

PAPA MURPHY'S HOLDINGS, INC.

FORM 10-Q (Quarterly Report)

Filed 08/09/17 for the Period Ending 07/03/17

| | |
|-------------|---|
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| Telephone | 360 260-7272 |
| CIK | 0001592379 |
| Symbol | FRSH |
| SIC Code | 5812 - Eating Places |
| Industry | Restaurants & Bars |
| Sector | Consumer Cyclical |
| Fiscal Year | 01/02 |

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 3, 2017

OR

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

For the transition period from to

Commission file number 001-36432



Papa Murphy's Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)
8000 NE Parkway Drive, Suite 350
Vancouver, WA
(Address of principal executive offices)

27-2349094
(IRS Employer
Identification No.)

98662
(Zip Code)

(360) 260-7272
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes . No .

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At August 4, 2017, there were 16,948,969 shares of the Registrant's common stock, \$0.01 par value, outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

| <i>(In thousands, except share and per share data)</i> | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Revenues | | | | |
| Franchise royalties | \$ 9,101 | \$ 9,538 | \$ 19,135 | \$ 20,034 |
| Franchise and development fees | 837 | 574 | 1,438 | 1,528 |
| Company-owned store sales | 18,715 | 19,470 | 39,490 | 40,144 |
| Other | 449 | 312 | 1,033 | 1,173 |
| Total revenues | 29,102 | 29,894 | 61,096 | 62,879 |
| Costs and Expenses | | | | |
| Store operating costs: | | | | |
| Cost of food and packaging | 6,303 | 6,781 | 13,518 | 14,053 |
| Compensation and benefits | 5,923 | 5,577 | 12,257 | 11,311 |
| Advertising | 2,113 | 1,897 | 4,241 | 4,063 |
| Occupancy | 2,314 | 1,503 | 4,015 | 2,878 |
| Other store operating costs | 1,955 | 2,555 | 4,177 | 4,846 |
| Selling, general, and administrative | 3,408 | 5,912 | 20,621 | 14,967 |
| Depreciation and amortization | 2,906 | 2,915 | 6,023 | 5,630 |
| Loss (gain) on disposal or impairment of property and equipment | 11,041 | (59) | 11,050 | (5) |
| Total costs and expenses | 35,963 | 27,081 | 75,902 | 57,743 |
| Operating (Loss) Income | (6,861) | 2,813 | (14,806) | 5,136 |
| Interest expense, net | 1,286 | 1,208 | 2,513 | 2,387 |
| Other expense, net | 48 | 43 | 92 | 85 |
| (Loss) Income Before Income Taxes | (8,195) | 1,562 | (17,411) | 2,664 |
| (Benefit from) provision for income taxes | (2,008) | 610 | (5,810) | 1,070 |
| Net (Loss) Income | \$ (6,187) | \$ 952 | \$ (11,601) | \$ 1,594 |
| (Loss) earnings per share of common stock | | | | |
| Basic | \$ (0.37) | \$ 0.06 | \$ (0.69) | \$ 0.10 |
| Diluted | \$ (0.37) | \$ 0.06 | \$ (0.69) | \$ 0.10 |
| Weighted average common stock outstanding | | | | |
| Basic | 16,867,929 | 16,744,553 | 16,853,587 | 16,730,581 |
| Diluted | 16,867,929 | 16,766,587 | 16,853,587 | 16,760,578 |

See accompanying notes.

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except par value and share data)

| | July 3, 2017 | January 2, 2017 |
|---|--------------|-----------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 1,539 | \$ 2,069 |
| Accounts receivable, net | 2,957 | 5,330 |
| Current portion of notes receivable | 73 | 92 |
| Inventories | 809 | 917 |
| Prepaid expenses and other current assets | 2,402 | 4,708 |
| Total current assets | 7,780 | 13,116 |
| Property and equipment, net | 15,677 | 28,516 |
| Notes receivable, net of current portion | 34 | 57 |
| Goodwill | 107,751 | 108,470 |
| Trade name and trademarks | 87,002 | 87,002 |
| Definite-life intangibles, net | 33,928 | 36,313 |
| Other assets | 363 | 398 |
| Total assets | \$ 252,535 | \$ 273,872 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 5,024 | \$ 6,160 |
| Accrued expenses and other current liabilities | 8,652 | 7,503 |
| Current portion of unearned franchise and development fees | 1,091 | 1,358 |
| Current portion of long-term debt | 8,400 | 7,879 |
| Total current liabilities | 23,167 | 22,900 |
| Long-term debt, net of current portion | 96,432 | 100,965 |
| Unearned franchise and development fees, net of current portion | 450 | 410 |
| Deferred tax liability | 38,023 | 44,179 |
| Other long-term liabilities | 4,167 | 3,922 |
| Total liabilities | 162,239 | 172,376 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' Equity | | |
| Preferred stock (\$0.01 par value; 15,000,000 shares authorized; no shares issued) | — | — |
| Common stock (\$0.01 par value; 200,000,000 shares authorized; 16,948,969 and 16,955,970 shares issued, respectively) | 169 | 170 |
| Additional paid-in capital | 120,334 | 119,932 |
| Accumulated deficit | (30,207) | (18,606) |
| Total stockholders' equity | 90,296 | 101,496 |
| Total liabilities and stockholders' equity | \$ 252,535 | \$ 273,872 |

See accompanying notes.

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

| <i>(In thousands)</i> | Six Months Ended | |
|--|------------------|---------------|
| | July 3, 2017 | June 27, 2016 |
| Operating Activities | | |
| Net (loss) income | \$ (11,601) | \$ 1,594 |
| Adjustments to reconcile to cash from operating activities | | |
| Depreciation and amortization | 6,023 | 5,630 |
| Loss (gain) on disposal/impairment of property and equipment | 11,050 | (5) |
| Deferred taxes | (6,156) | 232 |
| Stock-based compensation | 405 | 427 |
| Other non-cash items | 259 | 158 |
| Change in operating assets and liabilities | | |
| Accounts receivable | 2,373 | 1,984 |
| Prepaid expenses and other assets | 1,620 | 1,072 |
| Unearned franchise and development fees | (226) | (347) |
| Accounts payable | (1,481) | (3,840) |
| Accrued expenses and other liabilities | 1,398 | (1,520) |
| Net cash from operating activities | 3,664 | 5,385 |
| Investing Activities | | |
| Acquisition of property and equipment | (2,259) | (9,533) |
| Acquisition of stores, less cash acquired | — | (2,449) |
| Proceeds from sale of stores | 2,206 | 136 |
| Payments received on notes receivable | 42 | 37 |
| Net cash from investing activities | (11) | (11,809) |
| Financing Activities | | |
| Payments on term loan | (5,779) | (3,321) |
| Advances on revolver | 10,500 | 10,300 |
| Payments on revolver | (8,900) | (7,300) |
| Repurchases of common stock | (4) | (80) |
| Proceeds from exercise of stock options | — | 293 |
| Payments received on subscription receivables | — | 100 |
| Net cash from financing activities | (4,183) | (8) |
| Net change in cash and cash equivalents | (530) | (6,432) |
| Cash and Cash Equivalents, beginning of year | 2,069 | 6,867 |
| Cash and Cash Equivalents, end of period | \$ 1,539 | \$ 435 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the period for interest | \$ 2,389 | \$ 2,243 |
| Cash (received) paid during the period for income taxes | (275) | 136 |
| Non-cash Supplemental Disclosures of Investing and Financing Activities | | |
| Acquisition of property and equipment in accounts payable | \$ 259 | \$ 2,509 |

See accompanying notes.

Papa Murphy's Holdings, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Note 1 — Description of Business and Basis of Presentation

Description of business

Papa Murphy's Holdings, Inc. ("Papa Murphy's" or the "Company"), together with its subsidiaries, is a franchisor and operator of a Take 'N' Bake pizza chain. The Company franchises the right to operate Papa Murphy's Take 'N' Bake pizza franchises and operates Papa Murphy's Take 'N' Bake pizza stores owned by the Company. As of July 3, 2017, the Company had 1,550 stores consisting of 1,507 domestic stores (1,358 franchised stores and 149 Company-owned stores) across 39 states, plus 43 franchised stores in Canada and the United Arab Emirates.

Substantially all of the Company's revenues are derived from retail sales of pizza and other food and beverage products to the general public by Company-owned stores and the collection of franchise royalties and fees associated with franchise and development rights.

Basis of presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all information and footnotes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. In the Company's opinion, all necessary adjustments, consisting of only normal recurring adjustments, have been made for the fair statement of the results of the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year. The accompanying interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and the related notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2017.

Principles of consolidation

The interim unaudited condensed consolidated financial statements include the accounts of Papa Murphy's Holdings, Inc., its subsidiaries and certain entities which the Company consolidates as variable interest entities. All significant intercompany transactions and balances have been eliminated.

Throughout the interim unaudited condensed consolidated financial statements and the related notes thereto, "Papa Murphy's" and "the Company" refer to Papa Murphy's Holdings, Inc. and its consolidated subsidiaries.

Fiscal year

The Company uses a 52- or 53-week fiscal year, ending on the Monday nearest to December 31. Fiscal year 2017 is a 52-week year and fiscal 2016 was a 53-week year. All three month periods presented herein contain 13 weeks. All references to years and quarters relate to fiscal periods rather than calendar periods. References to fiscal 2017 and 2016 are references to fiscal years ending January 1, 2018 and ended January 2, 2017, respectively.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), a new standard to achieve a consistent application of revenue recognition within the U.S., resulting in a single revenue model to be applied by reporting companies under GAAP. The new standard, as amended, requires adoption by the first quarter of fiscal 2018. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* ("ASU 2016-08") which is an amendment to the new revenue recognition standard on assessing whether an entity is a principal or an agent in a revenue transaction. This amendment addresses implementation issues that were discussed by the Revenue Recognition Transition Resource Group to clarify the principal versus agent assessment and lead to more consistent application. ASU 2016-08 has the same effective date and transition requirements as ASU 2014-09.

The new revenue standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company anticipates adopting the standard in the first quarter of fiscal 2018 using the full retrospective method to restate each prior reporting period presented.

The Company anticipates this standard will have a material impact on its consolidated financial statements. While the Company continues to assess all potential impacts of the standard, it currently believes the most significant effects will relate to its: (i) accounting for franchise and development fees, and (ii) accounting for its advertising funds. The Company expects revenue related to its franchise royalties, which are based on a percentage of franchise sales, and revenue from Company-owned restaurants to remain substantially unchanged. Specifically, under the new standard the Company expects to recognize franchise fees ratably over the life of the contract rather than at the time the store is opened or a successive contract commences. In addition, the Company expects to account for advertising fund revenues on a gross basis, instead of net, as the Company has determined that it is the principal since it controls the funds and determines how the funds collected will be spent. The Company continues to evaluate the impact the adoption of this standard will have on the recognition of other revenue transactions such as the refranchising of Company-owned restaurants.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). This update requires that lessees recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than twelve months. ASU 2016-02 also will require disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include both qualitative and quantitative information. The effective date for ASU 2016-02 is for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with earlier adoption permitted. The Company is still evaluating the impact of ASU 2016-02 on its financial position and results of operations, but expects there will be an increase in assets and liabilities on its Consolidated Balance Sheets at adoption due to the recording of right-of-use assets and corresponding lease liabilities, which may be material.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 320)* (“ASU 2016-15”). This update clarifies the presentation of certain cash receipts and cash payments in the statement of cash flows. The effective date for ASU 2016-15 is for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company is still evaluating the impact of ASU 2016-15 on its Consolidated Statements of Cash Flows.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment* (“ASU 2017-04”). The new standard simplifies how an entity measures goodwill impairment by removing the second step of the two-step quantitative goodwill impairment test. An entity will no longer perform a hypothetical purchase price allocation to measure goodwill impairment. Instead, impairment will be measured at the amount by which the carrying value exceeds the fair value of a reporting unit; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform a qualitative assessment of whether it is more-likely-than-not that a reporting unit’s fair value is less than its carrying amount. ASU 2017-04 requires prospective adoption and is effective for the annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is still evaluating the impact of ASU 2017-04 on its financial position and results of operations.

Note 2 — Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

| <i>(in thousands)</i> | July 3, 2017 | January 2, 2017 |
|---|--------------|-----------------|
| Prepaid media production costs | \$ — | \$ 606 |
| Prepaid software and support | 1,010 | 985 |
| Prepaid rents | 560 | 622 |
| Prepaid insurance | 59 | 453 |
| Taxes receivable | — | 547 |
| Assets held for sale | 525 | 1,406 |
| Advertising cooperative assets, restricted | 78 | 48 |
| Other | 170 | 41 |
| Total prepaid expenses and other current assets | \$ 2,402 | \$ 4,708 |

Note 3 — Property and Equipment

Property and equipment are net of accumulated depreciation of \$20.2 million and \$17.1 million at July 3, 2017, and January 2, 2017, respectively. Depreciation expense amounted to \$1.7 million and \$1.7 million during the three months ended

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July 3, 2017 , and June 27, 2016 , respectively. Depreciation expense amounted to \$3.6 million and \$3.1 million during the six months ended July 3, 2017 , and June 27, 2016 , respectively.

During the three months ended July 3, 2017, the Company decided to replace its current online ordering system with a new online and mobile ordering system. As part of this decision, the Company recognized an impairment of the software component of its property and equipment of \$9.1 million during the three months ended July 3, 2017.

During the three months ended July 3, 2017, the Company made the decision to close 13 underperforming Company-owned stores, 12 of which were closed during the second quarter of 2017. In connection with the closures, the Company recognized asset impairment charges of \$1.9 million during the three months ended July 3, 2017, and the remaining \$0.5 million of store property and equipment was transferred to assets held for sale on the Company's Condensed Consolidated Balance Sheets .

Note 4 — Divestitures

On May 1, 2017 , the Company completed the sale and refranchise of six Company-owned stores in Colorado. On May 8, 2017 , the Company completed the sale and refranchise of one Company-owned store in Colorado in an unrelated transaction. The aggregate sale price for the seven stores was \$2.5 million , paid in cash, and the Company recognized a pre-tax gain of \$0.1 million . In connection with the sale, the buyers paid \$0.3 million in franchise fees. The assets sold were classified as assets held for sale on the Company's Condensed Consolidated Balance Sheets . These dispositions did not meet the criteria for accounting as a discontinued operation.

Note 5 — Goodwill

The following summarizes changes to the Company's goodwill, by reportable segment:

| <i>(in thousands)</i> | Domestic Company Stores | Domestic Franchise | Total |
|----------------------------|----------------------------|-----------------------|------------|
| Balance at January 2, 2017 | \$ 26,924 | \$ 81,546 | \$ 108,470 |
| Disposition | (719) | — | (719) |
| Balance at July 3, 2017 | \$ 26,205 | \$ 81,546 | \$ 107,751 |

There is no goodwill associated with the International segment. The Company has determined that during the three months ended July 3, 2017 , there were no triggering events that would require an updated impairment review. The Company recorded goodwill disposals in 2017 from the sale of Company-owned stores to franchise owners.

Note 6 — Intangible Assets

Definite-lived intangible assets are net of accumulated amortization of \$29.0 million and \$26.6 million as of July 3, 2017 , and January 2, 2017 , respectively. Amortization expense amounted to \$1.2 million and \$1.3 million during the three months ended July 3, 2017 , and June 27, 2016 , respectively. Amortization expense amounted to \$2.4 million and \$2.5 million during the six months ended July 3, 2017 , and June 27, 2016 , respectively.

Note 7 — Receivables

Notes Receivable

Notes receivable consist of a note maturing in 2020 that is collateralized by store assets. Changes in the account balance represent amortization payments collected pursuant to the terms of the note.

Accounts Receivable

Allowance for doubtful accounts amounted to \$23,000 and \$37,000 as of July 3, 2017 , and January 2, 2017 , respectively.

Note 8 — Financing Arrangements

Long-term debt consists of the following:

| <i>(in thousands)</i> | July 3, 2017 | January 2, 2017 |
|--|--------------|-----------------|
| Term loan | \$ 100,100 | \$ 105,879 |
| Revolving line of credit | 2,400 | 800 |
| Notes payable | 3,000 | 3,000 |
| Total principal amount of long-term debt | 105,500 | 109,679 |
| Unamortized debt issuance costs | (668) | (835) |
| Total long-term debt | 104,832 | 108,844 |
| Less current portion | (8,400) | (7,879) |
| Total long-term debt, net of current portion | \$ 96,432 | \$ 100,965 |

Senior secured credit facility

On August 28, 2014, PMI Holdings, Inc., a wholly-owned subsidiary of Papa Murphy's Holdings, Inc., entered into a \$132.0 million senior secured credit facility (the "Senior Credit Facility") consisting of a \$112.0 million term loan and a \$20.0 million revolving credit facility, which includes a \$2.5 million letter of credit subfacility and a \$1.0 million swing-line loan subfacility. The term loan and any loans made under the revolving credit facility mature in August 2019. As of July 3, 2017, the term loan was subject to the LIBOR rate option at 4.48%. As of July 3, 2017, the revolving credit facility was subject to the LIBOR rate option at 4.46%.

With a maturity date of over one year from July 3, 2017, balances outstanding under the Senior Credit Facility are classified as non-current on the Condensed Consolidated Balance Sheets, except for mandatory, minimum term loan amortization payments of \$2.1 million due on the last day of each fiscal quarter.

The weighted average interest rate for all borrowings under our Senior Credit Facility for the second quarter of 2017 was 4.29%.

Notes payable

Papa Murphy's Company Stores, Inc., a wholly owned subsidiary of Papa Murphy's Holdings, Inc., has a \$3.0 million note payable which bears interest at 5.0% and matures in December 2018. This note is subordinated to the Senior Credit Facility.

Note 9 — Fair Value Measurement

The Company determines the fair value of assets and liabilities based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. GAAP defines a fair value hierarchy that prioritizes the assumptions used to measure fair value. The three levels of the fair value hierarchy are defined as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
- Level 2 — Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis:

| <i>(in thousands)</i> | July 3, 2017 | | January 2, 2017 | | Fair Value Measurement |
|---------------------------------|----------------|------------|-----------------|------------|------------------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value | |
| Financial assets | | | | | |
| Notes receivable ⁽¹⁾ | \$ 107 | \$ 103 | \$ 149 | \$ 150 | Level 3 |

(1) The fair value of notes receivable was estimated primarily using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

Financial instruments not included in the table above consist of cash and cash equivalents, accounts receivable, accounts payable, and long-term debt. The fair values of cash and cash equivalents, accounts receivable, and accounts payable

approximate carrying value because of the short-term nature of the accounts. The fair value of long-term debt approximates carrying value because the borrowings are made with variable market rates and negotiated terms and conditions that are consistent with current market rates.

Note 10 — Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

| <i>(in thousands)</i> | July 3, 2017 | January 2, 2017 |
|--|-----------------|-----------------|
| Accrued compensation and related costs | \$ 3,951 | \$ 2,192 |
| Gift cards payable | 2,344 | 3,033 |
| Accrued interest and non-income taxes payable | 382 | 524 |
| Convention fund balance | 827 | 1,025 |
| Advertising cooperative liabilities | 148 | 204 |
| Income taxes payable | 75 | — |
| Other | 925 | 525 |
| Total accrued expenses and other current liabilities | <u>\$ 8,652</u> | <u>\$ 7,503</u> |

Note 11 — Income Taxes

Information on the Company's income taxes for the periods reported is as follows:

| <i>(in thousands)</i> | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| (Benefit from) provision for income taxes | \$ (2,008) | \$ 610 | \$ (5,810) | \$ 1,070 |
| (Loss) income before income taxes | (8,195) | 1,562 | (17,411) | 2,664 |
| Effective income tax rate | 24.5% | 39.1% | 33.4% | 40.2% |

The effective income tax rate for the three months ended July 3, 2017, includes the effect of a switch during the quarter from an expected full year provision rate to a full year benefit rate. The effective income tax rate for the three months ended June 27, 2016, includes the effect of an adjustment for a tax benefit shortfall created by share-based payments at settlement that were made during the period.

The effective income tax rate for the six months ended July 3, 2017, includes the effect of a discrete adjustment for the share-based compensation expense recorded for vesting restricted common shares. The effective tax rate for the six months ended June 27, 2016, includes the effect of an adjustment for a tax benefit shortfall created by share-based payments at settlement that were made during the period.

Note 12 — Share-based Compensation

In May 2010, the Company's Board of Directors approved the 2010 Amended Management Incentive Plan (the "2010 Plan"). In May 2014, the Company's Board of Directors adopted the 2014 Equity Incentive Plan (the "2014 Plan," and together with the 2010 Plan, the "Incentive Plans"). The Incentive Plans reserve 2,116,747 common shares for equity incentive awards consisting of incentive stock options, non-qualified stock options, restricted stock awards, and unrestricted stock awards. Equity incentive awards may be issued from either the 2014 Plan or the 2010 Plan.

Restricted common shares

Information with respect to restricted stock awards is as follows:

| | Number of Shares of Restricted Common Stock | | Weighted Average Award Date Fair Value Per Share |
|---------------------------|---|------------------|--|
| | Time Vesting | Market Condition | |
| Unvested, January 2, 2017 | 30,670 | 148,946 | \$ 2.70 |
| Granted | 11,333 | — | 4.41 |
| Vested | (20,580) | (94,866) | 4.78 |
| Repurchased | — | (3,772) | 0.19 |
| Unvested, July 3, 2017 | 21,423 | 50,308 | \$ 4.09 |

Stock options

Information with respect to stock option activity is as follows:

| | Number of Shares Subject to Options | | Weighted Average Exercise Price Per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (thousands) |
|------------------------------|-------------------------------------|------------------|---|---|---------------------------------------|
| | Time Vesting | Market Condition | | | |
| Outstanding, January 2, 2017 | 951,688 | 171,495 | \$ 11.48 | | |
| Granted | 308,000 | — | 4.01 | | |
| Forfeited | (506,808) | (83,276) | 11.34 | | |
| Outstanding, July 3, 2017 | 752,880 | 88,219 | \$ 8.84 | 8.1 years | \$ 118 |
| Exercisable, July 3, 2017 | 285,500 | — | \$ 11.36 | 7.2 years | \$ — |

Compensation cost

Stock-based compensation expense recognized in connection with the Incentive Plans for the three months ended July 3, 2017 and June 27, 2016 amounted to \$175,000 and \$196,000, respectively. Stock-based compensation expense recognized in connection with the Incentive Plans for the six months ended July 3, 2017 and June 27, 2016 amounted to \$405,000 and \$427,000, respectively.

As of July 3, 2017, the total unrecognized stock-based compensation expense was \$1.3 million, with \$1.1 million associated with time vesting awards and \$0.2 million associated with market condition awards. The remaining weighted average vesting period for unrecognized stock-based compensation expense was 2.2 years as of July 3, 2017.

Note 13 — Advertising Fund

Franchised and Company-owned stores in the United States contribute to an advertising fund that the Company manages on behalf of these stores. In addition, certain suppliers contribute to the advertising fund. Under our franchise agreements and other agreements, contributions received by the advertising fund must be spent on marketing, creative efforts, media support, or other related purposes specified in the agreements and result in no profit recognized. Contributions to the advertising fund are netted against the related expense. Expenditures of the advertising fund are primarily amounts paid to third-parties, but may also include personnel expenses and allocated costs. At each reporting date, to the extent contributions to the advertising fund exceed expenditures on a cumulative basis, the excess contributions are accounted for as a deferred liability and are recorded in accrued expenses in the Company's Condensed Consolidated Balance Sheets. However, if expenditures exceed contributions on a cumulative basis, the excess is recorded as an expense within selling, general and administrative expenses. In subsequent periods, previously recognized expenses may be recovered if subsequent contributions exceed expenditures.

Information on the Company's advertising fund balance for the periods reported is as follows:

| (in thousands) | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Opening fund balance (deficit) | \$ (9,872) | \$ (2,324) | \$ (1,586) | \$ (1,200) |
| Net activity during the period | 2,792 | 387 | (5,494) | (737) |
| Ending fund balance (deficit) | \$ (7,080) | \$ (1,937) | \$ (7,080) | \$ (1,937) |

As of July 3, 2017, previously recognized expenses of \$7.1 million may be recovered in future periods if subsequent advertising fund contributions exceed expenditures.

Note 14 — Earnings per Share (EPS)

The number of shares and earnings per share (“EPS”) data for all periods presented are based on the historical weighted-average shares of common stock outstanding. Basic EPS is calculated by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding during each period. Diluted EPS is calculated using income available to common stockholders divided by diluted weighted-average shares of common stock outstanding during each period, which includes unvested restricted common stock and outstanding stock options. Diluted EPS considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the common shares underlying such securities would have an anti-dilutive effect.

The following table sets forth the computations of basic and diluted EPS :

| <i>(in thousands, except per share data)</i> | Three Months Ended | | Six Months Ended | |
|--|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Earnings: | | | | |
| Net (loss) income | \$ (6,187) | \$ 952 | \$ (11,601) | \$ 1,594 |
| Shares: | | | | |
| Weighted average common shares outstanding | 16,868 | 16,745 | 16,854 | 16,731 |
| Dilutive effect of restricted equity awards ⁽¹⁾ | — | 22 | — | 30 |
| Diluted weighted average number of shares outstanding | 16,868 | 16,767 | 16,854 | 16,761 |
| (Loss) earnings per share: | | | | |
| Basic (loss) earnings per share | \$ (0.37) | \$ 0.06 | \$ (0.69) | \$ 0.10 |
| Diluted (loss) earnings per share | \$ (0.37) | \$ 0.06 | \$ (0.69) | \$ 0.10 |

(1) The Company’s securities that provide a right to receive common stock in the future such as stock options and restricted stock were not included in the computation of diluted EPS for the three and six months ended July 3, 2017, as the effect of including these shares in the calculation would have been anti-dilutive.

For the three months ended July 3, 2017, and June 27, 2016, an aggregated total of 0.9 million shares and 0.5 million shares, respectively, have been excluded from the diluted EPS calculation because their effect would have been anti-dilutive. For the six months ended July 3, 2017, and June 27, 2016, an aggregated total of 1.1 million shares and 0.4 million shares, respectively, have been excluded from the diluted EPS calculation because their effect would have been anti-dilutive.

Note 15 — Commitments and Contingencies

Operating lease commitments

The Company leases facilities and various office equipment under non-cancelable operating leases which expire through December 2025. Lease terms for its Company-owned stores are generally for five years with renewal options and generally require the Company to pay a proportionate share of real estate taxes, insurance, common area maintenance, and other operating costs.

The Company has entered into operating leases that it has subleased to two franchised stores. These operating leases have minimum base rent terms, contingent rent terms if individual franchised store sales exceed certain levels and have terms expiring on various dates from May 2020 to October 2020.

Lease guarantees

The Company is the guarantor for operating leases of 22 franchised stores that have terms expiring on various dates from January 2018 to November 2021. The obligations from these leases will generally continue to decrease over time as the leases expire. The applicable franchise owners continue to have primary liability for these operating leases. As of July 3, 2017, the Company does not believe it is probable it would be required to perform under the outstanding guarantees.

Legal proceedings

There have been no material developments in the legal proceedings described in Part I, Item 3, of the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2017 .

Note 16 — Segment Information

The Company has the following reportable segments: (i) Domestic Franchise; (ii) Domestic Company Stores; and (iii) International. The Domestic Franchise segment includes operations with respect to franchised stores in the United States and derives its revenues primarily from franchise and development fees and franchise royalties from franchised stores in the United States. The Domestic Company Stores segment includes operations with respect to Company-owned stores in the United States and derives its revenues from retail sales of pizza and side items to the general public. The International segment includes operations related to the Company's operations outside the United States and derives its revenues from franchise and development fees and franchise royalties from franchised stores outside the United States.

The Company measures the performance of its segments based on segment adjusted EBITDA and allocates resources based primarily on this measure. " EBITDA " is calculated as net (loss) income before interest expense, income taxes, depreciation, and amortization. Segment adjusted EBITDA excludes certain unallocated and corporate expenses. Although segment adjusted EBITDA is not a measure of financial condition or performance determined in accordance with GAAP , the Company uses segment adjusted EBITDA to compare the operating performance of its segments on a consistent basis and to evaluate the performance and effectiveness of its operational strategies. The Company's calculation of segment adjusted EBITDA may not be comparable to that reported by other companies.

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The following tables summarize information on revenues, segment adjusted EBITDA and assets for each of the Company's reportable segments and includes a reconciliation of segment adjusted EBITDA to (loss) income before income taxes:

| (in thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|--------------------|------------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Revenues | | | | |
| Domestic Franchise | \$ 10,292 | \$ 10,337 | \$ 21,421 | \$ 22,552 |
| Domestic Company Stores | 18,714 | 19,470 | 39,490 | 40,144 |
| International | 96 | 87 | 185 | 183 |
| Total | \$ 29,102 | \$ 29,894 | \$ 61,096 | \$ 62,879 |
| Segment Adjusted EBITDA | | | | |
| Domestic Franchise | \$ 8,491 | \$ 6,059 | \$ 8,650 | \$ 11,349 |
| Domestic Company Stores | 363 | 591 | 937 | 1,742 |
| International | 91 | 78 | 160 | 142 |
| Total reportable segments adjusted EBITDA | 8,945 | 6,728 | 9,747 | 13,233 |
| Corporate and unallocated | (1,062) | (1,043) | (4,538) | (2,552) |
| Depreciation and amortization | (2,906) | (2,915) | (6,023) | (5,630) |
| Interest expense, net | (1,286) | (1,208) | (2,513) | (2,387) |
| CEO transition and restructuring ⁽¹⁾ | (131) | — | (2,329) | — |
| E-commerce impairment ⁽²⁾ | (9,124) | — | (9,124) | — |
| Store closures ⁽³⁾ | (2,631) | — | (2,631) | — |
| (Loss) Income Before Income Taxes | \$ (8,195) | \$ 1,562 | \$ (17,411) | \$ 2,664 |

(1) Represents non-recurring management transition and restructuring costs in connection with the recruitment of a new Chief Executive Officer and other executive positions.

(2) Represents impairment charges on the write-down of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.

(3) Represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores, plus lease loss reserves associated with related contractual lease obligations.

| (in thousands) | July 3, 2017 | January 2, 2017 |
|-------------------------|-------------------|-------------------|
| Total Assets | | |
| Domestic Franchise | \$ 119,805 | \$ 133,466 |
| Domestic Company Stores | 45,403 | 52,531 |
| International | 295 | 318 |
| Other ⁽¹⁾ | 87,032 | 87,557 |
| Total | \$ 252,535 | \$ 273,872 |

(1) Other assets which are not allocated to the individual segments primarily include trade names and trademarks and taxes receivable.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017. To match our operating cycle, we use a 52- or 53-week fiscal year, ending on the Monday nearest to December 31. Our fiscal quarters each contain 13 operating weeks, with the exception of the fourth quarter of a 53-week fiscal year, which contains 14 operating weeks. Fiscal year 2017 is a 52-week period ending on January 1, 2018, and 2016 was a 53-week period ended on January 2, 2017.

Cautionary Note Regarding Forward-Looking Statements

In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors including, but not limited to, those discussed in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017. All statements other than statements of historical fact or relating to present

facts or current conditions included in this discussion and analysis are forward-looking statements. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. Examples of forward-looking statements include those regarding our future financial or operating results, cash flows, sufficiency of liquidity, financing resources, business strategies and priorities, effects of advertising cost increases and shift in mix of marketing efforts, decrease in the advertising fund deficit over the remainder of 2017, resolution of litigation and claims, expansion and growth opportunities, the number and mix of new store openings, our refranchising initiative and its effects on our operating results, reduction in the number of Company-owned stores, adoption of new accounting standards, our qualification as an "emerging growth company," exposure to foreign currency and interest rate risk, as well as industry trends and outlooks. These statements may include words such as "anticipate," "estimate," "expect," "project," "plan," "intend," "believe," "may," "should," "can have," "likely" and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events .

The forward-looking statements contained in this discussion and analysis are based on assumptions that we have made in light of our industry experience and our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. As you read and consider this discussion and analysis, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties (many of which are beyond our control) and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual operating and financial performance and cause our performance to differ materially from the performance anticipated in the forward-looking statements. We believe these factors include, but are not limited to, those described under the section entitled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017 . Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual operating and financial performance may vary in material respects from expectations based on these forward-looking statements.

Any forward-looking statement made by us in this discussion and analysis speaks only as of the date on which we make it. Factors or events that could cause our actual operating and financial performance to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

2017 Highlights

Revenue

Total revenues for the three months ended July 3, 2017 , compared to the three months ended June 27, 2016 , declined 2.6% from \$29.9 million to \$29.1 million , primarily due to a decline in comparable store sales and the sale of seven company-owned stores during the three months ended July 3, 2017 , partially offset by increased fees from refranchising and transfers. Total revenues for the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , declined 2.8% from \$62.9 million to \$61.1 million primarily due to a decline in comparable store sales and lower fees from fewer franchise store openings. Comparable store sales in 2017 compared to 2016 for selected segments were as follows:

| | Three Months Ended | | Six Months Ended | |
|-------------------------|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Domestic Franchise | (4.1)% | (3.7)% | (4.3)% | (3.3)% |
| Domestic Company Stores | (6.6)% | (6.6)% | (8.4)% | (4.7)% |
| Total domestic stores | (4.3)% | (4.0)% | (4.7)% | (3.4)% |

Comparable store sales for the three and six months ended July 3, 2017 were lower due to a variety of competitive actions, including lower advertising spending in the three months ended July 3, 2017 compared to the same period last year. Results for the six months ended July 3, 2017 were further impacted due to the unsatisfactory results of our first test of national advertising during the first quarter of 2017 .

Store Development

Our franchise owners opened 13 stores, including 11 in the United States, in the three months ended July 3, 2017 . In the six months ended July 3, 2017 , we and our franchise owners opened 20 stores, including 17 in the United States. While we operate a small percentage of stores as Company-owned stores, we expect the majority of our new store expansion to continue to come from new franchised store openings.

Refranchising

During the past several years, we have focused our financial resources on accelerating the build out of several markets with Company-owned stores. Consistent with our strategy, we are now working to refranchise more than 100 of our Company-owned stores to experienced and well-capitalized franchisees who can further grow these markets. In May 2017, we successfully refranchised seven Company-owned stores pursuant to this strategy. Our target is to continue reducing the number of Company-owned stores to no more than 50 stores by 2020.

Company-owned Store Closures

In the second quarter of 2017, we made the decision to close 13 underperforming Company-owned stores, 12 of which were closed during the second quarter of 2017. In connection with the closures, we recognized asset impairment charges of \$1.9 million before taxes and recorded lease loss reserves related to remaining contractual lease obligations of \$0.7 million before taxes.

National Media

During the first quarter of 2017, we aired a national media campaign for all domestic stores. Several of our markets that historically receive no television media were provided with a few weeks of national cable advertising. This campaign resulted in a large deficit within our advertising fund, of which \$2.8 million was recovered during the second quarter of 2017. We anticipate that the remaining \$7.1 million advertising fund deficit, as of July 3, 2017, will be recovered over the next 12 to 18 months.

E-commerce

We began the system-wide roll-out of our online ordering platform in early 2016 and have seen positive results to date as the average transaction amount continues to be about 20% higher with online orders than in-store orders. We strategically use online-only promotions communicated through text and email messaging. On June 5, 2017, the Company announced plans to accelerate its convenience strategy by moving to a third-party's platform, which will enable online and mobile ordering to be fully integrated with third-party marketplace and delivery services, where available. As part of the transition, the Company recognized a non-cash charge of \$9.1 million before taxes related to the impairment of its current online ordering platform in the three months ended July 3, 2017.

Our Segments

We operate in three business segments: Domestic Franchise, Domestic Company Stores, and International. Our Domestic Franchise segment consists of our domestic franchised stores, which represent the majority of our system-wide stores. Our Domestic Company Stores segment consists of our Company-owned stores in the United States. Our International segment consists of our stores outside of the United States, all of which are franchised.

We measure the performance of our segments based on segment adjusted EBITDA and allocate resources based primarily on this measure. "EBITDA" is calculated as net (loss) income before interest expense, income taxes, depreciation, and amortization. Segment adjusted EBITDA excludes certain unallocated and corporate expenses, which include costs related to our board of directors, CEO, CFO and certain legal expenses. Although segment adjusted EBITDA is not a measure of financial condition or performance determined in accordance with GAAP, we use segment adjusted EBITDA to compare the operating performance of our segments on a consistent basis and to evaluate the performance and effectiveness of our operational strategies. Our calculation of segment adjusted EBITDA may not be comparable to that reported by other companies.

Our measure of segment performance has changed beginning in fiscal year 2017. Previously, segment operating income was used as the measure of segment performance. Our Chief Operating Decision Maker ("CODM") now uses segment adjusted EBITDA as the primary measure of segment performance to allocate resources. The CODM believes this measure provides an enhanced basis for consistently measuring segment performance against operational objectives and strategies.

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The following table sets forth our revenues and segment adjusted EBITDA for each of our segments for the periods presented:

| (in thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|--------------------|-----------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Revenues | | | | |
| Domestic Franchise | \$ 10,292 | \$ 10,337 | \$ 21,421 | \$ 22,552 |
| Domestic Company Stores | 18,714 | 19,470 | 39,490 | 40,144 |
| International | 96 | 87 | 185 | 183 |
| Total | \$ 29,102 | \$ 29,894 | \$ 61,096 | \$ 62,879 |
| Segment Adjusted EBITDA | | | | |
| Domestic Franchise | \$ 8,491 | \$ 6,059 | \$ 8,650 | \$ 11,349 |
| Domestic Company Stores | 363 | 591 | 937 | 1,742 |
| International | 91 | 78 | 160 | 142 |
| Total reportable segments adjusted EBITDA | 8,945 | 6,728 | 9,747 | 13,233 |
| Corporate and unallocated | (1,062) | (1,043) | (4,538) | (2,552) |
| Depreciation and amortization | (2,906) | (2,915) | (6,023) | (5,630) |
| Interest expense, net | (1,286) | (1,208) | (2,513) | (2,387) |
| CEO transition and restructuring ⁽¹⁾ | (131) | — | (2,329) | — |
| E-commerce impairment ⁽²⁾ | (9,124) | — | (9,124) | — |
| Store closures ⁽³⁾ | (2,631) | — | (2,631) | — |
| (Loss) Income Before Income Taxes | \$ (8,195) | \$ 1,562 | \$ (17,411) | \$ 2,664 |

- (1) Represents non-recurring management transition and restructuring costs in connection with the recruitment of a new Chief Executive Officer and other executive positions.
- (2) Represents impairment charges on the write-down of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.
- (3) Represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores, plus lease loss reserves associated with related contractual lease obligations.

Key Operating Metrics

We evaluate the performance of our business using a variety of operating and performance metrics. Set forth below is a description of our key operating metrics.

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Domestic store average weekly sales | \$ 10,167 | \$ 10,759 | \$ 10,656 | \$ 11,342 |
| Domestic comparable store sales | (4.3)% | (4.0)% | (4.7)% | (3.4)% |
| Domestic comparable stores | 1,440 | 1,410 | 1,440 | 1,410 |
| System-wide sales (in thousands) | \$ 204,536 | \$ 215,253 | \$ 430,146 | \$ 452,104 |
| System-wide stores | 1,550 | 1,570 | 1,550 | 1,570 |
| Adjusted EBITDA (in thousands) | \$ 7,883 | \$ 5,685 | \$ 5,209 | \$ 10,681 |

Average Weekly Sales

Average Weekly Sales (“AWS”) consists of the average weekly sales of domestic franchised and Company-owned stores over a specified period of time. AWS is calculated by dividing the total net sales of our domestic system-wide stores for the relevant time period by the number of weeks these stores were open in such time period. This measure allows management to assess changes in customer traffic and spending patterns in our domestic stores.

Comparable Store Sales

Comparable store sales represents the change in year-over-year sales for comparable stores. A comparable store is a store open for at least 52 full weeks from the comparable date (the Tuesday following the opening date). Comparable store sales

reflects changes in the number of transactions and in customer spend per transaction at existing stores. Customer spend per transaction is affected by changes in menu prices, sales mix, and the number of items sold per customer.

System-Wide Sales

System-wide sales include net sales by all of our system-wide stores. This measure allows management to assess the health of our brand, our relative position to competitors, and changes in our royalty revenues.

Store Openings, Closures, Acquisitions, and Divestitures

We review the number of new stores, the number of closed stores, and the number of acquired and divested stores to assess growth in system-wide sales, royalty revenues, and Company-owned store sales. We operate through a footprint of 1,550 stores as of July 3, 2017, of which 90.4% are franchised, located in 39 states plus Canada and the Middle East. The following table presents the changes in the number of stores in our system for the six months ended July 3, 2017.

| | Domestic Company Stores | Domestic Franchise | Total Domestic | International | Total |
|--------------------------------|----------------------------|-----------------------|----------------|---------------|-------|
| Store count at January 2, 2017 | 168 | 1,369 | 1,537 | 40 | 1,577 |
| Openings | — | 17 | 17 | 3 | 20 |
| Closings | (12) | (35) | (47) | — | (47) |
| Net transfers ⁽¹⁾ | (7) | 7 | — | — | — |
| Store count at July 3, 2017 | 149 | 1,358 | 1,507 | 43 | 1,550 |

(1) Net transfers are the number of franchised stores acquired by the Company, less the number of Company-owned stores refranchised.

EBITDA and Adjusted EBITDA

To supplement our condensed consolidated financial statements presented in accordance with generally accepted accounting principles in the U.S. (“GAAP”), we consider certain financial measures that are not prepared in accordance with GAAP. These non-GAAP financial measures are not based on any standardized methodology prescribed by GAAP and are not necessarily comparable to similarly-titled measures presented by other companies.

Adjusted “EBITDA” is calculated as net (loss) income before interest expense, income taxes, depreciation, and amortization (“EBITDA”) as adjusted for the effects of items that we do not consider indicative of our operating performance. Adjusted EBITDA is a supplemental measure of operating performance that does not represent and should not be considered as an alternative to net (loss) income, as determined by GAAP, and our calculation of Adjusted EBITDA may not be comparable to that reported by other companies.

Adjusted EBITDA is a non-GAAP financial measure. Management believes that this financial measure, when viewed with our results of operations in accordance with GAAP and our reconciliation of Adjusted EBITDA to net (loss) income, provides additional information to investors about certain material or unusual items that we do not expect to continue at the same level in the future. By providing this non-GAAP financial measure, we believe we are enhancing investors’ understanding of our business and our results of operations, and assisting investors in evaluating how well we are executing strategic initiatives. We believe Adjusted EBITDA is used by investors as a supplemental measure to evaluate the overall operating performance of companies in our industry.

Management uses Adjusted EBITDA and other similar measures:

- in comparing our operating performance on a consistent basis;
- to calculate incentive compensation for our employees;
- for planning purposes, including the preparation of our internal annual operating budget; and
- to evaluate the performance and effectiveness of our operational strategies.

Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of the limitations are:

- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect the cash requirements for such replacements; and
- Adjusted EBITDA does not reflect our tax expense or the cash requirements to pay our taxes.

To address these limitations, we reconcile Adjusted EBITDA to the most directly comparable GAAP measure, net income. Further, we also review GAAP measures and evaluate individual measures that are not included in Adjusted EBITDA.

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The following table provides a reconciliation of our net (loss) income to Adjusted EBITDA for the periods presented:

| <i>(in thousands)</i> | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Net (Loss) Income | \$ (6,187) | \$ 952 | \$ (11,601) | \$ 1,594 |
| Depreciation and amortization | 2,906 | 2,915 | 6,023 | 5,630 |
| (Benefit from) provision for income taxes | (2,008) | 610 | (5,810) | 1,070 |
| Interest expense, net | 1,286 | 1,208 | 2,513 | 2,387 |
| EBITDA | \$ (4,003) | \$ 5,685 | \$ (8,875) | \$ 10,681 |
| CEO transition and restructuring ⁽¹⁾ | 131 | — | 2,329 | — |
| E-commerce impairment ⁽²⁾ | 9,124 | — | 9,124 | — |
| Store closures ⁽³⁾ | 2,631 | — | 2,631 | — |
| Adjusted EBITDA | \$ 7,883 | \$ 5,685 | \$ 5,209 | \$ 10,681 |

(1) Represents non-recurring management transition and restructuring costs in connection with the recruitment of a new Chief Executive Officer and other executive positions.

(2) Represents impairment charges on the write-down of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.

(3) Represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores, plus lease loss reserves associated with related contractual lease obligations.

Results of Operations

The following table sets forth our results of operations in dollars and as a percentage of total revenues for the three and six months ended July 3, 2017, and June 27, 2016.

| (in thousands) | Three Months Ended | | | | Six Months Ended | | | |
|---|--------------------|---------------------|---------------|---------------------|------------------|---------------------|---------------|---------------------|
| | July 3, 2017 | | June 27, 2016 | | July 3, 2017 | | June 27, 2016 | |
| | \$ | Total % of Revenues | \$ | Total % of Revenues | \$ | Total % of Revenues | \$ | Total % of Revenues |
| Revenues | | | | | | | | |
| Franchise royalties | \$ 9,101 | 31.3 % | \$ 9,538 | 32.0 % | \$ 19,135 | 31.3 % | \$ 20,034 | 31.9% |
| Franchise and development fees | 837 | 2.9 % | 574 | 1.9 % | 1,438 | 2.4 % | 1,528 | 2.4% |
| Company-owned store sales | 18,715 | 64.3 % | 19,470 | 65.1 % | 39,490 | 64.6 % | 40,144 | 63.8% |
| Other | 449 | 1.5 % | 312 | 1.0 % | 1,033 | 1.7 % | 1,173 | 1.9% |
| Total revenues | 29,102 | 100.0 % | 29,894 | 100.0 % | 61,096 | 100.0 % | 62,879 | 100.0% |
| Costs and Expenses | | | | | | | | |
| Store operating costs: | | | | | | | | |
| Cost of food and packaging ⁽¹⁾ | 6,303 | 21.5 % | 6,781 | 22.8 % | 13,518 | 22.1 % | 14,053 | 22.3% |
| Compensation and benefits ⁽¹⁾ | 5,923 | 20.4 % | 5,577 | 18.7 % | 12,257 | 20.1 % | 11,311 | 18.0% |
| Advertising ⁽¹⁾ | 2,113 | 7.3 % | 1,897 | 6.3 % | 4,241 | 6.9 % | 4,063 | 6.5% |
| Occupancy ⁽¹⁾ | 2,314 | 8.0 % | 1,503 | 5.0 % | 4,015 | 6.6 % | 2,878 | 4.6% |
| Other store operating costs ⁽¹⁾ | 1,955 | 6.7 % | 2,555 | 8.5 % | 4,177 | 6.8 % | 4,846 | 7.7% |
| Selling, general, and administrative ⁽²⁾ | 3,408 | 11.8 % | 5,912 | 19.7 % | 20,621 | 33.7 % | 14,967 | 23.7% |
| Depreciation and amortization | 2,906 | 10.0 % | 2,915 | 9.8 % | 6,023 | 9.9 % | 5,630 | 9.0% |
| Loss (gain) on disposal or impairment of property and equipment | 11,041 | 37.9 % | (59) | (0.2)% | 11,050 | 18.1 % | (5) | 0.0% |
| Total costs and expenses | 35,963 | 123.6 % | 27,081 | 90.6 % | 75,902 | 124.2 % | 57,743 | 91.8% |
| Operating (Loss) Income | (6,861) | (23.6)% | 2,813 | 9.4 % | (14,806) | (24.2)% | 5,136 | 8.2% |
| Interest expense, net | 1,286 | 4.4 % | 1,208 | 4.1 % | 2,513 | 4.1 % | 2,387 | 3.9% |
| Other expense, net | 48 | 0.2 % | 43 | 0.1 % | 92 | 0.2 % | 85 | 0.1% |
| (Loss) Income Before Income Taxes | (8,195) | (28.2)% | 1,562 | 5.2 % | (17,411) | (28.5)% | 2,664 | 4.2% |
| (Benefit from) provision for income taxes | (2,008) | (6.9)% | 610 | 2.0 % | (5,810) | (9.5)% | 1,070 | 1.7% |
| Net (Loss) Income | (6,187) | (21.3)% | 952 | 3.2 % | (11,601) | (19.0)% | 1,594 | 2.5% |

(1) Please see the table presented in *Costs and Expenses* below, which presents Company-owned store expenses as a percentage of Company-owned store sales for the three and six months ended July 3, 2017 and June 27, 2016.

(2) To the extent the advertising fund expenditures exceed contributions on a cumulative basis, the excess is recorded as an expense within selling, general and administrative expenses. In subsequent periods, previously recognized expenses will be recovered when contributions exceed expenditures on a cumulative basis, resulting in a reduction to selling, general, and administrative expenses. See "Costs and Expenses—Selling, general, and administrative" below for further discussion on current impacts of this policy.

Revenues

Total revenues. In the three months ended July 3, 2017, total revenues decreased compared to the three months ended June 27, 2016, primarily due to a decline in domestic comparable store sales of 4.3%. In the six months ended July 3, 2017, total revenues decreased compared to the six months ended June 27, 2016, primarily due to a decline in domestic comparable store sales of 4.7%.

Franchise royalties. Franchise royalties decreased in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, primarily due to a decline in Domestic Franchise comparable store sales of 4.1% and a reduction in the number of franchised stores period-over-period.

Franchise royalties decreased in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, primarily due to a decline in Domestic Franchise comparable store sales of 4.3% and a reduction in the number of franchised stores period-over-period.

Franchise and development fees. Franchise and development fees increased in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, primarily due to the increase in revenues from store transfer fees.

Franchise and development fees decreased in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, primarily due to reduced revenues from franchised store openings and fewer forfeitures, partially offset by an increase in revenues from store transfer fees.

Company-owned store sales. Company-owned store sales decreased in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, due to a decline in comparable store sales of 6.6% in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, partially offset by an increase in the number of Company-owned stores period-over-period.

Company-owned store sales decreased in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, due a decline in comparable store sales of 8.4% in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, partially offset by an increase in the number of Company-owned stores period-over-period.

Costs and Expenses

Total costs and expenses. Total costs and expenses increased in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, primarily as a result of impairments related to the announced discontinuation of our online ordering system and the closure of certain Company-owned stores. Total costs and expenses increased in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, primarily as a result of the aforementioned impairments and an increase in advertising costs associated with our national media campaign.

Store operating costs. Store operating costs as a percentage of total revenues increased in the three and six months ended July 3, 2017, compared to the three and six months ended June 27, 2016. The following table presents the components of store operating costs as a percentage of Company-owned store sales for the periods reported:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Store operating costs as a % of Company-owned store sales: | | | | |
| Cost of food and packaging | 33.7% | 34.8% | 34.2% | 35.0% |
| Compensation and benefits | 31.6% | 28.6% | 31.0% | 28.2% |
| Advertising | 11.3% | 9.7% | 10.7% | 10.1% |
| Occupancy | 12.4% | 7.7% | 10.2% | 7.2% |
| Other store operating costs | 10.4% | 13.3% | 10.7% | 12.0% |
| Total store operating costs | 99.4% | 94.1% | 96.8% | 92.5% |

Total store operating costs as a percentage of Company-owned store sales increased 530 and 430 basis points overall in the three and six months ended July 3, 2017, compared to the three and six months ended June 27, 2016, due primarily to the effect of Company-owned store portfolio changes in select markets, as further explained below:

- **Occupancy.** As a result of the increase in the number of Company-owned stores period-over-period, which was mostly in markets with lower AWS, costs that are primarily fixed at the individual store level, such as Occupancy, increased overall on an absolute dollar basis and as a percentage of Company-owned store sales. Additionally, \$0.7 million in net charges were incurred in the three and six months ended July 3, 2017 related to contractual lease obligations associated with store closures.
- **Compensation and benefits.** Compensation and benefits as a percentage of Company-owned store sales increased due to an increase in fixed labor costs such as store manager salaries, driven by the increase in the number of Company-owned stores period-over-period, mostly in markets with lower AWS. In addition, increases in the minimum wage has negatively affected several of our established markets.
- **Other store operating costs.** Other store operating costs declined in the three and six months ended July 3, 2017, compared to the three and six months ended June 27, 2016, due primarily to a decrease in store pre-opening costs because the Company has not built or opened any Company-owned stores in 2017.

Selling, general, and administrative. Selling, general, and administrative costs decreased in the three months ended July 3, 2017, compared to the three months ended June 27, 2016, primarily due to the recovery of advertising fund contributions in excess of advertising fund expenses of \$2.8 million in the three months ended July 3, 2017 compared to a recovery of \$0.4 million in the three months ended June 27, 2016.

Selling, general, and administrative costs increased in the six months ended July 3, 2017, compared to the six months ended June 27, 2016, primarily due to advertising fund expenses associated with our first national media program. Advertising fund expenses exceeded fund contributions by \$5.5 million and \$0.8 million in the six months ended July 3, 2017 and June 27, 2016, respectively. Since our national media test did not provide the desired results, advertising funds will be

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redirected back to regional advertising, enhanced with increasing digital media advertising. Additionally, severance and restructuring costs of \$2.3 million were recorded in the six months ended July 3, 2017 .

In accordance with our accounting policy, when advertising expenditures exceed contributions on a cumulative basis, the change in the fund balance during the period is recorded to selling, general, and administrative costs. The table below shows the impact of the advertising fund on selling, general, and administrative costs and the current advertising fund deficit which we expect to continue to reverse over the next 12 to 18 months.

| (in thousands) | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|---------------|------------------|---------------|
| | July 3, 2017 | June 27, 2016 | July 3, 2017 | June 27, 2016 |
| Opening fund balance (deficit) | \$ (9,872) | \$ (2,324) | \$ (1,586) | \$ (1,200) |
| Net activity during the period | 2,792 | 387 | (5,494) | (737) |
| Ending fund balance (deficit) | \$ (7,080) | \$ (1,937) | \$ (7,080) | \$ (1,937) |

Depreciation and amortization. Depreciation and amortization was largely unchanged in the three months ended July 3, 2017 , compared to the three months ended June 27, 2016 . Depreciation and amortization increased in the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , primarily due to the depreciation associated with an increased number of Company-owned stores and increased capital expenditures for business technology projects.

Interest expense, net. Interest expense, net increased in the three and six months ended July 3, 2017 , compared to the three and six months ended June 27, 2016 , due to increased average borrowing rates and draws on our revolving credit facility.

Income taxes. Income taxes decreased in the three and six months ended July 3, 2017 , compared to the three and six months ended June 27, 2016 , due to the impact of a switch during the second quarter of 2017 from an expected full year provision rate to a full year benefit rate.

The effective tax rate for the three months ended July 3, 2017 , was 24.5% compared to 39.1% for the three months ended June 27, 2016 . The effective tax rate for the six months ended July 3, 2017 , was 33.4% compared to 40.2% for the six months ended June 27, 2016 . The effective tax rates decreased as a result of switching to a benefit rate from a provision rate and from the negative impact of a discrete adjustment for share-based compensation expense recorded for vesting restricted common shares recorded earlier in the year. Our income taxes have varied from what would be expected from the application of prevailing statutory rates mainly due to the impact of meal and entertainment expenses and share-based compensation expenses.

Segment Results

Domestic Franchise. Total revenues for the Domestic Franchise segment were flat in the three months ended July 3, 2017 , compared to the three months ended June 27, 2016 . Total revenues for the Domestic Franchise segment decreased \$1.1 million in the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , primarily due to a decline in Domestic Franchise comparable store sales of 4.3% and a reduction in the number of franchised stores period-over-period.

Adjusted EBITDA for the Domestic Franchise segment increased \$2.4 million in the three months ended July 3, 2017 , compared to the three months ended June 27, 2016 , primarily due to a non-recurring adjustment of \$9.1 million resulting from the impairment of our online ordering system recorded in the three months ended July 3, 2017 .

Adjusted EBITDA for the Domestic Franchise segment increased \$2.7 million in the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , primarily due to advertising fund expenses associated with our first national media program and the aforementioned non-recurring adjustment resulting from the impairment of our online ordering system. Advertising fund expenses exceeded fund contributions by \$5.5 million and \$0.8 million in the six months ended July 3, 2017 and June 27, 2016 , respectively. We expect the advertising fund deficit to largely reverse over the next 12 to 18 months. Additionally, severance and restructuring costs of \$2.3 million were recorded in the six months ended July 3, 2017 .

Domestic Company Stores. Total revenues for the Domestic Company Stores segment decreased \$0.8 million in the three months ended July 3, 2017 compared to the three months ended June 27, 2016 , primarily due to a decline in comparable store sales of 6.6% , partially offset by an increase in the number of total weeks all Company-owned stores were open period-over-period. Total revenues for the Domestic Company Stores segment decreased \$0.7 million in the six months ended July 3, 2017 compared to the six months ended June 27, 2016 , primarily due to a decline in comparable store sales of 8.4% , partially offset by an increase in the number of total weeks all Company-owned stores were open period-over-period.

Adjusted EBITDA for the Domestic Company Stores segment decreased \$0.2 million in the three months ended July 3, 2017 , compared to the three months ended June 27, 2016 , as a result of the aforementioned decline in comparable store sales and increased costs for labor and occupancy. Adjusted EBITDA for the Domestic Company Stores segment decreased \$0.8 million in the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , as a result of the aforementioned decline in comparable store sales and increased costs for labor and occupancy.

International. Total revenues for the International segment were flat for the three and six months ended July 3, 2017 , compared to the three and six months ended June 27, 2016 .

Adjusted EBITDA for the International segment increased for the three and six months ended July 3, 2017 , compared to the three and six months ended June 27, 2016 , primarily due to reductions in selling, general and administrative costs.

Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operating activities and proceeds from the incurrence of debt, which together are sufficient to fund our operations, tax payments, capital expenditures, interest, fees, and principal payments on our debt as well as support our growth strategy. If the need arises, we may seek additional funding. Our ability to obtain additional financing will depend on many factors, including prevailing market conditions, our financial condition, and our ability to negotiate favorable terms and conditions. Financing may not be available on terms that are acceptable or favorable to us, if at all.

As of July 3, 2017 , we had Cash and cash equivalents of \$1.5 million and \$20.0 million of available borrowings under a revolving credit facility, of which \$2.4 million was drawn. As of July 3, 2017 , we had \$105.5 million of outstanding indebtedness. Principal payments under our Senior Credit Facility are due on the last day of each fiscal quarter through the life of the Senior Credit Facility . We believe that our cash flows from operations, available cash and cash equivalents, and available borrowings under our revolving credit facility will be sufficient to meet our liquidity needs for at least the next 12 months.

As of July 3, 2017 , we were in compliance with all of our covenants and other obligations under our Senior Credit Facility .

Cash Flows

The following table presents a summary of cash flows from operating, investing, and financing activities for the periods presented:

| <i>(in thousands)</i> | Six Months Ended | |
|--------------------------------------|------------------|-------------------|
| | July 3, 2017 | June 27, 2016 |
| Cash flows from operating activities | \$ 3,664 | \$ 5,385 |
| Cash flows from investing activities | (11) | (11,809) |
| Cash flows from financing activities | (4,183) | (8) |
| Total cash flows | <u>\$ (530)</u> | <u>\$ (6,432)</u> |

Cash Flows from Operating Activities

Net cash provided by operating activities of \$3.7 million for the six months ended July 3, 2017 , resulted primarily from a net loss of \$11.6 million , adjusted for items such as depreciation and amortization, gains and losses on the disposal or impairment of property and equipment, and changes in operating assets and liabilities. The \$1.7 million decrease for the six months ended July 3, 2017 , compared to the six months ended June 27, 2016 , was primarily driven by increased spending on marketing during the first quarter of 2017 related to our first ever national media campaign, offset by increased advertising fee collections and savings in other selling, general and administrative costs

Cash Flows from Investing Activities

Net cash used by investing activities was \$11,000 for the six months ended July 3, 2017 , compared to net cash used of \$11.8 million for the six months ended June 27, 2016 . The \$11.8 million decrease in cash used by investing activities was due primarily to a period-over-period decrease of \$7.3 million in capital expenditures for property, plant, and equipment, primarily relating to the opening of Company-owned stores and development of our new e-commerce and online ordering platform during the six months ended June 27, 2016 .

Cash Flows from Financing Activities

Net cash used by financing activities was \$4.2 million for the six months ended July 3, 2017 , compared to net cash used of \$8,000 for the six months ended June 27, 2016 . The \$4.2 million increase in net cash used by financing activities was primarily due to an increase in payments on our long-term debt, partially offset by reduced borrowings under our revolving credit facility during the six months ended July 3, 2017 .

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. On an ongoing basis, we evaluate our judgments and estimates including those related to revenue recognition, impairment of goodwill and intangible assets, income taxes, advertising expense, and share-based compensation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The accounting policies we believe to be most critical to understanding our financial results and condition and that require complex and subjective management judgments and estimates are identified and described in our annual consolidated financial statements and the notes included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017 .

JOBS Act

We qualify as an “emerging growth company” pursuant to the provisions of the Jumpstart Our Business Startup Act of 2012 (the “ JOBS Act ”). For as long as we are an “emerging growth company,” we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies,” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, reduced disclosure obligations relating to the presentation of financial statements in Management’s Discussion and Analysis of Financial Condition and Results of Operations, exemptions from the requirements of holding advisory “say-on-pay” votes on executive compensation and shareholder advisory votes on golden parachute compensation. We have availed ourselves of these reduced reporting and disclosure requirements in our existing filings and expect to continue to avail ourselves of the reduced reporting and disclosure requirements available to emerging growth companies in future filings. We could be an “emerging growth company” until the end of our 2019 fiscal year.

In addition, an emerging growth company can delay its adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we are choosing to “opt out” of this extended transition period, and as a result, we plan to comply with any new or revised accounting standards on the relevant dates on which non-emerging growth companies must adopt the standards. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As of July 3, 2017 , there have been no material changes in our market risk exposure from that disclosed in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017 . For a discussion of our market risk exposure, please see “Item 7A. Quantitative and Qualitative Disclosure About Market Risk” contained in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017 .

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 (the “ Exchange Act ”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

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

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material developments in the legal proceedings described in Part I, Item 3, of our Annual Report on Form 10-K for the fiscal year ended January 2, 2017.

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. A detailed discussion of our risk factors is included under the section title “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017. If any of these risks, as well as other risks and uncertainties that are not yet identified or that we currently think are immaterial, actually occur, our business, results of operations or financial condition could be materially and adversely affected. In such an event, the trading price of our common stock could decline and you could lose part or all of your investment. The risk factors and other information included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2017, should be carefully considered before making an investment decision relating to our common stock.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases of Common Stock

During the three months ended July 3, 2017, the Company repurchased the following shares of common stock:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|------------------------------|----------------------------------|------------------------------|--|--|
| April 4 to April 30, 2017 | — | \$ — | — | N/A |
| May 1 to May 31, 2017 | 3,772 ⁽¹⁾ | 0.19 | — | N/A |
| June 1, 2017 to July 3, 2017 | — | — | — | N/A |
| Total | 3,772 | \$ 0.19 | — | N/A |

(1) The Company repurchased unvested restricted shares from a former employee whose employment with the Company had terminated. The unvested shares were repurchased by the Company at the historical price paid by the former employee for the unvested shares.

Item 6. Exhibits.

| Exhibit Number | Description of Exhibits |
|----------------|--|
| 10.1*‡ | Offer Letter dated June 9, 2017 from Papa Murphy's Holdings, Inc. to Weldon Spangler. |
| 31.1* | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herewith

‡ A management contract or compensatory plan or arrangement

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized

PAPA MURPHY'S HOLDINGS, INC.

By: /s/ Mark Hutchens

Name: Mark Hutchens

Title: Chief Financial Officer

Date: August 9, 2017



June 9, 2017

Mr. Weldon Spangler
c/o The Elliot Group
505 White Plains Road, Ste. 228
Tarrytown, NY 10591

Dear Mr. Spangler:

We are pleased to offer you the position of Chief Executive Officer with Papa Murphy's. In this position you would be a full-time employee reporting directly to me, Chair of the Board.

We look forward to a mutually beneficial relationship and believe that your skills and experience will help us to reach our goals. This letter will serve as an outline of the terms of the agreement.

Base Salary and Short-Term Incentive Compensation

Base salary of \$515,000 annualized. Your salary will be reviewed every year beginning in 2018 consistent with the Leadership Team compensation and performance review cycle.

This position qualifies to receive a target incentive payment of 75% of your base salary contingent on the Company's attainment of its sales and profitability goals, the Company's ability to fund the incentive compensation pool, and attainment of your personal performance goals. In recognition of the value we believe you will add immediately, upon joining our team we will guarantee a prorated 2017 incentive payment equal to 75% of your base salary to be paid in the normal course following our fiscal 2017 year end.

Long-Term Incentive Compensation

This position qualifies to receive stock options to purchase, on the terms and conditions set forth in the management incentive equity plans and applicable stock option agreements, 250,000 shares of Papa Murphy's Holdings, Inc. (FRSH) stock. One-third of the options are subject to performance restrictions that would lapse upon a Qualifying Event while the remaining two-thirds will vest in 1/4th installments on the first, second, third and fourth anniversaries of the date of grant, subject to your continued employment through the applicable vesting dates. The options will be granted to you on the first business day of the quarter following your start date (e.g., if you start in July 2017, the options would be granted on the first business day of the fourth quarter or October 3, 2017).

Executive Employment and Non-Competition Agreement

Papa Murphy's will enter into an Executive Employment and Non-Competition Agreement in the form attached hereto which will set forth terms of severance should your employment be terminated after its execution. The term of the Executive Employment and Non-Competition

Agreement will commence on your first day of employment with Papa Murphy's and renew each year on April 1 beginning in 2019. The Agreement will include, among other provisions, that should Papa Murphy's terminate your employment without Cause (as defined therein) you will be eligible to receive salary and benefits for 12 months, subject to non-competition, non-solicitation and confidentiality provisions.

Relocation

Papa Murphy's will provide a not-to-exceed budget of up to \$50,000 to be used for reasonable expenses related to your relocation to the Vancouver, Washington area. This budget is typically used for, but not limited to, the cost of moving your personal and household goods and automobiles, airfare commuting between your home and Papa Murphy's Support Center, and rental car until your relocation is complete. In addition to the \$50,000 not-to-exceed budget, Papa Murphy's will pay for 30-days of reasonable temporary living expenses. To obtain reimbursement will require you submit all receipts for such expenses. With the exception of the 30-days of temporary living, any expenses over and above the \$50,000 will be at your sole cost and expense.

You will be responsible for all tax liability associated with the relocation payment. We recommend you contact a tax advisor regarding the deductibility of various moving expenses from your federal income tax. If you voluntarily separate from Papa Murphy's before your one-year anniversary, you will repay all costs incurred or paid for by Papa Murphy's as part of your relocation.

This offer requires Vancouver, WA be your primary residence on or before February 28, 2018. Failure to relocate on or before this date will constitute Cause under the Executive Employment and Non-Competition Agreement.

Signing Bonus

You will also be given a \$80,000 signing bonus, grossed-up to account for tax liability, to be paid on your first regular pay date.

Medical Benefits and 401(k)

You will be eligible to apply for Papa Murphy's Health and Welfare plan which includes: Medical, Dental, Rx, optional Vision and FSA coverage.

Company paid Life and Accidental Death and Dismemberment Insurance. Life Insurance is equal to your annual base salary up to a maximum of \$400,000.

You will be eligible to enroll in the 401(k) savings plan the first of the month after six months of service. If you contribute to the 401(k) plan, you will be eligible to receive a Safe Harbor matching contribution equal to 100% of the amount you contribute to the plan up to the first 3% plus 50% of the amount you contribute between 3% and 5%. Match contributions are immediately vested.

Paid Time Off and Observed Company Holidays

As Papa Murphy's Chief Executive Officer your Paid Time Off (PTO) is subject to the terms and conditions of the Company's Leadership Team Flexible PTO Policy. This policy applies to

June 9, 2017

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eligible employees' absences not related to the Family and Medical Leave Act (FMLA) leave lasting less than four weeks, including bereavement, sick, vacation, and jury duty. In essence, you are not held to the constraints of a PTO bank of hours. PTO simply requires my approval.

Company paid Holidays include: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving, Day after Thanksgiving, and Christmas.

Liability

As the Chief Executive Officer and a Director, you will have insurance coverage under Papa Murphy's Directors and Officers liability insurance plans.

Pizza Perk

50% pizza discount at Papa Murphy's Company Stores.

Weldon, we understand the significance of this decision for you professionally and personally. While we would appreciate your response by close of business Friday, should you need extra time we are amenable to receiving your response by Monday, June 12th. Please sign the acceptance portion of this letter scan/email it to me at jean.birch@papamurphys.com. We would like you to begin work no later than July 17, 2017. Lastly, this offer is contingent upon the successful completion of an investigative consumer report (background check). We will notify you upon completion of this check.

We look forward to you joining the Papa Murphy's team! Please contact me at (972) XXX-XXXX if you have any questions.

Sincerely,

/s/ Jean Birch

Jean Birch

Chair of the Board and Interim Chief Executive Officer

Accepted: _____
Weldon Spangler Date

**CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Weldon Spangler, certify that:

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

Date: August 9, 2017

/s/ Weldon Spangler

Weldon Spangler
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark Hutchens, certify that:

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

Date: August 9, 2017

/s/ Mark Hutchens

Mark Hutchens

Chief Financial Officer

(Principal Financial Officer)

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

In connection with the Quarterly Report of Papa Murphy's Holdings, Inc. (the "Company") on Form 10-Q for the period ended July 3, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Weldon Spangler, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 9, 2017

/s/ Weldon Spangler

Weldon Spangler

Chief Executive Officer

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

In connection with the Quarterly Report of Papa Murphy's Holdings, Inc. (the "Company") on Form 10-Q for the period ended July 3, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark Hutchens, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 9, 2017

/s/ Mark Hutchens

Mark Hutchens

Chief Financial Officer