UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 2, 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)	**27-2349094** (IRS Employer Identification No.)
8000 NE Parkway Drive, Suite 350 **Vancouver, WA** (Address of principal executive offices)	**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 [X]. 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 [X]. 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 [X]
Non-accelerated filer [ ]	Smaller reporting company [ ]
	Emerging growth company [X]

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. [X]

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

At November 3, 2017, there were 16,965,461 shares of the Registrant’s common stock, $0.01 par value, outstanding.

TABLE OF CONTENTS

PART I — FINANCIAL INFORMATION

PART II — OTHER INFORMATION

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Operations

	Three Months Ended		Nine Months Ended	
(In thousands, except share and per share data)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Revenues				
Franchise royalties	$ 8,539	$ 8,834	$ 27,674	$ 28,868
Franchise and development fees	310	645	1,748	2,173
Company-owned store sales	17,520	18,705	57,010	58,849
Other	455	335	1,488	1,507
Total revenues	26,824	28,519	87,920	91,397
Costs and Expenses				
Store operating costs:				
Cost of food and packaging	5,858	6,488	19,376	20,541
Compensation and benefits	5,478	5,748	17,735	17,058
Advertising	1,954	1,727	6,195	5,790
Occupancy	1,390	1,608	5,405	4,487
Other store operating costs	1,967	2,762	6,144	7,608
Selling, general, and administrative	5,595	6,198	26,216	21,165
Depreciation and amortization	2,336	3,137	8,359	8,767
Loss on disposal or impairment of property and equipment	4,327	160	15,377	155
Total costs and expenses	28,905	27,828	104,807	85,571
Operating (Loss) Income	(2,081)	691	(16,887)	5,826
Interest expense, net	1,305	1,201	3,818	3,587
Other expense, net	57	41	149	125
(Loss) Income Before Income Taxes	(3,443)	(551)	(20,854)	2,114
(Benefit from) provision for income taxes	(1,574)	(130)	(7,384)	941
Net (Loss) Income	$ (1,869)	$ (421)	$ (13,470)	$ 1,173
(Loss) earnings per share of common stock				
Basic	$ (0.11)	$ (0.03)	$ (0.80)	$ 0.07
Diluted	$ (0.11)	$ (0.03)	$ (0.80)	$ 0.07
Weighted average common stock outstanding				
Basic	16,882,193	16,753,292	16,863,122	16,738,151
Diluted	16,882,193	16,753,292	16,863,122	16,772,627

See accompanying notes.

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except par value and share data)	**October 2, 2017**	**January 2, 2017**
ASSETS		
Current Assets		
Cash and cash equivalents	$ 900	$ 2,069
Accounts receivable, net	3,044	5,330
Current portion of notes receivable	97	92
Inventories	787	917
Prepaid expenses and other current assets	2,917	4,708
Total current assets	7,745	13,116
Property and equipment, net	11,036	28,516
Notes receivable, net of current portion	10	57
Goodwill	107,751	108,470
Trade name and trademarks	87,002	87,002
Definite-life intangibles, net	32,779	36,313
Other assets	351	398
Total assets	$ 246,674	$ 273,872
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 4,757	$ 6,160
Accrued expenses and other current liabilities	10,412	7,503
Current portion of unearned franchise and development fees	1,063	1,358
Current portion of long-term debt	8,400	7,879
Total current liabilities	24,632	22,900
Long-term debt, net of current portion	92,013	100,965
Unearned franchise and development fees, net of current portion	900	410
Deferred tax liability	36,642	44,179
Other long-term liabilities	3,977	3,922
Total liabilities	158,164	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; 16,965,461 and 16,955,970 shares issued, respectively)	170	170
Additional paid-in capital	120,416	119,932
Accumulated deficit	(32,076)	(18,606)
Total stockholders' equity	88,510	101,496
Total liabilities and stockholders' equity	$ 246,674	$ 273,872

See accompanying notes.

Papa Murphy's Holdings, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

	Nine Months Ended	
(In thousands)	October 2, 2017	September 26, 2016
Operating Activities		
Net (loss) income	$ (13,470)	$ 1,173
Adjustments to reconcile to cash from operating activities		
Depreciation and amortization	8,359	8,767
Loss on disposal/impairment of property and equipment	15,377	155
Deferred taxes	(7,537)	789
Stock-based compensation	489	660
Other non-cash items	341	240
Change in operating assets and liabilities		
Accounts receivable	2,285	992
Prepaid expenses and other assets	1,174	824
Unearned franchise and development fees	195	(339)
Accounts payable	(2,028)	(2,120)
Accrued expenses and other liabilities	3,040	(1,841)
Net cash from operating activities	8,225	9,300
Investing Activities		
Acquisition of property and equipment	(2,957)	(14,485)
Acquisition of stores, less cash acquired	—	(2,455)
Proceeds from sale of stores	2,206	136
Payments received on notes receivable	42	57
Net cash from investing activities	(709)	(16,747)
Financing Activities		
Payments on term loan	(7,879)	(3,321)
Advances on revolver	12,700	14,800
Payments on revolver	(13,500)	(10,700)
Repurchases of common stock	(6)	(84)
Proceeds from exercise of stock options	—	293
Payments received on subscription receivables	—	100
Net cash from financing activities	(8,685)	1,088
Net change in cash and cash equivalents	(1,169)	(6,359)
Cash and Cash Equivalents, beginning of year	2,069	6,867
Cash and Cash Equivalents, end of period	$ 900	$ 508
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for interest	$ 3,637	$ 3,423
Cash (received) paid during the period for income taxes	(246)	138
Non-cash Supplemental Disclosures of Investing and Financing Activities		
Acquisition of property and equipment in accounts payable	$ 568	$ 1,438

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 October 2, 2017, the Company had 1,542 stores consisting of 1,501 domestic stores (1,353 franchised stores and 148 Company-owned stores) across 39 states, plus 41 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 year 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 under the new standard, it is the principal since it controls the funds and determines how the funds collected will be spent. The Company also expects that application of the new standard will result in a material increase in its liabilities related to the unrecognized portion of franchise and development fees.

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 a material 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, but does not expect a material impact to its results of operations or cash flows.

The new lease 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 year 2018 using the full retrospective method to restate each prior reporting period presented.

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:

(in thousands)	October 2, 2017	January 2, 2017
Prepaid media production costs	$ 64	$ 606
Prepaid software and support	751	985
Prepaid rents	553	622
Prepaid insurance	427	453
Taxes receivable	148	547
Assets held for sale	524	1,406
Advertising cooperative assets, restricted	140	48
Other	310	41
Total prepaid expenses and other current assets	$ 2,917	$ 4,708

Note 3 — Property and Equipment

Property and equipment are net of accumulated depreciation of $21.2 million and $17.1 million at October 2, 2017, and January 2, 2017, respectively. Depreciation expense amounted to $1.2 million and $1.9 million during the three months ended October 2, 2017, and September 26, 2016, respectively. Depreciation expense amounted to $4.8 million and $5.0 million during the nine months ended October 2, 2017, and September 26, 2016, respectively.

During the nine months ended October 2, 2017, the Company decided to replace its current e-commerce platform. 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 nine months ended October 2, 2017.

During the nine months ended October 2, 2017, the Company made the decision to close 13 underperforming Company-owned stores. In connection with the closures, the Company recognized asset impairment charges of $1.9 million during the nine months ended October 2, 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.

As part of the Company's property and equipment impairment review, the Company recorded an impairment of $4.4 million to its Company-owned store assets during the three months ended October 2, 2017.

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:

(in thousands)	Domestic Company Stores	Domestic Franchise	Total
Balance at January 2, 2017	$ 26,924	$ 81,546	$ 108,470
Disposition	(719)	—	(719)
Balance at October 2, 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 October 2, 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 $30.1 million and $26.6 million as of October 2, 2017, and January 2, 2017, respectively. Amortization expense amounted to $1.1 million and $1.2 million during the three months ended October 2, 2017, and September 26, 2016, respectively. Amortization expense amounted to $3.5 million and $3.8 million during the nine months ended October 2, 2017, and September 26, 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 $24,000 and $37,000 as of October 2, 2017, and January 2, 2017, respectively.

Note 8 — Financing Arrangements

Long-term debt consists of the following:

(in thousands)	October 2, 2017	January 2, 2017
Term loan	$ 98,000	$ 105,879
Revolving line of credit	—	800
Notes payable	3,000	3,000
Total principal amount of long-term debt	101,000	109,679
Unamortized debt issuance costs	(587)	(835)
Total long-term debt	100,413	108,844
Less current portion	(8,400)	(7,879)
Total long-term debt, net of current portion	$ 92,013	$ 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 October 2, 2017, the term loan was subject to the LIBOR rate option at 4.5%.

With a maturity date of over one year from October 2, 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 third quarter of 2017 was 4.5%.

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:

	October 2, 2017		January 2, 2017		
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value	Fair Value Measurement
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

Table of Contents

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:

(in thousands)	October 2, 2017	January 2, 2017
Accrued compensation and related costs	$ 4,814	$ 2,192
Gift cards payable	2,282	3,033
Accrued interest and non-income taxes payable	426	524
Convention fund balance	1,074	1,025
Advertising cooperative liabilities	239	204
Other	1,577	525
Total accrued expenses and other current liabilities	$ 10,412	$ 7,503

Note 11 — Income Taxes

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

	Three Months Ended		Nine Months Ended	
(in thousands)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
(Benefit from) provision for income taxes	$ (1,574)	$ (130)	$ (7,384)	$ 941
(Loss) income before income taxes	(3,443)	(551)	(20,854)	2,114
Effective income tax rate	45.7%	23.6%	35.4%	44.5%

The effective income tax rate for the three months ended October 2, 2017, includes the effect of certain Federal General Business Credits confirmed during the quarter. The effective income tax rate for the three months ended September 26, 2016, includes the effect of certain permanent adjustments arising from differences between U.S. GAAP and U.S. federal and state income tax law and the relative impact of those adjustments on a small quarterly loss before income taxes.

The effective income tax rate for the nine months ended October 2, 2017, includes the effect of a discrete adjustment for the share-based compensation expense recorded for the vesting of restricted common shares. The effective tax rate for the nine months ended September 26, 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	29,333	—	4.39
Vested	(23,580)	(104,820)	5.16
Repurchased	(1,508)	(3,772)	5.48
Unvested, October 2, 2017	34,915	40,354	$ 3.36

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	455,000	—	4.13		
Forfeited	(607,240)	(96,701)	10.91		
Outstanding, October 2, 2017	799,448	74,794	$ 8.11	8.2 years	$ 695
Exercisable, October 2, 2017	278,727	—	$ 11.11	7.0 years	$ 19

Compensation cost

Stock-based compensation expense recognized in connection with the Incentive Plans for the three months ended October 2, 2017 and September 26, 2016 amounted to $0.1 million and $0.2 million, respectively. Stock-based compensation expense recognized in connection with the Incentive Plans for the nine months ended October 2, 2017 and September 26, 2016 amounted to $0.5 million and $0.7 million, respectively.

As of October 2, 2017, the total unrecognized stock-based compensation expense was $1.2 million, with $1.0 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 2.1 years as of October 2, 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:

	Three Months Ended		Nine Months Ended	
(in thousands)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Opening fund deficit	$ (7,080)	$ (1,937)	$ (1,586)	$ (1,200)
Net activity during the period	1,677	15	(3,817)	(722)
Ending fund deficit	$ (5,403)	$ (1,922)	$ (5,403)	$ (1,922)

As of October 2, 2017, previously recognized expenses of $5.4 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:

	Three Months Ended		Nine Months Ended	
(in thousands, except per share data)	**October 2, 2017**	**September 26, 2016**	**October 2, 2017**	**September 26, 2016**
Earnings:				
Net (loss) income	$ (1,869)	$ (421)	$ (13,470)	$ 1,173
Shares:				
Weighted average common shares outstanding	16,882	16,753	16,863	16,738
Dilutive effect of restricted equity awards (1)	—	—	—	34
Diluted weighted average number of shares outstanding	16,882	16,753	16,863	16,773
(Loss) earnings per share:				
Basic (loss) earnings per share	$ (0.11)	$ (0.03)	$ (0.80)	$ 0.07
Diluted (loss) earnings per share	$ (0.11)	$ (0.03)	$ (0.80)	$ 0.07

(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 nine months ended October 2, 2017, as the effect of including these shares in the calculation would have been anti-dilutive.

For the three months ended October 2, 2017, and September 26, 2016, an aggregated total of 0.7 million shares and 1.2 million shares, respectively, have been excluded from the diluted EPS calculation because their effect would have been anti-dilutive. For the nine months ended October 2, 2017, and September 26, 2016, an aggregated total of 1.0 million shares and 0.6 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 August 2020.

Lease guarantees

The Company is the guarantor for operating leases of 21 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 October 2, 2017, the Company does not believe it is probable it would be required to perform under the outstanding guarantees.

Legal proceedings

Except as set forth below, 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.

The Company currently is subject to litigation with a group of its franchise owners. In January 2014, six franchise owner groups claimed that the Company misrepresented its sales volumes, made false representations to them and charged excess advertising fees, among other things. The Company engaged in mediation with these franchise owners, which is required under the terms of their franchise agreements, in order to address and resolve their claims, but was unable to reach a settlement agreement. On April 4, 2014, a total of 12 franchise owner groups, including those franchise owners that previously made the allegations described above, filed a lawsuit against the Company in the Superior Court in Clark County, Washington, making essentially the same allegations for violation of the Washington Franchise Investment Protection Act, fraud, negligent misrepresentation and breach of contract and seeking declaratory and injunctive relief, as well as monetary damages. Based on motions filed by the Company in that lawsuit, the court ruled on July 9, 2014, that certain of the plaintiffs' claims under the anti-fraud and nondisclosure provisions of the Washington Franchise Investment Protection Act should be dismissed and that certain other claims in the case would need to be more specifically alleged. The court also ruled that the six franchise owner groups who had not mediated with the Company prior to filing the lawsuit must mediate with the Company in good faith, and that their claims shall be stayed until they have done so.

On June 18, 2014, an additional 16 franchise owner groups, represented by the same counsel as the plaintiffs described above, filed a lawsuit in the Superior Court in Clark County, Washington making essentially the same allegations as made in the lawsuit described above and seeking declaratory and injunctive relief, as well as monetary damages. The court consolidated the two lawsuits into a single case and ordered that the plaintiffs in the new lawsuit, none of whom had mediated with the Company prior to filing the lawsuit, must do so, and that their claims be stayed until they have completed mediating with the Company in good faith.

In October 2014, the Company engaged in mediation with the 22 franchise owner groups who had not previously done so. As a result of that mediation and other efforts, the Company reached resolution with 13 of the franchise owner groups involved in the consolidated lawsuits, and their claims have either been dismissed or dismissal is pending.

In February 2015, the remaining franchise owner groups in the consolidated lawsuits filed an amended complaint, removing some claims, amending some claims, adding claims and naming some of the Company's former and current franchise sales staff as additional individual defendants. In September 2016, the remaining 15 franchise owner groups in the consolidated lawsuits filed an amended complaint to add a claim under the Washington Consumer Protection Act based on substantially the same allegations as the prior claims, to re-plead claims under the Washington Franchise Investment Protection Act that had previously been dismissed, and to dismiss Dan Harmon as a defendant.

In June 2017, the Company, members of its board of directors and the plaintiffs each filed motions for summary judgment. A hearing on the summary judgment motions was held on October 13, 2017.

In July 2017, the Company engaged in mediation with the remaining 15 franchise owner groups in the consolidated lawsuits. As a result of that mediation and other efforts, the Company reached resolution with five of the remaining franchise owner groups, and their claims have either been dismissed or dismissal is pending.

The Company continues to believe the allegations in this litigation lack merit and, for those plaintiffs with whom the Company is unable to reach resolution, it will continue to vigorously defend its interests, including by asserting a number of affirmative defenses and, where appropriate, counterclaims. The Company provides no assurance that it will be successful in its defense of these lawsuits; however, it does not currently expect the cost of resolving them to have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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.

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

	Three Months Ended		Nine Months Ended	
(in thousands)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Revenues				
Domestic Franchise	$ 9,227	$ 9,725	$ 30,648	$ 32,276
Domestic Company Stores	17,520	18,705	57,010	58,849
International	77	89	262	272
Total	$ 26,824	$ 28,519	$ 87,920	$ 91,397
Segment Adjusted EBITDA				
Domestic Franchise	$ 6,131	$ 4,968	$ 14,782	$ 16,317
Domestic Company Stores	365	(197)	1,303	1,545
International	62	80	222	222
Total reportable segments adjusted EBITDA	6,558	4,851	16,307	18,084
Corporate and unallocated	(1,261)	(1,064)	(5,800)	(3,616)
Depreciation and amortization	(2,336)	(3,137)	(8,359)	(8,767)
Interest expense, net	(1,305)	(1,201)	(3,818)	(3,587)
CEO transition and restructuring(1)	(190)	—	(2,519)	—
E-commerce impairment(2)	—	—	(9,124)	—
Store closures and impairments(3)	(4,446)	—	(7,078)	—
Litigation settlements(4)	(463)	—	(463)	—
(Loss) Income Before Income Taxes	$ (3,443)	$ (551)	$ (20,854)	$ 2,114

(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 of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.
(3) Represents non-cash charges associated with the disposal or impairment of store assets upon the determination that the book value of certain stores was higher than the fair value of those stores, plus lease buyouts and reserves for the residual contractual lease obligations on closed stores.
(4) Payments and accruals made towards franchisee litigation settlements.

(in thousands)	October 2, 2017	January 2, 2017
Total Assets		
Domestic Franchise	$ 119,151	$ 133,466
Domestic Company Stores	40,047	52,531
International	289	318
Other (1)	87,187	87,557
Total	$ 246,674	$ 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 fiscal year 2016 was a 53-week period ended on January 2, 2017.

Table of Contents

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, e-commerce initiatives, shift in mix of marketing efforts, decrease in the advertising fund deficit over future periods, resolution of litigation and claims, expansion and growth opportunities, the number and mix of new store openings, our refranchising initiative, 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 October 2, 2017, compared to the three months ended September 26, 2016, declined 5.9% from $28.5 million to $26.8 million, primarily due to a decline in Company-owned store sales attributable to the refranchising of seven and closure of 12 Company-owned stores during the second quarter of 2017, and the closure of one Company-owned store during the three months ended October 2, 2017. Total revenues were further impacted by negative comparable store sales as noted below and a decline in franchise and development fees. Total revenues for the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, declined 3.8% from $91.4 million to $87.9 million primarily due to the same causes as for the decline in total revenues for the three months ended October 2, 2017. Comparable store sales in 2017 compared to 2016 for selected segments were as follows:

	Three Months Ended		Nine Months Ended	
	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Domestic Franchise	(4.2)%	(5.6)%	(4.3)%	(4.0)%
Domestic Company Stores	(2.7)%	(7.7)%	(6.6)%	(5.6)%
Total domestic stores	(4.1)%	(5.8)%	(4.5)%	(4.1)%

Comparable store sales for the three and nine months ended October 2, 2017 were lower due to a variety of competitive actions, including lower advertising expenditures in the three months ended October 2, 2017 compared to the same period last year. Results for the nine months ended October 2, 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 nine stores, including eight in the United States, in the three months ended October 2, 2017. In the nine months ended October 2, 2017, we and our franchise owners opened 29 stores, including 25 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, and one at the start of the third 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.

Company-owned Store Asset Impairment

In the third quarter of 2017, as part of our impairment analysis of the book value of the property and equipment associated with our Company-owned stores, it was determined that the book value of our stores in four markets was higher than the fair value of the stores located in those markets. Accordingly, we recognized an asset impairment charge of $4.4 million before taxes during the third quarter of 2017.

National Media

During the first quarter of 2017, we aired a national media campaign for all domestic stores. Several of our markets that historically received no television media were provided with a few weeks of national cable advertising. This test campaign resulted in a large deficit within our advertising fund, of which $1.7 million was recovered during the third quarter of 2017. We anticipate that the remaining $5.4 million advertising fund deficit, as of October 2, 2017, will be recovered over the next 12 to 18 months.

E-commerce

We began the system-wide roll-out of an e-commerce 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 also 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 e-commerce platform in the second quarter of 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 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.

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

	Three Months Ended		Nine Months Ended	
(in thousands)	**October 2, 2017**	**September 26, 2016**	**October 2, 2017**	**September 26, 2016**
Revenues				
Domestic Franchise	$ 9,227	$ 9,725	$ 30,648	$ 32,276
Domestic Company Stores	17,520	18,705	57,010	58,849
International	77	89	262	272
Total	$ 26,824	$ 28,519	$ 87,920	$ 91,397
Segment Adjusted EBITDA				
Domestic Franchise	$ 6,131	$ 4,968	$ 14,782	$ 16,317
Domestic Company Stores	365	(197)	1,303	1,545
International	62	80	222	222
Total reportable segments adjusted EBITDA	6,558	4,851	16,307	18,084
Corporate and unallocated	(1,261)	(1,064)	(5,800)	(3,616)
Depreciation and amortization	(2,336)	(3,137)	(8,359)	(8,767)
Interest expense, net	(1,305)	(1,201)	(3,818)	(3,587)
CEO transition and restructuring [(1)]	(190)	—	(2,519)	—
E-commerce impairment[(2)]	—	—	(9,124)	—
Store closures and impairments[(3)]	(4,446)	—	(7,078)	—
Litigation settlements[(4)]	(463)	—	(463)	—
(Loss) Income Before Income Taxes	$ (3,443)	$ (551)	$ (20,854)	$ 2,114

(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 of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.
(3) Represents non-cash charges associated with the disposal or impairment of store assets upon the determination that the book value of certain stores was higher than the fair value of those stores, plus lease buyouts and reserves for the residual contractual lease obligations on closed stores.
(4) Payments and accruals made toward franchisee litigation settlements.

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		Nine Months Ended	
	October 2, 2017	**September 26, 2016**	**October 2, 2017**	**September 26, 2016**
Domestic store average weekly sales	$ 9,695	$ 9,819	$ 10,339	$ 10,829
Domestic comparable store sales	(4.1)%	(5.8)%	(4.5)%	(4.1)%
Domestic comparable stores	1,448	1,418	1,448	1,418
System-wide sales (in thousands)	$ 192,903	$ 199,318	$ 623,049	$ 651,422
System-wide stores	1,542	1,582	1,542	1,582
Adjusted EBITDA (in thousands)	$ 5,297	$ 3,787	$ 10,507	$ 14,468

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

Table of Contents

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 1,542 stores as of October 2, 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 nine months ended October 2, 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	—	25	25	4	29
Closings	(13)	(48)	(61)	(3)	(64)
Net transfers [(1)]	(7)	7	—	—	—
Store count at October 2, 2017	148	1,353	1,501	41	1,542

(1) Net transfers are the number of franchised stores acquired by the Company, less the number of Company-owned stores refranchised. During this period, the Company refranchised seven Company-owned stores and did not acquire any franchised stores.

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.

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

	Three Months Ended		Nine Months Ended	
(in thousands)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Net (Loss) Income	$ (1,869)	$ (421)	$ (13,470)	$ 1,173
Depreciation and amortization	2,336	3,137	8,359	8,767
(Benefit from) provision for income taxes	(1,574)	(130)	(7,384)	941
Interest expense, net	1,305	1,201	3,818	3,587
EBITDA	$ 198	$ 3,787	$ (8,677)	$ 14,468
CEO transition and restructuring[1]	190	—	2,519	—
E-commerce impairment[2]	—	—	9,124	—
Store closures and impairments[3]	4,446	—	7,078	—
Litigation settlements[4]	463	—	463	—
Adjusted EBITDA	$ 5,297	$ 3,787	$ 10,507	$ 14,468

(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 of our e-commerce platform based on the decision to move to a third-party developed and hosted solution.
(3) Represents non-cash charges associated with the disposal or impairment of store assets upon the determination that the book value of certain stores was higher than the fair value of those stores, plus lease buyouts and reserves for the residual contractual lease obligations on closed stores.
(4) Payments and accruals made toward franchisee settlements.

Table of Contents

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 nine months ended October 2, 2017, and September 26, 2016.

	Three Months Ended				Nine Months Ended			
	October 2, 2017		September 26, 2016		October 2, 2017		September 26, 2016	
(in thousands)	$	Total % of Revenues	$	Total % of Revenues	$	Total % of Revenues	$	Total % of Revenues
Revenues								
Franchise royalties	$ 8,539	31.8 %	$ 8,834	30.9 %	$ 27,674	31.5 %	$ 28,868	31.6%
Franchise and development fees	310	1.2 %	645	2.3 %	1,748	2.0 %	2,173	2.4%
Company-owned store sales	17,520	65.3 %	18,705	65.6 %	57,010	64.8 %	58,849	64.4%
Other	455	1.7 %	335	1.2 %	1,488	1.7 %	1,507	1.6%
Total revenues	26,824	100.0 %	28,519	100.0 %	87,920	100.0 %	91,397	100.0%
Costs and Expenses								
Store operating costs:								
Cost of food and packaging (1)	5,858	21.9 %	6,488	22.7 %	19,376	22.1 %	20,541	22.5%
Compensation and benefits (1)	5,478	20.4 %	5,748	20.2 %	17,735	20.2 %	17,058	18.7%
Advertising (1)	1,954	7.3 %	1,727	6.1 %	6,195	7.0 %	5,790	6.3%
Occupancy (1)	1,390	5.2 %	1,608	5.6 %	5,405	6.1 %	4,487	4.9%
Other store operating costs (1)	1,967	7.3 %	2,762	9.7 %	6,144	7.0 %	7,608	8.3%
Selling, general, and administrative (2)	5,595	20.9 %	6,198	21.7 %	26,216	29.8 %	21,165	23.1%
Depreciation and amortization	2,336	8.7 %	3,137	11.0 %	8,359	9.5 %	8,767	9.6%
Loss on disposal or impairment of property and equipment	4,327	16.1 %	160	0.6 %	15,377	17.5 %	155	0.2%
Total costs and expenses	28,905	107.8 %	27,828	97.6 %	104,807	119.2 %	85,571	93.6%
Operating (Loss) Income	(2,081)	(7.8)%	691	2.4 %	(16,887)	(19.2)%	5,826	6.4%
Interest expense, net	1,305	4.8 %	1,201	4.2 %	3,818	4.3 %	3,587	4.0%
Other expense, net	57	0.2 %	41	0.1 %	149	0.2 %	125	0.1%
(Loss) Income Before Income Taxes	(3,443)	(12.8)%	(551)	(1.9)%	(20,854)	(23.7)%	2,114	2.3%
(Benefit from) provision for income taxes	(1,574)	(5.8)%	(130)	(0.4)%	(7,384)	(8.4)%	941	1.0%
Net (Loss) Income	(1,869)	(7.0)%	(421)	(1.5)%	(13,470)	(15.3)%	1,173	1.3%

(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 nine months ended October 2, 2017, and September 26, 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 October 2, 2017, total revenues decreased compared to the three months ended September 26, 2016, primarily due to a decline in Company-owned store sales attributable to the refranchising of seven and closure of 12 Company-owned stores during the second quarter of 2017, and the closure of one Company-owned store during the three months ended October 2, 2017. Total revenues were further impacted by a decline in domestic comparable store sales of 4.1% and a decline in franchise and development fees. In the nine months ended October 2, 2017, total revenues decreased compared to the nine months ended September 26, 2016, primarily due to the decrease in store counts as mentioned above and a decline in domestic comparable store sales of 4.5%.

Franchise royalties. Franchise royalties decreased in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily due to a decline in Domestic Franchise comparable store sales of 4.2% and a reduction in the number of franchised stores period-over-period.

Franchise royalties decreased in the nine months ended October 2, 2017, compared to the nine months ended September 26, 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 decreased in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily due to a decline in revenues from successive franchise agreements and a decline in initial franchise fees as a result of the opening of fewer franchised stores. Franchise and development fees decreased in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily due to a decline in revenues from successive franchise agreements and a decline in initial franchise fees as a result of the opening of fewer franchised stores, 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 October 2, 2017, compared to the three months ended September 26, 2016, due to a decline in comparable store sales of 2.7% in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, and a decrease in the number of Company-owned stores, period-over-period.

Company-owned store sales decreased in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, due a decline in comparable store sales of 6.6% in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, and a decrease 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 October 2, 2017, compared to the three months ended September 26, 2016, primarily due to the impairment of property and equipment at Company-owned stores, partially offset by advertising fund contributions in excess of advertising fund expenses of $1.7 million and a decline in depreciation and amortization expense mostly due to the impairments recognized in the second quarter of 2017 related to our e-commerce platform and the closing of 13 company-owned stores.

Total costs and expenses increased in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily as a result of the significant impairments related to (a) property and equipment at Company-owned stores, (b) the e-commerce platform, and (c) the closing of 13 company-owned stores, in addition to advertising fund expenses greater than advertising fund contributions by $3.8 million, primarily due to advertising costs associated with the first test of national advertising in the first quarter of 2017.

Store operating costs. Store operating costs as a percentage of total revenues decreased and increased in the three and nine months ended October 2, 2017, respectively, compared to the three and nine months ended September 26, 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		Nine Months Ended	
	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Store operating costs as a % of Company-owned store sales:				
Cost of food and packaging	33.4%	34.7%	34.0%	34.9%
Compensation and benefits	31.3%	30.7%	31.1%	29.0%
Advertising	11.2%	9.2%	10.9%	9.8%
Occupancy	7.9%	8.6%	9.5%	7.6%
Other store operating costs	11.2%	14.8%	10.7%	13.0%
Total store operating costs	95.0%	98.0%	96.2%	94.3%

Total store operating costs as a percentage of Company-owned store sales decreased 300 basis points and increased 190 basis points overall in the three and nine months ended October 2, 2017, respectively, compared to the three and nine months ended September 26, 2016, due primarily to the effect of Company-owned store portfolio changes in select markets and as further explained below:

- ***Occupancy.*** The decrease in occupancy costs as a percentage of Company-owned store sales during the three months ended October 2, 2017, compared to the three months ended September 26, 2016 is primarily a result of the closing of stores that had occupancy costs as a percentage of store sales that were higher than the system average.

  The increase in occupancy costs as a percentage of Company-owned store sales during the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016 is primarily a result of lease buyouts or reserves for contractual lease obligations associated with store closures.

- ***Compensation and benefits.*** Compensation and benefits as a percentage of Company-owned store sales increased in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016, due to fixed labor costs such as store manager salaries representing a larger portion of compensation in lower volume stores. In addition, increases in the minimum wage have negatively affected several of our established markets.

- ***Other store operating costs.*** Other store operating costs declined in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016, due primarily to a decrease in store pre-opening costs since we have not built or opened any Company-owned stores in 2017.

- ***Advertising costs.*** Advertising costs increased in the three and nine months ended October 2, 2017 compared to the three and nine months ended September 26, 2016 due primarily to spending on our first test of national advertising.

Selling, general, and administrative. Selling, general, and administrative costs decreased in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily due to the recovery of advertising fund contributions in excess of advertising fund expenses of $1.7 million in the three months ended October 2, 2017 compared to a recovery of $15,000 in the three months ended September 26, 2016.

Selling, general, and administrative costs increased in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily due to advertising fund expenses incurred in the first quarter of 2017 associated with our first test of a national media campaign. Advertising fund expenses exceeded fund contributions by $3.8 million and $0.7 million in the nine months ended October 2, 2017 and September 26, 2016, respectively. Since our test national media campaign did not provide the desired results, advertising funds are being redirected to regional advertising and digital media advertising. Additionally, severance and restructuring costs of $2.5 million were recorded in the nine months ended October 2, 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.

	Three Months Ended		Nine Months Ended	
(in thousands)	October 2, 2017	September 26, 2016	October 2, 2017	September 26, 2016
Opening fund deficit	$ (7,080)	$ (1,937)	$ (1,586)	$ (1,200)
Net activity during the period	1,677	15	(3,817)	(722)
Ending fund deficit	$ (5,403)	$ (1,922)	$ (5,403)	$ (1,922)

Depreciation and amortization. Depreciation and amortization decreased in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016, primarily due to a reduction in Company-owned stores period-over-period and the impairment of our current e-commerce platform.

Interest expense, net. Interest expense, net increased in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016, due to increased average borrowing rates and draws on our revolving line of credit .

Income taxes. The benefit from income taxes increased in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016, due primarily to a change in income (loss) before income taxes.

The effective income tax rate for the three months ended October 2, 2017, was 45.7% compared to 23.6% for the three months ended September 26, 2016. The effective income tax rate increased primarily due to the effect in the three months ended September 26, 2016 of certain permanent adjustments arising from differences between U.S. GAAP and U.S. federal and state income tax law and the relative impact of those adjustments on a small quarterly loss before income taxes.

The effective tax rate for the nine months ended October 2, 2017, was 35.4% compared to 44.5% for the nine months ended September 26, 2016. The effective income tax rate 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 the vesting of 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 decreased $0.5 million and $1.6 million in the three and nine months ended October 2, 2017, respectively, compared to the three and nine months ended September 26, 2016, primarily due to a decline in Domestic Franchise comparable store sales of 4.2% and 4.3% and a reduction in the number of franchised stores period-over-period.

Adjusted EBITDA for the Domestic Franchise segment increased $1.2 million in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily due to advertising fund contributions in excess of advertising fund expenses of $1.7 million.

Adjusted EBITDA for the Domestic Franchise segment decreased $1.5 million in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily due to advertising fund expenses associated with our first test of national advertising. Advertising fund expenses exceeded fund contributions by $3.8 million and $0.7 million in the nine months ended October 2, 2017 and September 26, 2016, respectively. We expect the advertising fund deficit to largely reverse over the next 12 to 18 months.

Domestic Company Stores. Total revenues for the Domestic Company Stores segment decreased $1.2 million in the three months ended October 2, 2017 compared to the three months ended September 26, 2016, primarily due to a decline in comparable store sales of 2.7% and a reduction in the number of Company-owned stores period-over-period. Total revenues for the Domestic Company Stores segment decreased $1.8 million in the nine months ended October 2, 2017 compared to the nine months ended September 26, 2016, primarily due to a decline in comparable store sales of 6.6% and a reduction in the number of Company-owned stores period-over-period.

Adjusted EBITDA for the Domestic Company Stores segment increased $0.6 million in the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily as a result of a reduction in new store pre-opening costs resulting from a decrease in new store openings period-over-period, partially offset by the aforementioned decline in comparable store sales and increased costs for labor and occupancy. Adjusted EBITDA for the Domestic Company Stores segment decreased $0.2 million in the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily 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 decreased for the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016 primarily as a result of a reduction in franchise fees from fewer franchised store openings in the three and nine months ended October 2, 2017, compared to the three and nine months ended September 26, 2016.

Adjusted EBITDA for the International segment decreased for the three months ended October 2, 2017, compared to the three months ended September 26, 2016, primarily due to the aforementioned reductions in franchise fees from fewer franchised store openings. Adjusted EBITDA for the International segment remained flat for the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, primarily due to the aforementioned reductions in franchise fees from fewer franchised store openings, offset by 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 October 2, 2017, we had Cash and cash equivalents of $0.9 million and $20.0 million of available borrowings under a revolving line of credit, of which $0 was drawn. As of October 2, 2017, we had $101.0 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 October 2, 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:

	Nine Months Ended	
(in thousands)	**October 2, 2017**	**September 26, 2016**
Cash flows from operating activities	$ 8,225	$ 9,300
Cash flows from investing activities	(709)	(16,747)
Cash flows from financing activities	(8,685)	1,088
Total cash flows	$ (1,169)	$ (6,359)

Cash Flows from Operating Activities

Net cash provided by operating activities of $8.2 million for the nine months ended October 2, 2017, resulted primarily from a net loss of $13.5 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 $1.1 million decrease for the nine months ended October 2, 2017, compared to the nine months ended September 26, 2016, was primarily driven by increased spending on marketing during the first quarter of 2017 related to our first test of national advertising, partially 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 $0.7 million for the nine months ended October 2, 2017, compared to net cash used of $16.7 million for the nine months ended September 26, 2016. The $16.0 million decrease in cash used by investing activities was due primarily to a period-over-period decrease of $11.5 million in capital expenditures for property, plant, and equipment, primarily relating to the opening of Company-owned stores and development of our e-commerce ordering platform during the nine months ended September 26, 2016.

Cash Flows from Financing Activities

Net cash used by financing activities was $8.7 million for the nine months ended October 2, 2017, compared to net cash provided of $1.1 million for the nine months ended September 26, 2016. The $9.8 million increase in net cash used by financing activities was primarily due to an increase in payments on our long-term debt and a net reduction in the outstanding borrowings under our revolving credit facility during the nine months ended October 2, 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 in 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 chose to “opt out” of this extended transition period, and as a result, we will 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 October 2, 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

Except as set forth below, 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.

We currently are subject to litigation with a group of our franchise owners. In January 2014, six franchise owner groups claimed that we misrepresented our sales volumes, made false representations to them and charged excess advertising fees, among other things. We engaged in mediation with these franchise owners, which is required under the terms of their franchise agreements, in order to address and resolve their claims, but we were unable to reach a settlement agreement. On April 4, 2014, a total of 12 franchise owner groups, including those franchise owners that previously made the allegations described above, filed a lawsuit against us in the Superior Court in Clark County, Washington, making essentially the same allegations for violation of the Washington Franchise Investment Protection Act, fraud, negligent misrepresentation and breach of contract and seeking declaratory and injunctive relief, as well as monetary damages. Based on motions filed by us in that lawsuit, the court ruled on July 9, 2014, that certain of the plaintiffs' claims under the anti-fraud and nondisclosure provisions of the Washington Franchise Investment Protection Act should be dismissed and that certain other claims in the case would need to be more specifically alleged. The court also ruled that the six franchise owner groups who had not mediated with us prior to filing the lawsuit must mediate with us in good faith, and that their claims shall be stayed until they have done so.

On June 18, 2014, an additional 16 franchise owner groups, represented by the same counsel as the plaintiffs described above, filed a lawsuit in the Superior Court in Clark County, Washington making essentially the same allegations as made in the lawsuit described above and seeking declaratory and injunctive relief, as well as monetary damages. The court consolidated the two lawsuits into a single case and ordered that the plaintiffs in the new lawsuit, none of whom had mediated with us prior to filing the lawsuit, must do so, and that their claims be stayed until they have completed mediating with us in good faith.

In October 2014, we engaged in mediation with the 22 franchise owner groups who had not previously done so. As a result of that mediation and other efforts, we reached resolution with 13 of the franchise owner groups involved in the consolidated lawsuits, and their claims have either been dismissed or dismissal is pending.

In February 2015, the remaining franchise owner groups in the consolidated lawsuits filed an amended complaint, removing some claims, amending some claims, adding claims and naming some of our former and current franchise sales staff as additional individual defendants. In September 2016, the remaining 15 franchise owner groups in the consolidated lawsuits filed an amended complaint to add a claim under the Washington Consumer Protection Act based on substantially the same allegations as the prior claims, to re-plead claims under the Washington Franchise Investment Protection Act that had previously been dismissed, and to dismiss Dan Harmon as a defendant.

In June 2017, the Company, members of our board of directors and the plaintiffs each filed motions for summary judgment. A hearing on the summary judgment motions was held on October 13, 2017.

In July 2017, we engaged in mediation with the remaining 15 franchise owner groups in the consolidated lawsuits. As a result of that mediation and other efforts, we reached resolution with five of the remaining franchise owner groups, and their claims have either been dismissed or dismissal is pending.

We continue to believe the allegations in this litigation lack merit and, for those plaintiffs with whom we are unable to reach resolution, we will continue to vigorously defend our interests, including by asserting a number of affirmative defenses and, where appropriate, counterclaims. We provide no assurance that we will be successful in our defense of these lawsuits; however, we do not currently expect the cost of resolving them to have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

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 October 2, 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
July 4 to July 31, 2017	—	$ —	—	N/A
August 1 to August 31, 2017	1,508 (1)	1.42	—	N/A
September 1, 2017 to October 2, 2017	—	—	—	N/A
Total	1,508	$ 1.42	—	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
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

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: November 8, 2017

Exhibit 31.1

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: November 8, 2017

/s/ Weldon Spangler

Weldon Spangler
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

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: November 8, 2017

/s/ Mark Hutchens

Mark Hutchens
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

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 October 2, 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: November 8, 2017

/s/ Weldon Spangler

Weldon Spangler
Chief Executive Officer

Exhibit 32.2

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 October 2, 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: November 8, 2017

/s/ Mark Hutchens

Mark Hutchens
Chief Financial Officer