

POTBELLY CORP
Form 10-Q
May 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 29, 2015

OR

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

For the Transition Period from _____ to _____

Commission File Number: 001-36104

Potbelly Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction)

36-4466837
(IRS Employer)

of Incorporation)

Identification Number)

222 Merchandise Mart Plaza, 23rd Floor

Chicago, Illinois 60654

(Address, including Zip Code, of Principal Executive Offices)

Registrant's telephone number, including area code: (312) 951-0600

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common stock, \$0.01 Par Value 30,003,391 shares as of May 1, 2015

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Table of Contents**POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

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

	March 29, 2015	December 28, 2014
ASSETS		
Current assets		
Cash and cash equivalents	\$ 61,726	\$ 63,005
Accounts receivable, net of allowances of \$23 and \$19 as of March 29, 2015 and December 28, 2014, respectively	5,211	4,016
Inventories	2,598	2,768
Deferred income taxes, current	473	507
Prepaid expenses and other current assets	9,851	9,922
Total current assets	79,859	80,218
Property and equipment, net	89,804	85,704
Indefinite-lived intangible assets	3,404	3,404
Goodwill	1,428	1,428
Deferred income taxes, non-current	17,860	17,860
Deferred expenses, net and other assets	3,479	3,333
Total assets	\$ 195,834	\$ 191,947
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	\$ 3,096	\$ 3,301
Accrued expenses	21,939	16,349
Accrued income taxes	343	226
Current portion of long-term debt	986	1,008
Total current liabilities	26,364	20,884
Deferred rent and landlord allowances	14,615	14,012
Other long-term liabilities	704	726
Total liabilities	41,683	35,622
Equity		
Common stock, \$0.01 par value authorized, 200,000,000 shares; outstanding 28,710,056 and 28,934,700 shares as of March 29, 2015, and December 28, 2014, respectively	299	298
Warrants	909	909
Additional paid-in-capital	393,579	391,972

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Treasury stock, held at cost, 1,161,776 and 827,090 shares as of March 29, 2015, and December 28, 2014, respectively	(14,652)	(10,246)
Accumulated deficit	(226,343)	(226,874)
Total stockholders' equity	153,792	156,059
Non-controlling interest	359	266
Total equity	154,151	156,325
Total liabilities and equity	\$ 195,834	\$ 191,947

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statements of Operations**

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

	For the 13 Weeks Ended	
	March 29, 2015	March 30, 2014
Revenues		
Sandwich shop sales, net	\$ 85,397	\$ 73,523
Franchise royalties and fees	371	358
Total revenues	85,768	73,881
Expenses		
Sandwich shop operating expenses		
Cost of goods sold, excluding depreciation	24,345	21,086
Labor and related expenses	24,600	21,460
Occupancy expenses	11,347	9,979
Other operating expenses	9,657	8,158
General and administrative expenses	8,831	7,822
Depreciation expense	5,151	4,717
Pre-opening costs	541	252
Impairment and loss on disposal of property and equipment	348	848
Total expenses	84,820	74,322
Income (loss) from operations	948	(441)
Interest expense	61	42
Income (loss) before income taxes	887	(483)
Income tax expense (benefit)	351	(191)
Net income (loss)	536	(292)
Net income attributable to non-controlling interest	5	9
Net income (loss) attributable to Potbelly Corporation	\$ 531	\$ (301)
Net income (loss) per share:		
Basic	\$ 0.02	\$ (0.01)
Diluted	\$ 0.02	\$ (0.01)
Weighted average shares outstanding:		
Basic	28,905,084	29,150,824
Diluted	29,675,032	29,150,824

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents**POTBELLY CORPORATION AND SUBSIDIARIES****Condensed Consolidated Statement of Equity (Deficit)**

(amounts in thousands, except share data, unaudited)

	Common Stock Shares	Treasury Stock Amount	Additional Paid-In-Capital	Accumulated Deficit	Non-Controlling Interest	Total Equity (Deficit)	
Balance at December 29, 2013	29,148,029	\$ 291	\$ 909	\$ 383,077	\$ (231,232)	\$ 228	\$ 153,273
Net (loss) income					(301)	9	(292)
Exercise of stock options	3,399			8			8
Amortization of stock-based compensation				488			488
Balance at March 30, 2014	29,151,428	\$ 291	\$ 909	\$ 383,573	\$ (231,533)	\$ 237	\$ 153,477
Balance at December 28, 2014	28,934,700	\$ 298	\$ (10,246)	\$ 391,972	\$ (226,874)	\$ 266	\$ 156,325
Net income					531	5	536
Exercise of stock options	110,042	1		1,069			1,070
Repurchases of common stock	(334,686)		(4,406)				(4,406)
Contributions from non-controlling interest						88	88
Amortization of stock-based compensation				538			538
Balance at March 29, 2015	28,710,056	\$ 299	\$ (14,652)	\$ 393,579	\$ (226,343)	\$ 359	\$ 154,151

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the 13 Weeks Ended	
	March 29,	March 30,
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 536	\$ (292)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,151	4,717
Deferred income tax	34	(364)
Deferred rent and landlord allowances	602	344
Amortization of stock compensation expense	538	488
Asset impairment, store closure and disposal of property and equipment	399	848
Amortization of debt issuance costs	18	18
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,195)	(871)
Inventories	170	81
Prepaid expenses and other assets	(155)	(1,641)
Accounts payable	(52)	1,324
Accrued and other liabilities	4,107	1,864
Net cash provided by operating activities	10,153	6,516
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(8,163)	(6,536)
Net cash (used in) investing activities	(8,163)	(6,536)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on note payable	(21)	(20)
Proceeds from exercise of stock options	1,284	8
Payment of payroll taxes related to stock-based compensation awards	(214)	
Treasury stock repurchase	(4,406)	
Contributions from non-controlling interest	88	
Net cash (used in) financing activities	(3,269)	(12)
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,279)	(32)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	63,005	69,579

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 61,726	\$ 69,547
<u>Supplemental cash flow information:</u>		
Income taxes paid	\$ 17	\$ 356
Interest paid	58	42
<u>Supplemental non-cash investing and financing activities:</u>		
Unpaid liability for purchases of property and equipment	\$ 4,138	\$ 1,626

See accompanying notes to the unaudited condensed consolidated financial statements

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POTBELLY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Organization and Other Matters

Business

Potbelly Corporation (the Company or Potbelly), through its wholly-owned subsidiaries, operates Potbelly Sandwich Works sandwich shops in 27 states and the District of Columbia. As of March 29, 2015 and March 30, 2014, the Company had 339 and 305 company-operated shops, respectively. During the 13 weeks ended March 29, 2015, the Company opened seven new company-operated shops and closed two shops. During the 13 weeks ended March 30, 2014, the Company opened nine new company-operated shops and closed no shops.

The Company also sells and administers franchises of Potbelly Sandwich Works sandwich shops. The first domestic and international franchise locations administered by the Company opened during February 2011. As of March 29, 2015, 17 franchised shops were in operation domestically and 12 franchised shops were in operation internationally. During the 13 weeks ended March 29, 2015, the Company did not open or close any franchised shops. During the 13 weeks ended March 30, 2014, the Company opened two franchised shops and closed no franchised shops.

Basis of Presentation

The unaudited condensed consolidated financial statements and notes herein should be read in conjunction with the audited consolidated financial statements of Potbelly Corporation and its subsidiaries and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 28, 2014. The unaudited condensed consolidated financial statements included herein have been prepared by the Company without audit, pursuant to the rules and regulations of the SEC regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the SEC's rules and regulations. In the opinion of management, all adjustments, which are of a normal and recurring nature (except as otherwise noted), that are necessary to present fairly the Company's financial position as of December 28, 2014 and March 29, 2015, its statement of operations for the 13 weeks ended March 30, 2014 and March 29, 2015 and its statement of cash flows for the 13 weeks ended March 30, 2014 and March 29, 2015 have been included. The consolidated statements of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the full year.

The Company does not have any components of other comprehensive income (loss) recorded within its consolidated financial statements, and, therefore, does not separately present a statement of comprehensive income (loss) in its consolidated financial statements.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of Potbelly Corporation; its wholly owned subsidiary, Potbelly Illinois, Inc. (PII); PII's wholly owned subsidiaries, Potbelly Franchising, LLC and Potbelly Sandwich Works LLC (LSW) and 18 of LSW's wholly owned subsidiaries and the LSW's three joint ventures, collectively, the Company. All significant intercompany balances and transactions have been eliminated in consolidation. For consolidated joint ventures, non-controlling interest represents a non-controlling partner's share of the assets, liabilities and operations related to the three joint venture investments. The Company has ownership

interests ranging from 65-80% in these consolidated joint ventures.

Fiscal Year

The Company uses a 52/53-week fiscal year that ends on the last Sunday of the calendar period. Approximately every five or six years a 53rd week is added. Fiscal years 2014 and 2015 each consist of 52 weeks. The fiscal quarters ended March 30, 2014 and March 29, 2015 each consisted of 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, primarily related to the long-lived assets and income taxes, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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POTBELLY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

(2) Fair Value Measurement

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate fair values due to the short maturities of these balances.

The Company assesses potential impairments to its long-lived assets, which includes property and equipment, whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Shop-level assets are grouped at the individual shop-level for the purpose of the impairment assessment. Recoverability of an asset is measured by a comparison of the carrying amount of an asset to its estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset. After performing a periodic review of our shops during the first fiscal quarter of 2015, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance of shop profitability. We performed an impairment analysis related to these shops and recorded impairment charges of \$0.3 million for the 13 weeks ended March 29, 2015 related to the excess of the carrying amounts recorded on our balance sheet over the identified shops' estimated fair values. The fair value of the shop assets was determined using the discounted future cash flow method of anticipated cash flows through the shop's lease-end date using fair value measurement inputs classified as Level 3. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

In fiscal 2014, the Company established a non-qualified deferred compensation plan, Potbelly Non-Qualified Deferred Compensation Plan, which allows highly compensated employees to defer a portion of their base salary and variable compensation each plan year. The Company maintains a rabbi trust to fund obligations under the deferred compensation plan. Amounts in the rabbi trust are invested in mutual funds. The investments in the rabbi trust are designated as trading securities and carried at fair value. Fair market value of investments in the rabbi trust is measured using Level 1 inputs (quoted prices for identical assets in