar Cheese; and Ham, Mushroom, Egg & Swiss Cheese. Like our lunch and dinner sandwiches, our breakfast sandwiches are served toasty warm and any of our toppings can be added. We also offer steel cut oatmeal with toppings such as raisins, brown sugar, bananas, walnuts, apples and cranberries, and have other breakfast items available such as yogurt parfaits, bagels and dark roast coffee.

Our shops use high quality ingredients such as fresh produce which is delivered two to three times per week, artisanal-style hearth-baked bread, and whole-block cheeses sliced daily in our shops. We use all-natural chicken (meaning without preservatives or artificial flavors) in our sandwiches and salads. Our turkey, hickory-smoked ham and black angus roast beef are all whole-muscle meats sliced daily in our shops. Our dry-cured salami is made with fresh garlic and real red wine and we use white albacore tuna in our home-made tuna salad.

Overall, we believe our menu of high quality food at reasonable prices offers considerable value to our customers. Our system-wide average check has historically been under \$7.00. We generally do not discount our menu items in order to help ensure that we are able to maintain our high standards, as opposed to the discounting programs implemented by some other restaurant operators that increase traffic and revenue but may impact profitability and quality.

### *Customer Feedback*

We seek customer feedback on our food and operations in various ways. For example, we conduct an annual customer survey via email to learn what our customers think about us. We circulate a voluntary online survey to each customer listed in our company-wide email database, which includes email addresses obtained through our website, customer complaints and compliments, our in-shop business card drop, our Facebook page and other methods. In 2012, we sent the online survey to over 300,000 customers, with over 20,000 customers electing to participate. Customers who take the annual survey are not compensated.

We also solicit feedback via quarterly in-person “Customer Advisories” in each of our major markets of Chicago, Washington DC and Dallas. At each “Customer Advisory,” certain executives and local managers meet with approximately 10 customers to get feedback on our products and initiatives. The customers who participate are selected from those listed in our company-wide email database as having recently dined at the shop in which the “Customer Advisory” will be held. Our marketing team strives to have participants who are representative of the diverse customers who patronize the specific shop. Customer participants in each “Customer Advisory” receive a nominal Potbelly gift card as a thank you for their participation.

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### *Evolution of Our Menu*

We have selectively expanded our menu offerings in response to shifts in customer tastes and demand. For example, we began offering breakfast items in 2001 and Bigs and Skinmys in 2008. We also added new grilled chicken salads in 2010 and recently introduced the all-veggie Mediterranean sandwich. We will continue to respond to consumer trends and customer feedback as we believe menu innovations are a way for us to continue to grow our business.

When we enter new markets, we employ a “lifecycle” approach to introducing our menu. Shops opened in new markets initially offer only our Original sandwiches to introduce new customers to our core menu items. Additionally, this approach simplifies our line operations and allows our new shops to focus on execution and speed of service. We gradually increase our menu offerings at these shops until the full range of Potbelly offerings are available.

### *Food Preparation and Safety*

Food safety is a top priority, and we dedicate substantial resources, including our supply chain team and quality assurance teams, to help ensure that our customers enjoy safe, quality food products. We have taken various steps to mitigate food quality and safety risks, including having personnel focused on this goal together with our supply chain team. Our shops undergo third-party food safety reviews, internal safety audits and routine health inspections. We also consider food safety and quality assurance when selecting our distributors and suppliers.

### **Shop Operations and Management**

We believe having an excellent manager in each shop is a critical factor in achieving continuous excellence in operations. Managers hire our employees, help ensure consistent execution of our menu items and strive to achieve specific targets that are evaluated on a quarterly basis. We devote significant time and resources to identifying, selecting and training our managers who plan, manage and operate their shops and who, along with our employees, provide a positive customer experience to our Potbelly fans. We believe our comprehensive processes for developing business leaders, such as our shop managers, are a key factor in driving our success.

### *Potbelly Operations*

Our operations are structured around the elements of People, Customers, Sales and Profits. During our peak hours of 11:30 a.m. to 1:30 p.m., our employees greet our customers and take their orders while they wait in line using a proprietary tablet system in some shops to communicate with our food preparation employees. We focus on effective communication, technology and management to provide a quick and seamless experience for our customers. In addition, each shop completes quarterly tactical plans designed to help the shop achieve its targets relative to each element. In order to better assess and improve the Potbelly experience, we use a Balanced Scorecard that tracks elements such as sales and profitability metrics, employee turnover and a “mystery shopper” score, which essentially is a survey of customer satisfaction with the Potbelly experience. We review overall scores locally, regionally and nationally in order to assess our operational progress and identify areas of operational focus. Attaining certain ratings on the Balanced Scorecard allows a shop to be eligible for incentive targets paid quarterly and annual merit awards.

### *Our People*

We look to attract, hire and retain smart, talented and outgoing people who share and demonstrate our values. We value friendly employees who engage with our customers in a genuine way to provide a personalized experience. We select employees using interview questions based on our values to determine the extent of candidate fit. All employees attend culture training classes that include team exercises and scenarios to practice utilizing the tools relative to our values of integrity, teamwork, accountability, positive energy and coaching. We strive to empower our employees to do what is right and encourage them to perform at their personal best. We believe we make expectations and accountabilities clear through our culture training and our Ethics Code of

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Conduct, which summarizes employee conduct guidelines and is required to be reviewed and signed by every employee as a condition of employment. We believe we encourage each employee to perform at their personal best by establishing personal and professional goals through an ongoing continuous development plan. We believe the success of these programs is evident in our turnover rates and our internal promotion rates. For example, our associate, shift leader, assistant manager and general manager turnover rates have experienced significant reductions in the last four years since the inception of these programs. Eighty-seven percent of our general managers as of September 23, 2012 were promoted from within the company. Employees are further encouraged to perform at their personal best through an ongoing scorecard measuring system that is tied directly to a pay for performance compensation program. We believe our sustainable process to hire, train and develop our people enables us to deliver a positive customer experience. A typical Potbelly shop consists of one manager, one assistant manager and as many as 12 to 16 employees during our peak hours.

Most of our managers live in the neighborhood in which their shop is located. We believe this allows them to get to know their customers, understand the unique character of each neighborhood and form deep roots within the community. The shop manager has primary responsibility for the day-to-day operation of the shop and is required to abide by Potbelly's operating standards. Our Management Training Program provides new managers with six to eight weeks of training that emphasizes culture, standards, strategy and procedures to prepare them for success, and is followed by on-going in-shop coaching with their District or Market manager. Our shop managers report to District or Market Managers who typically report to a Zone Manager, and ultimately to our Senior Vice President of Operations. In addition, members of senior management visit shops regularly to help ensure that our culture, strategy and quality standards are being adhered to in all aspects of our operations.

Shop managers are responsible for selecting and training the employees for each new shop. The training period for new non-management employees lasts approximately eight weeks and is characterized by on-the-job supervision by an experienced employee. Ongoing employee training remains the responsibility of the shop manager, but, as noted above, we provide specific training for our employees around *The Potbelly Advantage* several times a year. Special emphasis is placed on the consistency and quality of food preparation and service which is monitored through ongoing meetings with managers. In addition, we have other continuing communications with all of our employees.

### *The Potbelly Experience*

We seek to deliver a positive experience for every customer at every opportunity through our tasty food, unique atmosphere and outgoing and engaging employees. We seek to staff each shop with experienced teams to ensure consistent and attentive customer service. We look to hire employees who are friendly and responsive to the needs of our customers as they assist them in selecting menu items complementing individual preferences. We strive to staff at 110% during peak hours to ensure a fast yet personal Potbelly experience for each customer, with face-to-face interaction from start to finish. We also provide backline services, including catering, delivery and online ordering to serve our Potbelly fans.

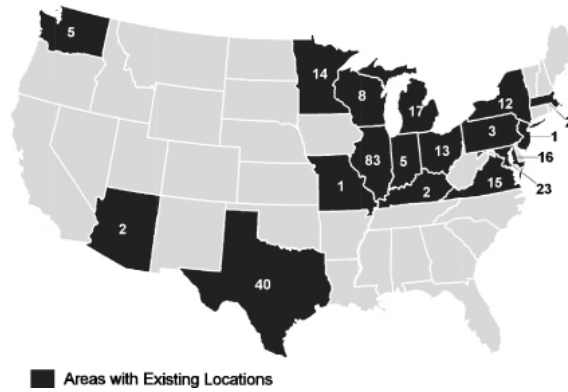
In addition, music has been integral to the Potbelly culture since our first shop opened in 1977 and adds a neighborhood vibe. Local musicians frequently perform live at Potbelly shops creating a distinctive dining experience. Some of our shops also host special events. For example, the Potbelly Jazz Series in Chicago features solo jazz musicians and Open Mic Night in Ann Arbor and New York City feature up-and-coming local musicians.

We believe the combination of our great food, people and atmosphere makes Potbelly "The Best Place for Lunch."



**Site Selection and Expansion**

We believe we are well positioned to continue growth in our existing markets and have significant expansion potential in new geographic areas throughout the United States. As of September 23, 2012, we had a domestic base of 262 shops in 17 states and the District of Columbia. Of these, the company operates 257 shops and franchisees operate five shops. In addition, there are seven franchised shops in Kuwait, Dubai and Bahrain. The following map shows the number of stores in each of the states in which we operated as of September 23, 2012.



We plan to grow our number of shops by 10% annually. In 2011 and for the 39 weeks ended September 23, 2012 we opened 21 and 24 new shops, respectively, and expanded into New York, Seattle, Boston and Phoenix. In 2013, we expect to open 25 to 35 shops.

Our proven shop model is designed to generate strong cash flow, attractive shop-level financial results and high returns on investment. With an average new shop investment of approximately \$600,000 and average unit volumes in excess of \$1 million, which represent the average net sandwich shop sales for all shops on an annual basis, we strive to generate average shop-level profit margins, a non-GAAP measure, above 20% and cash-on-cash returns above 25%. However, we cannot provide any assurances that we will achieve and maintain similar profit margins or cash returns in the future.

*Site Selection Process*

We consider the location of a shop to be a critical variable in its long-term success and as such, we devote significant effort to the investigation and evaluation of potential locations. We actively develop shops in both new and existing markets and plan to continue to expand in selected regions throughout the United States. Our Real Estate Committee, which includes most of our senior management team, meets weekly to discuss all aspects of our development program. The process for selecting locations incorporates management's experience and expertise and includes extensive data collection and analysis. We proactively seek new shop locations based on specific criteria, such as demographic characteristics, daytime population thresholds and traffic patterns, along with the potential visibility of, and accessibility to, the shop. Additionally, we use information and intelligence gathered from managers and other shop personnel that live in or near the neighborhoods we are considering. New shops are built with only one purpose in mind: to generate cash flow that meets or exceeds those modeled in our return targets. We are disciplined in our development, and we routinely forego sites that have many positive attributes, including strong visibility and street presence, but have challenging economics, such as high occupancy costs.

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Since we do not have standardized requirements with respect to size, shape or location, we are flexible in our site selection process. This allows us to choose and open shops with a wide variety of shapes in a wide variety of areas, including in urban central business districts and suburban areas near shopping malls or other high-traffic locations. Proposed locations are visited, reviewed and approved by key members of our Real Estate Committee.

### *Shop Design*

We strive to create a unique customer experience that delivers a neighborhood feel for each shop. We typically design the interior of our shops in-house, utilizing outside architects when necessary. Our design team sources most furnishings and decorations for our shops. Each of our shops features vintage décor and shared design elements, such as the use of wood, wallpaper motifs and our signature Potbelly stove. Consistent with *The Potbelly Advantage*, our shops display locally-themed photos and other decorative items inspired by the neighborhood. Most of our shops also feature a space for musicians to perform. Our shop size averages approximately 2,300 square feet; however, we currently target shop sizes between 1,800 and 2,200 square feet for new openings. The dining area of a typical shop can seat anywhere from 50 to 60 people. Some of our shops incorporate larger dining areas and outdoor patios. We believe the unique atmosphere and local music creates a lively place where friends and family can get together, encourages repeat visits by our customers and drives increased sales.

### *Construction*

Construction of a new shop generally takes approximately 50 to 70 days from the date the location is leased or under contract and fully permitted. Each new shop requires a total cash investment of approximately \$600,000, but this figure could be materially higher or lower depending on the market, shop size and condition of the premises upon landlord delivery. We generally construct shops in third-party leased retail space but also construct free-standing buildings on leased properties. In the future, we intend to continue converting existing third-party leased retail space or constructing new shops in the majority of circumstances. For additional information regarding our leases, see “—Properties.”

### **Franchising**

In 2010, we initiated a program to selectively franchise our shops to take advantage of incremental growth opportunities. We intend to expand the number of franchise shops on a disciplined basis as we develop our franchise program. As of September 23, 2012, we had five domestic franchised shops in five locations. Internationally, our first franchise partner is Alshaya, a company with which we had discussions for several years. At September 23, 2012, Alshaya operated seven franchised shops in Kuwait, Dubai and Bahrain and has exclusive franchising rights in the Middle East. Our agreement with Alshaya provides that Alshaya may also open shops in Egypt, Jordan, Lebanon, Oman, Qatar, Saudi Arabia and elsewhere in the United Arab Emirates.

We look for franchisees who love working with a team and have solid business experience, financial qualifications and personal motivation. Our franchise arrangements grant third parties a license to establish and operate a shop using our systems and our trademarks in a given area. The franchisee pays us for the ideas, strategy, marketing, operating system, training, purchasing power and brand recognition. All new franchisees participate in an eight week training program consisting of real life experience in our company-operated stores, as well as training at our Potbelly Support Center in Chicago. Franchised shops must be operated in compliance with our methods, standards and specifications, regarding menu items, ingredients, materials, supplies, services, fixtures, furnishings, décor and signs. Although we do not expect franchise activities to result in significant revenue in the near term, we see the selective expansion of our franchising efforts to be a valuable potential growth opportunity over time.

## **Advertising and Marketing**

We believe our shops appeal to a broad base of loyal customers who return again and again for our great food and fun environment staffed by friendly people. Historically, one to two percent of our annual revenue has been spent on marketing efforts. A portion of our marketing budget is spent at the shop level, with the goal of building relationships within our neighborhoods to increase the frequency of return visits and attract new customers. Our methods of marketing and advertising promote and maintain the Potbelly brand image and, among other things, generate awareness of shop locations and new menu offerings.

### *Neighborhood Shop Marketing*

Consistent with our neighborhood approach, a portion of our marketing investments are made at the shop level. Neighborhood shops frequently hire local musicians and hold a variety of community events, including fundraisers. For example, during a "Shake Fundraiser" for smaller community organizations, Potbelly donates a portion of sales for each customized milkshake sold. For larger organizations, Potbelly sponsors local cause fundraisers, where 25% of sales gathered at the event are donated to the organization's cause. Our shops promote these events and other events through social media, public relations, in-shop materials and local support, which results in increased traffic. Additionally, we engage in a variety of promotional activities, such as contributing food, time and money to charitable, civic and cultural programs, in order to give back to the communities we serve and increase public awareness and appreciation of our shops and our employees.

### *Advertising*

We also promote our shops through regional and local media in markets in which we have scale. The use of radio and outdoor media are the most common advertising vehicles used in these markets. Additionally, we rely on in-shop materials to communicate and market to our customers. Our internal corporate production staff is responsible for the creative work around our advertising and other forms of communication. In the end, our best advertising comes from our customers. We believe the Potbelly experience fosters strong customer loyalty and encourages our fans to promote the brand through word-of-mouth marketing.

### *E-Marketing and Social Media*

We have increased our use of e-marketing tools, which enable us to reach a significant number of people in a timely and targeted fashion at a fraction of the cost of traditional media. We believe that our customers are frequent internet users and will use social media to make dining decisions or to share dining experiences. We have a Facebook page and Twitter feed and advertise on various social media and other websites.

## **Sourcing and Supply Chain**

Our Supply Chain team sources, negotiates and purchases food supplies for our shops. We believe in using high quality ingredients while maintaining our value position in the marketplace. We benchmark our products against the competition using consumer panels. For example, we conduct periodic surveys of our customers to evaluate our product quality against our competition and review industry data to understand overall market trends. We contract with Distribution Market Advantage, Inc., or DMA, a cooperative of multiple food distributors located throughout the nation. DMA is a broker with whom we negotiate and gain access to third-party food distributors and suppliers. For the twelve months ended September 23, 2012, distributors through our DMA arrangement supplied us with approximately 90%-95% of our food supplies through four primary distributors: Reinhart FoodService, L.L.C., Ben E. Keith Company, Food Services of America, and Shamrock Foods. Our remaining food supplies are distributed by other distributors under separate contracts. Our distributors deliver supplies to our shops approximately two to three times per week.

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We negotiate pricing and volume terms directly with certain of our suppliers and distributors or through DMA. Our supply chain team uses a flexible cost lock-in model, and currently we have pricing understandings of varying lengths with our distributors and suppliers, including distributors and suppliers of meats, dairy, bread, cookie dough and other products. Meats represent about 25% of our product purchasing composition. In fiscal year 2011, more than 95% of our meat products were sourced from nine suppliers under non-exclusive contracts. For all our signature multi-grain and regular bread, we have a non-exclusive contract with Campagna-Turano Bakery, Inc. We believe we would be able to source our meat and bread requirements from different suppliers if doing so became necessary. However, changes in the price or availability of certain products may affect the profitability of certain items, our ability to maintain existing prices and our ability to purchase sufficient amounts of items to satisfy our customers' demands.

Many of our products, ingredients and supplies are currently sourced from multiple suppliers. Additionally, our supply chain team has established contingency plans for many key products. For example, manufacturers of certain products maintain alternative production facilities capable of satisfying our requirements should the primary facility experience interruptions. For other products, we believe we have identified alternate suppliers that could meet our requirements at competitive prices or, in some cases, have identified a product match that could be used in our shops. Our supply chain team regularly updates our procurement strategies to include contingency plans for new products and ingredients, as well as additional secondary and alternate suppliers. We believe these strategies would collectively enable us to obtain sufficient product quantities from other sources at competitive prices without material disruption should a current supplier be unable to fulfill its commitment to us.

### **Management Information Systems**

Shop level financial and accounting controls are handled through a point-of-sale computer system and network in each shop that communicates with our corporate headquarters. The POS system is also used to authorize and transmit credit card sales transactions and to manage the business and control costs, such as labor. Our company-operated shops are connected through data centers and a portal to provide our corporate employees with access to business information and tools that allow them to collaborate, communicate, train and share information between shops and the corporate office. We believe our systems currently comply with all credit card industry security standards for processing of credit and gift cards.

### **Competition**

We compete in the restaurant industry, primarily in the LSR segment but also with restaurants in the FSR segment, and face significant competition from a wide variety of restaurants, convenience stores and other outlets on a national, regional and local level. We believe that we compete primarily based on product quality, restaurant concept, service, convenience, value perception and price. Our competition continues to intensify as competitors increase the breadth and depth of their product offerings and open new units. Although new competitors may emerge at any time due to the low barriers to entry, our competitors include: Chipotle, Jimmy John's, Panera Bread and Subway, among others. Additionally, we compete with LSRs, specialty restaurants and other retail concepts for prime shop locations.

### **Government Regulation**

We and our franchisees are subject to various federal, state, local and international laws affecting our business. Each of our shops is subject to licensing and regulation by a number of governmental authorities, which may include, among others, health and safety, nutritional menu labeling, health care, environmental and fire agencies in the state, municipality or country in which the shop is located. Difficulty in obtaining or failing to obtain the required licenses or approvals could delay or prevent the development of a new shop in a particular area. Additionally, difficulties or inability to retain or renew licenses, or increased compliance costs due to changed regulations, could adversely affect operations at existing shops.

Our shop operations are also subject to federal and state labor laws, including the Fair Labor Standards Act, governing such matters as minimum wages, overtime and worker conditions. Significant numbers of our food service and preparation personnel are paid at rates related to the applicable minimum wage, and further increases in the minimum wage or other changes in these laws could increase our labor costs. Our ability to respond to minimum wage increases by increasing menu prices will depend on the responses of our competitors and customers. Further, we are continuing to assess the impact of federal health care legislation on our health care benefit costs. The requirement that we provide health insurance benefits to employees that are more extensive than the health insurance benefits we currently provide, or the imposition of additional employer paid employment taxes on income earned by our employees, could have an adverse effect on our results of operations and financial position. Our distributors and suppliers also may be affected by higher minimum wage and benefit standards, which could result in higher costs for goods and services supplied to us.

We and our franchisees may also be subject to lawsuits from our employees, the U.S. Equal Employment Opportunity Commission or others alleging violations of federal and state laws regarding workplace and employment matters, discrimination and similar matters.

The Patient Protection and Affordability Act of 2010 (the "PPACA") enacted in March 2010 requires chain restaurants with 20 or more locations in the United States to comply with federal nutritional disclosure requirements. It is expected that the FDA will issue final regulations by the end of 2012 or the beginning of 2013 and will begin enforcing regulations by the middle of 2013. A number of states, counties and cities have also enacted menu labeling laws requiring multi-unit restaurant operators to disclose certain nutritional information to customers, or have enacted legislation restricting the use of certain types of ingredients in restaurants. Although the federal legislation is intended to preempt conflicting state or local laws on nutrition labeling, until we are required to comply with the federal law we will be subject to a patchwork of state and local laws and regulations regarding nutritional content disclosure requirements. Many of these requirements are inconsistent or are interpreted differently from one jurisdiction to another. While our ability to adapt to consumer preferences is a strength of our concepts, the effect of such labeling requirements on consumer choices, if any, is unclear at this time.

There is also a potential for increased regulation of certain food establishments in the United States, where compliance with a HACCP approach may now be required. HACCP refers to a management system in which food safety is addressed through the analysis and control of potential hazards from production, procurement and handling, to manufacturing, distribution and consumption of the finished product. Many states have required restaurants to develop and implement HACCP Systems and the United States government continues to expand the sectors of the food industry that must adopt and implement HACCP programs. For example, the FSMA, signed into law in January 2011, granted the FDA new authority regarding the safety of the entire food system, including through increased inspections and mandatory food recalls. Although restaurants are specifically exempted from or not directly implicated by some of these new requirements, we anticipate that the new requirements may impact our industry. Additionally, our suppliers may initiate or otherwise be subject to food recalls that may impact the availability of certain products, result in adverse publicity or require us to take actions that could be costly for us or otherwise harm our business.

We and our franchisees are subject to the Americans with Disabilities Act (the "ADA"), which, among other things, requires our shops to meet federally mandated requirements for the disabled. The ADA prohibits discrimination in employment and public accommodations on the basis of disability. Under the ADA, we and our franchisees could be required to expend funds to modify our shops to provide service to, or make reasonable accommodations for the employment of, disabled persons. In addition, our employment practices are subject to the requirements of the Immigration and Naturalization Service relating to citizenship and residency. Government regulations could affect and change the items we procure for resale. We and our franchisees may also become subject to legislation or regulation seeking to tax and/or regulate high-fat and high-sodium foods, particularly in the United States, which could be costly to comply with. Our results can be impacted by tax legislation and regulation in the jurisdictions in which we operate and by accounting standards or pronouncements.

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We and our franchisees are also subject to laws and regulations relating to information security, privacy, cashless payments, gift cards and consumer credit, protection and fraud, and any failure or perceived failure to comply with these laws and regulations could harm our reputation or lead to litigation, which could adversely affect our financial condition.

Our franchising activities are subject to the rules and regulations of the Federal Trade Commission (“FTC”) and various state laws regulating the offer and sale of franchises. The FTC’s franchise rule and various state laws require that we furnish a franchise disclosure document (“FDD”) containing certain information to prospective franchisees and a number of states require registration of the FDD with state authorities. Substantive state laws that regulate the franchisor-franchisee relationship exist in a substantial number of states, and bills have been introduced in Congress from time to time that would provide for federal regulation of the franchisor-franchisee relationship. The state laws often limit, among other things, the duration and scope of non-competition provisions, the ability of a franchisor to terminate or refuse to renew a franchise and the ability of a franchisor to designate sources of supply. We believe that our FDDs, together with any applicable state versions or supplements, and franchising procedures comply in all material respects with both the FTC franchise rule and all applicable state laws regulating franchising in those states in which we have offered franchises.

See “Risk Factors” for a discussion of risks relating to federal, state, local and international regulation of our business.

## **Employees**

As of September 23, 2012, we employed approximately 4,900 persons, of which approximately 160 are corporate personnel, 480 are shop management personnel and the remainder are hourly shop personnel.

## **Properties**

We do not own any real property. As of September 23, 2012, we had the following number of company-operated shops located in the following areas:

<u>Location</u>	<u>Number of Shops</u>	<u>Location</u>	<u>Number of Shops</u>
Illinois	83	Wisconsin	8
Texas	39	Washington	5
District of Columbia	23	Indiana	4
Michigan	17	Pennsylvania	3
Maryland	16	Arizona	2
Virginia	15	Massachusetts	2
Minnesota	14	Kentucky	1
New York	12	New Jersey	1
Ohio	12	<b>Total</b>	<b>257</b>

Initial lease terms for our properties are generally ten years, with the majority of the leases providing for an option to renew for two additional five-year terms. Nearly all of our leases provide for a minimum annual rent, and some of our leases call for additional rent based on sales volume at the particular location over specified minimum levels. Generally, the leases are net leases that require us to pay our share of the costs of real estate taxes, utilities, building operating expenses, insurance and other charges in addition to rent. For additional information regarding our leases, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations.”

As of September 23, 2012, we leased approximately 20,000 square feet of office space in Chicago, Illinois for our corporate headquarters under a lease expiring February 29, 2016.

**Intellectual Property and Trademarks**

We regard our “Potbelly” and “Potbelly Sandwich Works” trademarks as having significant value and as being important factors in the marketing of our shops. We have also obtained trademarks for several of our other menu items, such as “A Wreck,” and for various advertising slogans, including “Good Vibes, Great Sandwiches” and “A First Class Dive.” We are aware of names and marks similar to the trademarks of ours used by other persons in certain geographic areas in which we have shops. However, we believe such uses will not adversely affect us. Our policy is to pursue registration of our intellectual property whenever possible and to oppose vigorously any infringement thereof.

We license the use of our registered trademarks to franchisees through franchise arrangements. The franchise arrangements restrict franchisees’ activities with respect to the use of our trademarks and impose quality control standards in connection with goods and services offered in connection with the trademarks.

**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.

**MANAGEMENT**

Below is a list of the names, ages as of December 30, 2012, positions, and a brief account of the business experience, of the individuals who serve as the executive officers and directors as of the date of this prospectus.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Aylwin Lewis	58	Director, Chief Executive Officer and President
John Morlock	57	Senior Vice President of Operations
Matthew Revord	49	Senior Vice President, General Counsel and Secretary
Carl Segal	46	Senior Vice President of Operations—Operations Support
Charles Talbot	47	Senior Vice President and Chief Financial Officer
Nancy Turk	48	Senior Vice President Human Resources and Corporate Communications
Bryant Keil	48	Director and Founding Chairman (2)(3)
Vann Avedisian	48	Director (3)
Peter Bassi	63	Director (1)
Gerald Gallagher	71	Director (2)
Marla Gottschalk	52	Director (1)(2)
Matthew Levine	37	Director (1)
Dan Levitan	55	Director (2)(3)

(1) Member of Audit Committee.

(2) Member of Nominating and Corporate Governance Committee.

(3) Member of Compensation Committee.

*Aylwin Lewis* has served as our Chief Executive Officer and President and a director since June 2008. From September 2005 to February 2008, Aylwin served as Chief Executive Officer and President of Sears Holdings Corporation. Prior to that, Aylwin was President of Sears Holdings and Chief Executive Officer of KMart and Sears Retail following Sears' acquisition of KMart Holding Corporation in 2005. Aylwin had been President and Chief Executive Officer of KMart since October 2004 until that acquisition. From January 2003 to October 2004, he was President, Chief Multi-Branding and Operating Officer of Yum! Brands, Inc. and served as Chief Operating Officer of Yum! Brands from December 1999 to January 2003. Aylwin has over 26 years of experience in the restaurant industry. Aylwin is also a member of the board of directors of The Walt Disney Company. Our board of directors believes Aylwin's qualifications to serve as a member include his role as Chief Executive Officer and President, his extensive experience in the restaurant industry and his leadership experience as an executive at publicly-traded companies in the restaurant and retail sectors.

*John Morlock* has been our Senior Vice President of Operations since December 2002. John has deep experience in the restaurant and retail industries. John started his career with S & A Restaurants from 1978 to 1983. He then went on to be an Operational Partner with Grady's Goodtimes, a casual dining restaurant from 1983 to 1986. John became Director of Operations for the largest Blockbuster Franchisee and in 1991 became the Zone Vice President for Blockbuster Entertainment Corporation. John's experience includes Senior Vice President of Operations of Boston Chicken, Inc. from 1992 to 1994 and then as a Midwest Franchisee with over 100 stores of Boston Market and Einstein Bros. Bagels until 1997. John has also served as Chief Executive Officer of Clubhouse International Inc., an owner and operator of three country club themed restaurants.

*Matthew Revord* has been our Senior Vice President, General Counsel and Secretary since January 2007 and oversees all legal matters of the company and international development. From January 2002 to January 2007, Matt served as Deputy General Counsel of Brunswick Corporation and General Counsel of Brunswick New Technologies. He began his career at the law firm of Kirkland & Ellis LLP and has worked with several



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Chicago-based companies, including Sears, Roebuck and Co. and True North Communications Inc., where he handled mergers and acquisitions, litigation and corporate securities. Matt is also a member of the board of directors of The Illinois Restaurant Association.

*Carl Segal* has been our Senior Vice President of Operations—Operations Support since August 2009 and has been an executive officer of Potbelly since 2000, including as Senior Vice President of Operations—Special Projects from March 2007 to August 2009 and as Chief Training and Recruiting Officer, Chief People Officer and Senior Vice President—Operations and Development. Carl has broad experience in the restaurant industry. He was a founding partner of Bistro Zinc restaurants in Chicago and previously served as a principal in the consulting firm of Segal Eslick Associates, Ltd. where he created and executed restaurant concepts for Boston Chicken, The Levy Restaurants and The Rosenthal Group/Soprafina. Carl began his restaurant career with Lettuce Entertain You Enterprises, where he spent ten years managing restaurants and working on restaurant concepts such as Ed Debevic's, Scoozi, Maggiano's Little Italy and Foodlife.

*Charles Talbot* has been our Senior Vice President and Chief Financial Officer since October 2008. From March 2007 to September 2008, Charlie served as Vice President of Strategy, Corporate Planning and Development of Nuveen Investments, a global provider of investment services to institutional and individual investors. Prior to his role with Nuveen, Charlie spent nine years in the restaurant industry with Yum! Brands in various roles, including Vice President of Corporate Strategy and Mergers and Acquisitions, and as Chief Financial Officer of Long John Silver's and A&W Restaurants.

*Nancy Turk* has been our Senior Vice President, Human Resources and Corporate Communications since September 2008. Nancy has extensive experience in Human Resources and Corporate Communications in retail, credit and manufacturing organizations. From 2005 to September 2008, Nancy served as the Divisional Vice President of Corporate Communications at Sears Holdings, and held various HR leadership roles at Sears Holdings since 1993, where she was involved in divestitures, mergers and acquisitions with Sears Credit, Lands' End and KMart. Prior to joining Sears, Nancy led Human Resources for Packard Instrument Company and Ametek, Inc.

*Bryant Keil* has been our Founding Chairman since June 2011 and a director since 1996. Bryant currently serves as a director pursuant to our Stockholders Agreement. In 1996, Bryant acquired Potbelly Sandwich Works as a single unit operation on Lincoln Avenue in Chicago and has been instrumental in our expansion since then. Bryant is a 2007 Ernst & Young Entrepreneur of the Year Award recipient. He was named the 2003 Illinois Restaurateur of the Year by the Illinois Restaurant Association and was named a Henry Crown Fellow, a part of the Aspen Institute, in 2007. Bryant is currently a director of Vingette Beverage Company and a board member of The Field Museum of Natural History, Big Shoulders and The Chicago Entrepreneur Center. Our board of directors believes Bryant's qualifications to serve as a member include his extensive experience in the restaurant industry and his historical perspective of our business and strategic challenges, including his leadership in expanding Potbelly to over 200 stores.

*Vann Avedisian* has served as our director since September 2001 and was appointed to the board of directors by Oxford Blackpoint Venture Partners VII, LLC pursuant to our Stockholders Agreement. Vann is a Principal of Highgate Holdings, a fully integrated real estate investment firm that has acquired more than \$7 billion of real estate assets. Vann serves on Highgate's Investment Committee, oversees the firm's capital markets activities and serves as an integral member of the investment platform. Prior to joining Highgate, Vann co-founded Oxford Capital Partners and directed the firm's real estate principal investments with an aggregate value in excess of \$1 billion. Vann currently serves on the Board of Trustees of the William Blair Mutual Funds where he serves on the Audit and Nominating and Governance Committees. Vann was a Vice President at LaSalle Partners and a Director and Shareholder of Citizens National Bank of Lake Geneva. Our board of directors believes Vann's qualifications to serve as a member of our board include his financial expertise, his knowledge of our business and his extensive experience in managing capital intensive operations, corporate finance and strategic advisory services.

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*Peter Bassi* has served as our director since January 2009 and was appointed to the board of directors by Maveron Equity Partners 2000, L.P., Maveron Equity Partners III, L.P. and their affiliated funds pursuant to our Stockholders Agreement. Peter retired in 2005 as Chairman of Yum! Restaurants International (“YRI”), the international division of Yum! Brands, Inc., where he served as President beginning in July 1997 and was in charge of YRI’s Asian business prior to that. Yum! was created in 1997 in a spin-off from PepsiCo, Inc. Peter joined PepsiCo in 1972 and served in various assignments at Pepsi Cola International, Pizza Hut (U.S. and International), Frito Lay and Taco Bell. From 2002 to 2009, Peter served on the board of The Pep Boys – Manny, Moe & Jack and from 2008 to 2010, he served on the board of El Pollo Loco, Inc. Peter currently serves on the board of BJ’s Restaurants, Inc. Our board of directors believes Peter’s qualifications to serve as a member of our board include his extensive experience in the restaurant industry and his years of experience in his leadership roles as a director and executive officer.

*Gerald Gallagher* has served as our director since November 2007 and was jointly appointed to the board of directors by Oak Investment Partners IX, Limited Partnership, and Benchmark Capital Partners IV, L.P., and each of their respective related entities pursuant to our Stockholders Agreement. Jerry has been involved with the retail industry for over 40 years, holding positions as an analyst, manager and venture capitalist. His career includes a Wall Street background at Donaldson, Lufkin & Jenrette where he was a retail industry analyst and an Institutional Investor Magazine “All American.” Jerry joined Oak Investment Partners, a venture capital partnership, in 1987, and through Oak has sponsored many restaurant and retail industry businesses, including Baja Fresh, Chamate, Cheddar’s Casual Café, Dick’s Sporting Goods, Jamba Juice, Office Depot, PetSmart, P.F. Chang’s China Bistro, Ulta Salon, Cosmetics & Fragrance and Whole Foods Market. Prior to joining Oak, Jerry was Vice Chairman of Dayton-Hudson Corporation where he served for ten years in both operating and staff positions. Jerry also served as an officer in the submarine service of the U.S. Navy. He is currently a director of six privately held companies. Our board of directors believes Jerry’s qualifications to serve as a member of our board include his extensive experience with the retail industry and his experience as an analyst, manager and venture capitalist.

*Marla Gottschalk* has served as our director since November 2009. She has served as Chief Executive Officer of The Pampered Chef Ltd., a marketer of kitchen tools, food products and cookbooks for preparing food in the home, since May 2006 and as its President and Chief Operating Officer since December 2003. Marla joined Pampered Chef from Kraft Foods, Inc., where she worked for 14 years in various management positions, including as Senior Vice President of Financial Planning and Investor Relations for Kraft, Executive Vice President and General Manager of Post Cereal Division and Vice President of Marketing and Strategy of Kraft Cheese Division. Marla is currently a member of the Board of Trustees of Underwriters Laboratories, a world leader in safety testing and certification, and has previously served as independent director of GATX Corp. and as a director of Visteon Corp. Our board of directors believes Marla’s qualifications to serve as a member of our board include her extensive experience with global companies, her expertise in the food industry and her years of experience in operations and strategic management.

*Matthew Levine* has served as our director since April 2009 and was appointed to the board of directors by ASP PBSW, LLC, an affiliate of American Securities, pursuant to our Stockholders Agreement. He is a Managing Director of American Securities and has been with the firm since 1999. Matthew’s private equity experience spans the industrial and consumer industry and particularly the restaurant segment where he has built expertise in restaurant franchising and expansion with both Potbelly and El Pollo Loco, Inc. Prior to American Securities, he was with Salomon Smith Barney in the Financial Entrepreneurs Group, focusing on leveraged buyouts and recapitalizations. Matthew is also a director of United Central Industrial Supply, Global Tel\*Link and FiberMark, Inc. Our board of directors believes Matthew’s qualifications to serve as a member of our board include his extensive private equity experience in the industrial and consumer industry, particularly within the restaurant segment and his experience in leadership roles as a director.

*Dan Levitan* served as our director since September 2001 and was appointed to the board by the holders of our Series A Preferred Stock pursuant to our Stockholders Agreement. Dan has served as a co-founder and Managing Member of Maveron, a venture capital firm, since 1998. Prior to Maveron, he was a Managing

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Director at Schroder Wertheim & Co., an investment banking firm in New York, where he headed consumer investment banking, new business development and founded the West Coast investment banking division. Dan also serves on the boards of six privately held companies. Our board of directors believes Dan’s qualifications to serve as a member of our board include his extensive venture capital experience, his industry and financial and real estate expertise and his years of experience providing strategic advisory services to complex organizations.

**Board Composition**

Our board of directors currently consists of eight directors, all of whom were elected as directors pursuant to our Stockholders Agreement. The Stockholders Agreement, including the provisions regarding the right of our stockholders to nominate and elect members of the board, will terminate upon the completion of this offering. See “Related Party Transactions—Arrangements with Our Investors—Stockholders Agreement.”

Upon completion of this offering, our board of directors will consist of nine members, including \_\_\_\_\_, and our certificate of incorporation will provide that our board of directors will consist of not more than twelve directors, as such number of directors may from time to time be fixed by our board of directors pursuant to our by-laws. Upon the completion of this offering, our certificate of incorporation will divide our board into three classes with staggered three-year terms. At each annual meeting of stockholders, the successors to directors whose terms then expire will be elected to serve from the time of election and qualification until the third annual meeting following election or until their earlier death, resignation or removal. Our classified board structure will be in effect for at least one full election cycle so that at the fifth annual meeting of stockholders, we will begin the process of phasing out our staggered elections.

Our certificate of incorporation, as amended and restated upon completion of the offering, will provide that directors may only be removed for cause. To remove a director for cause, 66-2/3% of the voting power of the outstanding voting stock must vote as a single class to remove the director at an annual or special meeting. The certificate will also provide that, if a director is removed or if a vacancy occurs due to either an increase in the size of the board or the death, resignation, disqualification or other cause, the vacancy will be filled solely by the affirmative vote of a majority of the remaining directors then in office, even if less than a quorum remain.

This classification of the board of directors, together with the ability of the stockholders to remove our directors only for cause and the inability of stockholders to call special meetings, may have the effect of delaying or preventing a change in control or management. See “Description of Capital Stock—Anti-Takeover Effects of Our Certificate of Incorporation and By-laws” for a discussion of other anti-takeover provisions that will be found in our certificate of incorporation.

*Director Independence*

Our board of directors has determined that all directors except Aylwin Lewis are “independent” as such term is defined by the Nasdaq Stock Market (“Nasdaq”), corporate governance standards and the federal securities laws.

*Board Leadership Structure*

Our board of directors does not have a formal policy on whether the roles of Chief Executive Officer and chairman of the board of directors should be separate. However, upon completion of this offering, Aylwin Lewis will serve as both Chief Executive Officer and Chairman. Our board of directors has carefully considered its leadership structure and believes at this time that the company and its stockholders are best served by having one person serve both positions. We believe that combining the roles fosters accountability, effective decision-making and alignment between interests of the board of directors and management. Aylwin also is able to use the in-depth focus and perspective gained in his executive function to assist our board of directors in addressing both internal and external issues affecting the company.

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Our board of directors determined as part of our corporate governance principles, and our by-laws will provide, that the chairperson of our nominating and corporate governance committee will serve as lead independent director. The by-laws also will provide that the chairperson of each of our committees will rotate every three years, so that our board of directors will have a new lead director every three years. The lead director will, among other responsibilities, preside over periodic meetings of our independent directors and oversee the function of our board of directors and committees. Further, our board of directors believes that its other structural features, including only one non-independent director and key committees consisting entirely of independent directors, provide for substantial independent oversight of the company's management.

Our board of directors recognizes that depending on future circumstances, other leadership models may become more appropriate. Accordingly, our board of directors will continue to periodically review its leadership structure.

### **Board Committees**

Our board of directors has established three standing committees to assist it with its responsibilities. The composition and responsibilities of each committee are described below. Members will serve on these committees until their resignation or until otherwise determined by our board of directors. Furthermore, the chairperson of each committee will rotate every three years. In the future, the board may establish other committees, as it deems appropriate, to assist it with its responsibilities.

#### *Audit Committee*

The purpose of the audit committee will be set forth in the audit committee charter and will be primarily to assist the board in overseeing:

- the integrity of our financial statements, our financial reporting process and our systems of internal accounting and financial controls;
- our compliance with legal and regulatory requirements;
- the independent auditor's qualifications and independence;
- the evaluation of enterprise risk issues; and
- the performance of our internal audit function and independent auditor.

Upon completion of this offering, the audit committee will consist of \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ and the chairperson will be \_\_\_\_\_. Our board of directors has determined that \_\_\_\_\_ is an independent director and an "audit committee financial expert" within the meaning of Item 407 of Regulation S-K. Prior to the completion of this offering, our board of directors will adopt a written charter under which the audit committee will operate. A copy of the charter, which will satisfy the applicable standards of the Securities and Exchange Commission (the "SEC") and Nasdaq, will be available on our website.

#### *Nominating and Corporate Governance Committee*

The purpose of the nominating and corporate governance committee will be set forth in the nominating and corporate governance committee charter and will be primarily to:

- identify individuals qualified to become members of our board of directors, and to recommend to our board of directors the director nominees for each annual meeting of stockholders or to otherwise fill vacancies on the board;
- review and recommend to our board of directors committee structure, membership and operations;

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- recommend to our board of directors the persons to serve on each committee and a chairman for such committee;
- develop and recommend to our board of directors a set of corporate governance guidelines applicable to us; and
- lead our board of directors in its annual review of its performance.

Upon completion of this offering, the nominating and corporate governance committee will consist of \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ and the chairperson will be \_\_\_\_\_. Prior to the completion of this offering, our board of directors will adopt a written charter under which the nominating and corporate governance committee will operate. A copy of the charter, which will satisfy the applicable standards of the SEC and Nasdaq, will be available on our website.

*Compensation Committee*

The purpose of the compensation committee will be set forth in the compensation committee charter and will be primarily to:

- oversee our executive compensation policies and practices;
- discharge the responsibilities of our board of directors relating to executive compensation by determining and approving the compensation of our Chief Executive Officer and our other executive officers and reviewing and approving any compensation and employee benefit plans, policies and programs, and exercising discretion in the administration of such programs; and
- produce, approve and recommend to our board of directors for its approval reports on compensation matters required to be included in our annual proxy statement or annual report, in accordance with all applicable rules and regulations.

Upon completion of this offering, the compensation committee will consist of \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ and the chairperson will be \_\_\_\_\_. Prior to the completion of this offering, our board of directors will adopt a written charter under which the compensation committee will operate. A copy of the charter, which will satisfy the applicable standards of the SEC and Nasdaq, will be available on our website.

**Compensation Committee Interlocks and Insider Participation**

None of our executive officers have served as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our board of directors or compensation committee.

**Board's Role in Risk Oversight**

The entire board of directors is engaged in risk management oversight. At the present time, the board of directors has not established a separate committee to facilitate its risk oversight responsibilities. The board of directors expects to continue to monitor and assess whether such a committee would be appropriate. The audit committee assists the board of directors in its oversight of our risk management and the process established to identify, measure, monitor, and manage risks, in particular major financial risks. The board of directors will receive regular reports from management, as well as from the audit committee, regarding relevant risks and the actions taken by management to address those risks.

**Code of Business Conduct and Ethics**

We have a written code of business conduct and ethics that applies to our directors, officers and employees. Prior to the completion of this offering, we will adopt a new written code of business conduct and ethics that applies specifically to our directors and officers, including our principal executive officer, principal financial and principal accounting officer and persons performing similar functions. A copy of this new code, and information regarding any amendment to or waiver from its provisions, will be posted on our website.

**EXECUTIVE AND DIRECTOR COMPENSATION****Introduction**

Our compensation philosophy is to pay for performance, rewarding employees when performance targets are met. Merit increases, annual incentive compensation, option grants and incremental paid time off are all tied to performance and results. Our compensation programs are designed to attract, retain, motivate and reward employees. Pay is commensurate with the scope and influence of the employee's role and the extent to which an employee contributes to the achievement of key initiatives and financial targets and demonstrates our values. All of our compensation programs are designed to align and reward actions that we believe contribute to our competitiveness and encourage superior performance.

For 2011, the compensation committee considered relevant market practices when setting executive compensation to align our executive compensation program with the market for which we compete for executive talent. Our market for executive recruiting is generally other restaurant or retail concepts. For non-operations executives, we look at the general restaurant industry. In evaluating the competitiveness of our executive compensation program, we target compensation against the restaurant industry, specifically the limited-service restaurant segment, national and local competitors to help ensure we are competitive, focusing on items such as options, merit pay, incentive pay and vacation. We evaluate our executives on a scale of one through five. A score of three means the executive is a "Contributor," four is a "High Contributor" and five is a "Star." Annual cash compensation varies based on the executive's score, performance and contributions to Potbelly.

Executive pay is tied to both the company's and the individual's annual performance. Merit increases, annual incentive compensation, options and personal performance days (paid time off) generally are awarded in March or April of each year, following completion of the first quarter annual performance review cycle, the annual financial audit and approval from the compensation committee. The employment agreements of our named executive officers, as described below, specify each executive's annual incentive bonus target. At the discretion of our Chief Executive Officer, up to 10% of the annual bonus pool approved by the compensation committee may be applied on a discretionary basis to award exceptional individual performers, including the other named executive officers.

**2011 Summary Compensation Table**

The following table summarizes compensation for the one-year period ending December 25, 2011 earned by our principal executive officer and our two other most highly compensated executive officers. These individuals are referred to as our named executive officers.

Name and Principal Position	Year	Salary	Bonus (1)	Option Awards (2)	Non-Equity Incentive Plan Compensation (3)	Total
Aylwin Lewis Chief Executive Officer (Principal Executive Officer)	2011	\$ 700,000	\$ 0	\$ 1,050,196	\$ 570,683	\$ 2,320,879
Charles Talbot Chief Financial Officer (Principal Financial Officer)	2011	\$ 332,125	\$ 12,500	\$ 735,138	\$ 144,410	\$ 1,224,173
John Morlock Chief Operating Officer	2011	\$ 381,145	\$ 12,500	\$ 209,190	\$ 165,724	\$ 768,559

(1) Represents discretionary bonuses.

(2) Represents the aggregate grant date fair value of stock option awards. The stock option awards were valued at fair value on the grant date computed in accordance with Financial Accounting Standards Board

Accounting Standards Codification Topic 718, Compensation—Stock Compensation (“FASB ASC Topic 718”). See Note 12, “Stock Options,” to our Consolidated Financial Statements for the year ended December 25, 2011 for the assumptions made to value the stock option awards. Stock options granted in 2011 were awarded for 2010 performance.

- (3) Non-equity incentive plan compensation represents the amounts earned under the Support Center Incentive Plan.

#### **Employment Agreements**

The following is a summary of the employment agreements that we have entered into with each of our named executive officers. The summary below does not contain complete descriptions of all provisions of the employment agreements of our named executive officers and is qualified in its entirety by reference to such employment agreements, copies of which will be included as exhibits to the registration statement of which this prospectus forms a part. See “Where You Can Find More Information.”

*Aylwin Lewis.* Aylwin serves as our President and Chief Executive Officer pursuant to an Executive Employment Contract and Equity Incentive Plan effective as of June 16, 2008, as amended. The term of Aylwin’s employment continues until June 16, 2013 and thereafter automatically renews for subsequent one-year terms. The agreement terminates upon death, disability, termination by the company with or without cause, resignation with or without good reason or by either party giving a non-renewal notice 60 days prior to the end of the existing term. The employment agreement provides Aylwin with a base salary of \$700,000, subject to increase (but not decrease) at the discretion of our board of directors. Under the employment agreement, Aylwin is eligible for a target bonus equal to 75% of his base salary, with a maximum bonus opportunity equal to 125% of his base salary. In connection with his employment agreement, Aylwin agreed to confidentiality, noncompetition, noninterference and intellectual property provisions, with the noncompetition and noninterference covenants lasting for two years after termination of employment.

The employment agreement provided for an initial equity grant to Aylwin of options to purchase 780,000 shares of our common stock. Currently, 80% of the options granted to Aylwin under his employment agreement have vested, with the remaining 20% to vest on June 16, 2013. For information regarding the severance benefits and the treatment of Aylwin’s outstanding equity awards upon a qualifying termination of employment or a corporate transaction, see “—Potential Payments Upon Termination of Employment or a Corporate Transaction—Aylwin Lewis Employment Agreement.”

*Charles Talbot and John Morlock.* Charlie and John each entered into an employment agreement with the company in August 2009 pursuant to which Charlie serves as our Senior Vice President and Chief Financial Officer and John serves as Senior Vice President of Operations. Charlie’s agreement provided for an initial base salary of \$325,000, and John’s agreement provided for an initial base salary of \$372,968. Our Chief Executive Officer may increase, but not decrease, their respective base salaries. Each of these executives is eligible for an annual target bonus of 40% of his base salary. Each of the employment agreements terminates upon death, disability, termination by the company with or without cause or resignation with or without good reason. In connection with their employment agreements, Charlie and John each agreed to confidentiality, noncompetition, noninterference and intellectual property provisions, with the noncompetition and noninterference covenants lasting for one year after termination of employment.

The employment agreements contemplate that the executives may be granted options under the company’s equity incentive plans, with the option price equivalent to or above the fair market value of shares of our common stock. For information regarding the severance benefits and the treatment of Charlie and John’s outstanding equity awards upon a qualifying termination of employment or a corporate transaction, see “—Potential Payments Upon Termination of Employment or a Corporate Transaction—Charles C. Talbot and John B. Morlock Employment Agreements.”



## Equity Awards

*General Option Terms.* It is our practice to award options based on a target of 10% of base salary if the executive receives an individual performance appraisal rating of “Contributor.” If the executive receives an individual performance rating of “High Contributor,” the target for the option award increases to 15% of base salary, and if the executive receives an individual performance rating of “Star,” the target for the option award increases to 20% of base salary. The compensation committee determines Aylwin’s performance rating and reviews his recommendations with respect to the performance rating of the other named executive officers. The compensation committee establishes an option pool each year for purposes of awarding options based on the performance formula described above. If any options remain in the pool, Aylwin has the discretion to award additional options above the performance formula to the other named executive officers, while the compensation committee has the authority to award additional options from the pool to Aylwin.

Options granted to our named executive officers before 2010 generally provided that shares acquired upon exercise of the option were subject to transfer restrictions, unless we were public or as otherwise permitted by our board of directors. In addition, in the case of options granted to Charlie and John prior to 2010, such options generally would not become exercisable until the consummation of our initial public offering. In addition, we have the right to repurchase shares acquired upon the exercise of such options from employees and former employees following certain terminations of employment or the occurrence of a corporate transaction. We refer to these provisions as the “IPO Clause.”

Shares issuable upon the exercise of options prior to our initial public offering are subject to transfer restrictions and drag-along rights and an irrevocable proxy in favor of the company. Each executive is bound by a lock-up agreement with the representatives of the underwriters which regulates sales of our common stock for a period of at least 180 days after the date of this prospectus, subject to certain exceptions. See “Underwriting—No Sales of Similar Securities.”

*2011 Awards.* In 2011, the named executive officers each received an option grant to align their equity interests with similarly-situated executives in the restaurant industry, as determined by the compensation committee based on advice it received from JMW Partners Inc., its compensation consultant. The grants have a three-year vesting period, which is less than the five-year vesting period that we generally used for options granted prior to 2011. Other than the 2011 option grants, no other equity awards have been granted to the named executive officers in 2011 or 2012. The stock option agreements for the 2011 option grants do not contain the IPO Clause.

## Non-Equity Incentive Awards

The company has established the Support Center Annual Incentive Plan to provide annual non-equity incentive compensation to executives. Incentives are earned based on the achievement of pre-established targets for performance EBITDA, or earnings before interest, taxes, depreciation and amortization, excluding Support Center bonus, asset impairment, stock-based compensation, unusual non-cash charges and board of director approved unusual cash charges. This plan sets a threshold, target and maximum level of EBITDA applicable to all participants, and the amounts paid are based on the actual EBITDA achieved by the company. The targets are set for the year by the compensation committee based on recommendations from our Chief Executive Officer and Chief Financial Officer and are communicated to executives at the beginning of each year. To be eligible for an award under the plan, the executive must receive an annual individual performance appraisal rating of “Contributor” or higher.

In 2011, the Support Center Annual Incentive Plan threshold for both Charlie and John was 8% of base salary; the target for both Charlie and John was 40% of base salary while the target for Aylwin was 75% of base salary; and the maximum for both Charlie and John was 60% of base salary while the maximum for Aylwin was 125% of base salary. Based on actual EBITDA, under the Support Center Annual Incentive Plan, Charlie and John received 43.5% of their base salary (which amount was in addition to their discretionary bonuses) and Aylwin received 81.5% of his base salary as non-equity incentive compensation for 2011.

**Discretionary Cash Bonuses**

Based on a recommendation from Aylwin, in 2011, the compensation committee approved a discretionary cash bonus pool, which was equal to approximately 10% of the aggregate pool available under our non-equity incentive plan, to be allocated among employees, other than the chief executive officer. The compensation committee authorized Aylwin to allocate this discretionary cash bonus pool to employees whom Aylwin deemed to be exceptional performers. Charlie and John each received discretionary cash bonuses of \$12,500 from this pool.

**Outstanding Equity Awards at Fiscal Year-End**

The following table summarizes outstanding stock options for each named executive officer as of December 25, 2011.

Named Executive Officer	Options Awards			
	Number of Securities Underlying Unexercised Options (#)		Option Exercise Price Per Share	Option Expiration Date
	Exercisable	Unexercisable (1)		
Aylwin Lewis	468,000*	312,000*	\$ 8.00	6/16/2018
	0	286,157*	\$ 7.22	5/10/2021
Charles Talbot	60,000	40,000	\$ 8.00	1/7/2019
	2,000	8,000	\$ 7.00	7/1/2020
	0	200,310*	\$ 7.22	5/10/2021
John Morlock	115,000	0	\$ 5.00	12/2/2012
	20,000	0	\$ 9.00	1/1/2014
	25,000	0	\$ 12.00	1/1/2015
	75,000	0	\$ 14.00	11/15/2017
	12,000	8,000	\$ 8.00	5/14/2018
	2,424	3,637	\$ 8.00	8/5/2019
	2,000	8,000	\$ 7.00	7/1/2020
	0	57,000*	\$ 7.22	5/10/2021

(\*) Not subject to the IPO Clause.

(1) Contingent on continued employment and subject to the IPO Clause described under "General Option Terms," above (except when otherwise indicated), the vesting dates for the awards described in the Outstanding Equity Awards at Fiscal Year-End table are as follows:

Named Executive Officer	Vest Date	Number of Securities Underlying Unexercised Options
Aylwin Lewis	6/16/2012(*)	156,000
	6/16/2013(*)	156,000
	5/10/2012(*)	95,386
	5/10/2013(*)	95,385
	5/10/2014(*)	95,386
Charles Talbot	10/20/2012	20,000
	10/20/2013	20,000
	1/1/2012	2,000
	1/1/2013	2,000
	1/1/2014	2,000
	1/1/2015	2,000
	5/10/2012(*)	66,770
	5/10/2013(*)	66,770
	5/10/2014(*)	66,770

Name	Vest Date	Number of Securities Underlying Unexercised Options
John Morlock	1/1/2012	4,000
	1/1/2013	4,000
	8/5/2012	1,212
	8/5/2013	1,212
	8/5/2014	1,213
	1/1/2012	2,000
	1/1/2013	2,000
	1/1/2014	2,000
	1/1/2015	2,000
	5/10/2012 <sup>(*)</sup>	19,000
	5/10/2013 <sup>(*)</sup>	19,000
	5/10/2014 <sup>(*)</sup>	19,000

(\*) Not subject to the IPO Clause.

**Potential Payments Upon Termination of Employment or a Corporate Transaction**

Each of our named executive officers serves at the pleasure of our board of directors. We have entered into employment agreements with each of our named executive officers, which include provisions requiring us to make post-termination payments upon certain qualifying termination events. The disclosure below describes certain compensation that may become payable as a result of a qualifying termination of employment, based on the employment agreement in effect for each executive on December 25, 2011. In addition, the following disclosure describes the impact of a qualifying termination of employment or a corporate transaction under the terms of the equity awards held by each of our named executive officers as of December 25, 2011. These benefits are in addition to benefits available generally to salaried employees.

*Aylwin Lewis Employment Agreement.* Pursuant to his employment agreement, Aylwin is entitled to receive severance pay and severance benefits if the company elects not to extend his term of employment, if we terminate his employment agreement without cause or if Aylwin terminates his employment for good reason (collectively referred to as qualifying terminations). The agreement defines “cause” as intentional misrepresentation of material information, a felony indictment, commission of an act involving moral turpitude, material breach or material default of written obligations that remain unremedied for 30 days after notice, fraud, embezzlement, failure to comply with our board of director’s written lawful direction that remains unremedied for 30 days after notice or willful action to harm the company or its affiliates. The agreement defines “good reason” as reduction in base salary or target or maximum bonus percentages, material reduction in position, authority, office, responsibilities or duties of Aylwin, material breach of the employment agreement by us, failure to be re-elected to the board of directors while employed as President and Chief Executive Officer or relocation to a place more than 50 miles from Chicago, in each case without the employee’s consent. If terminated for a qualifying termination, Aylwin is eligible to receive severance equal to one year of his then-current base salary, bonus for the then-current fiscal year (calculated assuming that the target level of performance is achieved) and health and dental coverage at active employee contribution rates for 12 months. If Aylwin is terminated for a qualifying termination of employment, death or disability, he will receive a prorated bonus for the year of termination based on target performance.

The options granted to Aylwin under his employment agreement terminate automatically if Aylwin is terminated for cause. In the event of Aylwin’s qualifying termination of employment, death or disability, then a prorated portion of the options granted to Aylwin under his employment agreement shall accelerate, with such prorated portion determined based on the number of months Aylwin was employed by us during the vesting term plus an additional 25% of the vested options. If Aylwin is terminated other than for cause or upon death or disability, his options would remain exercisable until the earlier of one year after his termination date or June 16,

2018 (which is the expiration date of these options). Upon the occurrence of a Corporate Transaction (which term generally includes transactions involving a 50% change in ownership of the company, whether through acquisition of common stock or voting power or through the consummation of a reorganization, merger, consolidation or asset sale), 75% of any then non-vested and unexercisable options will vest and become exercisable, with the balance becoming vested and exercisable on the dates originally scheduled (but 100% shall become vested and exercisable in the event of a qualifying termination, death or disability occurring subsequent to a Corporate Transaction). Under Aylwin's option award agreements, in the event of a Corporate Transaction, the board of directors may take action such as (i) providing for the options to be assumed, or equivalent options to be substituted, by the acquiring company; (ii) providing for termination of vested but unexercised options unless exercised prior to the transaction; (iii) providing for receipt by Aylwin of a cash payment based on the difference between the transaction price and the exercise price; and/or (iv) providing for accelerated vesting prior to the transaction and termination following such transaction. However, with respect to vested options, Aylwin would have the right to exercise the options prior to the transaction or receive a net cash payment, and his unvested options would either become vested or be assumed, or substituted, by the acquiring company. The shares issuable upon the exercise of options, or purchased, pursuant to Aylwin's employment agreement are subject to repurchase rights of the company, restrictions on transfer, drag-along obligations, tag-along rights and lock-ups.

*Charles Talbot and John Morlock Employment Agreements.* The employment agreements for Charlie and John provide for severance pay and severance benefits if the executive is terminated by the company without cause or if the executive terminates his employment for good reason. The employment agreements for Charlie and John define "cause" and "good reason" comparably to the corresponding terms in Aylwin's agreement (except with respect to the election to the board). Upon such a termination, the severance pay and benefits consist of base salary and company-paid health and dental insurance coverage pursuant to the federal health care continuation law commonly known as COBRA for 12 months in the case of Charlie and nine months in the case of John. If an executive's employment is terminated without cause or with good reason, or upon the executive's death or disability, the executive will receive a pro-rated bonus if bonuses are paid to other executive-level employees, at the target level for the year of termination.

The employment agreements for Charlie and John provide that upon the occurrence of a Corporate Transaction, 50% of the then non-vested and unexercisable portion shall vest and become exercisable and the remaining portion shall vest and become exercisable on the date originally scheduled. If the company's initial public offering has not been consummated, and the company terminates the employment agreement without cause, the executive terminates the employment agreement for good reason, or the executive dies or becomes disabled, vested options will remain exercisable for three or four years, depending on how long the executive has been employed by the company. However such extended exercise period will not exceed the earlier to occur of the option's term or the tenth anniversary of the option's grant date. In addition, if the initial public offering occurs during the extended exercise period, the options will expire on the earlier of the date the extended exercise period expires or 90 days after consummation of the initial public offering. The options automatically expire if our initial public offering has not occurred and the company terminates the executive for cause or if the executive resigns without good reason.

*Options Granted Prior to 2011.* Our option grants for our named executive officers generally contain the following termination and change in control provisions:

- If an executive's employment with the company terminates for any reason other than cause, disability or death, vested options may thereafter be exercised by the executive until the earlier to occur of: (i) the date that is 90 days after the effective date of the executive's termination of employment, and (ii) the expiration date of the option, and to the extent the options are not so exercised, they shall terminate upon such earlier date. If the executive dies following a termination for other than cause during the period described in the preceding sentence, vested options may thereafter be exercised by the executive's legal representative until the earlier to occur of: (i) the

date that is one year after the effective date of the executive’s termination of employment, and (ii) the expiration date, and to the extent the options are not so exercised, they shall terminate upon such earlier date.

- If an executive’s employment with the company terminates by reason of disability or death, vested options may thereafter be exercised by the executive or the executive’s legal representative until the earlier to occur of: (i) the date that is one year after the effective date of the executive’s termination of employment, and (ii) the expiration date, and to the extent the options are not so exercised, they shall terminate upon such earlier date.
- If an executive is terminated for cause or the executive breaches a covenant in an agreement with the company, the options automatically terminate.

In addition, in the event of a Corporate Transaction, the board of directors may take action such as (i) providing for the options to be assumed, or equivalent options to be substituted, by the acquiring company; (ii) providing for termination of vested but unexercised options unless exercised prior to the transaction; (iii) providing for receipt by the executive of a cash payment based on the difference between the transaction price and the exercise price; and/or (iv) providing for accelerated vesting prior to the transaction and termination following such transaction.

*Options Granted in 2011.* Under the 2011 option grants, if the executive has been an employee of the company for at least 24 consecutive months, in the event of a Corporate Transaction, 50% of the executive’s non-vested and unexercisable options shall vest and become exercisable and the remaining options shall vest in accordance with their original vesting schedule. In addition to the option acceleration provisions noted in the bullets above, the 2011 option grants provide that if an executive is terminated without cause or because of death or disability or if an executive resigns for good reason, the exercise period for vested options ties to length of service (two years to exercise if employed by the company for at least two years; three years to exercise if employed by the company for at least three years; capped at four years to exercise if employed by the company for at least four years).

*401(k) Plan.* Our named executive officers are eligible to participate in our 401(k) plan. The company matches 50% of the contributions that our named executive officers make to this plan, up to 6% of compensation, with a maximum matching contribution of \$3,000 per year.

**2011 Director Compensation**

The following table summarizes the amounts earned and paid to our non-employee members of our board of directors for 2011. Aylwin, our President and Chief Executive Officer, receives no additional compensation for his service on our board of directors:

Name	Fees Earned or Paid in Cash	Total
Bryant Keil (1)	\$ 0	\$ 0
Vann Avedisian	\$ 0	\$ 0
Peter Bassi (2)	\$ 60,000	\$ 60,000
Gerald Gallagher	\$ 0	\$ 0
Marla Gottschalk (2)	\$ 60,000	\$ 60,000
Matthew Levine	\$ 0	\$ 0
Dan Levitan	\$ 0	\$ 0

(1) At December 25, 2011, Bryant had options to purchase 125,000 shares of common stock and 500,000 shares of non-voting common stock, which he received as an employee of the company, all of which are vested.

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Immediately prior to the completion of this offering our non-voting common stock will automatically convert into common stock on a 1:1 basis pursuant to our sixth amended and restated certificate of incorporation.

- (2) Peter elected to receive \$30,000 of his compensation in options to purchase common stock and Marla elected to receive all \$60,000 of her compensation as options to purchase common stock. For both of these directors, the number of options granted in lieu of cash compensation was based on the aggregate grant date fair value of stock option awards computed in accordance with FASB ASC Topic 718. See Note 12, "Stock Options," to our consolidated financial statements for the year ended December 25, 2011 for the assumptions made to value the stock option awards. At December 25, 2011, Peter had options to purchase 19,585 shares of common stock and Marla had options to purchase 39,169 shares of common stock. These options vest 50% upon the first anniversary of the award and 50% upon the second anniversary of the award.

Our board of directors has generally been comprised of the original investors that have served the company while receiving no compensation. Only our two newest directors, Peter Bassi and Marla Gottschalk, are compensated by the company for their service. They currently receive an annual fee of \$60,000, which they may elect to receive in the form of cash, options or a combination of cash and options.

After the consummation of our initial public offering, we intend to implement a director compensation program pursuant to which all non-employee directors will receive an annual retainer of \$40,000 in cash plus options having a grant date fair value of \$40,000. At that time, we also intend to add stock ownership guidelines for our directors which will require them to own an amount of shares of our common stock valued at four times annual cash compensation for directors. Directors will have five years following the consummation of our initial public offering, or, if later, five years from the date they join the board of directors, to achieve the requisite amount of stock ownership. Only ownership of common stock will count towards our stock ownership threshold and, under the guidelines, unexercised options will not count for this purpose.

### **Equity Incentive Plans**

The following is a summary of the company's existing equity incentive plans as well as a summary of the equity incentive plan that we intend to adopt in connection with this offering. The summary below does not contain complete descriptions of all provisions of our equity incentive plans and is qualified in its entirety by reference to the plans, copies of which will be included as exhibits to the registration statement of which this prospectus forms a part. See "Where You Can Find More Information."

#### *2013 Long-Term Incentive Plan*

In connection with this offering, we plan to adopt the Potbelly Corporation 2013 Long-Term Incentive Plan (the "2013 Incentive Plan"), which will replace our 2004 Incentive Plan (described below) (provided that awards outstanding under the 2004 Incentive Plan will continue to be subject to the terms of the 2004 Incentive Plan). The following summary describes the material terms of the 2013 Incentive Plan.

*Purpose.* The purpose of the 2013 Incentive Plan is to:

- align the interests of our stockholders and the recipients of awards under the plan by increasing the proprietary interest of such recipients in the company's growth and success;
- advance the company's interests by attracting and retaining qualified employees, outside directors and other persons providing services to the company and/or its related companies; and
- motivate such persons to act in the long-term best interests of our stockholders.

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*Administration.* The 2013 Incentive Plan generally will be administered by the compensation committee of the board of directors. The compensation committee will select award recipients under the 2013 Incentive Plan who will thereby become participants, the types of awards to be granted and the applicable terms, conditions, performance criteria, restrictions and other provisions of such awards, not inconsistent with the plan. The compensation committee will also have the authority to conclusively interpret the 2013 Incentive Plan. Subject to the applicable exchange rules and applicable law, the compensation committee may delegate all or any portion of its responsibilities or powers under the 2013 Incentive Plan to persons selected by it.

*Authorized Shares.* The company plans to reserve \_\_\_\_\_ shares of our common stock for issuance pursuant to the 2013 Incentive Plan. Any shares of our common stock covered by an award under the 2013 Incentive Plan that expires or is forfeited or terminated without issuance of shares of common stock (including shares of common stock that are attributable to awards that are settled in cash or used to satisfy the applicable tax withholding obligation or to pay the exercise price of an award) will again be available for awards under the 2013 Incentive Plan.

*Additional Limits.* The following additional limits will apply to awards under the 2013 Incentive Plan: (i) no more than \_\_\_\_\_ shares of common stock may be subject to incentive stock options (“ISOs”) granted under the 2013 Incentive Plan; (ii) the maximum number of shares of common stock that may be covered by options and SARs granted to any one participant in any one calendar year may not exceed \_\_\_\_\_ shares of common stock; (iii) with respect to full value awards (as described below) that are intended to be performance-based compensation, the maximum number of shares of common stock that may be delivered pursuant to any such award granted to any one participant during any calendar year, regardless of whether settlement of the award is to occur prior to, at the time of, or after the time of vesting, may not exceed \_\_\_\_\_ shares of common stock; and (iv) in the case of cash incentive awards that are intended to be performance-based compensation, the maximum amount payable to any one participant with respect to any performance period of twelve months (pro rated for performance periods of greater or lesser than 12 months) is \$ \_\_\_\_\_.

*Adjustments.* In the event of a corporate transaction, including a stock dividend, stock split, reverse stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, exchange of shares, sale of assets or subsidiaries, combination or other corporate transaction, that affects our common stock such that the compensation committee determines that an adjustment is warranted in order to preserve the benefits or prevent the enlargement of benefits of awards under the 2013 Incentive Plan, the compensation committee will make adjustments to awards in a manner that it determines to be equitable in its discretion. Actions that the compensation committee may take are: (i) adjustment of the number and kind of shares which may be delivered under the 2013 Incentive Plan (including adjustments to the individual limitations described above); (ii) adjustment of the number and kind of shares subject to outstanding awards; (iii) adjustment of the exercise price of outstanding options and SARs; and (iv) any other adjustments that the compensation committee determines to be equitable, which may include, without limitation, (A) replacement of awards with other awards which the compensation committee determines have comparable value and which are based on stock of a company resulting from the transaction, and (B) cancellation of the award in return for cash payment of the current value of the award, determined as though the award is fully vested at the time of payment, provided that in the case of an option or SAR, the amount of such payment may be the excess of the value of the shares of common stock subject to the option or SAR at the time of the transaction over the exercise price.

*Eligibility.* The compensation committee may grant awards under the 2013 Incentive Plan to any officer, director, employee, consultant, independent contractor or agent of the company and/or a related company, and persons who are expected to become an officer, director, employee, consultant, independent contractor or agent of the company or a related company. Awards to a person who is expected to become a service provider to the company or a related company cannot be effective prior to the date on which such person’s service begins. ISOs may only be granted to employees of the company and its corporate related companies which satisfy certain Code requirements.

*Types of Awards.* The 2013 Incentive Plan will provide for grants of options (including nonqualified stock options (“NQOs”) and ISOs), SARs, full value awards and cash incentive awards.

- *Options and SARs.* The compensation committee may grant options to purchase shares of common stock, which options may be either ISOs or NQOs. ISOs may only be granted to employees of the company or its permitted corporate subsidiaries and must satisfy other requirements of section 422 of the Code. An option that does not satisfy the requirements for an ISO will be treated as a NQO. An SAR entitles the participant to receive (in shares of common stock or cash) an amount that is equal to the excess of the fair market value of a specified number of shares of common stock on the exercise date over the exercise price of the SAR. The exercise price of an option or SAR must be no less than the fair market value of a share of common stock on the date the option or SAR is granted. Except for reductions approved by the company’s stockholders or adjustment for business combinations, the exercise price of an option or SAR may not be decreased after the date of grant nor may an option or SAR be surrendered to the company as consideration for the grant of a replacement option or SAR with a lower exercise price or a full value award. In addition, except as approved by the company’s stockholders, no option granted under the 2013 Incentive Plan may be surrendered to the company in consideration of a cash payment if, at the time of such surrender, the exercise price of the option is greater than the then fair market value of a share of common stock. Except as provided by the compensation committee at the time of grant, an option or SAR will expire on the earliest to occur of the following (i) the one-year anniversary after the participant’s employment or service terminates for death or disability (as defined in the 2013 Incentive Plan), (ii) the three-month anniversary after the participant’s employment or service terminates other than for death, disability or cause (as defined in the 2013 Incentive Plan), or (iii) the day preceding the date on which the participant’s employment or service terminates for cause. In any event, an option or SAR will expire no later than the 10<sup>th</sup> anniversary of the date on which it is granted (or such shorter period required by the rules of any stock exchange on which the common stock is listed).
- *Full Value Awards.* A full value award is a grant of one or more shares of common stock or a right to receive one or more shares of common stock in the future (including restricted stock, restricted stock units, deferred stock units, performance stock and performance stock units). Any full value awards will be subject to such other conditions, restrictions and contingencies as the compensation committee determines including provisions relating to dividends or dividend equivalent rights and deferred payment or settlement. Special vesting restrictions also apply to full value awards made to employees.
- *Cash Incentive awards.* A cash incentive award is the grant of a right to receive a payment of cash (or in the discretion of the compensation committee, shares of common stock having value equivalent to the cash otherwise payable) that is contingent on achievement of performance objectives over a specified period established by the compensation committee. The grant of cash incentive awards may also be subject to such other conditions, restrictions and contingencies, as determined by the compensation committee, including provisions relating to deferred payment.

*Performance Measures.* The compensation committee may designate a Full Value Award or cash incentive award granted to any participant as “performance-based compensation” within the meaning of section 162(m) of the Code and regulations thereunder. To the extent required by section 162(m) of the Code, any Full Value Award or cash incentive award so designated shall be conditioned on the achievement of one or more performance targets as determined by the compensation committee, as follows: (i) earnings including operating income, net operating income, same store net operating income, earnings before or after taxes, earnings before or after interest, depreciation, amortization, or extraordinary or special items or book value per share (which may exclude nonrecurring items) or net earnings; (ii) pre-tax income or after-tax income; (iii) earnings per share (basic or diluted); (iv) operating profit; (v) revenue, revenue growth or rate of revenue growth; (vi) return on assets (gross or net), return on investment (including cash flow return on investment), return on capital (including



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return on total capital or return on invested capital), or return on equity; (vii) returns on sales or revenues; (viii) operating expenses; (ix) stock price appreciation; (x) cash flow (before or after dividends), free cash flow, cash flow return on investment (discounted or otherwise), net cash provided by operations, cash flow in excess of cost of capital or cash flow per share (before or after dividends); (xi) implementation or completion of critical projects or processes; (xii) economic value created; (xiii) cumulative earnings per share growth; (xiv) operating margin or profit margin; (xv) stock price or total stockholder return; (xvi) cost targets, reductions and savings, productivity and efficiencies; (xvii) strategic business criteria, consisting of one or more objectives based on meeting specified market penetration, geographic business expansion, customer satisfaction, employee satisfaction, human resources management, supervision of litigation and other legal matters, information technology, and goals relating to contributions, dispositions, acquisitions, development and development related activity, capital markets activity and credit ratings, joint ventures and other private capital activity including generating incentive and other fees and raising equity commitments, and other transactions, and budget comparisons; (xviii) personal professional objectives, including any of the foregoing performance targets, the implementation of policies and plans, the negotiation of transactions, the development of long term business goals, formation and reorganization of joint ventures and other private capital activity including generating incentive and other fees and raising equity commitments, research or development collaborations, and the completion of other corporate transactions; (xix) funds from operations (FFO) or funds available for distribution (FAD); (xx) economic value added (or an equivalent metric); (xxi) stock price performance; (xxii) improvement in or attainment of expense levels or working capital levels; (xxiii) operating portfolio metrics including leasing and tenant retention, (xxiv) new store results, or (xxv) any combination of, or a specified increase in, any of the foregoing. The performance targets may be expressed in terms of attaining a specified level of the particular criteria or the attainment of a percentage increase or decrease in the particular criteria, and may be applied to one or more of the company, a related company, or a division or strategic business unit of the company, or may be applied to the performance of the company relative to a market index, a group of other companies or a combination thereof, all as determined by the compensation committee.

*Transferability.* Awards under the plan generally may not be transferred except through will or by the laws of descent and distribution; provided, however, that unless otherwise provided by the compensation committee, awards (other than an ISO) may be transferred to or for the benefit of the participant's family (including, without limitation, to a trust or partnership for the benefit of a Participant's family) in accordance with rules established by the compensation committee.

*Change in Control.* In the event that (i) a participant is employed on the date of a Change in Control (as defined in the 2013 Incentive Plan) and the participant's employment or service, as applicable, is terminated by the company, its successor or a related company that is the participant's employer for reasons other than cause (as defined in the 2013 Incentive Plan) within 24 months following the Change in Control, or (ii) the 2013 Incentive Plan is terminated by the company or its successor following a Change in Control without provision for the continuation of outstanding awards under the 2013 Incentive Plan, all options, SARs and related awards which have not otherwise expired will become immediately exercisable and all other awards will become fully vested. A participant's employment or service will be deemed to have been terminated by the company or a successor for reasons other than for cause if the participant terminates employment or service after a substantial adverse alteration in the nature of the participant's status or responsibilities from those in effect immediately prior to the Change in Control or a material reduction in the participant's annual base salary and target bonus, or in the case of an outside director his annual compensation, as in effect immediately prior to the Change in Control. Special rules apply if, upon a Change in Control, awards in other shares or securities are substituted for outstanding awards under the 2013 Incentive Plan and if, immediately prior to the Change in Control, the participant becomes an employee or a director of, as applicable, the successor to the company.

*Amendment and Termination.* The board of directors may, at any time, amend or terminate the 2013 Incentive Plan, and the board of directors or the compensation committee may amend any award agreement, provided that no amendment or termination may, in the absence of written consent to the change by the affected participant (or, if the participant is not then living, the affected beneficiary), adversely affect the rights of any

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participant or beneficiary under any award granted under the 2013 Incentive Plan prior to the date such amendment is adopted by the board of directors (or the compensation committee, if applicable). Adjustments to the 2013 Incentive Plan and awards on account of business transactions (as described above) are not subject to the foregoing prohibition. The provisions of the 2013 Incentive Plan that prohibit repricing of options and SARs or exchanges of an option or SAR for another award if the exercise price is below fair market value on the date of the exchange cannot be amended unless the amendment is approved by the company's stockholders.

*2004 Equity Incentive Plan*

The following is a description of the material terms of the Potbelly Corporation 2004 Equity Incentive Plan (the "2004 Incentive Plan"). As discussed above, once the 2013 Incentive Plan is effective, we will no longer make awards under the 2004 Incentive Plan. However, the 2004 Incentive Plan will continue to govern outstanding awards granted prior to its termination.

*Types and Terms of Awards.* The 2004 Incentive Plan provides for grants of stock options, stock appreciation rights, restricted stock, bonus stock and performance shares. The terms of the award, such as amount, exercise price, expiration date, vesting, restriction period, performance period and performance measures, are set at the time of grant.

*Administration.* The 2004 Incentive Plan is administered by the compensation committee of the board of directors.

*Authorized Shares.* A total of 4,025,998 shares of common stock were available under the 2004 Incentive Plan. As of September 23, 2012, options to purchase 3,675,325 shares of our common stock at a weighted average exercise price of approximately \$8.74 were outstanding under the 2004 Incentive Plan.

*Eligibility.* The 2004 Incentive Plan permits awards to be granted to officers, other employees, persons expected to become officers or other employees, directors, consultants, independent contractors and agents of the company.

*Termination of Employment.* The terms relating to exercise, cancellation, other disposition, forfeiture, satisfaction of performance measures, termination of restriction periods or termination of performance periods upon termination of employment with or service to the company, whether by reason of disability, cause, retirement, death or other termination, are set forth in the underlying award agreement.

*Transferability.* Awards under the 2004 Incentive Plan generally may not be transferred except through will or by the laws of descent and distribution, unless approved by the company. However, if provided in an award agreement, certain additional transfers may be permitted in limited circumstances.

*Change in Control.* In the event of a Corporate Transaction (which term includes transactions involving a 50% change in ownership of the company, whether through acquisition of common stock or voting power or through the consummation of a reorganization, merger, consolidation or asset sale, as further defined in the 2004 Incentive Plan), the board of directors may:

- provide that such options shall be assumed, or equivalent options shall be substituted, by the acquiring or succeeding corporation or entity (or an affiliate thereof);
- upon written notice to the optionees, provide that (A) all exercisable but unexercised options will terminate immediately prior to the consummation of such transaction unless exercised by the optionee within a specified period following the date of such notice and prior to the consummation of such event or transaction and (B) all unexercisable options will terminate upon consummation of such event or transaction;

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- in the event of a merger or consolidation under the terms of which holders of our common stock will receive a cash payment for each share surrendered in the merger or consolidation, make or provide for a cash payment to the optionees equal to the difference between the merger price and the exercise price of all such outstanding options, in exchange for the termination of such options; or
- provide that all or any outstanding options shall become exercisable in full immediately prior to such event or transaction and shall cease to be exercisable at any time after such event or transaction.

*Amendment and Termination.* The board of directors may, at any time, amend, suspend or terminate the 2004 Incentive Plan as it shall deem advisable, subject to any stockholder approval required by applicable law, rule or regulation. No amendment may impair the rights of a holder of an outstanding award without the consent of such holder.

### *2001 Equity Incentive Plan*

Awards may no longer be made under the Potbelly Sandwich Works, Inc. 2001 Equity Incentive Plan (the “2001 Incentive Plan”). However, the 2001 Incentive Plan will continue to govern outstanding awards granted prior to its termination. The 2001 Incentive Plan is generally comparable to the 2004 Incentive Plan. The plan provided for grants of stock options, stock appreciation rights, restricted stock, bonus stock and performance shares. The plan permitted awards to officers, other employees, persons expected to become officers or other employees, directors, consultants, independent contractors and agents of the company. Originally, 1,075,499 shares of common stock were available under the 2001 Incentive Plan. As of September 23, 2012, options to purchase 270,724 shares of our common stock at a weighted average exercise price of approximately \$5.86 were outstanding under the 2001 Incentive Plan. The provisions under the 2001 Incentive Plan with respect to a Corporate Transaction are comparable to the provisions described above with respect to the 2004 Incentive Plan. The terms relating to exercise, cancellation, other disposition, forfeitures, satisfaction of performance measures, termination of restriction periods or termination of performance periods upon termination of employment with or service to the company, whether by reason of disability, cause, retirement, death or other termination, are set forth in the underlying award agreements. The board of directors may, at any time, amend, suspend or terminate the 2001 Incentive Plan as it shall deem advisable, subject to any stockholder approval required by applicable law, rule or regulation. No amendment may impair the rights of a holder of an outstanding award without the consent of such holder.

## RELATED PARTY TRANSACTIONS

### Arrangements with Our Investors

#### *Stockholders Agreement*

On June 1, 2011, we entered into a Seventh Amended and Restated Stockholders Agreement (the “Stockholders Agreement”) with certain holders of our preferred stock, including ASP PBSW, LLC (“American Securities”); Benchmark Capital Partners IV, L.P., Benchmark Founders’ Fund IV, L.P., Benchmark Founders’ Fund IV-A, L.P., Benchmark Founders’ Fund IV-B, L.P. and related parties; Maveron Equity Partners 2000, L.P., Maveron Equity Partners III, L.P. and their affiliated funds (the “Maveron Stockholders”); Oak Investment Partners IX, Limited Partnership, Oak IX Affiliates Fund, Limited Partnership and Oak IX Affiliates Fund-A, Limited Partnership (the “Oak Stockholders”); and Oxford Blackpoint Venture Partners VII, LLC (the “Oxford Stockholder”), some of whom individually or together with their affiliates own 5% or more of our capital stock. The Stockholders Agreement superseded and replaced the previous stockholders agreement among the parties.

The Stockholders Agreement gives certain stockholders or groups of stockholders the right to appoint one or more directors each to our board of directors. It also provides that our Chief Executive Officer shall serve as a director and shall be entitled to appoint an additional independent director. The Stockholders Agreement sets a minimum voting threshold for the board of directors to take certain actions, including, among other things, a sale of the company, entering into a related party transaction, or amending our charter or by-laws. Among other things, the Stockholders Agreement also sets forth restrictions on transfers of our preferred stock and any sale of the company.

Upon the completion of a “QPO,” or a qualified public offering, with such term defined in the Stockholders Agreement to mean an initial public offering which meets certain pricing thresholds, the Stockholders Agreement will terminate in accordance with its terms. We believe that this offering will meet the requirements of a QPO.

#### *2012 Warrant Issuance*

In March 2012, we issued a warrant to purchase 241,704 shares of common stock at a price of \$8.16 per share to Oxford Capital Partners, Inc., (“OCPI”) an affiliate of the Oxford Stockholder. The warrant was issued to replace a previous warrant to purchase 200,000 shares of common stock at a price of \$5.00 per share that expired on September 1, 2011. Pursuant to the terms of the newly issued warrant, OCPI may exercise the warrant at any time prior to the earliest to occur of (i) our initial public offering, (ii) March 28, 2022 or (iii) a Liquidity Event (which term generally includes a sale of all or substantially all of our assets or a transfer of the voting power to elect a majority of our board of directors through a sale of our capital stock or the consummation of a merger or consolidation). The warrant was issued to OCPI in recognition of the exemplary past and expected continued service of one of our directors, Vann Avedisian, a co-owner of OCPI.

#### *2011 Stock Repurchase*

In June 2011, we repurchased certain common and preferred shares from Bryant Keil, our Founding Chairman. We repurchased and retired 500,000 shares of \$0.01 par value Series A preferred stock at a purchase price of \$10.00 per share and 1,180,748 of \$0.01 par value common stock at a purchase price of \$7.22 per share, for a total purchase price of approximately \$13,525,000. In connection with the stock repurchase, we entered into an agreement with Bryant that, among other things, provided Bryant the right to terminate (a) 50,000 options with an exercise price of \$6.00 per share that expire on February 6, 2013 and (b) 75,000 options with an exercise price of \$9.00 per share that expire on January 1, 2014. If Bryant elects to terminate these options prior to their expiration, we will provide him with economically equivalent replacement options. In accordance with the agreement and upon termination of such options, the number of shares and exercise price of the replacement options will be calculated in accordance with set formulas based on multiple factors as determined by our board of directors, including future target common share prices. The replacement options will be exercisable within ten years after the respective expiration dates of the terminated option agreements. As of September 23, 2012, no replacement options had been issued.

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### *2010 Stock Issuance and Repurchase*

In July 2010, we issued 84,898 shares (59,895 shares net of tax withholding) of our Series F preferred stock to Aylwin Lewis, our Chief Executive Officer and President, as his 2009 bonus compensation. The fair market value of such issuance was \$9.35 per share, or \$793,796 in aggregate consideration. We then immediately repurchased 25,003 shares of our Series F preferred stock from Aylwin at fair value for a total purchase price of \$233,778.

### *2009 Preferred Stock Issuances*

In January 2009, we sold a total of 679,641 shares of our Series F preferred stock at a price of \$8.00 per share. We sold the following shares of our Series F preferred stock in the amounts and to the parties set forth below:

- 100,000 shares of our Series F preferred stock for an aggregate purchase price of \$800,000 to the Oak Stockholders;
- 100,000 shares of our Series F preferred stock for an aggregate purchase price of \$800,000 to certain of the Maveron Stockholders;
- 104,375 shares of our Series F preferred stock for an aggregate purchase price of \$835,000 to WI-Potbelly II, LLC, an affiliate of Waveland Investments LLC; and
- 100,000 shares of our Series F preferred stock for an aggregate purchase price of \$800,000 to American Securities.

Concurrent with this issuance of our Series F preferred stock, we issued warrants to purchase our common stock with an exercise price of \$0.01 to the Oak Stockholders for 30,000 shares, to certain of the Maveron Stockholders for 30,000 shares, to WI-Potbelly II, LLC, an affiliate of Waveland Investments LLC, for 16,929 shares, and to American Securities, for 30,000 shares. These warrants expire prior to the earliest to occur of (i) an initial public offering, (ii) a liquidity event or (iii) December 24, 2013.

### *2009 Common Stock Issuances*

In March 2009, we issued 25,000 shares (17,637 shares net of tax withholding) to Aylwin Lewis, our Chief Executive Officer and President, as his 2008 bonus compensation in lieu of a cash bonus of \$200,000, for an effective price of \$8.00 per share.

### **Indemnification Agreements**

We expect to enter into indemnification agreements with our current directors and executive officers prior to the completion of this offering and expect to enter into a similar agreement with any new directors or executive officers. We expect to increase our directors' and officers' liability insurance coverage prior to the completion of this offering.

### **Review, Approval or Ratification of Transactions With Related Persons**

We adopted requirements for the approval of certain related party transactions in our by-laws effective June 1, 2011, and in the Stockholders Agreement (defined above). Both documents require a vote of at least six members of the board of directors to approve a transaction or dealing with any of our Affiliates, as such term is defined in the Stockholders Agreement.

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We will adopt a new policy relating to the approval of related party transactions following the completion of this offering. Our audit committee will review certain financial transactions, arrangements and relationships between us and any of the following related parties to determine whether any such transaction, arrangement or relationship is a related party transaction:

- any of our directors, director nominees or executive officers;
- any beneficial owner of more than 5% of our outstanding stock; and
- any immediate family member of any of the foregoing.

Our audit committee will review any financial transaction, arrangement or relationship that:

- involves or will involve, directly or indirectly, any related party identified above and is in an amount greater than \$120,000;
- would cast doubt on the independence of a director;
- would present the appearance of a conflict of interest between us and the related party; or
- is otherwise prohibited by law, rule or regulation.

The audit committee will review each such transaction, arrangement or relationship to determine whether a related party has, has had or expects to have a direct or indirect material interest. Following its review, the audit committee will take such action as it deems necessary and appropriate under the circumstances, including approving, disapproving, ratifying, cancelling or recommending to management how to proceed if it determines a related party has a direct or indirect material interest in a transaction, arrangement or relationship with us. Any member of the audit committee who is a related party with respect to a transaction under review will not be permitted to participate in the discussions or evaluations of the transaction; however, the audit committee member will provide all material information concerning the transaction to the audit committee. The audit committee will report its action with respect to any related party transaction to the board of directors.

## DESCRIPTION OF CREDIT FACILITY

On September 21, 2012, our wholly-owned subsidiary, Potbelly Sandwich Works, LLC (“PSW”), as borrower, Potbelly Illinois, Inc., PSW’s immediate parent corporation, Potbelly Corporation and all of our wholly-owned subsidiaries entered into a senior secured credit facility with JPMorgan Chase Bank, N.A. (“Chase”), as lender and administrative agent. The credit facility provides for senior secured financing, consisting of a revolving credit facility in an initial aggregate commitment amount of \$35.0 million, including a letter of credit sub-facility, that matures September 21, 2017. PSW 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 obligations under the credit facility are guaranteed by us and each of our existing and future domestic wholly-owned subsidiaries and are secured by a perfected security interest on substantially all of the assets of us and such subsidiaries.

The credit facility requires us to comply with certain financial covenants, including a Debt Service Coverage Ratio and a Leverage Ratio (both as defined in the credit agreement). In addition, the credit agreement includes negative covenants limiting, among other things, additional indebtedness, additional liens, transactions with affiliates, sales of assets, investments and advancements, prepayments of debt, mergers and acquisitions and certain other matters customarily restricted in such agreements. The credit facility also limits the “restricted payments” (primarily distributions and equity repurchases) that PSW or Potbelly Corporation may make to \$20 million in any trailing 12-month period or \$40 million during the term of the credit facility. The credit facility contains certain customary representations and warranties, affirmative covenants and events of default. If an event of default occurs, the lenders under the credit facility will be entitled to take various actions, including the acceleration of amounts due under the credit facility and all actions permitted to be taken by a secured creditor.

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 1.10% to 1.75% or (ii) a prime rate as announced by Chase plus a margin ranging from 0.00% to 0.50%. The applicable margin is determined based upon our consolidated total leverage ratio. Swingline loans bear interest at the rate applicable to base rate loans. On the last day of each calendar quarter, PSW is required to pay a commitment fee ranging from 0.25% to 0.35% per annum in respect of any unused commitments under the credit facility, with the specific rate determined based upon our consolidated total leverage ratio.

This summary describes the material provisions of the credit facility, but may not contain all the information that is important to you. We urge you to read the provisions of the credit agreement governing the credit facility, which has been included as an exhibit to the registration statement of which this prospectus forms a part. See “Where You Can Find More Information.”

**PRINCIPAL AND SELLING STOCKHOLDERS**

The following table sets forth certain information with respect to the beneficial ownership of our common stock at \_\_\_\_\_, 2012 for:

- each person whom we know beneficially owns more than five percent of our common stock;
- each of our named executive officers;
- each of our directors;
- all of our directors and executive officers as a group; and
- each selling stockholder.

The number of shares beneficially owned by each stockholder is determined under rules issued by the SEC. Unless otherwise indicated below, the address for each listed director, officer and stockholder is c/o Potbelly Corporation, 222 Merchandise Mart Plaza, 23<sup>rd</sup> Floor, Chicago, Illinois 60654. Certain of the selling stockholders in this offering may be deemed to be underwriters.

Beneficial ownership and the percentage of beneficial ownership by each person before the offering is based on \_\_\_\_\_ shares of common stock outstanding as of \_\_\_\_\_, 2012 after giving effect to the conversion of all outstanding shares of all series of our preferred stock into, and the exercise of all outstanding warrants for, an aggregate of 16,897,088 shares of common stock immediately prior to the completion of this offering, and the percentage beneficially owned after the offering is based on \_\_\_\_\_ shares of common stock expected to be outstanding following this offering after giving effect to the issuance of \_\_\_\_\_ of the shares of common stock offered hereby. See “Description of Capital Stock.” The information set forth below does not reflect any shares of our common stock that any of the persons named below may purchase pursuant to the reserved share program described elsewhere in this prospectus. See “Underwriting—Reserved Shares.” Shares of common stock that may be acquired within 60 days following \_\_\_\_\_, 2012 pursuant to the exercise of options are deemed to be outstanding for the purpose of computing the percentage ownership of such holder but are not deemed to be outstanding for computing the percentage ownership of any other person shown in the table.

Name of Beneficial Owner	Shares Beneficially Owned before the Offering		Number of Shares Offered	Shares Beneficially Owned after the Offering				
	Number	Percentage		Number	Percentage	Number of Shares Offered at Underwriters Option	Number if Option Exercised in Full	Percentage if Option Exercised in Full
<b>5% stockholders:</b>								
Maveron								
American Securities LLC								
Oak Investment Partners								
Benchmark Capital								
Oxford Blackpoint Venture Partners VII, LLC								
Waveland Investments LLC								



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<u>Name of Beneficial Owner</u>	<u>Shares Beneficially Owned before the Offering</u>		<u>Number of Shares Offered</u>	<u>Shares Beneficially Owned after the Offering</u>				
	<u>Number</u>	<u>Percentage</u>		<u>Number</u>	<u>Percentage</u>	<u>Number of Shares Offered at Underwriters Option</u>	<u>Number if Option Exercised in Full</u>	<u>Percentage if Option Exercised in Full</u>
<b>Named executive officers and directors:</b>								
Aylwin Lewis								
John Morlock								
Carl Segal								
Charles Talbot								
Matthew Revord								
Nancy Turk								
Bryant Keil								
Vann Avedisian								
Peter Bassi								
Gerald Gallagher								
Marla Gottschalk								
Matthew Levine								
Dan Levitan								
All executive officers and directors as a group (13 persons)								
<b>Other Selling Stockholders:</b>								

\* Indicates less than one percent of common stock.

## DESCRIPTION OF CAPITAL STOCK

### General

Upon the closing of this offering, our certificate of incorporation will be amended and restated to provide for authorized capital stock of \_\_\_\_\_ shares of common stock, par value \$0.01 per share, and \_\_\_\_\_ shares of undesignated preferred stock. As of September 23, 2012, we had outstanding 3,972,873 shares of common stock held by 33 stockholders of record, and we had outstanding options to purchase 4,446,049 shares of our common stock at a weighted average exercise price of \$9.16 per share, of which options to purchase 3,032,113 shares at a weighted average exercise price of \$9.90 were vested as of September 23, 2012.

After giving effect to this offering, we will have \_\_\_\_\_ shares of common stock and no shares of preferred stock outstanding. The following summary describes all material provisions of our capital stock. We urge you to read our certificate of incorporation and our by-laws, which are included as exhibits to the registration statement of which this prospectus forms a part.

Our certificate of incorporation and by-laws will contain provisions that are intended to enhance the likelihood of continuity and stability in the composition of the board of directors and that may have the effect of delaying, deferring or preventing a future takeover or change in control of our company unless that takeover or change in control is approved by our board of directors. These provisions include a classified board of directors, elimination of stockholder action by written consents (except in limited circumstances), elimination of the ability of stockholders to call special meetings (except in limited circumstances), advance notice procedures for stockholder proposals, and supermajority vote requirements for amendments to our by-laws.

### Common Stock

*Dividend Rights.* Subject to preferences that may apply to shares of preferred stock outstanding at the time, holders of outstanding shares of common stock will be entitled to receive dividends out of assets legally available at the times and in the amounts as the board of directors may from time to time determine.

*Voting Rights.* Each outstanding share of common stock will be entitled to one vote on all matters submitted to a vote of stockholders. Our certificate of incorporation will not provide for cumulative voting in connection with the election of directors, and accordingly, holders of more than 50% of the shares voting will be able to elect all of the directors. The holders of a majority of the shares of common stock issued and outstanding constitute a quorum at all meetings of the stockholders for the transaction of business.

*Preemptive Rights.* Our common stock will not be entitled to preemptive or other similar subscription rights to purchase any of our securities.

*Conversion or Redemption Rights.* Our common stock will be neither convertible nor redeemable.

*Liquidation Rights.* Upon our liquidation, the holders of our common stock will be entitled to receive pro rata our assets that are legally available for distribution, after payment of all debts and other liabilities and subject to the prior rights of any holders of preferred stock then outstanding.

*Listing.* We have applied to have our shares of common stock listed on the Nasdaq Global Select Market under the symbol “\_\_\_\_\_.”

### Warrants

As of September 23, 2012, we had outstanding warrants to purchase 620,700 shares of common stock. As of such date, warrants to purchase 378,996 shares of common stock were exercisable by the holders thereof

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for \$0.01 per share at any time prior to the earliest to occur of (i) the company's initial public offering, (ii) December 24, 2013 or (iii) a Liquidity Event (which term generally includes a sale of all or substantially all of the assets of the company or a transfer of the voting power to elect a majority of the board of directors of the company through a sale of the company's capital stock or the consummation of a merger or consolidation). Additionally, warrants to purchase 241,704 shares of common stock were exercisable by the holders thereof for \$8.16 per share at any time prior to the earliest to occur of (i) the company's initial public offering, (ii) March 28, 2022 or (iii) a Liquidity Event. Accordingly, upon the consummation of this offering, no warrants exercisable for our common stock will be outstanding.

### **Preferred Stock**

Our board of directors may, without further action by our stockholders, from time to time, direct the issuance of shares of preferred stock in series and may, at the time of issuance, determine the designations, powers, preferences, privileges, and relative participating, optional or special rights as well as the qualifications, limitations or restrictions thereof, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, any or all of which may be greater than the rights of the common stock. Satisfaction of any dividend preferences of outstanding shares of preferred stock would reduce the amount of funds available for the payment of dividends on shares of our common stock. Holders of shares of preferred stock may be entitled to receive a preference payment in the event of our liquidation before any payment is made to the holders of shares of our common stock. Under specified circumstances, the issuance of shares of preferred stock may render more difficult or tend to discourage a merger, tender offer or proxy contest, the assumption of control by a holder of a large block of our securities or the removal of incumbent management. Upon the affirmative vote of a majority of the total number of directors then in office, our board of directors, without stockholder approval, may issue shares of preferred stock with voting and conversion rights that could adversely affect the holders of shares of our common stock and the market value of our common stock. Upon completion of this offering, there will be no shares of preferred stock outstanding, and we have no present intention to issue any shares of preferred stock.

### **Registration Rights Agreement**

The following describes the registration rights of certain of our stockholders pursuant to our registration rights agreement.

*Long-Form Registration Rights.* At any time following the earlier of (a) December 24, 2013 or (b) the date which is six months after the date we consummate our initial public offering, holders of our Registrable Securities (as defined below) may require us to register such Registrable Securities under the Securities Act (a "Long-Form Registration"). All holders of Registrable Securities have the right to request a Long-Form Registration. However, the registration rights agreement provides that we are not required to conduct a Long-Form Registration unless such a registration is requested by holders of a majority of the Registrable Securities (excluding certain Registrable Securities held by Bryant Keil and his affiliates) then outstanding. We are not required to conduct more than two Long-Form Registrations. "Registrable Securities" include, among other things, any common stock held by our preferred stockholders and any common stock issued upon the conversion of any preferred stock or the exercise of certain warrants. As of December 30, 2012, we had 20,125,917 Registrable Securities outstanding.

*Short-Form Registration Rights.* When we become qualified to file registration statements on Form S-3, any preferred stockholder may request that we register such holder's Registrable Securities on Form S-3. However, we are not required to register securities on Form S-3 more than twice in one year or if the aggregate offering price would be less than \$1 million.

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*Piggyback Registration Rights.* If we propose to register any of our securities under the Securities Act, and the registration form to be used may be used for the registration of Registrable Securities, then we are required to give notice to all holders of Registrable Securities and provide them with the right to include their shares in the registration statement. Such piggyback registration rights are subject to certain exceptions, conditions and limitations, including, without limitation, pro rata reductions in the number of shares to be sold by holders of Registrable Securities. In addition, pursuant to the terms of the registration rights agreement, the holders of Registrable Securities may not require registration of their securities in this offering unless other stockholders' securities are included in such registration.

*Expenses of Registration.* We are required to bear the registration expenses (other than underwriting discounts and commissions) associated with any registration in accordance with the registration rights agreement, including, in certain cases, the reasonable fees of counsel chosen by the holders of a majority of the Registrable Securities included in the registration.

*Termination of Registration Rights.* The registration rights agreement will terminate on the fourth anniversary of the consummation of our initial public offering.

### **Anti-Takeover Effects of Our Certificate of Incorporation and By-laws**

#### *Delaware Anti-Takeover Law*

We are subject to Section 203 of the Delaware General Corporation Law. Section 203 generally prohibits a public Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless:

- prior to the date of the transaction, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;
- upon consummation of the transactions which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding (a) shares owned by persons who are directors and also officers and (b) shares owned by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- on or subsequent to the date of the transaction, the business combination is approved by the board of directors of the corporation and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66-2/3% of the outstanding voting stock which is not owned by the interested stockholder.

Section 203 defines a business combination to include:

- any merger or consolidation of the corporation or any majority-owned subsidiary of the corporation with the interested stockholder;
- any sale, transfer, pledge or other disposition involving of 10% or more of the assets of the corporation involving the interested stockholder;
- subject to exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;

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- any transaction involving the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation beneficially owned by the interested stockholder; and
- the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.

In general, Section 203 defines an interested stockholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation at any time within three years immediately prior to the date of determination and any entity or person affiliated with or controlling or controlled by the entity or person.

### *Certificate of Incorporation and By-law Provisions*

Our certificate of incorporation and by-laws will contain certain provisions that are intended to enhance the likelihood of continuity and stability in the composition of our board of directors and that may have the effect of delaying, deferring or preventing a future takeover or change in control of the company unless that takeover or change in control is approved by our board of directors.

These provisions include:

*Classified Board.* Our certificate of incorporation will provide that our board of directors will be divided into three classes of directors, with the classes as nearly equal in number as possible. As a result, approximately one-third of our board of directors will be elected each year. Our classified board structure will be in effect for at least one full election cycle so that at the fifth annual meeting of stockholders following the completion of this offering, we will begin the process of phasing out staggered elections. Accordingly, beginning with the 2018 annual meeting of stockholders, directors will be elected for a term expiring at the next annual meeting of stockholders. Until our board of directors is fully declassified, the classified nature of our board of directors could have the effect of delaying or discouraging an acquisition of us or a change in our management.

In addition, because our board initially will be classified, under Delaware General Corporation Law, directors may only be removed for cause. Our certificate of incorporation will also provide that, subject to any rights of holders of preferred stock to elect additional directors under specified circumstances, the number of directors will be fixed exclusively pursuant to a resolution adopted by our board of directors but will consist of not more than twelve directors. Upon completion of this offering, our board of directors will have nine members. Our certificate of incorporation and by-laws will provide that the authorized number of directors may be changed only by resolution of the board of directors and that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum.

*Action by Written Consent; Special Meetings of Stockholders.* Our certificate of incorporation will provide that stockholder action can be taken only at an annual or special meeting of stockholders and cannot be taken by written consent in lieu of a meeting. Our certificate of incorporation and by-laws will also provide that special meetings of our stockholders may be called only by the chairman of the board, our Chief Executive Officer or the board of directors pursuant to a resolution adopted by a majority of the total number of authorized directors. Except as otherwise required by law, stockholders will not be permitted to call a special meeting or to require the board of directors to call a special meeting.

*Super Majority Approval Requirements.* The Delaware General Corporation Law generally provides that the affirmative vote of a majority of the outstanding stock entitled to vote on any matter is required to amend a corporation's bylaws, unless either a corporation's certificate of incorporation or bylaws require a greater percentage. Our certificate of incorporation provides that the affirmative vote of holders of at least 66-2/3% of

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the total votes entitled to vote in the election of directors will be required to amend, alter, change or repeal our by-laws. This requirement of a supermajority vote to approve amendments to our by-laws could enable a minority of our stockholders to exercise veto power over any such amendments. Our board of directors retains the right to amend our by-laws.

*Advance Notice Procedures.* Our by-laws will establish an advance notice procedure for stockholder proposals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to the board of directors. Stockholders at an annual meeting will only be able to consider proposals or nominations specified in the notice of meeting or brought before the meeting by or at the direction of the board of directors or by a stockholder who was a stockholder of record on the record date for the meeting, who is entitled to vote at the meeting and who has given our Secretary timely written notice, in accordance with our by-laws, of the stockholder's intention to bring that business before the meeting. Although the by-laws will not give the board of directors the power to approve or disapprove stockholder nominations of candidates or proposals regarding other business to be conducted at a special or annual meeting, the by-laws may have the effect of precluding the conduct of certain business at a meeting if the proper procedures are not followed or may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect its own slate of directors or otherwise attempting to obtain control of the company.

*Authorized but Unissued Shares.* Our authorized but unissued shares of common stock and preferred stock will be available for future issuance without stockholder approval. These additional shares may be utilized for a variety of corporate purposes, including future public offerings to raise additional capital, corporate acquisitions and employee benefit plans. The existence of authorized but unissued shares of common stock and preferred stock could render more difficult or discourage an attempt to obtain control of a majority of our common stock by means of a proxy contest, tender offer, merger or otherwise.

*Exclusive Jurisdiction of Certain Actions.* Our certificate of incorporation will require, to the fullest extent permitted by law that derivative actions brought in the name of the company, actions against directors, officers and employees for breach of fiduciary duty and other similar actions may be brought only in the Court of Chancery in the State of Delaware. Although we believe this provision benefits the company by providing increased consistency in the application of Delaware law in the types of lawsuits to which it applies, the provision may have the effect of discouraging lawsuits against our directors and officers.

**Limitations on Liability and Indemnification of Officers and Directors**

Our certificate of incorporation will limit the liability of our directors to the fullest extent permitted by the Delaware General Corporation Law, and our by-laws will provide that we will indemnify them to the fullest extent permitted by such law. We expect to enter into indemnification agreements with our current directors and executive officers prior to the completion of this offering and expect to enter into a similar agreement with any new directors or executive officers. We expect to increase our directors' and officers' liability insurance coverage prior to the completion of this offering.

**Transfer Agent and Registrar**

The transfer agent and registrar for our common stock will be . Its telephone number is (toll free) or .

## SHARES ELIGIBLE FOR FUTURE SALE

Prior to this offering, there has been no market for shares of our common stock. We cannot predict the effect, if any, that future sales of shares of our common stock, or the availability for future sale of shares of our common stock, will have on the market price of shares of our common stock prevailing from time to time. The sale of substantial amounts of shares of our common stock in the market, or the perception that such sales could occur, could harm the prevailing market price of shares of our common stock.

### Sale of Restricted Shares

Upon completion of this offering, we will have \_\_\_\_\_ shares of common stock outstanding. Of these shares, the shares sold in this offering will be freely tradable without restriction under the Securities Act, except for any shares purchased by our “affiliates” as that term is defined in Rule 144 promulgated under the Securities Act. In general, affiliates include our executive officers, directors, and 10% stockholders. Shares purchased by affiliates will remain subject to the resale limitations of Rule 144.

Upon completion of this offering, \_\_\_\_\_ shares of our common stock will be “restricted securities,” as that term is defined in Rule 144 promulgated under the Securities Act. These restricted securities are eligible for public sale only if they are registered under the Securities Act or if they qualify for an exemption from registration under Rules 144 or 701 promulgated under the Securities Act, which are summarized below.

As a result of the lock-up agreements described below and the provisions of Rules 144 and Rule 701 promulgated under the Securities Act, the shares of our common stock (excluding the shares sold in this offering) will be available for sale in the public market as follows:

- no shares will be eligible for sale on the date of this prospectus;
- \_\_\_\_\_ shares will be eligible for sale upon the expiration of the lock-up agreements, as more particularly described below, beginning 180 days after the date of this prospectus, subject to certain exceptions; and
- \_\_\_\_\_ shares will be eligible for sale, upon the exercise of vested options and upon the expiration of the lock-up agreements, as more particularly described below, beginning 180 days after the date of this prospectus, subject to certain exceptions.

### Rule 144

Generally, Rule 144 provides that an affiliate who has beneficially owned “restricted” shares of our common stock for at least six months will be entitled to sell on the open market in brokers’ transactions, within any three-month period, a number of shares that does not exceed the greater of:

- 1% of the number of shares of our common stock then outstanding, which will equal approximately \_\_\_\_\_ shares immediately after this offering; or
- the average weekly trading volume of the common stock on the Nasdaq Global Select Market during the four calendar weeks preceding the filing of a notice on Form 144 with respect to such sale.

In addition, sales under Rule 144 are subject to requirements with respect to manner of sale, notice, and the availability of current public information about us.

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If any person who is deemed to be our affiliate purchases shares of our common stock, sales under Rule 144 of the shares held by that person will be subject to the volume limitations and other restrictions described in the preceding two paragraphs.

The volume limitation, manner of sale and notice provisions described above will not apply to sales by non-affiliates. For purposes of Rule 144, a non-affiliate is any person or entity who is not our affiliate at the time of sale and has not been our affiliate during the preceding three months. Once we have been a reporting company for 90 days, persons who have beneficially owned restricted shares of our common stock for six months may rely on Rule 144 provided that certain public information regarding us is available. The six-month holding period increases to one year if we have not been a reporting company for at least 90 days. However, a non-affiliate who has beneficially owned the restricted shares proposed to be sold for at least one year will not be subject to any restrictions under Rule 144 regardless of how long we have been a reporting company.

### **Rule 701**

Under Rule 701, each of our employees, officers, directors, consultants or advisors who purchased shares pursuant to a written compensatory plan or contract is eligible to resell these shares 90 days after the effective date of this offering in reliance upon Rule 144, but without compliance with specific restrictions. Rule 701 provides that affiliates may sell their Rule 701 shares under Rule 144 without complying with the holding period requirement and that non-affiliates may sell their shares in reliance on Rule 144 without complying with the holding period, public information, volume limitation, or notice provisions of Rule 144.

### **Lock-Up Agreements**

We, our directors and officers and substantially all of our stockholders have agreed, subject to certain exceptions, not to offer, sell or transfer any common stock or securities convertible into or exchangeable or exercisable for common stock for 180 days after the date of this prospectus without first obtaining the written consent of each of the representatives of the underwriters, subject to certain exceptions. See “Underwriting—No Sales of Similar Securities” for a description of these lock-up agreements.

### **Registration Statements**

We intend to file one or more registration statements under the Securities Act as soon as practicable after the completion of this offering for shares issued upon the exercise of options and shares to be issued under our employee benefit plans. As a result, any such options or shares will be freely tradable in the public market. Options to purchase shares of our common stock will have vested and will be exercisable as of the completion of this offering. However, such shares held by affiliates will still be subject to the volume limitation, manner of sale, notice, and public information requirements of Rule 144 unless otherwise resalable under Rule 701.



**MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS  
FOR NON-U.S. HOLDERS**

The following is a summary of the material U.S. federal income tax considerations relating to the purchase, ownership and disposition of our common stock by Non-U.S. Holders (defined below). This summary does not purport to be a complete analysis of all the potential tax considerations relevant to Non-U.S. Holders of our common stock. This summary is based upon the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"), the Treasury regulations promulgated or proposed thereunder and administrative and judicial interpretations thereof, all as of the date hereof and all of which are subject to change or differing interpretations at any time, possibly with retroactive effect.

This summary assumes that shares of our common stock are held as "capital assets" within the meaning of Section 1221 of the Internal Revenue Code. This summary does not purport to deal with all aspects of U.S. federal income taxation that might be relevant to particular Non-U.S. Holders in light of their particular investment circumstances or status, nor does it address specific tax considerations that may be relevant to particular persons (including, for example, financial institutions, broker-dealers, insurance companies, partnerships or other pass-through entities, certain U.S. expatriates, tax-exempt organizations, pension plans, "controlled foreign corporations," "passive foreign investment companies," corporations that accumulate earnings to avoid U.S. federal income tax, persons in special situations, such as those who have elected to mark securities to market or those who hold common stock as part of a straddle, hedge, conversion transaction, synthetic security or other integrated investment, or holders subject to the alternative minimum tax). In addition, except as explicitly addressed herein with respect to estate tax, this summary does not address estate and gift tax considerations or considerations under the tax laws of any state, local or non-U.S. jurisdiction.

For purposes of this summary, a "Non-U.S. Holder" means a beneficial owner of common stock that for U.S. federal income tax purposes is not treated as a partnership and is not:

- an individual who is a citizen or resident of the United States;
- a corporation or any other organization treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate, the income of which is included in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust, if (i) a U.S. court is able to exercise primary supervision over the trust's administration and one or more U.S. persons have the authority to control all of the trust's substantial decisions or (ii) the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If an entity or arrangement that is classified as a partnership for U.S. federal income tax purposes holds our common stock, the tax treatment of persons treated as its partners for U.S. federal income tax purposes will generally depend upon the status of the partner and the activities of the partnership. Partnerships and other entities that are classified as partnerships for U.S. federal income tax purposes and persons holding our common stock through a partnership or other entity classified as a partnership for U.S. federal income tax purposes are urged to consult their own tax advisors.

There can be no assurance that the Internal Revenue Service ("IRS") will not challenge one or more of the tax consequences described herein, and we have not obtained, nor do we intend to obtain, a ruling from the IRS with respect to the U.S. federal income or estate tax consequences to a Non-U.S. Holder of the purchase, ownership or disposition of our common stock.

THIS SUMMARY IS NOT INTENDED TO BE TAX ADVICE. EACH NON-U.S. HOLDER IS URGED TO CONSULT ITS OWN TAX ADVISOR ABOUT THE U.S. FEDERAL INCOME AND ESTATE TAXATION, STATE, LOCAL AND NON-U.S. TAXATION AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF OUR COMMON STOCK.

#### **Distributions on Our Common Stock**

As discussed under “Dividend Policy” above, we do not currently expect to pay regular dividends on our common stock. If we do make a distribution of cash or property with respect to our common stock, any such distributions generally will constitute dividends for U.S. federal income tax purposes to the extent of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. If a distribution exceeds our current and accumulated earnings and profits, the excess will constitute a return of capital and will first reduce the holder’s basis in our common stock, but not below zero. Any remaining excess will be treated as capital gain, subject to the tax treatment described below in “—Gain on Sale, Exchange or Other Taxable Disposition of Our Common Stock.” Any such distribution would also be subject to the discussion below in “—Additional Withholding and Information Reporting Requirements.”

Dividends paid to a Non-U.S. Holder generally will be subject to withholding of U.S. federal income tax at a 30% rate unless such Non-U.S. Holder provides us or our agent, as the case may be, with the appropriate IRS Form W-8, such as:

- IRS Form W-8BEN (or successor form) certifying, under penalties of perjury, a reduction in the rate of withholding of tax under an applicable income tax treaty, or
- IRS Form W-8ECI (or successor form) certifying that a dividend paid on common stock is not subject to withholding of tax because it is effectively connected with a trade or business in the United States of the Non-U.S. Holder (in which case such dividend generally will be subject to regular graduated U.S. federal income tax rates as described below).

The certification requirement described above also may require a Non-U.S. Holder that provides an IRS form or that claims treaty benefits to provide its U.S. taxpayer identification number. Special certification and other requirements apply in the case of certain Non-U.S. Holders that are intermediaries or pass-through entities for U.S. federal income tax purposes.

Each Non-U.S. Holder is urged to consult its own tax advisor about the specific methods for satisfying these requirements. A claim for exemption will not be valid if the person receiving the applicable form has actual knowledge or reason to know that the statements on the form are false.

If dividends are effectively connected with a trade or business in the United States of a Non-U.S. Holder (and, if required by an applicable income tax treaty, attributable to a permanent establishment maintained by such Non-U.S. Holder in the United States), the Non-U.S. Holder, although exempt from the withholding of tax described above (provided that the certifications described above are satisfied), generally will be subject to U.S. federal income tax on such dividends on a net income basis in the same manner as if it were a resident of the United States. In addition, if a Non-U.S. Holder is treated as a corporation for U.S. federal income tax purposes, the Non-U.S. Holder may be subject to an additional “branch profits tax” equal to 30% (unless reduced by an applicable income treaty) of its earnings and profits in respect of such effectively connected dividend income.

If a Non-U.S. Holder is eligible for a reduced rate of U.S. federal withholding tax pursuant to an income tax treaty, the holder may obtain a refund or credit of any excess amount withheld by timely filing an appropriate claim for refund with the IRS.

### **Gain on Sale, Exchange or Other Taxable Disposition of Our Common Stock**

Subject to the discussion below in “—Additional Withholding and Information Reporting Requirements,” in general, a Non-U.S. Holder will not be subject to U.S. federal income tax or withholding of tax on gain realized upon such holder’s sale, exchange or other taxable disposition of shares of our common stock unless (i) such Non-U.S. Holder is an individual who is present in the United States for 183 days or more in the taxable year of disposition, and certain other conditions are met, (ii) we are or have been a “United States real property holding corporation,” as defined in the Internal Revenue Code (a “USRPHC”), at any time within the shorter of the five-year period preceding the disposition and the Non-U.S. Holder’s holding period in the shares of our common stock, and certain other requirements are met, or (iii) such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business in the United States (and, if required by an applicable income tax treaty, is attributable to a permanent establishment maintained by such Non-U.S. Holder in the United States).

If the first exception applies, the Non-U.S. Holder generally will be subject to U.S. federal income tax at a rate of 30% (or at a reduced rate under an applicable income tax treaty) on the amount by which such Non-U.S. Holder’s capital gains allocable to U.S. sources (including gain, if any, realized on a disposition of our common stock) exceed capital losses allocable to U.S. sources during the taxable year of the disposition. If the third exception applies, the Non-U.S. Holder generally will be subject to U.S. federal income tax with respect to such gain on a net income basis in the same manner as if it were a resident of the United States, and a Non-U.S. Holder that is a corporation for U.S. federal income tax purposes may also be subject to a branch profits tax with respect to any earnings and profits attributable to such gain at a rate of 30% (or at a reduced rate under an applicable income tax treaty).

Generally, a corporation is a USRPHC only if the fair market value of its U.S. real property interests (as defined in the Internal Revenue Code) equals or exceeds 50% of the sum of the fair market value of its worldwide real property interests plus its other assets used or held for use in a trade or business. Although there can be no assurance in this regard, we believe that we are not, and do not anticipate becoming, a USRPHC. Even if we are or become a USRPHC, a Non-U.S. Holder would not be subject to U.S. federal income tax on a sale, exchange or other taxable disposition of our common stock by reason of our status as a USRPHC so long as our common stock is “regularly traded on an established securities market” at any time during the calendar year in which the disposition occurs and such Non-U.S. Holder does not own and is not deemed to own (directly, indirectly or constructively) more than 5% of our common stock at any time during the shorter of the five-year period ending on the date of disposition and the holder’s holding period. However, no assurance can be provided that our common stock will be regularly traded on an established securities market for purposes of the rules described above. Each Non-U.S. Holder is urged to consult its own tax advisor about the possible consequences to them if we are, or were to become, a USRPHC.

### **Additional Withholding and Information Reporting Requirements**

Legislation enacted in March 2010 (commonly referred to as “FATCA”) generally will impose a 30% withholding tax on U.S. source dividends and gross proceeds from the sale or other disposition of stock or property that is capable of producing U.S. source dividends paid to (i) a foreign financial institution (as defined in Section 1471(d)(4) of the Code) unless such foreign financial institution enters into a reporting agreement with the U.S. Treasury Department to collect and disclose certain information regarding its U.S. account holders (including certain account holders that are foreign entities that have U.S. owners) and satisfies certain other requirements, and (ii) certain other non-U.S. entities unless the entity provides the payor with information regarding certain direct and indirect U.S. owners of the entity, or certifies that it has no such U.S. owners, and complies with certain other requirements. As currently proposed, the FATCA withholding rules would apply to certain payments, including dividend payments on our common stock, if any, paid after December 31, 2013, and to payments of gross proceeds from the sale or other dispositions of our common stock paid after December 31, 2014. These new FATCA withholding rules apply regardless of whether a payment would otherwise be exempt from the withholding of tax described above in respect of distributions on and dispositions of our common stock.

Although administrative guidance and proposed regulations have been issued, regulations implementing the new FATCA regime have not yet been finalized and the exact scope of these rules remains unclear and potentially subject to material changes. Each Non-U.S. Holder is urged to consult its own tax advisor about the possible impact of these rules on their investment in our common stock, and the entities through which they hold our common stock, including, without limitation, the process and deadlines for meeting the applicable requirements to prevent the imposition of this 30% withholding of tax under FATCA.

#### **Backup Withholding and Information Reporting**

We must report annually to the IRS and to each Non-U.S. Holder the gross amount of the distributions on our common stock paid to the holder and the tax withheld, if any, with respect to the distributions. Pursuant to tax treaties or other agreements, the IRS may make its reports available to tax authorities in the Non-U.S. Holder's country of residence, organization or incorporation.

Non-U.S. Holders may have to comply with specific certification procedures to establish that the holder is not a United States person (as defined in the Internal Revenue Code) in order to avoid backup withholding at the applicable rate, currently 28% and scheduled to increase to 31% for taxable years 2013 and thereafter, with respect to dividends on our common stock. Dividends paid to Non-U.S. Holders subject to withholding of U.S. federal income tax, as described above in "—Distributions on Our Common Stock," generally will be exempt from U.S. backup withholding.

Information reporting and backup withholding will generally apply to the proceeds of a disposition of our common stock by a Non-U.S. Holder effected by or through the U.S. office of any broker, U.S. or foreign, unless the holder certifies its status as a Non-U.S. Holder and satisfies certain other requirements, or otherwise establishes an exemption. Dispositions effected through a non-U.S. office of a U.S. broker or a non-U.S. broker with substantial U.S. ownership or operations generally will be treated in a manner similar to dispositions effected through a U.S. office of a broker. Each Non-U.S. Holder is urged to consult its own tax advisor about the application of the information reporting and backup withholding rules to them.

Copies of information returns may be made available to the tax authorities of the country in which the Non-U.S. Holder resides or in which the Non-U.S. Holder is incorporated under the provisions of a specific treaty or agreement.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a Non-U.S. Holder can be refunded or credited against the Non-U.S. Holder's U.S. federal income tax liability, if any, provided that an appropriate claim is timely filed with the IRS.

#### **Federal Estate Tax**

Common stock owned (or treated as owned) by an individual who is not a citizen or a resident of the United States (as defined for U.S. federal estate tax purposes) at the time of death will be included in the individual's gross estate for U.S. federal estate tax purposes, unless an applicable estate or other tax treaty provides otherwise, and, therefore, may be subject to U.S. federal estate tax.

#### **Medicare Contributions Tax**

For taxable years beginning after December 31, 2012, a 3.8% tax is imposed on the net investment income (which includes dividends and gains recognized upon a disposition of stock) of certain individuals, trusts and estates with adjusted gross income in excess of certain thresholds. This tax is imposed on individuals, estates and trusts that are U.S. Holders. The tax is expressly not imposed on nonresident aliens; however, estates and trusts that are not U.S. Holders are not expressly exempted from the tax. Therefore, each Non-U.S. Holder is urged to consult its own tax advisor about the application of this Medicare contribution tax in their particular situations.

**UNDERWRITING**

Merrill Lynch, Pierce, Fenner & Smith Incorporated and Goldman, Sachs & Co. are acting as representatives of each of the underwriters named below. Subject to the terms and conditions set forth in an underwriting agreement among us, the selling stockholders and the underwriters, we and the selling stockholders have agreed to sell to the underwriters, and each of the underwriters has agreed, severally and not jointly, to purchase from us and the selling stockholders, the number of shares of common stock set forth opposite its name below.

<u>Underwriter</u>	<u>Number of Shares</u>
Merrill Lynch, Pierce, Fenner & Smith Incorporated	
Goldman, Sachs & Co.	
Robert W. Baird & Co. Incorporated	
William Blair & Company, L.L.C.	
Piper Jaffray & Co.	
Total	

Subject to the terms and conditions set forth in the underwriting agreement, the underwriters have agreed, severally and not jointly, to purchase all of the shares sold under the underwriting agreement if any of these shares are purchased. If an underwriter defaults, the underwriting agreement provides that the purchase commitments of the nondefaulting underwriters may be increased or the underwriting agreement may be terminated.

We and the selling stockholders have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the underwriters may be required to make in respect of those liabilities.

The underwriters are offering the shares, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the shares, and other conditions contained in the underwriting agreement, such as the receipt by the underwriters of officer's certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

**Commissions and Discounts**

The representatives have advised us and the selling stockholders that the underwriters propose initially to offer the shares to the public at the public offering price set forth on the cover page of this prospectus and to dealers at that price less a concession not in excess of \$ per share. After the initial offering, the public offering price, concession or any other term of the offering may be changed.

The following table shows the public offering price, underwriting discount and proceeds before expenses to us and the selling stockholders. The information assumes either no exercise or full exercise by the underwriters of their option to purchase additional shares.

	<u>Per Share</u>	<u>Without Option</u>	<u>With Option</u>
Public offering price	\$	\$	\$
Underwriting discount	\$	\$	\$
Proceeds, before expenses, to us	\$	\$	\$
Proceeds, before expenses, to the selling stockholders	\$	\$	\$

The expenses of the offering, not including the underwriting discount, are estimated at \$ and are payable by us and the selling stockholders.

#### **Option to Purchase Additional Shares**

We and the selling stockholders have granted an option to the underwriters, exercisable for 30 days after the date of this prospectus, to purchase up to \_\_\_\_\_ additional shares at the public offering price, less the underwriting discount. If the underwriters exercise this option, each will be obligated, subject to conditions contained in the underwriting agreement, to purchase a number of additional shares proportionate to that underwriter's initial amount reflected in the above table.

#### **Reserved Shares**

At our request, the underwriters have reserved for sale, at the initial public offering price, up to \_\_\_\_\_ shares offered by this prospectus for sale to certain of our officers and non-restaurant employees. If these persons purchase reserved shares, this will reduce the number of shares available for sale to the general public. Any reserved shares that are not so purchased will be offered by the underwriters to the general public on the same terms as the other shares offered by this prospectus.

#### **No Sales of Similar Securities**

We and the selling stockholders, our executive officers and directors and our other existing security holders and purchasers of the reserved shares described above have agreed not to sell or transfer any common stock or securities convertible into, exchangeable for, exercisable for, or repayable with common stock, for 180 days after the date of this prospectus without first obtaining the written consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated and Goldman, Sachs & Co. Specifically, we and these other persons have agreed, with certain limited exceptions, not to directly or indirectly

- offer, pledge, sell or contract to sell any common stock,
- sell any option or contract to purchase any common stock,
- purchase any option or contract to sell any common stock,
- grant any option, right or warrant for the sale of any common stock,
- lend or otherwise dispose of or transfer any common stock,
- request or demand that we file a registration statement related to the common stock, or
- enter into any swap or other agreement that transfers, in whole or in part, the economic consequence of ownership of any common stock whether any such swap or transaction is to be settled by delivery of shares or other securities, in cash or otherwise.

This lock-up provision applies to common stock and to securities convertible into or exchangeable or exercisable for or repayable with common stock. It also applies to common stock owned now or acquired later by the person executing the agreement or for which the person executing the agreement later acquires the power of disposition.

#### **Nasdaq Global Select Market Listing**

We expect the shares to be approved for listing on the Nasdaq Global Select Market, subject to notice of issuance, under the symbol “\_\_\_\_\_.”

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Before this offering, there has been no public market for our common stock. The initial public offering price will be determined through negotiations among us, the selling stockholders and the representatives. In addition to prevailing market conditions, the factors to be considered in determining the initial public offering price are

- the valuation multiples of publicly traded companies that the representatives believe to be comparable to us,
- our financial information,
- the history of, and the prospects for, our company and the industry in which we compete,
- an assessment of our management, its past and present operations, and the prospects for, and timing of, our future revenues,
- the present state of our development, and
- the above factors in relation to market values and various valuation measures of other companies engaged in activities similar to ours.

An active trading market for the shares may not develop. It is also possible that after the offering the shares will not trade in the public market at or above the initial public offering price.

The underwriters do not expect to sell more than 5% of the shares in the aggregate to accounts over which they exercise discretionary authority.

### **Price Stabilization, Short Positions and Penalty Bids**

Until the distribution of the shares is completed, SEC rules may limit underwriters and selling group members from bidding for and purchasing our common stock. However, the representatives may engage in transactions that stabilize the price of the common stock, such as bids or purchases to peg, fix or maintain that price.

In connection with the offering, the underwriters may purchase and sell our common stock in the open market. These transactions may include short sales, purchases on the open market to cover positions created by short sales and stabilizing transactions. Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in the offering. "Covered" short sales are sales made in an amount not greater than the underwriters' option to purchase additional shares described above. The underwriters may close out any covered short position by either exercising their option to purchase additional shares or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the option granted to them. "Naked" short sales are sales in excess of such option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of our common stock in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of various bids for or purchases of shares of common stock made by the underwriters in the open market prior to the completion of the offering.

The underwriters may also impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the representatives have repurchased shares sold by or for the account of such underwriter in stabilizing or short covering transactions.

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Similar to other purchase transactions, the underwriters' purchases to cover the syndicate short sales may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. The underwriters may conduct these transactions on the Nasdaq Global Select Market, in the over-the-counter market or otherwise.

Neither we nor any of the underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of our common stock. In addition, neither we nor any of the underwriters make any representation that the representatives will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

### **Electronic Distribution**

In connection with the offering, certain of the underwriters or securities dealers may distribute prospectuses by electronic means, such as e-mail.

### **Other Relationships**

The underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include sales and trading, commercial and investment banking, advisory, investment management, investment research, principal investment, hedging, market making, brokerage and other financial and non-financial activities and services. Certain of the underwriters and their respective affiliates have provided, and may in the future provide, a variety of these services to the issuer and to persons and entities with relationships with the issuer, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the underwriters and their respective affiliates, officers, directors and employees may purchase, sell or hold a broad array of investments and actively trade securities, derivatives, loans, commodities, currencies, credit default swaps and other financial instruments for their own account and for the accounts of their customers, and such investment and trading activities may involve or relate to assets, securities and/or instruments of the issuer (directly, as collateral securing other obligations or otherwise) and/or persons and entities with relationships with the issuer. The underwriters and their respective affiliates may also communicate independent investment recommendations, market color or trading ideas and/or publish or express independent research views in respect of such assets, securities or instruments and may at any time hold, or recommend to clients that they should acquire, long and/or short positions in such assets, securities and instruments.

### **Notice to Prospective Investors in the European Economic Area**

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "Relevant Member State"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "Relevant Implementation Date"), no offer of shares may be made to the public in that Relevant Member State other than:

- A. to any legal entity which is a qualified investor as defined in the Prospectus Directive;
  - B. to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the representatives; or
  - C. in any other circumstances falling within Article 3(2) of the Prospectus Directive,
- provided that no such offer of shares shall require the company or the representatives to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.



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Each person in a Relevant Member State who initially acquires any shares or to whom any offer is made will be deemed to have represented, acknowledged and agreed that (A) it is a “qualified investor” within the meaning of the law in that Relevant Member State implementing Article 2(1)(e) of the Prospectus Directive, and (B) in the case of any shares acquired by it as a financial intermediary, as that term is used in Article 3(2) of the Prospectus Directive, the shares acquired by it in the offering have not been acquired on behalf of, nor have they been acquired with a view to their offer or resale to, persons in any Relevant Member State other than “qualified investors” as defined in the Prospectus Directive, or in circumstances in which the prior consent of the representatives has been given to the offer or resale. In the case of any shares being offered to a financial intermediary as that term is used in Article 3(2) of the Prospectus Directive, each such financial intermediary will be deemed to have represented, acknowledged and agreed that the shares acquired by it in the offer have not been acquired on a non-discretionary basis on behalf of, nor have they been acquired with a view to their offer or resale to, persons in circumstances which may give rise to an offer of any shares to the public other than their offer or resale in a Relevant Member State to qualified investors as so defined or in circumstances in which the prior consent of the representatives has been obtained to each such proposed offer or resale.

The company, the representatives and their affiliates will rely upon the truth and accuracy of the foregoing representation, acknowledgement and agreement.

This prospectus has been prepared on the basis that any offer of shares in any Relevant Member State will be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of shares. Accordingly any person making or intending to make an offer in that Relevant Member State of shares which are the subject of the offering contemplated in this prospectus may only do so in circumstances in which no obligation arises for the company or any of the underwriters to publish a prospectus pursuant to Article 3 of the Prospectus Directive in relation to such offer. Neither the company nor the underwriters have authorized, nor do they authorize, the making of any offer of shares in circumstances in which an obligation arises for the company or the underwriters to publish a prospectus for such offer.

For the purpose of the above provisions, the expression “an offer to the public” in relation to any shares in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the shares to be offered so as to enable an investor to decide to purchase or subscribe the shares, as the same may be varied in the Relevant Member State by any measure implementing the Prospectus Directive in the Relevant Member State and the expression “Prospectus Directive” means Directive 2003/71/EC (including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member States) and includes any relevant implementing measure in the Relevant Member State and the expression “2010 PD Amending Directive” means Directive 2010/73/EU.

### **Notice to Prospective Investors in the United Kingdom**

In addition, in the United Kingdom, this document is being distributed only to, and is directed only at, and any offer subsequently made may only be directed at persons who are “qualified investors” (as defined in the Prospectus Directive) (i) who have professional experience in matters relating to investments falling within Article 19 (5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the “Order”) and/or (ii) who are high net worth companies (or persons to whom it may otherwise be lawfully communicated) falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as “relevant persons”). This document must not be acted on or relied on in the United Kingdom by persons who are not relevant persons. In the United Kingdom, any investment or investment activity to which this document relates is only available to, and will be engaged in with, relevant persons.

### **Notice to Prospective Investors in Switzerland**

The shares may not be publicly offered in Switzerland and will not be listed on the SIX Swiss Exchange (“SIX”) or on any other stock exchange or regulated trading facility in Switzerland. This document has been prepared without regard to the disclosure standards for issuance prospectuses under art. 652a or art. 1156 of the

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Swiss Code of Obligations or the disclosure standards for listing prospectuses under art. 27 ff. of the SIX Listing Rules or the listing rules of any other stock exchange or regulated trading facility in Switzerland. Neither this document nor any other offering or marketing material relating to the shares or the offering may be publicly distributed or otherwise made publicly available in Switzerland.

Neither this document nor any other offering or marketing material relating to the offering, the company, the shares have been or will be filed with or approved by any Swiss regulatory authority. In particular, this document will not be filed with, and the offer of shares will not be supervised by, the Swiss Financial Market Supervisory Authority FINMA (FINMA), and the offer of shares has not been and will not be authorized under the Swiss Federal Act on Collective Investment Schemes (“CISA”). The investor protection afforded to acquirers of interests in collective investment schemes under the CISA does not extend to acquirers of shares.

### **Notice to Prospective Investors in the Dubai International Financial Centre**

This prospectus relates to an Exempt Offer in accordance with the Offered Securities Rules of the Dubai Financial Services Authority (“DFSA”). This prospectus is intended for distribution only to persons of a type specified in the Offered Securities Rules of the DFSA. It must not be delivered to, or relied on by, any other person. The DFSA has no responsibility for reviewing or verifying any documents in connection with Exempt Offers. The DFSA has not approved this prospectus nor taken steps to verify the information set forth herein and has no responsibility for the prospectus. The shares to which this prospectus relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the shares offered should conduct their own due diligence on the shares. If you do not understand the contents of this prospectus you should consult an authorized financial advisor.

### **Notice to Prospective Investors in Hong Kong**

This prospectus has not been approved by or registered with the Securities and Futures Commission of Hong Kong or the Registrar of Companies of Hong Kong. The shares will not be offered or sold in Hong Kong other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance. No advertisement, invitation or document relating to the shares which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) has been issued or will be issued in Hong Kong or elsewhere other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance and any rules made under that Ordinance.

### **Notice to Prospective Investors in Singapore**

This prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the notes may not be circulated or distributed, nor may the notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”), (ii) to a relevant person, or any person pursuant to Section 275(1A), and in accordance with the conditions, specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the notes are subscribed or purchased under Section 275 by a relevant person which is: (a) a corporation (which is not an accredited investor) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or (b) a trust

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(where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest in that trust shall not be transferable for six months after that corporation or that trust has acquired the notes under Section 275 except: (1) to an institutional investor under Section 274 of the SFA or to a relevant person, or any person pursuant to Section 275(1A), and in accordance with the conditions, specified in Section 275 of the SFA; (2) where no consideration is given for the transfer; or (3) by operation of law.

**Notice to Prospective Investors in Japan**

The securities have not been and will not be registered under the Financial Instruments and Exchange Law of Japan (the Financial Instruments and Exchange Law) and each underwriter has agreed that it will not offer or sell any securities, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

## LEGAL MATTERS

Mayer Brown LLP, Chicago, Illinois, has passed upon the validity of the common stock offered hereby on our behalf. The underwriters are being represented by Sidley Austin LLP, Chicago, Illinois. Sidley Austin LLP has represented us on certain matters.

## EXPERTS

The consolidated financial statements as of December 25, 2011 and December 26, 2010 and for each of the two years in the period ended December 25, 2011 included in this prospectus have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report appearing herein. Such financial statements are included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

## WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1 under the Securities Act that registers the shares of our common stock to be sold in this offering. This prospectus does not contain all of the information set forth in the registration statement and the exhibits and schedules thereto. For further information with respect to us and our common stock, you should refer to the registration statement and the exhibits and schedules filed as a part of the registration statement. Statements contained in this prospectus concerning the contents of any contract or any other document are not necessarily complete. If a contract or document has been filed as an exhibit to the registration statement, we refer you to the copy of the contract or document that has been filed. Each statement in this prospectus relating to a contract or document filed as an exhibit is qualified in all respects by the filed exhibit.

We are not currently subject to the informational requirements of the Securities Exchange Act of 1934. As a result of this offering, we will become subject to the informational requirements of the Exchange Act and, in accordance therewith, will file reports and other information with the SEC. The registration statement, reports and other information we file with the SEC can be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington D.C. 20549. You may obtain information regarding the operation of the public reference room by calling 1-800-SEC-0330. The SEC also maintains a website (<http://www.sec.gov>) that contains reports, proxy and information statements and other information that we file electronically with the SEC. We also maintain a website at [www.potbelly.com](http://www.potbelly.com). Our website, and the information contained on or accessible through our website, is not part of this prospectus.

We intend to furnish our stockholders with annual reports containing audited financial statements and make available to our stockholders quarterly reports for the first three quarters of each fiscal year containing unaudited interim financial information.

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**Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors of  
Potbelly Corporation and subsidiaries

We have audited the accompanying consolidated balance sheets of Potbelly Corporation and subsidiaries (the "Company") as of December 25, 2011 and December 26, 2010, and the related consolidated statements of operations, redeemable convertible preferred stock and equity (deficit), and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 25, 2011 and December 26, 2010, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP  
Chicago, Illinois

November 13, 2012

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

	December 26, 2010	December 25, 2011	September 23, 2012	Pro Forma September 23, 2012 (unaudited)
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 28,980	\$ 24,146	\$ 24,954	\$ 26,930
Accounts receivable, net of allowances of \$4, \$17 and \$7 as of December 26, 2010, December 25, 2011 and September 23, 2012, respectively	1,966	2,355	3,214	3,214
Inventories	2,292	2,620	1,789	1,789
Prepaid expenses and other current assets	3,614	4,825	2,789	2,789
Total current assets	36,852	33,946	32,746	34,722
Property and equipment, net	55,913	59,421	68,747	68,747
Intangible assets, net	3,424	3,404	3,404	3,404
Goodwill	1,428	1,428	1,428	1,428
Deferred expenses, net and other assets	807	911	2,472	2,472
<b>Total assets</b>	<b>\$ 98,424</b>	<b>\$ 99,110</b>	<b>\$ 108,797</b>	<b>\$ 110,773</b>
<b>LIABILITIES AND EQUITY</b>				
Current liabilities				
Accounts payable	\$ 4,180	\$ 2,559	\$ 3,063	\$ 3,063
Accrued expenses	13,730	14,606	14,266	14,266
Accrued income taxes	114	221	139	139
Current portion of long-term debt	4,064	70	74	74
Total current liabilities	22,088	17,456	17,542	17,542
Long-term debt, net of current portion	5,249	15,173	15,335	15,335
Deferred rent and landlord allowances	11,165	10,866	12,183	12,183
Deferred tax liabilities	647	760	839	839
Other long-term liabilities	374	309	266	266
Total liabilities	39,523	44,564	46,165	46,165
Commitments and contingencies				
Redeemable convertible preferred stock, \$0.01 par value—authorized 17,183,632 shares; issued and outstanding, 16,586,375, 16,086,375, 16,086,375 and no shares as of December 26, 2010, December 25, 2011, September 23, 2012, and September 23, 2012 on a pro forma basis, respectively	228,544	239,848	253,735	—
Equity (deficit)				
Common stock, \$0.01 par value—authorized, 35,500,000 shares; issued and outstanding, 4,978,621, 3,972,873, 3,972,873 and 20,809,961 shares as of December 26, 2010, December 25, 2011, September 23, 2012, and September 23, 2012 on a pro forma basis, respectively	50	40	40	204
Warrants	2,225	2,068	2,977	—
Additional paid-in-capital	—	—	—	258,524
Accumulated deficit	(171,918)	(187,410)	(194,315)	(194,315)
Total stockholders' equity (deficit)	(169,643)	(185,302)	(191,298)	64,413
Non-controlling interest	—	—	195	195
Total equity (deficit)	(169,643)	(185,302)	(191,103)	64,608
<b>Total liabilities and equity (deficit)</b>	<b>\$ 98,424</b>	<b>\$ 99,110</b>	<b>\$ 108,797</b>	<b>\$ 110,773</b>

The unaudited pro forma balance sheet gives effect to the conversion of all outstanding warrants and shares of redeemable convertible preferred stock into 16,897,088 shares of common stock upon the completion of an initial public offering.

See accompanying notes to consolidated financial statements.

**POTBELLY CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Operations**  
(amounts in thousands, except share and per share data)

	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
			(unaudited)	
<b>Revenues</b>				
Sandwich shop sales, net	\$ 220,573	\$ 237,463	\$ 176,303	\$ 200,853
Franchise royalties and fees	—	503	348	553
<b>Total revenues</b>	<u>220,573</u>	<u>237,966</u>	<u>176,651</u>	<u>201,406</u>
<b>Expenses</b>				
Sandwich shop operating expenses				
Cost of goods sold, excluding depreciation	63,009	68,491	50,784	58,389
Labor and related expenses	63,506	67,036	49,865	56,618
Occupancy expenses	25,238	26,511	19,493	22,885
Other operating expenses	22,620	24,095	17,899	20,767
General and administrative expenses	26,563	26,911	20,308	22,542
Depreciation expense	15,647	14,838	11,085	11,633
Pre-opening costs	267	1,521	1,046	1,760
Impairment and loss on disposal of property and equipment	2,952	365	29	78
<b>Total expenses</b>	<u>219,802</u>	<u>229,768</u>	<u>170,509</u>	<u>194,672</u>
Income from operations	771	8,198	6,142	6,734
Interest expense	519	495	359	427
Other expense (income)	9	1	(2)	6
<b>Income before income taxes</b>	<u>243</u>	<u>7,702</u>	<u>5,785</u>	<u>6,301</u>
Income tax expense	773	537	591	765
<b>Net income (loss)</b>	<u>(530)</u>	<u>7,165</u>	<u>5,194</u>	<u>5,536</u>
Net loss attributable to non-controlling interest	—	—	—	(35)
<b>Net income (loss) attributable to Potbelly Corporation</b>	<u>(530)</u>	<u>7,165</u>	<u>5,194</u>	<u>5,571</u>
Accretion of redeemable convertible preferred stock to maximum redemption value	(45,992)	(17,410)	(9,011)	(13,887)
<b>Net loss attributable to common stockholders</b>	<u>\$ (46,522)</u>	<u>\$ (10,245)</u>	<u>\$ (3,817)</u>	<u>\$ (8,316)</u>
Net loss per common share attributable to common stockholders:				
Basic	\$ (9.34)	\$ (2.35)	\$ (0.85)	\$ (2.09)
Diluted	(9.34)	(2.35)	(0.85)	(2.09)
Weighted average shares outstanding:				
Basic	4,978,621	4,359,930	4,503,982	3,972,873
Diluted	4,978,621	4,359,930	4,503,982	3,972,873
Unaudited pro forma net income per common share attributable to common stockholders:				
Basic		\$ 0.34		\$ 0.27
Diluted		0.33		0.27
Unaudited pro forma weighted average shares outstanding:				
Basic		21,386,375		20,787,320
Diluted		21,437,590		20,855,416

The unaudited pro forma per share data gives effect to the conversion of all outstanding warrants and shares of redeemable convertible preferred stock into 16,897,088 shares of common stock upon the completion of an initial public offering.

See accompanying notes to consolidated financial statements.



**POTBELLY CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Redeemable Convertible Preferred Stock and Equity (Deficit)**

(amounts in thousands, except share data)

	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		Noncontrolling Interest
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount					
Balance at December 27, 2009	4,197,377	\$ 33,617	3,290,294	\$ 26,353	1,646,595	\$ 19,872	1,250,000	\$ 18,340	4,194,366	\$ 68,321	1,947,848	\$ 16,048	16,526,480	\$182,551	4,978,621	\$ 50	\$ 2,225	\$ —	\$ (126,987)	\$ —	\$(124,712)
Net loss	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	(530)	—	(530)
Issuance of preferred stock	—	—	—	—	—	—	—	—	—	84,898	1	84,898	1	—	—	—	—	793	—	—	793
Repurchase of preferred stock	—	—	—	—	—	—	—	—	—	(25,003)	—	(25,003)	—	—	—	—	—	(234)	—	—	(234)
Changes in redemption value of preferred stock	—	17,638	—	13,825	—	408	—	1,160	—	4,493	—	8,468	—	45,992	—	—	—	(1,591)	(44,401)	—	(45,992)
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1,032	—	—	1,032
Balance at December 26, 2010	4,197,377	\$ 51,255	3,290,294	\$ 40,178	1,646,595	\$ 20,280	1,250,000	\$ 19,500	4,194,366	\$ 72,814	2,007,743	\$ 24,517	16,586,375	\$ 228,544	4,978,621	\$ 50	\$ 2,225	\$ —	\$ (171,918)	\$ —	\$(169,643)
Net income	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	7,165	—	7,165
Repurchase of common stock	—	—	—	—	—	—	—	—	—	—	—	—	—	—	(1,180,748)	(12)	—	—	(8,513)	—	(8,525)
Repurchase of preferred stock	(500,000)	(6,106)	—	—	—	—	—	—	—	—	—	—	(500,000)	(6,106)	—	—	—	1,106	—	—	1,106
Exercise of stock warrants	—	—	—	—	—	—	—	—	—	—	—	—	—	—	55,000	1	(157)	157	—	—	1
Exercise of stock options	—	—	—	—	—	—	—	—	—	—	—	—	—	—	120,000	1	—	479	—	—	480
Changes in redemption value of preferred stock	—	5,488	—	4,884	—	2,465	—	(1,930)	—	3,523	—	2,980	—	17,410	—	—	—	(3,266)	(14,144)	—	(17,410)
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	1,524	—	—	1,524
Balance at December 25, 2011	3,697,377	\$ 50,637	3,290,294	\$ 45,062	1,646,595	\$ 22,745	1,250,000	\$ 17,570	4,194,366	\$ 76,337	2,007,743	\$ 27,497	16,086,375	\$ 239,848	3,972,873	\$ 40	\$ 2,068	\$ —	\$ (187,410)	\$ —	\$(185,302)
Net income (loss)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	5,571	(35)	5,536
Contributions from noncontrolling interest	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	230
Issuance of stock warrants	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	909	(909)	—	—	—
Changes in redemption value of preferred stock	—	3,210	—	2,856	—	1,441	—	1,113	—	3,524	—	1,743	—	13,887	—	—	—	(1,411)	(12,476)	—	(13,887)
Amortization of stock-based compensation	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	2,320	—	—	2,320
Balance at September 23, 2012 (unaudited)	3,697,377	\$ 53,847	3,290,294	\$ 47,918	1,646,595	\$ 24,186	1,250,000	\$ 18,683	4,194,366	\$ 79,861	2,007,743	\$ 29,240	16,086,375	\$ 253,735	3,972,873	\$ 40	\$ 2,977	\$ —	\$ (194,315)	\$ 195	\$(191,103)

See accompanying notes to consolidated financial statements.

**POTBELLY CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

(amounts in thousands)

	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
	(unaudited)			
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net income (loss)	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,536
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation	15,647	14,838	11,085	11,633
Deferred income tax	647	113	85	78
(Accretion) amortization of deferred rent and landlord allowances	(1,221)	(295)	(331)	1,320
Amortization of stock compensation expense	1,032	1,524	1,096	2,320
Loss on impairment and disposal of property and equipment	2,952	365	29	78
Amortization of debt issuance costs	152	151	113	154
Changes in operating assets and liabilities:				
Accounts receivable, net	(245)	(389)	(927)	(859)
Inventories	(116)	(377)	(168)	(93)
Prepaid expenses and other assets	(370)	(1,467)	(1,308)	1,506
Accounts payable	(13)	(2,200)	(2,395)	345
Accrued and other liabilities	845	693	(1,634)	(1,561)
Net cash provided by operating activities	<u>18,780</u>	<u>20,121</u>	<u>10,839</u>	<u>20,457</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Purchases of property and equipment	(6,243)	(17,758)	(13,070)	(19,700)
Net cash used in investing activities	<u>(6,243)</u>	<u>(17,758)</u>	<u>(13,070)</u>	<u>(19,700)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Proceeds from exercise of stock options	—	480	—	—
Proceeds from exercise of stock warrants	—	1	—	—
Preferred stock repurchase	(234)	(5,000)	(5,000)	—
Common stock repurchase	—	(8,525)	(8,525)	—
Proceeds from long-term debt	—	10,000	10,000	14,000
Payments on debt	(4,000)	(4,000)	(4,000)	(14,000)
Payments on note payable	(148)	(153)	(134)	(55)
Payment of deferred financing costs	—	—	—	(124)
Contributions from non-controlling interest	—	—	—	230
Net cash (used in) provided by financing activities	<u>(4,382)</u>	<u>(7,197)</u>	<u>(7,659)</u>	<u>51</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>8,155</b>	<b>(4,834)</b>	<b>(9,890)</b>	<b>808</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>20,825</b>	<b>28,980</b>	<b>28,980</b>	<b>24,146</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b><u>\$28,980</u></b>	<b><u>\$ 24,146</u></b>	<b><u>\$ 19,090</u></b>	<b><u>\$ 24,954</u></b>
Supplemental cash flow information:				
Income taxes paid	\$ 294	\$ 452	\$ 428	\$ 794
Interest paid	377	344	205	621
Supplemental non-cash investing and financing activities:				
Unpaid liability for purchases of property and equipment	\$ 147	\$ 451	\$ 840	\$ 1,636
Accretion of redeemable convertible preferred stock to maximum redemption value	45,992	17,410	9,011	13,887
Issuance of preferred shares to settle accrued bonus obligation	560	—	—	—

See accompanying notes to consolidated financial statements.

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

**(1) Organization and Other Matters**

Potbelly Corporation (the “Company” or “Potbelly”), through its wholly owned subsidiary, Potbelly Sandwich Works LLC, operates Potbelly Sandwich Works sandwich shops in 17 states and the District of Columbia. As of September 23, 2012 and fiscal years ended 2011 and 2010, the Company had 257, 234 and 218 company-operated shops in operation, respectively. During the 39 week period ended September 23, 2012, the Company opened 24 new shops. During fiscal year 2011, the Company opened 21 shops and closed five shops. During fiscal 2010, the Company opened five 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 September 23, 2012, five franchised shops were in operation in domestic locations and seven franchised shops were in operation in the Middle East. As of the fiscal year ended 2011, one franchise shop was in operation domestically and four franchised shops were in operation internationally.

**(2) Summary of Significant Accounting Policies**

*(a) Unaudited Consolidated Interim Financial Statements*

The accompanying consolidated balance sheet as of September 23, 2012, the consolidated statements of operations and cash flows for the 39 weeks ended September 25, 2011 and September 23, 2012 and the consolidated statement of redeemable convertible preferred stock and equity (deficit) for the 39 weeks ended September 23, 2012 are unaudited. The financial data and the other information disclosed in these notes to the consolidated financial statements related to these 39 weeks are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual consolidated financial statements. 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, although management believes that the disclosures are adequate and make the information presented not misleading. 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 September 23, 2012, and its results of operations and cash flows for the 39 weeks ended September 23, 2012 and September 25, 2011 have been included.

The consolidated results of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the full year.

*(b) Principles of Consolidation*

The 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 consolidated joint ventures, non-controlling interests represent 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.

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.

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

*(c) Reporting Period*

The Company uses a 52/53-week fiscal year that ends on the last Sunday of the calendar year. Approximately every six or seven years a 53rd week is added. Fiscal 2011 and fiscal 2010 each consisted of 52 weeks. Fiscal 2012 consists of 53 weeks.

*(d) Segment Reporting*

The Company owns and operates Potbelly Sandwich Works sandwich shops in the United States. The Company also has domestic and international franchise operations of new Potbelly Sandwich Works sandwich shops. Our chief operating decision maker ("CODM") is our Chief Executive Officer. As our CODM reviews financial performance and allocates resources at a consolidated level on a recurring basis, the Company has one operating segment and one reportable segment.

*(e) Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions 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.

*(f) Fair Value Measurements*

The Company applies fair value accounting for all financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities that are required to be recorded at fair value, the Company assumes the highest and best use of the asset by market participants in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions, and credit risk.

The Company applies the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels, and base the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Observable inputs other than quoted prices in active markets for identical assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Inputs that are both unobservable and significant to the overall fair value measurement reflect an entity's estimates of assumptions that market participants would use in pricing the asset or liability.

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

*(g) Financial Instruments*

The Company records all financial instruments at cost, which is the fair value at the date of transaction. The amounts reported in the consolidated balance sheets for cash, accounts receivable, accounts payable and accrued liabilities approximate their fair value because of the short-term maturities of these instruments. The carrying amount of debt is a reasonable estimate of its fair value.

*(h) Cash and Cash Equivalents*

The Company maintains its cash in bank deposit accounts that, at times, may exceed federally insured limits; however, the Company has not experienced any losses in these accounts. The Company believes it is not exposed to any significant credit risk.

*(i) Accounts Receivable, net*

Accounts receivable, net consists of credit card and miscellaneous receivables. The Company had credit card receivables of \$0.9 million, \$1.4 million and \$2.3 million as of December 26, 2010, December 25, 2011 and September 23, 2012, respectively.

*(j) Inventories*

Inventories, which consist of food products, paper goods and supplies, and promotional items, are valued at the lower of cost (first-in, first-out) or market. No valuation reserve is deemed necessary to reduce inventory to its fair value due to the rapid turnover and high utilization of inventory.

*(k) Property and Equipment*

Property and equipment acquired is recorded at cost less accumulated depreciation. Property and equipment is depreciated based on the straight-line method over the estimated useful lives, generally ranging from three to five years for furniture and fixtures, computer equipment, computer software, and machinery and equipment. Leasehold improvements are depreciated over the shorter of their estimated useful lives or the related lease life, generally 10 to 15 years. For leases with renewal periods at the Company's option, the Company uses the original lease term as there is no substantial economic penalty for not renewing their leases.

Direct costs and expenditures for refurbishments and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized, whereas the costs of repairs and maintenance are expensed when incurred. The Company capitalizes certain internal costs associated with the development, design, and construction of new shop locations as these costs have a future benefit to the Company. The Company capitalized costs of \$0.3 million and \$0.6 million for the fiscal years ended December 26, 2010 and December 25, 2011, respectively, and \$0.6 million for the 39 weeks ended September 23, 2012. Capitalized costs are recorded as part of the asset to which they relate, primarily to leasehold improvements, and such costs are amortized over the asset's useful life. When assets are retired or sold, the asset cost and related accumulated depreciation are removed from the balance sheet and any gain or loss is recorded in the statement of operations.

The Company assesses potential impairments to its long-lived assets, which includes property and equipment and intangible assets with definite useful lives, whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. 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 exceeds its estimated undiscounted future cash flows, an impairment

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charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset. Shop-level assets are grouped together for the purpose of the impairment assessment. Due to unfavorable operating results at certain shops, the Company assessed the related assets for impairment for the fiscal years ended 2010 and 2011. 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. The Company used a weighted average cost of capital to discount the future cash flows. A 100 basis point change in weighted average cost of capital would not have a material impact on the calculation of an impairment charge. The Company recorded an impairment charge of \$2.9 million and \$0.4 million for the fiscal years 2010 and 2011, respectively, which is included in impairment and loss on disposal of property and equipment in the consolidated statements of operations. No impairment charge was recorded for the 39 weeks ended September 23, 2012.

*(l) Intangible Assets*

The Company reviews indefinite-lived intangible assets, which includes goodwill and tradenames, annually at fiscal year end for impairment or more frequently if events or circumstances indicate that the carrying value may not be recoverable. An impaired asset is written down to its estimated fair value based on the most recent information available. The Company assesses the fair values of its intangible assets, and its reporting unit for goodwill testing purposes, using both an income-based approach and a market approach. Under the income approach, fair value is based on the present value of estimated future cash flows. The income approach is dependent on a number of factors, including forecasted revenues and expenses, appropriate discount rates and other variables. The market approach measures fair value by comparison to the observed fair values of comparable companies, adjusted for the relative size and profitability of these comparable companies. The annual impairment review utilizes the estimated fair value of the intangible assets and the overall reporting unit and compares the estimated fair values to the carrying values as of the testing date. If the carrying value of these intangible assets or the reporting unit exceeds the fair values, the Company would then use the fair values to measure the amount of any required impairment charge. No impairment charge was recognized for the fiscal years 2010 and 2011 or for the 39 weeks ended September 25, 2011 or September 23, 2012.

*(m) Pre-opening Costs*

Pre-opening costs are expensed as incurred and primarily consist of manager salaries and training, travel, employee payroll, and related training costs incurred prior to the opening of a restaurant, as well as occupancy costs incurred from when we take site possession to shop opening.

*(n) Advertising Expenses*

Advertising costs are expensed as incurred and are included in general and administrative expenses in the consolidated statements of operations. Advertising expenses were \$2.3 million and \$2.4 million in fiscal years 2010 and 2011, respectively, and \$1.9 million and \$1.4 million for the 39 weeks ended September 25, 2011 and September 23, 2012, respectively.

*(o) Income Taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are attributable to differences between financial statement and income tax reporting. Deferred tax assets, net of any valuation allowances, represent the future tax return consequences of those differences and for operating loss and tax credit carryforwards, which will be deductible when the assets are recovered. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets

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will not be realized. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns.

The Company accounts for uncertain tax positions under current accounting guidance, which prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined as a tax position that is more likely than not to be sustained upon examination by tax authorities, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

*(p) Stock-Based Compensation*

The Company's 2001 and 2004 Equity Incentive Plans (the "Plans") permit the granting of awards to employees and nonemployee officers, consultants, agents, and independent contractors of the Company in the form of stock appreciation rights, stock awards, and stock options. The Company accounts for its stock-based employee compensation in accordance with ASC 718, *Stock Based Compensation*. The Company's stock option plan contains a performance condition that restricts certain option holders' ability to exercise vested options until the consummation of an initial public offering (IPO) under the Securities Act of 1933 or at the discretion of the Company's board of directors. As a result, no compensation cost related to vested employee stock options with these performance conditions has been recognized through September 23, 2012. Since the probability and the date of an IPO cannot be determined, the Company has not estimated what the potential compensation cost associated with vested options would be as of September 23, 2012. For stock options granted without these performance conditions, the Company records stock compensation expense on a straight-line basis over the vesting period based on the grant-date fair value of the option, determined using the Black-Scholes option pricing valuation model.

*(q) Leases*

The Company leases retail shops, warehouse and office space under operating leases. Most lease agreements contain tenant improvement allowances, rent holidays, lease premiums, rent escalation clauses, and/or contingent rent provisions. For purposes of recognizing incentives, premiums, and minimum rental expenses on a straight-line basis over the terms of the leases excluding lease renewal options, the Company uses the date it takes possession of the leased space for construction purposes as the beginning of the term, which is generally two to three months prior to a shop's opening date. In addition to rental expense, certain leases require the Company to pay a portion of real estate taxes, utilities, building operating expenses, insurance and other charges in addition to rent.

For tenant improvement allowances, rent escalations, and rent holidays, the Company records a deferred rent liability in its consolidated balance sheets and amortizes the deferred rent over the terms of the leases as reductions to occupancy expense in the consolidated statements of operations.

*(r) Revenue Recognition*

Revenue from retail shops are presented net of discounts and recognized when food and beverage products are sold. Sales taxes collected from customers are excluded from revenues and the obligation is included in accrued liabilities until the taxes are remitted to the appropriate taxing authorities.

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Revenues from the Company's gift cards are deferred and recognized upon redemption or after a period of thirty-six months of inactivity on gift card balances ("gift card breakage") and the Company does not have a legal obligation to remit the value of the unredeemed gift cards to the relevant jurisdictions. The Company recognized \$0.2 million and \$0.2 million in gift card breakage income included in other operating expenses in the consolidated statements of operations for the fiscal years ended 2010 and 2011, respectively, and \$0.1 million and \$34 thousand for the 39 weeks ended September 25, 2011 and September 23, 2012, respectively.

The Company earns an initial franchise fee and ongoing royalty fees under the Company's franchise agreements. Initial franchise fee revenue is recognized at the point a franchise shop opens for business to the public, as this is the point in time when the Company has substantially performed all initial services required under the franchise agreement. The Company recognized franchise fee revenue of \$0.2 million for fiscal year 2011 and \$0.2 million and \$0.1 million for the 39 weeks ended September 25, 2011 and September 23, 2012, respectively. Initial franchise fee payments received by the Company before the shop opens are recorded as deferred revenue in the consolidated balance sheet. The Company had deferred revenue of \$0.1 million recorded as accrued expenses for each period presented in the consolidated balance sheets as of December 26, 2010, December 25, 2011 and September 23, 2012. Royalty fees are based on a percentage of sales and are recorded as revenue as the fees are earned and become receivable from the franchisee. The Company recognized royalty fees revenue in the consolidated statements of operations for fiscal year 2011 of \$0.3 million and \$0.2 million and \$0.5 million for the 39 weeks ended September 25, 2011 and September 23, 2012, respectively.

*(s) Recent Accounting Pronouncements*

In May 2011, the FASB issued guidance, which amends the fair value measurement and disclosure requirements. The updated guidance was issued to provide a consistent definition of fair value and ensure that fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards ("IFRS"). The updated guidance is effective for fiscal years beginning after December 15, 2011. The adoption of this new accounting guidance did not have an impact on the Company's consolidated financial statements.

*(t) Commitments and Contingencies*

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, results of operations or cash flows.

Many of the food products we purchase are subject to changes in the price and availability of food commodities, including, among other things, beef, poultry, grains, dairy and produce. We work with our suppliers and use a mix of forward pricing protocols for certain items under which we agree with our supplier on fixed prices for deliveries at some time in the future, fixed pricing protocols under which we agree on a fixed price with our supplier for the duration of that protocol, and formula pricing protocols under which the prices we pay are based on a specified formula related to the prices of the goods, such as spot prices. Our use of any forward pricing arrangements varies substantially from time to time and these arrangements tend to cover relatively short periods (i.e., typically twelve months or less). Such contracts are used in the normal purchases of our food products and not for speculative purposes, and as such are not required to be evaluated as derivative instruments. We do not enter into futures contracts or other derivative instruments.



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**(3) Earnings per share**

Basic and diluted net loss per common share attributable to common stockholders have been calculated using the weighted average number of common shares outstanding for the period. Our redeemable convertible preferred stock are all considered participating securities requiring the two-class method to calculate basic and diluted earnings per share. In periods of a net loss attributable to common stockholders, the redeemable convertible preferred stock are 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. Diluted net loss per common share attributable to common stockholders is computed by dividing the resulting net loss attributable to common stockholders by the weighted average number of fully diluted common shares outstanding. The computation of diluted net loss per common share attributable to common stockholders assumes the conversion of preferred stock into common stock as if the conversion occurred at the beginning of the period. Dilutive securities do not include stock options awarded to employees that have 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 have no rights in our undistributed earnings until that time.

In addition, the table below presents the unaudited pro forma calculation of the weighted average common shares outstanding for basic and dilutive calculation purposes, and the resulting pro forma calculation of the earnings per share available to common stockholders as if the conversion had occurred as of the beginning of the period.

	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
	(\$ in thousands, except per share data)			
Calculation of undistributed income (loss) for basic and diluted shares:				
Net income (loss) attributable to Potbelly Corporation	\$ (530)	\$ 7,165	\$ 5,194	\$ 5,571
Less: Accretion of redeemable convertible preferred stock to maximum redemption value	(45,992)	(17,410)	(9,011)	(13,887)
Undistributed loss for basic and diluted shares	<u>\$ (46,522)</u>	<u>\$ (10,245)</u>	<u>\$ (3,817)</u>	<u>\$ (8,316)</u>
Allocation of undistributed losses to participating securities:				
Common shares	\$ (46,522)	\$ (10,245)	\$ (3,817)	\$ (8,316)
Redeemable convertible preferred shares	—	—	—	—
Undistributed loss	<u>\$ (46,522)</u>	<u>\$ (10,245)</u>	<u>\$ (3,817)</u>	<u>\$ (8,316)</u>
Weighted average common shares outstanding-basic	4,978,621	4,359,930	4,503,982	3,972,873
Plus: Effect of potential stock options exercise	—	—	—	—
Plus: Effect of potential warrant exercise	—	—	—	—
Weighted average common shares outstanding-diluted	<u>4,978,621</u>	<u>4,359,930</u>	<u>4,503,982</u>	<u>3,972,873</u>
Loss per share available to common stockholders-basic	\$ (9.34)	\$ (2.35)	\$ (0.85)	\$ (2.09)
Loss per share available to common stockholders-diluted	(9.34)	(2.35)	(0.85)	(2.09)
Potentially dilutive shares that are considered anti-dilutive:				
Common share options	3,611,076	4,261,010	4,261,010	4,446,049
Warrants	633,996	378,996	378,996	620,700

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	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
	(\$ in thousands, except per share data)			
Weighted average common shares outstanding-basic, as reported		4,359,930		3,972,873
Plus: Effect of converting preferred share		16,491,264		16,276,388
Plus: Effect of converting warrants		535,181		538,059
Pro forma weighted average common shares outstanding-basic		21,386,375		20,787,320
Plus: Effect of potential stock options exercise		51,216		68,096
Pro forma weighted average common shares outstanding-diluted		21,437,590		20,855,416
Pro forma earnings per share available to common stockholders-basic	\$	0.34	\$	0.27
Pro forma earnings per share available to common stockholders-diluted		0.33		0.27

**(4) Property and Equipment**

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

	December 26, 2010	December 25, 2011	September 23, 2012
Leasehold improvements	\$ 95,618	\$ 105,488	\$ 116,490
Machinery and equipment	20,630	24,217	28,045
Furniture and fixtures	16,069	17,769	19,589
Computer equipment and software	9,486	10,879	12,224
Construction in progress	1,113	1,868	4,125
	142,916	160,221	180,473
Less: accumulated depreciation	(87,003)	(100,800)	(111,726)
	\$ 55,913	\$ 59,421	\$ 68,747

**(5) Intangible assets and goodwill**

Intangible assets and goodwill consisted of the following (in thousands):

	December 26, 2010	December 25, 2011	September 23, 2012
Goodwill	\$ 1,428	\$ 1,428	\$ 1,428
Trade name	3,404	3,404	3,404
Indefinite-lived assets	4,832	4,832	4,832
Noncompete and nonsolicitation agreement	239	239	239
Accumulated amortization	(219)	(239)	(239)
Definite-lived assets	20	—	—
Total	\$ 4,852	\$ 4,832	\$ 4,832

Amortization expense for definite-lived intangibles was \$20 thousand for fiscal year 2011.

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**(6) Accrued Expenses**

Accrued expenses consisted of the following (in thousands):

	December 26, 2010	December 25, 2011	September 23, 2012
Accrued labor and related expenses	\$ 6,421	\$ 6,486	\$ 4,630
Deferred gift card revenue	1,341	1,409	846
Accrued occupancy expenses	1,262	1,321	1,146
Deferred rent—current	792	1,129	931
Accrued corporate and shop expenses	841	1,000	1,818
Accrued utilities	778	701	1,075
Accrued sales and use tax	662	792	842
Accrued construction	147	451	1,636
Accrued contract termination costs (a)	480	91	187
Accrued professional fees	287	360	393
Accrued other	719	866	762
Total	<u>\$ 13,730</u>	<u>\$ 14,606</u>	<u>\$ 14,266</u>

(a) The Company incurs expenses associated with exit activity for certain signed lease agreements, which are recognized in general and administrative expenses. Accrued contract termination costs consisted of the following (in thousands):

	December 26, 2010	December 25, 2011	September 23, 2012
Accrued contract termination costs—beginning balance	\$ 1,181	\$ 480	\$ 91
Contract termination costs incurred	452	231	170
Contract termination costs settled and paid	(1,153)	(620)	(74)
Accrued contract termination costs—ending balance	<u>\$ 480</u>	<u>\$ 91</u>	<u>\$ 187</u>

**(7) Income Taxes**

Income before income taxes for the Company's domestic and foreign operations was as follows (in thousands):

	Fiscal Year	
	2010	2011
Domestic operations	\$ 243	\$ 7,702
Foreign operations	—	—
Total	<u>\$ 243</u>	<u>\$ 7,702</u>

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Income tax expense consisted of the following (in thousands):

	Fiscal Year	
	2010	2011
Federal:		
Current	\$—	\$—
Deferred	579	89
	<u>579</u>	<u>89</u>
State and Local:		
Current	126	424
Deferred	68	24
	<u>194</u>	<u>448</u>
Foreign:		
Current	—	—
Deferred	—	—
	<u>—</u>	<u>—</u>
Income tax expense	<u>\$773</u>	<u>\$537</u>

Income tax expense differed from the amounts computed by applying the U.S. federal income tax rates to income before income taxes as a result of the following (in thousands):

	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
Computed "expected" tax (benefit) expense	\$ 83	\$ 2,619	\$ 1,967	\$ 2,142
Increase (reduction) resulting from:				
State and local income taxes, net of federal income tax effect	126	424	506	687
Change in valuation allowance	(83)	(2,619)	(1,967)	(2,142)
Other, net	647	113	85	78
	<u>\$773</u>	<u>\$ 537</u>	<u>\$ 591</u>	<u>\$ 765</u>

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities reflected in the consolidated balance sheets as of December 26, 2010 and December 25, 2011 are presented below (in thousands):

	December 26, 2010	December 25, 2011
Deferred tax assets—current:		
Accrued liabilities	\$ 1,229	\$ 1,070
Deferred revenue on gift certificates and gift cards	79	71
Deferred tax assets—non-current:		
Net operating loss carryforwards	6,603	7,167
Stock-based compensation	2,434	2,543
Property and equipment depreciation	10,515	6,935
Deferred rent and start-up amortization	2,364	2,590
Accrued liabilities	80	90
FICA and other tax credits	—	—
Total deferred tax assets	<u>23,304</u>	<u>20,466</u>
Less: valuation allowance	<u>(22,782)</u>	<u>(19,811)</u>
Net deferred tax assets	522	655
Deferred tax liabilities—current:		
Prepays	240	299
Deferred tax liabilities—non-current:		
Intangible asset	647	760
Smallwares	282	356
Total gross deferred tax liabilities	<u>1,169</u>	<u>1,415</u>
Net deferred tax liabilities	<u>\$ (647)</u>	<u>\$ (760)</u>

As of December 25, 2011, the Company had available net operating loss carryforwards for federal and state income tax purposes of approximately \$19.1 million and \$11.7 million, respectively, which will expire between 2017 and 2029 if unused. These net operating losses accounted for deferred tax assets of approximately \$6.5 million and \$0.7 million in the year ended December 25, 2011.

The Company has established a full valuation allowance for its net deferred tax assets. In accordance with ASC 740, *Income Taxes*, management has determined that, based on a general history of operating losses incurred since inception of the Company in 2001, a valuation allowance was warranted. The operating losses are primarily a result of the significant growth of the Company since 2001 and the start-up costs for shop development and management infrastructure that have occurred over this time in excess of the Company's existing shops' ability to generate earnings in excess of these start-up costs. While management believes the Company will be profitable in the future and will be able to utilize these deferred tax assets, in accordance with ASC 740, the existing evidence of past operating losses is weighted more heavily than the forecast of future earnings; therefore, due to the uncertainty of future recoverability of the deferred tax assets, management has determined that a valuation allowance for the full amount of net deferred taxes is warranted. However, the Company may re-evaluate the need for a full valuation allowance if forecasted results of operations indicate increased profitability and actual results demonstrate a sustained level of profitability. Since the Company has established a full valuation allowance for our net deferred tax assets, the change in valuation allowance in each period relates to the underlying changes in recorded deferred tax assets, primarily related to depreciation of property and equipment.

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In accordance with our accounting policy, the Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. The policy did not change as a result of the adoption of "FIN No. 48." As of December 25, 2011, the Company had no interest or penalties accrued.

The tax years prior to 2010 are generally closed for examination by the United States Internal Revenue Service as a result of previous audits; however, these tax years may be subject to audit as a result of the Company utilizing net operating losses currently recorded. State statutes are generally open for audit for the 2008 to 2010 tax years. Additionally, the tax years from 2001 to 2007 are open for examination by certain state tax authorities due to net operating losses generated at the state level.

**(8) Long-term debt**

Long-term debt consisted of the following (in thousands):

	December 26, 2010	December 25, 2011	September 23, 2012
Senior credit facility (a)	\$ 8,000	\$ 14,000	\$ 14,221
Note payable (b)	1,313	1,243	1,188
<b>Total long-term debt</b>	<b>9,313</b>	<b>15,243</b>	<b>15,409</b>
Less: Current portion	4,064	70	74
<b>Long-term debt, net of current portion</b>	<b>\$ 5,249</b>	<b>\$ 15,173</b>	<b>\$ 15,335</b>

The fair value of the current and long-term debt approximates the carrying value of the debt for all periods presented.

*(a) Credit facility**JPMorgan Chase Bank, N.A.*

On September 21, 2012, the Company entered into a five-year revolving credit facility agreement 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. The credit facility contains customary representations, warranties and 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 the Company may make. The Company was in compliance with these restrictions and conditions as of September 23, 2012. The credit facility is secured by substantially all assets of the Company. Borrowings under the credit facility bear interest at interest rates based upon either the base rate or the London InterBank Offered Rate, plus or minus the applicable margins. The base rate is the higher of the Wells Fargo prime rate and the federal funds rate, plus 0.50%. As of September 23, 2012, the Company had \$14.2 million outstanding under the credit facility with a weighted average interest rate of 1.35%.

*Wells Fargo Bank, N.A.*

On January 15, 2008, the Company entered into a five-year revolving credit facility agreement that would have expired in January 2013 and provided for borrowings up to \$35.0 million to fund capital expenditures for new shops and renovations and maintenance of existing shops, and to provide ongoing working capital for other general and corporate purposes. This facility terminated on September 21, 2012 upon the entry of the Company's credit facility with JPMorgan Chase Bank, N.A. The Company was in compliance with all of the financial covenants included in this credit facility at the time of its termination.

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*(b) Note payable*

On March 15, 2007, the Company entered into a long-term note payable associated with the acquisition of certain assets of Pot Belly Deli, Inc., an unrelated California company, including the Pot Belly trade name, certain design marks, and other related assets. The Company records interest on the note payable under the effective interest method at an interest rate of 6% and recorded \$0.1 million of interest expense in fiscal years 2010 and 2011 and for the 39 weeks ended September 23, 2012, respectively. Payment of interest and principal is made quarterly. The final payment of the note will be made on April 1, 2015.

As of September 23, 2012, the scheduled payments on debt were as follows (in thousands):

<u>Years Ending</u>	
2012	\$ 19
2013	79
2014	84
2015	1,006
2016	—
Thereafter	14,221
<b>Total payments</b>	<b><u>\$ 15,409</u></b>

**(9) Capital Stock and Warrants**

As of December 25, 2011, the Company had authorized an aggregate of 52,683,632 shares of capital stock, of which 35,000,000 shares were designated as common stock, 500,000 shares were designated as non-voting common stock, and 17,183,632 shares were designated as preferred stock. The preferred stock consisted of 4,197,377 shares designated as Series A preferred stock, 3,375,221 shares designated as Series B preferred stock, 1,666,668 shares designated as Series C preferred stock, 1,250,000 shares designated as Series D preferred stock, 4,194,366 shares designated as Series E preferred stock, and 2,500,000 shares designated as Series F preferred stock. As of December 25, 2011, the Company had issued and outstanding 3,697,377 shares of Series A preferred stock, 3,290,294 shares of Series B preferred stock, 1,646,595 shares of Series C preferred stock, 1,250,000 shares of Series D preferred stock, 4,194,366 shares of Series E preferred stock, and 2,007,743 shares of Series F preferred stock.

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A summary of the status of the Company's issued warrants as of September 23, 2012 is set forth below:

<u>Unexercised Warrants</u>	<u>Number of Warrants</u>
Outstanding - December 26, 2010	633,996
Less: Exercise of warrants at \$0.01 per share	55,000
Less: Expiration of warrants at \$5.00 per share (a)	200,000
Outstanding - December 25, 2011	378,996
Issuance of warrants at \$8.16 per share (a)	241,704
Outstanding - September 23, 2012	620,700

(a) As part of the initial investment by outside investors in 2001, the Company issued stock warrants convertible to 200,000 shares of common stock at an exercise price of \$5.00 per share, which expired on September 1, 2011. After the expiration of these shares and to recognize past and continued service to the Board, the Company issued an additional 241,704 warrants at an exercise price of \$8.16 per share. The Company used the following assumptions for purposes of valuing these warrants granted in 2011: common stock fair value of \$8.16 per share; expected life of warrants-five years; volatility-53%; risk-free interest rate-1.05%; and dividend yield-0%.

All series of preferred stock are subject to substantially the same general terms and conditions. Dividends accrue (whether or not declared) on each share of preferred stock at a rate of 6% per annum of the applicable liquidation value until the first to occur of (1) the date on which the applicable liquidation value of such share is paid to the holder in connection with a significant event, (2) the date on which such share is converted into common stock, or (3) the date on which such share is acquired by the Company. Dividends are cumulative, but are payable only upon their redemption or the occurrence of a significant event that would result in a distribution to their holders of less than 110% of the shares' liquidation value (generally the applicable gross issuance price of the shares). A significant event includes a merger, sale of substantially all assets, change of control, or liquidation of the Company, but it does not include an IPO. Unpaid dividends are forfeited upon any conversion of preferred stock into common stock.

All shares of preferred stock automatically convert to common stock in the event of a qualified IPO (as defined), the election of the holders of a majority of the shares of preferred stock, or the conversion of at least a majority of the shares of issued preferred stock. None of the shares of preferred stock are mandatorily redeemable. Subsequent to December 24, 2014, preferred stock may be redeemed upon a majority vote of the preferred stockholders in accordance with the terms of the agreement for a period of 12 months ("Redemption Election Period"). If the holders of at least a majority of the preferred stock then outstanding do not approve the redemption of preferred shares outstanding during the Redemption Election Period, the Company shall have no further obligation to redeem any shares of preferred stock. Dividends are cumulative, but are payable only upon their redemption or the occurrence of a significant event that would result in a distribution to their holders of less than 110% of the shares' liquidation value (generally the applicable gross issuance price of the shares). The Company classifies the preferred stock outside of permanent equity on the balance sheet as redemption of the preferred stock is outside the control of the Company.

The Company recognizes changes in the redemption value immediately as they occur via direct charges to additional paid-in capital and then to accumulated deficit, and adjusts the carrying value of the preferred stock to equal its maximum redemption value at the end of each reporting period. In the event of a redemption, the price paid by the Company for the preferred stock would be the greater of (a) the liquidation value of the preferred stock series being redeemed, plus any accrued and unpaid dividends, or (b) the amount in respect of such share of preferred stock that such holder would have been entitled to receive on an as-converted basis



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

assuming all the shares have been converted into common stock. The form of consideration in the event of liquidation would be the same for the common stockholders as would be provided to the preferred stockholders. Based on the terms of the agreements, the redemption and conversion features do not require bifurcation and separate measurement in the financial statements since neither of the features meet the net settlement criteria under ASC 815, *Derivatives and Hedging*.

The Company measures our redeemable convertible preferred stock at its maximum redemption value at each reporting period. The fair value of the Company, used to calculate the maximum redemption value of the redeemable convertible preferred stock and to measure the value of the common stock as a key assumption in the determination of the compensation expense associated with our stock options (see Note 12), was determined with assistance from an independent third-party valuation specialist. The valuations of the Company and our common stock were determined based on valuation methodologies and assumptions selected in accordance with the guidelines outlined in the American Institute of Certified Public Accountants Practice Aid, *Valuation of Privately-Held-Companies Equity Securities Issued as Compensation*. In the absence of observable market data regarding the value of our stock, the valuation of the Company and our common stock was estimated using multiple valuation approaches, primarily an income and market approach. The income approach is based on the present value of estimated future cash flows, and relies upon significant assumptions and estimates, including those related to the selected discount rate and forecasted revenues and expenses. The market approach is based on a comparison to observed fair values of comparable peer companies and recent market transactions, adjusted for the relative size and profitability of these peer companies relative to the Company.

Each share of common stock has the same relative rights and is identical in all respects with 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. Each share of non-voting common stock has no voting rights. All shares of non-voting common stock 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 include 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.

On December 24, 2008 (the "Initial Closing"), the Company issued 1,268,207 shares of Series F preferred stock at a gross issuance price of \$8.00 per share for total proceeds, net of offering costs, of \$10.0 million. Concurrent with the Initial Closing and issuance of the Series F preferred stock, the Company issued stock warrants convertible to 200,548 shares of common stock at an exercise price of \$0.01. These warrants expire prior to the earliest to occur of (i) an IPO, (ii) a liquidity event, or (iii) December 24, 2013. The warrants meet the criteria for classification as permanent equity, and as such were recorded at the fair value at the time of issuance.

In January 2009, prior to January 31, 2009 (the "Offering Termination Date"), the Company issued an additional 679,641 shares of Series F preferred stock at a gross issuance price of \$8.00 per share for total proceeds, net of offering costs, of \$5.4 million. Concurrent with this issuance of the Series F preferred stock, the Company issued stock warrants convertible to 178,448 shares of common stock at an exercise price of \$0.01. These warrants expire prior to the earliest to occur of (i) an IPO; (ii) a liquidity event; or (iii) the date specified in each warrant agreement, ranging between December 29, 2013 and January 30, 2014. The warrants meet the criteria for classification as permanent equity, and as such were recorded at the fair value at the time of issuance.

Subsequent to the Offering Termination Date, the applicable conversion price for the Series C preferred stock, Series D preferred stock, and Series E preferred stock was adjusted under the conversion procedure provision in order to prevent dilution. After the adjustment, the Series C preferred stock, Series D preferred stock, and Series E preferred stock are convertible into common stock at the conversion rates of 1:1.01, 1:1.03,

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

and 1:1.03, respectively. The Company recorded an additional beneficial conversion charge of \$0.9 million as a discount on the preferred shares and immediately accreted the discount as an increase to accumulated deficit.

On July 8, 2010, the Company issued 84,898 shares of Series F preferred stock as a settlement for the 2009 bonus compensation of one of the Company's senior executives. The Company immediately repurchased 25,003 shares for a total purchase price of \$234,000. The preferred stock was issued and repurchased at fair value. The compensation expense related to the bonus was recorded during the year ended December 27, 2009, and the related liability was included within accrued payroll and other related benefits as of December 27, 2009.

On June 1, 2011, the Company repurchased from a board member and retired 500,000 shares of \$0.01 par value Series A preferred stock at a purchase price of \$10.00 per share and 1,180,748 of \$0.01 par value common stock at a purchase price of \$7.22 per share for a total purchase price of \$13.5 million. The Company recorded the repurchase and retirement of the preferred and common shares at fair value with the amount in excess of par value allocated to additional paid-in-capital.

**(10) Operating Leases**

Rental expense under operating lease agreements were as follows (in thousands):

	Fiscal Year		For the 39 Weeks Ended	
	2010	2011	September 25, 2011	September 23, 2012
	Minimum rentals	\$19,474	\$20,152	\$ 15,884
Contingent rentals	1,363	1,353	1,026	1,029
Less: sublease rentals	(292)	(95)	(71)	(70)
Total	<u>\$20,545</u>	<u>\$21,410</u>	<u>\$ 16,839</u>	<u>\$ 19,642</u>

Of total rental expense, \$0.2 million and \$0.1 million was for two leases with BLK Properties, LLC (a company related through common ownership) for fiscal years 2010 and 2011, respectively. The first lease requires monthly payments of \$5 over the remaining lease term, which expires in March 2012. The related-party interest of the second lease was dissolved on September 29, 2010, when BLK Properties, LLC sold its ownership interest in the property to an unrelated party.

A schedule by year of future minimum rental payments required under operating leases, excluding contingent rent, that have initial or remaining noncancelable lease terms in excess of one year, as of December 25, 2011, is as follows (in thousands):

Years Ending	Minimum	Related Party
2012	\$ 22,700	\$ 16
2013	21,301	—
2014	19,027	—
2015	16,965	—
2016	14,152	—
Thereafter	30,172	—
Total minimum payments required*	<u>\$124,317</u>	<u>\$ 16</u>

\* Minimum payments have not been reduced by minimum sublease rentals of \$1,202 due in the future.

**POTBELLY CORPORATION AND SUBSIDIARIES**  
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Certain leases have outstanding letters of credit in lieu of rent deposits expiring at various dates through October 2012, totaling \$0.7 million for each of the years ended December 26, 2010 and December 25, 2011. Under the credit facility, outstanding letters of credit are subject to an annual fee of 1.00% and reduce the available borrowing to the Company.

**(11) Employee Benefit Plan**

The Company sponsors a 401(k) profit sharing plan for all employees who are eligible based upon age and length of service. The Company made matching contributions of \$0.3 million for both fiscal years 2010 and 2011.

**(12) Stock Options**

In connection with this offering, the Company's board of directors plans to adopt the 2012 Long-Term Incentive Plan, which will replace the 2004 Incentive Plan. Once the 2012 Incentive Plan is effective, the Company will no longer make awards under the 2004 Incentive Plan. However, the 2004 Incentive Plan will continue to govern outstanding awards granted prior to its termination.

The Company has granted stock options under its 2001 and 2004 Equity Incentive Plans (the "Plans"). The Plans permit the granting of awards to employees and nonemployee officers, consultants, agents, and independent contractors of the Company in the form of stock appreciation rights, stock awards, and stock options. The Plans give broad powers to the Company's board of directors to administer and interpret the Plans, including the authority to select the individuals to be granted options and rights and to prescribe the particular form and conditions of each option to be granted.

Under the Plans, the number of shares and exercise price of each option are determined by the committee designated by the Company's board of directors. The options granted are generally exercisable within a 10-year period from the date of grant, upon the consummation of an IPO under the Securities Act of 1933 or at the discretion of the board of directors. Certain options have been issued to key executives, which are exercisable without restriction. Options issued and outstanding expire on various dates up to the year 2022. The range of exercise prices of options granted as of December 25, 2011, is \$5 to \$14 per option, and the options vest over a range of immediately to five-year periods.

In 2007, the Company entered into the Stock Option Agreement and Plan (the "Agreement"), which granted a certain key executive 500,000 options of non-voting common stock.

Under the 2001 Plan the Company had 746,749 shares reserved for issuance. In September 2011, the 2001 Plan expired with options outstanding under the plan still available for exercise. As of December 25, 2011 and September 23, 2012, a total of 3,960,998 shares of common stock have been reserved for issuance under the 2004 Equity Incentive Plan and a total of 500,000 shares of non-voting common stock have been reserved for issuance under the Agreement.

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

Activity under the Plans and the Agreement, is as follows:

<u>Options</u>	<u>Shares (Thousands)</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value (Thousands)</u>	<u>Weighted Average Remaining Term (Years)</u>
Outstanding—December 27, 2009	3,506	\$ 9.83		
Granted	185	7.00		
Exercised	—	—		
Canceled	(80)	10.30		
Outstanding—December 26, 2010	3,611	9.68	\$ 1,329	5.80
Granted	1,258	7.20		
Exercised	(120)	4.00		
Canceled	(488)	7.70		
Outstanding—December 25, 2011	4,261	9.19	\$ 2,229	6.34
Granted	333	8.16		
Exercised	—	—		
Canceled	(148)	7.88		
Outstanding—September 23, 2012 (unaudited)	4,446	9.16	\$ 6,721	5.87
Vested—September 23, 2012	3,032	9.90	\$ 3,818	4.79
Vested and expected to vest—September 23, 2012	4,316	8.94	\$ 6,460	5.60
Exercisable without restriction—September 23, 2012	2,217	8.94	\$ 2,305	5.93

A summary of the status of the Company's non vested options as of September 23, 2012 is as follows:

<u>Nonvested Options</u>	<u>Shares (In thousands)</u>
Nonvested—December 26, 2010	1,126
Granted	1,258
Vested	(376)
Forfeited	(206)
Nonvested—December 25, 2011	1,802
Granted	333
Vested	(635)
Forfeited	(86)
Nonvested—September 23, 2012	1,414
Aggregate intrinsic value—September 23, 2012	\$ 2,903

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 (generally the vesting period of the grant). For those options that are exercisable without restriction, the Company recognized \$1.0 million and \$1.5 million in stock compensation expense for fiscal years 2010 and 2011, respectively, and \$1.1 million and \$2.3 million for the 39 weeks ended September 25, 2011 and September 23, 2012, respectively, with a corresponding increase to additional paid-in-capital. As of December 25, 2011 and September 23, 2012 the unrecognized stock compensation expense was

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

\$3.5 million and \$2.1 million, respectively, which will be recognized through 2014. The expenses were recorded as general and administrative expenses in the consolidated statements of operations.

On May 10, 2011, the Company issued 788,001 stock options to certain key executives, which are exercisable without restriction and vest over a three-year period. The fair value of the options was determined using the Black-Scholes-Merton option pricing model. The Company used the following assumptions for purposes of valuing these option grants in 2011: common stock fair value of \$7.22 per share; expected life of options—six years; volatility—51%; risk-free interest rate—2.57%; and dividend yield—0%. The Company used the simplified method for determining the expected life of the options. The Company is unable to calculate specific stock price volatility as a private company, and as such, the Company used a blended volatility rate for comparable publicly traded companies.

There were no options issued during the 39 weeks ended September 23, 2012, or fiscal year 2010 that are exercisable without restriction.

**(13) Subsequent Events**

The Company has evaluated subsequent events through November 12, 2012, the date the financial statements were available to be issued. Subsequent to the Company's fiscal period ended September 23, 2012, Hurricane Sandy developed and progressed up the eastern seaboard. The Company has a significant number of shops located in the mid-atlantic and northeastern region of the country directly impacted by this storm, as well as certain other locations throughout the country that were indirectly impacted. Many of our locations directly impacted were closed for several days and/or sustained damage to the shop. At this time, the Company cannot estimate the amount of lost sales and profits, damages to shops or expected amounts that may be recovered under our insurance policies.

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Until \_\_\_\_\_, \_\_\_\_\_, all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealer's obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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**Shares**



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PROSPECTUS

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**BofA Merrill Lynch**  
**Goldman, Sachs & Co.**  
**Baird**  
**William Blair**  
**Piper Jaffray**

**Part II****Information Not Required in Prospectus****Item 13. Other Expenses of Issuance and Distribution.**

The following table sets forth the estimated expenses payable by us in connection with the sale and distribution of the securities registered hereby, other than underwriting discounts or commissions. All amounts are estimates except for the SEC registration fee and the Financial Industry Regulatory Authority filing fee.

SEC Registration Fee	\$	*
Financial Industry Regulatory Authority, Inc. Filing Fee		*
Listing Fee		*
Blue Sky Fees and Expenses		*
Printing and Engraving		*
Legal Fees and Expenses		*
Accounting Fees and Expenses		*
Transfer Agent and Registrar Fees		*
Miscellaneous		*
Total	\$	*

\* To be completed by amendment.

**Item 14. Indemnification of Directors and Officers.**

The Registrant is governed by the Delaware General Corporation Law, or DGCL. Section 145 of the DGCL provides that a corporation may indemnify any person, including an officer or director, who was or is, or is threatened to be made, a party to any threatened, pending or completed legal action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person was or is an officer, director, employee or agent of such corporation or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided such officer, director, employee or agent acted in good faith and in a manner such person reasonably believed to be in, or not opposed to, the corporation's best interest and, for criminal proceedings, had no reasonable cause to believe that such person's conduct was unlawful. A Delaware corporation may indemnify any person, including an officer or director, who was or is, or is threatened to be made, a party to any threatened, pending or contemplated action or suit by or in the right of such corporation, under the same conditions, except that such indemnification is limited to expenses (including attorneys' fees) actually and reasonably incurred by such person, and except that no indemnification is permitted without judicial approval if such person is adjudged to be liable to such corporation. Where an officer or director of a corporation is successful, on the merits or otherwise, in the defense of any action, suit or proceeding referred to above, or any claim, issue or matter therein, the corporation must indemnify that person against the expenses (including attorneys' fees) which such officer or director actually and reasonably incurred in connection therewith.

The Registrant's amended and restated by-laws will authorize the indemnification of its officers and directors, consistent with Section 145 of the Delaware General Corporation Law, as amended. The Registrant intends to enter into indemnification agreements with each of its directors and executive officers. These agreements, among other things, will require the Registrant to indemnify each director and executive officer to the fullest extent permitted by Delaware law, including advancement of expenses such as attorneys' fees, judgments, fines and settlement amounts incurred by the director or executive officer in any action or proceeding, including any action or proceeding by or in right of the Registrant, arising out of the person's services as a director or executive officer.

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Reference is made to Section 102(b)(7) of the DGCL, which enables a corporation in its original certificate of incorporation or an amendment thereto to eliminate or limit the personal liability of a director for violations of the director's fiduciary duty, except (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 174 of the DGCL, which provides for liability of directors for unlawful payments of dividends or unlawful stock purchases or redemptions or (iv) for any transaction from which a director derived an improper personal benefit.

The Registrant expects to maintain standard policies of insurance that provide coverage (i) to its directors and officers against loss arising from claims made by reason of breach of duty or other wrongful act and (ii) to the Registrant with respect to indemnification payments that it may make to such directors and officers.

The proposed form of Underwriting Agreement to be filed as Exhibit 1.1 to this Registration Statement provides for indemnification to the Registrant's directors and officers by the underwriters against certain liabilities.

### **Item 15. Recent Sales of Unregistered Securities.**

#### ***Equity Securities***

In January 2009, we sold shares of our Series F preferred stock at a price of \$8.00 per share in the following amounts to the following purchasers: 3,665 shares to Robbins & Associates Capital Advisors Fund II, LLC, 25,000 shares to Michael and Beth Huffstetler, as joint tenants, 96,650 shares to Oak Investment Partners IX, 1,030 shares to Oak IX Affiliates Fund, 2,320 shares to Oak IX Affiliates Fund-A, 100,000 shares to ASP PBSW, LLC, 84,779 shares to Maveron Equity Partners III, L.P., 3,597 shares to Maveron III Entrepreneurs' Fund, L.P., 11,624 shares to MEP III Associates Fund, L.P., 104,375 shares to WI-Potbelly II, LLC, 42,049 shares to Wilblairco II, LLC, and 23,917 shares to Star H20 Partners, LLC.

In March 2009, we issued 25,000 shares (17,637 shares net of tax withholding) to Aylwin Lewis, our Chief Executive Officer and President, as his 2008 bonus compensation in lieu of a cash bonus of \$200,000, for an effective price of \$8.00 per share.

In July 2010, we issued 84,898 shares of Series F preferred stock to Aylwin Lewis, our Chief Executive Officer and President, as his 2009 bonus compensation. The fair market value of such issuance was \$9.35 per share, or \$793,796 in aggregate consideration. We then immediately repurchased 25,003 shares of Series F preferred stock from Aylwin at fair value for a total purchase price of \$233,778.

In May 2011, we sold 55,000 shares of common stock at a price per share of \$0.01 for an aggregate purchase price of \$550 to William Blair & Company, LLC upon exercise of warrants.

In October 2011, we sold 120,000 shares of our common stock at a price per share of \$4.00 for an aggregate purchase price of \$480,000 to Arthur Rubinfeld.

In January 2009, we issued warrants to purchase our common stock with an exercise price of \$0.01 to Michael and Beth Huffstetler, as joint tenants for 6,091 shares, to Oak Investment Partners IX for 28,995 shares, to Oak IX Affiliates Fund for 309 shares, to Oak IX Affiliates Fund-A for 696 shares, to Maveron Equity Partners III, L.P. for 25,434 shares, to Maveron III Entrepreneurs' Fund, L.P. for 1,079 shares, to MEP III Associates Fund, L.P. for 3,487 shares, to WI-Potbelly II, LLC for 16,929 shares, to Wilblairco II, LLC for 5,613 shares, and to Star H20 Partners, LLC for 6,052 shares. These warrants expire prior to the earliest to occur of (i) an initial public offering, (ii) a liquidity event or (iii) December 24, 2013.

In March 2012, we issued warrants to purchase 241,704 shares of common stock at a price of \$8.16 to Oxford Capital Partners, Inc. to replace warrants that expired on September 1, 2011.



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During the year ended December 26, 2010, we granted to certain eligible participants approximately 185,000 options to purchase our common stock at a weighted average exercise price of \$7.00 under our equity incentive plans.

During the year ended December 25, 2011, we granted to certain eligible participants approximately 1,258,000 options to purchase our common stock at a weighted average exercise price of \$7.20 under our equity incentive plans.

During the period beginning December 26, 2011 through September 23, 2012, we granted to certain eligible participants approximately 333,000 options to purchase our common stock at a weighted average exercise price of \$8.16 under 2004 our Equity Incentive Plan.

The issuances of options, shares upon the exercise of options, warrants, Series F preferred stock and common stock described above were deemed exempt from registration under Section 4(2) or Regulation D of the Securities Act, and in certain circumstances, in reliance on Rule 701 promulgated thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation. All of the foregoing securities are deemed restricted securities for purposes of the Securities Act. The recipients of securities in the transactions exempt under Section 4(2) or Regulation D of the Securities Act represented their intention to acquire the securities for investment purposes only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to the stock certificates and instruments issued in such transactions.

**Item 16. Exhibits and Financial Statement Schedules.**

**(a) Exhibits**

<u>Exhibit Number</u>	<u>Description of Exhibits</u>
1.1	Form of Underwriting Agreement*
3.1	Form of Seventh Amended and Restated Certificate of Incorporation of Potbelly Corporation (to be in effect prior to the completion of the offering made under this Registration Statement)*
3.2	Form of Second Amended and Restated By-laws of Potbelly Corporation (to be in effect prior to the completion of the offering being made under this Registration Statement)*
4.1	Form of Common Stock Certificate*
4.2	Seventh Amended and Restated Stockholders Agreement*
4.3	Fifth Amended and Restated Registration Rights Agreement*
4.4	Instruments which define the rights of holders of long-term debt represent debt of less than 10% of total assets. In accordance with Item 601(b)(4)(iii) of Regulation S-K, the Registrant agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.
5.1	Opinion of Mayer Brown LLP*
10.1	Potbelly Sandwich Works, Inc. 2001 Equity Incentive Plan*
10.2	Potbelly Corporation 2004 Equity Incentive Plan, as amended*
10.3	Form of Potbelly Corporation 2013 Long-Term Incentive Plan (to be in effect prior to the completion of the offering being made under this Registration Statement)*
10.4	Credit Agreement dated September 21, 2012, among Potbelly Sandwich Works, LLC, Potbelly Corporation, Potbelly Illinois, Inc., the lenders from time to time party thereto and JPMorgan Chase Bank, N.A.*
10.5	Executive Employment Contract between Potbelly Corporation and Aylwin B. Lewis*

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10.6	Executive Employment Contract between Potbelly Corporation and John Morlock*
10.7	Executive Employment Contract between Potbelly Corporation and Charles Talbot*
10.8	Form of stock option agreement pursuant to 2004 Equity Incentive Plan*
10.9	Form of stock option agreement pursuant to 2013 Long-Term Incentive Plan*
21.1	Subsidiaries of the Registrant*
23.1	Consent of Deloitte & Touche LLP*
23.3	Consent of Mayer Brown LLP (included in the opinion to be filed as Exhibit 5.1 hereto)*
24.1	Power of Attorney†

\* To be filed by amendment  
† Previously Filed

**(b) Financial Statement Schedules**

No financial statement schedules are provided because the information called for is not applicable or is shown in the financial statements or notes thereto.

**Item 17. Undertakings.**

The undersigned Registrant hereby undertakes to provide to the underwriters at the closing specified in the underwriting agreement, certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Chicago, State of Illinois, on \_\_\_\_\_, 2013.

POTBELLY CORPORATION

By: \_\_\_\_\_

Name: Aylwin Lewis  
Title: President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities held on \_\_\_\_\_, 2013.

<u>Name</u>	<u>Position</u>
_____ Aylwin Lewis	Director, Chief Executive Officer and President (Principal Executive Officer)
_____ Charles Talbot	Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)
_____ Bryant Keil	Director
_____ Vann Avedisian	Director
_____ Peter Bassi	Director
_____ Gerald Gallagher	Director
_____ Marla Gottschalk	Director
_____ Matthew Levine	Director
_____ Dan Levitan	Director

\*By: \_\_\_\_\_  
Matthew Revord  
Attorney-in-Fact

## EXHIBIT INDEX

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10.3	Form of Potbelly Corporation 2013 Long-Term Incentive Plan (to be in effect prior to the completion of the offering being made under this Registration Statement)*
10.4	Credit Agreement dated September 21, 2012, among Potbelly Sandwich Works, LLC, Potbelly Corporation, Potbelly Illinois, Inc., the lenders from time to time party thereto and JPMorgan Chase Bank, N.A.*
10.5	Executive Employment Contract between Potbelly Corporation and Aylwin B. Lewis*
10.6	Executive Employment Contract between Potbelly Corporation and John Morlock*
10.7	Executive Employment Contract between Potbelly Corporation and Charles Talbot*
10.8	Form of stock option agreement pursuant to 2004 Equity Incentive Plan*
10.9	Form of stock option agreement pursuant to 2013 Long-Term Incentive Plan*
21.1	Subsidiaries of the Registrant*
23.1	Consent of Deloitte & Touche LLP*
23.3	Consent of Mayer Brown LLP (included in the opinion to be filed as Exhibit 5.1 hereto)*
24.1	Power of Attorney†

\* To be filed by amendment  
† Previously Filed