ALLERGAN INC
Form 10-K
February 28, 2008

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

Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2007

or

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

Commission File No. 1-10269
Allergan, Inc.
(Exact name of Registrant as Specified in its Charter)

Delaware	**95-1622442**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*
2525 Dupont Drive	**92612**
Irvine, California	*(Zip Code)*
(Address of principal executive offices)	

(714) 246-4500
(Registrant s telephone number)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.01 par value	New York Stock Exchange
Preferred Share Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of June 29, 2007, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $17,685 million based on the closing sale price as reported on the New York Stock Exchange.

Common Stock outstanding as of February 22, 2008 307,511,888 shares (including 1,582,188 shares held in treasury).

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this report incorporates certain information by reference from the registrant s proxy statement for the annual meeting of stockholders to be held on May 6, 2008, which proxy statement will be filed no later than 120 days after the close of the registrant s fiscal year ended December 31, 2007.

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Statements made by us in this report and in other reports and statements released by us that are not historical facts constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21 of the Securities Exchange Act of 1934. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management based on our current estimates, expectations, forecasts and projections and include comments that express our current opinions about trends and factors that may impact future operating results. Disclosures that use words such as we believe, anticipate, estimate, intend, could, plan, expect, project of these, as well as similar expressions, are intended to identify forward-looking statements. These statements are not guarantees of future performance and rely on a number of assumptions concerning future events, many of which are outside of our control, and involve known and unknown risks and uncertainties that could cause our actual results, performance or achievements, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. We discuss such risks, uncertainties and other factors throughout this report and specifically under the caption Risk Factors in Item 1A of Part I of this report below. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in the context of the various disclosures made by us about our businesses including, without limitation, the risk factors discussed below. Except as required under the federal securities laws and the rules and regulations of the U.S. Securities and Exchange Commission, we do not have any intention or obligation to update publicly any forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise.

PART I

Item 1. *Business*

General Overview of our Business

We are a multi-specialty health care company focused on developing and commercializing innovative pharmaceuticals, biologics and medical devices that enable people to see more clearly, move more freely and express themselves more fully. Our diversified approach enables us to follow our research and development into new specialty areas where unmet needs are significant.

We discover, develop and commercialize specialty pharmaceutical, medical device and over-the-counter products for the ophthalmic, neurological, medical aesthetics, medical dermatological, breast aesthetics, obesity intervention, urological and other specialty markets in more than 100 countries around the world. We are a pioneer in specialty pharmaceutical research, targeting products and technologies related to specific disease areas such as glaucoma, retinal disease, chronic dry eye, psoriasis, acne, movement disorders, neuropathic pain and genitourinary diseases.

In March 2006, we completed the acquisition of Inamed Corporation, or Inamed, a global healthcare manufacturer and marketer of breast implants, a range of dermal filler products to correct facial wrinkles, and bariatric medical devices for approximately $3.3 billion, consisting of approximately $1.4 billion in cash and 34,883,386 shares of our common stock.

In January 2007, we acquired all of the outstanding capital stock of Groupe Cornéal Laboratoires, or Cornéal, a healthcare company that develops, manufactures and markets dermal fillers, viscoelastics and a range of ophthalmic surgical device products, for an aggregate purchase price of approximately $209.2 million, net of cash acquired. The acquisition of Cornéal expanded our marketing rights to *Juvéderm*™ and a range of hyaluronic acid dermal fillers from the United States, Canada and Australia to all countries worldwide and provided us with control over the manufacturing process and future research and development of *Juvéderm*™ and other dermal fillers.

In October 2007, we acquired all of the outstanding capital stock of Esprit Pharma Holding Company, Inc., or Esprit, for an aggregate purchase price of approximately $370.7 million, net of cash acquired. In addition to marketing

Sanctura® (trospium chloride), a twice-a-day anticholinergic approved for the treatment of overactive bladder, or OAB, the U.S. Food and Drug Administration, or FDA, approved *Sanctura XR*™ (trospium chloride extended release capsules) for the once-daily treatment of OAB in August 2007. By acquiring Esprit, we obtained an exclusive license to market *Sanctura*® and *Sanctura XR*™ in the United States and its territories from Indevus

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Pharmaceuticals, Inc., or Indevus. We pay royalties to Indevus based upon our sales of *Sanctura*® and *Sanctura XR*™ and assumed obligations of Esprit to pay certain other third-party royalties, also based upon sales of *Sanctura*® and *Sanctura XR*™. We entered into a co-promotion agreement with Indevus pursuant to which Indevus will co-promote *Sanctura*® and *Sanctura XR*™ through at least September 2008, subject to Indevus right to extend the agreement for up to six months. We launched *Sanctura XR*™ in the United States in January 2008.

We were founded in 1950 and incorporated in Delaware in 1977. Our principal executive offices are located at 2525 Dupont Drive, Irvine, California, 92612, and our telephone number at that location is (714) 246-4500. Our Internet website address is *www.allergan.com*. We make our periodic and current reports, together with amendments to these reports, available on our Internet website, free of charge, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission. Members of the public may read and copy any materials we file with, or furnish to, the Securities and Exchange Commission, or SEC, at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. To obtain information on the operation of the Public Reference Room, please call the SEC at 1-800-SEC-0330. The SEC maintains an Internet site at *www.sec.gov* that contains the reports, proxy statements and other information that we file electronically with the SEC. The information on our Internet website is not incorporated by reference into this Annual Report on Form 10-K.

Operating Segments

Through the first fiscal quarter of 2006, we operated our business on the basis of a single reportable segment specialty pharmaceuticals. Due to the Inamed acquisition, beginning in the second fiscal quarter of 2006, we operated our business on the basis of two reportable segments specialty pharmaceuticals and medical devices. The specialty pharmaceuticals segment produces a broad range of pharmaceutical products, including: ophthalmic products for glaucoma therapy, ocular inflammation, infection, allergy and chronic dry eye; *Botox*® for certain therapeutic and aesthetic indications; skin care products for acne, psoriasis and other prescription and over-the-counter dermatological products; and, beginning in the fourth quarter of 2007, urologics products. The medical devices segment produces a broad range of medical devices, including: breast implants for augmentation, revision and reconstructive surgery; obesity intervention products, including the *Lap-Band*® System and the *BIB*™ *BioEnterics*® Intragastric Balloon; and facial aesthetics products. The following table sets forth, for the periods indicated, product net sales for each of our product lines within our specialty pharmaceuticals segment and medical devices segment, domestic and international sales as a percentage of total product net sales within our specialty pharmaceuticals segment and medical devices segment, and segment operating income for our specialty pharmaceuticals segment and medical devices segment:

	Year Ended December 31,		
	2007	2006	2005
		(in millions)	
Specialty Pharmaceuticals Segment Product Net Sales by Product Line			
Eye Care Pharmaceuticals	$ 1,776.5	$ 1,530.6	$ 1,321.7
Botox®/Neuromodulator	1,211.8	982.2	830.9
Skin Care Products	110.7	125.7	120.2
Urologics	6.0		
Other(1)			46.4
Total Specialty Pharmaceuticals Segment Product Net Sales	$ 3,105.0	$ 2,638.5	$ 2,319.2

Specialty Pharmaceuticals Segment Product Net Sales			
Domestic	65.8%	67.9%	67.5%
International	34.2%	32.1%	32.5%

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	Year Ended December 31,		
	2007	2006	2005
	(in millions)		
Medical Devices Segment Product Net Sales by Product Line(2)			
Breast Aesthetics	$ 298.4	$ 177.2	$
Obesity Intervention	270.1	142.3	
Facial Aesthetics	202.8	52.1	
Core Medical Devices	771.3	371.6	
Other(3)	2.7		
Total Medical Devices Segment Product Net Sales	$ 774.0	$ 371.6	$
Medical Devices Segment Product Net Sales(2)			
Domestic	65.1%	64.2%	%
International	34.9%	35.8%	%
Specialty Pharmaceuticals Segment Operating Income(4)	$ 1,047.9	$ 888.8	$ 762.9
Medical Devices Segment Operating Income(2)(4)	207.1	119.9	
Consolidated Long-Lived Assets			
Domestic	$ 3,702.0	$ 3,279.0	$ 470.7
International	557.5	244.0	199.3

(1) Other specialty pharmaceutical product sales primarily consist of sales to a former subsidiary that was spun off to our stockholders in 2002.

(2) Due to the Inamed acquisition, beginning in the second quarter of 2006, we operated our business on the basis of two reportable segments specialty pharmaceuticals and medical devices.

(3) Other medical device product sales primarily consist of sales of ophthalmic surgical devices pursuant to a manufacturing and supply agreement entered into as part of the July 2007 sale of the former Cornéal ophthalmic surgical device business, which was substantially concluded in December 2007.

(4) Management evaluates business segment performance on an operating income basis exclusive of general and administrative expenses and other indirect costs, restructuring charges, in-process research and development expenses, amortization of identifiable intangible assets related to the Esprit, EndoArt, Cornéal and Inamed acquisitions and certain other adjustments, which are not allocated to our business segments for performance assessment by our chief operating decision maker. Other adjustments excluded from our business segments for purposes of performance assessment represent income or expenses that do not reflect, according to established company-defined criteria, operating income or expenses associated with our core business activities.

We do not discretely allocate assets to our operating segments, nor does our chief operating decision maker evaluate operating segments using discrete asset information.

See Note 16, Business Segment Information, in the notes to the consolidated financial statements listed under Item 15 of Part IV of this report, Exhibits and Financial Statement Schedules, for further information concerning our foreign and domestic operations.

Specialty Pharmaceuticals Segment

Eye Care Pharmaceuticals Product Line

We develop, manufacture and market a broad range of prescription and non-prescription products designed to treat diseases and disorders of the eye, including glaucoma, chronic dry eye, inflammation, infection and allergy.

Glaucoma. The largest segment of the market for ophthalmic prescription drugs is for the treatment of glaucoma, a sight-threatening disease typically characterized by elevated intraocular pressure leading to optic nerve damage. Glaucoma is currently the world s second leading cause of blindness, and we estimate that over 60 million people worldwide have glaucoma. According to IMS Health Incorporated, an independent marketing research firm,

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our products for the treatment of glaucoma, including *Lumigan*® (bimatoprost ophthalmic solution) 0.03%, or *Lumigan*®, *Alphagan*® (brimonidine tartrate ophthalmic solution) 0.2%, or *Alphagan*®, *Alphagan*® *P* (brimonidine tartrate ophthalmic solution) 0.15%, or *Alphagan*® *P, Alphagan*® *P* 0.1% (brimonidine tartrate ophthalmic solution) 0.1%, or *Alphagan*® *P* 0.1%, *Combigan*™ (brimonidine tartrate/timolol maleate ophthalmic solution) 0.2%/0.5%, or *Combigan*™ and *Ganfort*® (bimatoprost/timolol maleate ophthalmic solution) captured approximately 18% of the worldwide glaucoma market for the first nine months of 2007.

Lumigan® is a topical treatment indicated for the reduction of elevated intraocular pressure in patients with glaucoma or ocular hypertension who are either intolerant or insufficiently responsive when treated with other intraocular pressure-lowering medications. We currently sell *Lumigan*® in over 70 countries worldwide and it is now our largest selling eye care product. According to IMS Health Incorporated, *Lumigan*® was the third largest selling glaucoma product in the world for the first nine months of 2007. In March 2002, the European Commission approved *Lumigan*® through its centralized procedure. In January 2004, the European Union s Committee for Proprietary Medicinal Products approved *Lumigan*® as a first-line therapy for the reduction of elevated intraocular pressure in chronic open-angle glaucoma and ocular hypertension. In June 2006, the FDA approved *Lumigan*® as a first-line therapy. In May 2004, we entered into an exclusive licensing agreement with Senju Pharmaceutical Co., Ltd., or Senju, under which Senju became responsible for the development and commercialization of *Lumigan*® in Japan. Senju incurs associated costs, makes clinical development and commercialization milestone payments and makes royalty-based payments on product sales. We agreed to work collaboratively with Senju on overall product strategy and management. In June 2007, Senju filed a new drug application in Japan for *Lumigan*®.

In November 2003, we filed a New Drug Application with the FDA for *Ganfort*®, a *Lumigan*® and timolol combination designed to treat glaucoma or ocular hypertension. In August 2004, we announced that the FDA issued an approvable letter for *Ganfort*®, setting out the conditions, including additional clinical investigation, that we must meet in order to obtain final FDA approval. In May 2006, we received a license from the European Commission to market *Ganfort*® in the European Union. Combined sales of *Lumigan*® and *Ganfort*® represented approximately 10% of our total consolidated product net sales in 2007. Sales of *Lumigan*® represented approximately 11% of our total consolidated product net sales in 2006 and 12% of our total consolidated product net sales in 2005. The decline in the percentage of our total net sales represented by sales of *Lumigan*® primarily resulted from the significant increase in our net sales as a result of the Inamed acquisition.

Our third largest selling eye care pharmaceutical products are the ophthalmic solutions *Alphagan*®, *Alphagan*® *P*, and *Alphagan*® *P* 0.1%. *Alphagan*®, *Alphagan*® *P* and *Alphagan*® *P* 0.1% lower intraocular pressure by reducing aqueous humor production and increasing uveoscleral outflow. *Alphagan*® *P* and *Alphagan*® *P* 0.1% are improved reformulations of *Alphagan*® containing brimonidine, *Alphagan*® s active ingredient, preserved with *Purite*®. We currently market *Alphagan*®, *Alphagan*® *P,* and *Alphagan*® *P* 0.1% in over 70 countries worldwide.

Alphagan®, *Alphagan*® *P* and *Alphagan*® *P* 0.1% combined were the fifth best selling glaucoma products in the world for the first nine months of 2007, according to IMS Health Incorporated. Combined sales of *Alphagan*®, *Alphagan*® *P* and *Alphagan*® *P* 0.1% and *Combigan*™ represented approximately 9% of our total consolidated product net sales in 2007, 10% of our total consolidated product net sales in 2006 and 12% of our total consolidated product net sales in 2005. The decline in the percentage of our total net sales represented by sales of *Alphagan*®, *Alphagan*® *P*, *Alphagan*® *P* 0.1% and *Combigan*™ primarily resulted from the significant increase in our net sales as a result of the Inamed acquisition. In July 2002, based on the acceptance of *Alphagan*® *P*, we discontinued the U.S. distribution of *Alphagan*®. In May 2004, we entered into an exclusive licensing agreement with Kyorin Pharmaceutical Co., Ltd., or Kyorin, under which Kyorin became responsible for the development and commercialization of *Alphagan*® and *Alphagan*® *P* in Japan s ophthalmic specialty area. Kyorin subsequently sublicensed its rights under the agreement to Senju Pharmaceutical Co., Ltd. Under the licensing agreement, Senju incurs associated costs, makes clinical development and commercialization milestone payments, and makes royalty-based payments on product sales. We

agreed to work collaboratively with Senju on overall product strategy and management. *Alphagan® P* 0.1% was launched in the U.S. market in the first quarter of 2006. The marketing exclusivity period for *Alphagan® P* expired in the United States in September 2004 and the marketing exclusivity period for *Alphagan® P* 0.1% will expire in August 2008, although we have a number of patents covering the *Alphagan® P* and *Alphagan® P* 0.1% technology that extend to 2021 in the United States and 2009 in Europe, with

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corresponding patents pending in Europe. In May 2003, the FDA approved the first generic of *Alphagan*®. Additionally, a generic form of *Alphagan*® is sold in a limited number of other countries, including Canada, Mexico, India, Brazil, Colombia and Argentina. See Item 3 of Part I of this report, Legal Proceedings and Note 13, Commitments and Contingencies, in the notes to the consolidated financial statements listed under Item 15 of Part IV of this report, Exhibits and Financial Statement Schedules, for further information regarding litigation involving *Alphagan*®. Falcon Pharmaceuticals, Ltd., an affiliate of Alcon Laboratories, Inc., or Alcon, attempted to obtain FDA approval for and to launch a brimonidine product to compete with our *Alphagan*® *P* product. However, pursuant to a March 2006 settlement with Alcon, Alcon agreed not to sell, offer for sale or distribute its brimonidine product until September 30, 2009, or earlier if specified sales conditions occur. The primary sales condition will have occurred if prescriptions of *Alphagan*® *P* have been converted to other brimonidine-containing products we market above a specified threshold.

In addition to our *Alphagan*® and *Lumigan*® products, we developed the ophthalmic solution *Combigan*™, a brimonidine and timolol combination designed to treat glaucoma and ocular hypertension in people who are not responsive to treatment with only one medication and are considered appropriate candidates for combination therapy. In November 2005, we received positive opinions for *Combigan*™ from 20 concerned member states included in the *Combigan*™ Mutual Recognition Procedure for the European Union, and we launched *Combigan*™ in the European Union during the following year. In October 2007, the FDA approved *Combigan*™ and we launched *Combigan*™ in the United States in November 2007. *Combigan*™ is now sold in over 30 countries worldwide.

Chronic Dry Eye. *Restasis*® (cyclosporine ophthalmic emulsion) 0.05%, or *Restasis*®, is the first and currently the only prescription therapy for the treatment of chronic dry eye worldwide. *Restasis*® is our second largest selling eye care product. Chronic dry eye is a painful and irritating condition involving abnormalities and deficiencies in the tear film initiated by a variety of causes. The incidence of chronic dry eye increases markedly with age, after menopause in women and in people with systemic diseases such as Sjogren s syndrome and rheumatoid arthritis. Until the approval of *Restasis*®, physicians used lubricating tears as a temporary measure to provide palliative relief of the debilitating symptoms of chronic dry eye. We launched *Restasis*® in the United States in April 2003 under a license from Novartis AG, or Norvartis, for the ophthalmic use of cyclosporine. *Restasis*® is currently approved in 28 countries. In April 2005, we entered into a royalty buy-out agreement with Novartis related to *Restasis*® and agreed to pay $110 million to Novartis in exchange for Novartis worldwide rights and obligations, excluding Japan, for technology, patents and products relating to the topical ophthalmic use of cyclosporine A, the active ingredient in *Restasis*®. Under the royalty buy-out agreement, we no longer make royalty payments to Novartis in connection with our sales of *Restasis*®. In June 2001, we entered into a licensing, development and marketing agreement with Inspire Pharmaceuticals, Inc., or Inspire, under which we obtained an exclusive license to develop and commercialize Inspire s product candidate, *Prolacria*™ (diquafosol tetrasodium), or *Prolacria*™, a treatment to relieve the signs of chronic dry eye by rehydrating conjunctival mucosa and increasing non-lacrimal tear component production, in exchange for our agreement to make royalty payments to Inspire on sales of both *Restasis*® and, ultimately *Prolacria*™, and for Inspire to promote *Restasis*® in the United States. In December 2003, the FDA issued an approvable letter for *Prolacria*™ and also requested additional clinical data. In February 2005, Inspire announced that *Prolacria*™ failed to demonstrate statistically significant improvement as compared to a placebo for the primary endpoint of the incidence of corneal clearing. Inspire also announced that *Prolacria*™ achieved improvement compared to a placebo for a number of secondary endpoints. Inspire filed a New Drug Application amendment with the FDA in the second quarter of 2005. In December 2005, Inspire announced that it had received a second approvable letter from the FDA in connection with *Prolacria*™.

Inflammation. Our leading ophthalmic anti-inflammatory product is *Acular*® (ketorolac ophthalmic solution) 0.5%, or *Acular*®. *Acular*® is a registered trademark of and is licensed from its developer, Syntex (U.S.A.) Inc., a business unit of Hoffmann-LaRoche Inc. *Acular*® is indicated for the temporary relief of itch associated with seasonal allergic conjunctivitis, the inflammation of the mucus membrane that lines the inner surface of the eyelids, and for the

treatment of post-operative inflammation in patients who have undergone cataract extraction. *Acular PF*® was the first, and currently remains the only unit-dose, preservative-free topical non-steroidal anti-inflammatory drug, or NSAID, in the United States. *Acular PF*® is indicated for the reduction of ocular pain and photophobia following incisional refractive surgery. *Acular LS*® (ketorolac ophthalmic solution) 0.4% is a version of *Acular*® that has been reformulated for the reduction of ocular pain, burning and stinging

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following corneal refractive surgery. The *Acular*® franchise was the highest selling ophthalmic NSAID in the world during the first nine months of 2007, according to IMS Health Incorporated.

Our ophthalmic anti-inflammatory product *Pred Forte*® remains a leading topical steroid worldwide based on 2007 sales. *Pred Forte*® has no patent protection or marketing exclusivity and faces generic competition.

Infection. Our *Ocuflox*®*/Oflox*®*/Exocin*® ophthalmic solution is a leading product in the ophthalmic anti-infective market. *Ocuflox*® has no patent protection or marketing exclusivity and faces generic competition.

We license *Zymar*® (gatifloxacin ophthalmic solution) 0.3%, or *Zymar*®, from Kyorin Pharmaceutical Co. Ltd., and have worldwide ophthalmic commercial rights excluding Japan, Korea, Taiwan and certain other countries in Asia. We launched *Zymar*® in the United States in April 2003. *Zymar*® is a fourth-generation fluoroquinolone for the treatment of bacterial conjunctivitis and is currently approved in 29 countries. Laboratory studies have shown that *Zymar*® kills the most common bacteria that cause eye infections as well as specific resistant bacteria. According to Verispan, an independent research firm, *Zymar*® was the number two ophthalmic anti-infective prescribed by ophthalmologists in the United States in 2007. *Zymar*® was the third best selling ophthalmic anti-infective product in the world (and second in the United States) for the first nine months of 2007, according to IMS Health Incorporated.

Allergy. The allergy market is, by its nature, a seasonal market, peaking during the spring months. We market *Alocril*® ophthalmic solution for the treatment of itch associated with allergic conjunctivitis. We license *Alocril*® from Fisons Ltd., a business unit of Sanofi-Aventis, and hold worldwide ophthalmic commercial rights excluding Japan. *Alocril*® is approved in the United States, Canada and Mexico. We license *Elestat*® from Boehringer Ingelheim AG, and hold worldwide ophthalmic commercial rights excluding Japan. *Elestat*® is used for the prevention of itching associated with allergic conjunctivitis. We co-promote *Elestat*® in the United States under an agreement with Inspire within the ophthalmic specialty area and to allergists. Under the terms of our agreement with Inspire, Inspire provided us with an up-front payment and we make payments to Inspire based on *Elestat*® net sales. In addition, the agreement reduced our existing royalty payment to Inspire for *Restasis*®. Inspire has primary responsibility for selling and marketing activities in the United States related to *Elestat*®. We have retained all international marketing and selling rights. We launched *Elestat*® in Europe under the brand names *Relestat*® and *Purivist*® during 2004, and Inspire launched *Elestat*® in the United States during 2004. *Elestat*® (together with sales under its brand names *Relestat*® and *Purivist*®) is currently approved in 38 countries and was the fifth best selling ophthalmic allergy product in the world (and fourth in the United States) for the first nine months of 2007, according to IMS Health Incorporated.

Neuromodulator

Our neuromodulator product, *Botox*® (botulinum toxin type A), has a long-established safety profile and has been approved by the FDA for more than 18 years to treat a variety of medical conditions, as well as for aesthetic use since 2002. With more than 3,000 publications on botulinum toxin type A in scientific and medical journals, results of dozens of clinical trials involving more than 10,000 patients and having been used in clinical practice to treat more than a million patients worldwide, *Botox*® is a widely researched medicine with more than 100 therapeutic and aesthetic uses reported in the medical literature. *Botox*® is now accepted in many global regions as the standard therapy for indications ranging from therapeutic neuromuscular disorders and related pain to facial aesthetics. The versatility of *Botox*® is based on its localized treatment effect. Marketed as *Botox*®, *Botox*® Cosmetic, *Vistabel*® or *Vistabex*®, depending on the indication and country of approval, the product is currently approved in 77 countries for up to 20 unique indications. Sales of *Botox*® represented approximately 31%, 33% and 36% of our total consolidated product net sales in 2007, 2006 and 2005 respectively. The decline in the percentage of our total net sales represented by sales of *Botox*® primarily resulted from the significant increase in our net sales as a result of the Inamed acquisition.

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Botox® is used therapeutically for the treatment of certain neuromuscular disorders which are characterized by involuntary muscle contractions or spasms. The approved therapeutic indications for *Botox*® in the United States are as follows:

blepharospasm, the uncontrollable contraction of the eyelid muscles which can force the eye closed and result in functional blindness;

strabismus, or misalignment of the eyes, in people 12 years of age and over;

cervical dystonia, or sustained contractions or spasms of muscles in the shoulders or neck in adults, along with associated pain; and

severe primary axillary hyperhidrosis (underarm sweating) that is inadequately managed with topical agents.

In many countries outside of the United States, *Botox*® is also approved for treating hemifacial spasm, pediatric cerebral palsy and post-stroke focal spasticity. We are currently pursuing approvals for *Botox*® in the United States and Europe for new indications, including headache, post-stroke focal spasticity, overactive bladder and benign prostatic hypertrophy. In April 2005, we announced plans to move forward with a large Phase III clinical trial program to investigate the safety and efficacy of *Botox*® as a prophylactic therapy in patients with chronic migraine, and all patients have now exited the double blind phase of these studies. In May 2005, we reached agreement with the FDA to enter Phase III clinical trials for *Botox*® to treat neurogenic overactive bladder and Phase II clinical trials for *Botox*® to treat idiopathic overactive bladder. In December 2005, we initiated Phase II clinical trials for *Botox*® to treat benign prostatic hypertrophy.

Botox® *Cosmetic.* The FDA has approved *Botox*® for the temporary improvement in the appearance of moderate to severe glabellar lines in adult men and women age 65 or younger. Referred to as *Botox*®, *Botox*® Cosmetic, *Vistabel*® or *Vistabex*®, depending on the country of approval, this product is designed to relax wrinkle-causing muscles to smooth the deep, persistent, glabellar lines between the brow that often develop during the aging process. Currently, over 50 countries have approved facial aesthetic indications for *Botox*®, *Botox*® Cosmetic, *Vistabel*® or *Vistabex*®. Health Canada, the Canadian national regulatory body, also approved *Botox*® Cosmetic for the treatment of upper facial lines in November 2005, and this indication has also been approved in Australia and New Zealand. In 2002, we launched comprehensive direct-to-consumer marketing campaigns, including television commercials, radio commercials, print advertising and interactive media aimed at dermatologists, plastic and reconstructive surgeons and other aesthetic specialty physicians, as well as consumers, in Canada and the United States and these campaigns continue. We also continue to sponsor aesthetic specialty physician training in approved countries to further expand the base of qualified physicians using *Botox*®, *Botox*® Cosmetic, *Vistabel*® or *Vistabex*®. With the integration of the former Inamed medical products into our *Total Facial Rejuvenation*™ portfolio, we now have a worldwide leadership position in the facial aesthetics market.

In October 2005, we entered into a long-term arrangement with GlaxoSmithKline, or GSK, under which GSK agreed to develop and promote *Botox*® in Japan and China and we agreed to co-promote GSK s products *Imitrex STATdose System*® (sumatriptan succinate) and *Amerge*® (naratriptan hydrochloride) in the United States. Under the terms of the arrangement, we licensed to GSK all clinical development and commercial rights to *Botox*® in Japan and China, markets in which GSK has extensive commercial, regulatory and research and development resources, as well as expertise in neurology. We received an up-front payment, and we receive royalties on GSK s Japan and China *Botox*® sales. We also manufacture *Botox*® for GSK as part of a long-term supply agreement and collaboratively support GSK in its new clinical developments for *Botox*® and its strategic marketing in those markets, for which we receive payments. In addition, we obtained the right to co-promote GSK s products *Imitrex STATdose System*® and *Amerge*® in the United States to neurologists for a 5-year period, for which we receive fixed and performance payments from

GSK. *Imitrex STATdose System*® is approved for the treatment of acute migraine in adults and for the acute treatment of cluster headache episodes. *Amerge*® is approved for the acute treatment of migraine attacks with and without an aura in adults.

Skin Care Product Line

Our skin care product line focuses on the psoriasis, acne and physician-dispensed skin care markets, particularly in the United States and Canada.

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Avage®. Our product *Avage*® is a tazarotene cream indicated for the treatment of facial fine wrinkling, mottled hypo- and hyperpigmentation (blotchy skin discoloration) and benign facial lentigines (flat patches of skin discoloration) in patients using a comprehensive skin care and sunlight avoidance program. We launched *Avage*® in the United States in January 2003.

Azelex®. *Azelex*® cream is approved by the FDA for the topical treatment of mild to moderate inflammatory acne and is licensed from Intendis GmbH, or Intendis, a division of Bayer Schering Pharma AG. We market *Azelex*® cream primarily in the United States.

Finacea®. We co-promoted *Finacea*® (azelaic acid gel 15%), or *Finacea*®, a topical rosacea treatment, with Intendis GmbH through a collaboration with Intendis that ended by its terms in February 2008. Following the termination of the collaboration, we no longer promote *Finacea*® but continue to receive certain payments for up to three years.

Tazarotene Products. We market *Tazorac*® gel in the United States for the treatment of plaque psoriasis, a chronic skin disease characterized by dry red patches, and acne. We also market a cream formulation of *Tazorac*® in the United States for the treatment of psoriasis and the topical treatment of acne. We have also engaged Pierre Fabre Dermatologie as our promotion partner for *Zorac*® in certain parts of Europe, the Middle East and Africa. We entered into a strategic collaboration agreement with Stiefel Laboratories, Inc. to develop and market new products involving tazarotene for dermatological use worldwide, and to co-promote *Tazorac*® in the United States.

M.D. Forte®. We develop and market glycolic acid-based skin care products. We market our *M.D. Forte*® line of alpha hydroxy acid products to physicians in the United States.

Prevage®. In January 2005, we launched *Prevage*® cream, containing 1% idebenone, a clinically tested antioxidant designed to reduce the appearance of fine lines and wrinkles, as well as provide protection against environmental factors, including sun damage, air pollution and cigarette smoke. In May 2005, we entered into an exclusive license agreement with Elizabeth Arden, Inc., or Elizabeth Arden, granting Elizabeth Arden the right to globally market a new formulation of *Prevage*® containing 0.5% idebenone, to leading department stores and other prestige cosmetic retailers. In September 2005, we began marketing *Prevage*® MD, containing 1% idebenone, to physicians in the United States.

Vivite™. In April 2007, we launched *Vivite*™, an advanced anti-aging skin care line that uses proprietary *GLX Technology*™, creating a highly specialized blend of glycolic acid and natural antioxidants. We market our *Vivite*™ line of skin care products to physicians in the United States.

In January 2008, we entered into a strategic collaboration with Clinique Laboratories, LLC, or Clinique, a subsidiary of the Estée Lauder Companies Inc., to develop and exclusively market a new line "
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22,538

23,273

Accrued income taxes		
	176	
	176	
Total current liabilities		
	26,082	
	27,352	

Deferred rent and landlord allowances			
22,964			
22,987			
Other long-term liabilities			
4,214			
3,153			
Total liabilities			
53,260			

53,492

Stockholders’ equity

Common stock, $0.01 par value—authorized 200,000,000 shares; outstanding

25,286,229 and 24,999,688 shares as of April 1, 2018 and December 31,

2017, respectively

321

318

Additional paid-in-capital

424,771

421,657

Treasury stock, held at cost, 6,845,279 and 6,831,508 shares as of

April 1, 2018, and December 31, 2017, respectively

(85,441

)

(85,262

)

Accumulated deficit

(222,874

)

(219,990

)

Total stockholders’ equity

116,777

116,723

Non-controlling interest

556

515

Total stockholders' equity	117,333	117,238
Total liabilities and equity	$ 170,593	$ 170,730

See accompanying notes to the unaudited condensed consolidated financial statements.

Potbelly Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

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

	For the 13 Weeks Ended	
	April 1, 2018	March 26, 2017
Revenues		
Sandwich shop sales, net	$102,247	$100,859
Franchise royalties and fees	670	840
Total revenues	102,917	101,699
Expenses		
Sandwich shop operating expenses		
Cost of goods sold, excluding depreciation	26,636	26,663
Labor and related expenses	31,579	30,462
Occupancy expenses	14,726	14,169
Other operating expenses	12,500	11,633
General and administrative expenses	12,188	10,352
Depreciation expense	5,826	6,199
Pre-opening costs	68	73
Impairment and loss on disposal of property and equipment	2,024	885
Total expenses	105,547	100,436
Income (loss) from operations	(2,630)	1,263
Interest expense	27	28
Income (loss) before income taxes	(2,657)	1,235
Income tax expense (benefit)	(504)	553
Net income (loss)	(2,153)	682
Net income (loss) attributable to non-controlling interest	41	(1)
Net income (loss) attributable to Potbelly Corporation	$(2,194)	$683
Net income (loss) per common share attributable to common stockholders:		
Basic	$(0.09)	$0.03
Diluted	$(0.09)	$0.03
Weighted average shares outstanding:		
Basic	25,144,855	25,099,962
Diluted	25,144,855	26,082,478

See accompanying notes to the unaudited condensed consolidated financial statements.

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Potbelly Corporation and Subsidiaries

Condensed Consolidated Statements of Equity

(amounts in thousands, except share data, unaudited)

	Common Stock		Treasury		Additional Paid-In-	Accumulated	Non-Controlling	
	Shares	Amount	Stock	Warrants	Capital	Deficit	Interest	Total Equity
Balance at December 25, 2016	25,139,127	$ 309	$(72,321)	$ 909	$407,622	$ (213,034)	$ 751	$ 124,236
Net income (loss)	—	—	—	—	—	683	(1)	682
Exercise of stock options	59,119	1	—	—	550	—	—	551
Repurchases of common stock	(152,558)	—	(1,988)	—	—	—	—	(1,988)
Amortization of stock-based compensation	—	—	—	—	820	—	—	820
Balance at March 26, 2017	25,045,688	$ 310	$(74,309)	$ 909	$408,992	$ (212,351)	$ 750	$ 124,301
Balance at December 31, 2017	24,999,688	$ 318	$(85,262)	$ —	$421,657	$ (219,990)	$ 515	$ 117,238
Cumulative impact of Topic 606 at 1/1/2018	—	—	—	—	—	(690)	—	(690)
Net income (loss)	—	—	—	—	—	(2,194)	41	(2,153)
Exercise of stock options	300,312	3	—	—	2,252	—	—	2,255
Repurchases of common stock	(5,000)	—	(63)	—	—	—	—	(63)
Treasury shares used for stock-based plans	(8,771)	—	(116)	—	—	—	—	(116)
Amortization of stock-based compensation	—	—	—	—	862	—	—	862
Balance at April 1, 2018	25,286,229	$ 321	$(85,441)	$ —	$424,771	$ (222,874)	$ 556	$ 117,333

See accompanying notes to the unaudited condensed consolidated financial statements.

Potbelly Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(amounts in thousands, unaudited)

	For the 13 Weeks Ended	
	April 1, 2018	March 26, 2017
Cash flows from operating activities:		
Net income (loss)	$(2,153)	$682
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,826	6,199
Deferred income tax	—	185
Deferred rent and landlord allowances	(23)	632
Amortization of stock compensation expense	862	820
Excess tax deficiency from stock-based compensation	122	89
Asset impairment, store closure and disposal of property and equipment	2,381	907
Amortization of debt issuance costs	9	9
Changes in operating assets and liabilities:		
Accounts receivable, net	(41)	(1,074)
Inventories	68	223
Prepaid expenses and other assets	207	465
Accounts payable	(241)	865
Accrued and other liabilities	(352)	2,418
Net cash provided by operating activities:	6,665	12,420
Cash flows from investing activities:		
Purchases of property and equipment	(4,939)	(6,927)
Net cash used in investing activities:	(4,939)	(6,927)
Cash flows from financing activities:		
Proceeds from exercise of stock options	2,255	552
Employee taxes on certain stock-based payment arrangements	(512)	(60)
Treasury stock repurchases	(63)	(1,988)
Net cash provided by (used in) financing activities:	1,680	(1,496)
Net increase in cash and cash equivalents	3,406	3,997
Cash and cash equivalents at beginning of period	25,530	23,379
Cash and cash equivalents at end of period	$28,936	$27,376
Supplemental cash flow information:		
Income taxes paid	$—	$87
Interest paid	19	21
Supplemental non-cash investing and financing activities:		
Unpaid liability for purchases of property and equipment	$1,234	$2,220

See accompanying notes to the unaudited condensed consolidated financial statements

Potbelly Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements (unaudited)

(1) Organization and Other Matters

Business

Potbelly Corporation (the "Company" or "Potbelly"), through its wholly-owned subsidiaries, operates or franchises Potbelly Sandwich Shops in 32 states and the District of Columbia, and 17 franchises outside the United States.

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 31, 2017. The unaudited condensed consolidated financial statements included herein have been prepared by the Company without audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC") regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") have been condensed or omitted pursuant to the SEC 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 April 1, 2018 and December 31, 2017, its statement of operations for the 13 weeks ended April 1, 2018 and March 26, 2017 and its statement of cash flows for the 13 weeks ended April 1, 2018 and March 26, 2017 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 recorded within its consolidated financial statements and therefore, does not separately present a statement of comprehensive income in its condensed 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 ("LLC"); nine of LLC's wholly owned subsidiaries and LLC's five joint ventures, collectively, the "Company." All 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 five joint venture investments. The Company has ownership interests ranging from 51-80% 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 year 2018 consists of 52 weeks and 2017 consisted of 53 weeks. The fiscal quarters ended April 1, 2018 and March 26, 2017 each consisted of 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Significant estimates include amounts for long-lived assets and income taxes. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, “Revenue from Contracts with Customers.” The pronouncement was issued to clarify the principles for recognizing revenue and to develop a common revenue standard and disclosure requirements for U.S. GAAP and International Financial Reporting Standards (IFRS). In addition, the FASB issued ASU 2016-08, ASU 2016-10 and ASU 2016-12 in March 2016, April 2016 and May 2016, respectively, to help provide interpretive clarifications on the new guidance in Accounting Standards Codification (ASC) Topic 606. Potbelly adopted the standard effective January 1, 2018 using the modified retrospective method applied to contracts that were not completed as of the date of adoption. The adoption does not have a material impact on sandwich shop sales, but impacted the

recognition of franchise revenue and gift card breakage. Potbelly licenses intellectual property and trademarks to franchisees through franchise arrangements. As part of these agreements, Potbelly receives an initial franchise fee payment which historically was recognized as revenue when the shop opened. Under the new guidance, these franchise fees are considered highly dependent upon and interrelated with the franchise right granted in the franchise agreement. As such, these franchise fees are recognized over the contractual term of the franchise agreement. Effective for the annual period beginning January 1, 2018, initial franchise fees are recognized as revenue over the contractual term. Potbelly sells gift cards to customers and records the sale as a liability. The liability is released once the card is redeemed. Historically, a portion of these gift card sales were not redeemed by the customer ("breakage") and Potbelly would recognize breakage two years after the period of sale. Effective for the annual period beginning January 1, 2018, expected breakage is recognized as customers redeem the gift cards. Upon adoption of the standard, Potbelly's accumulated deficit increased by $0.7 million (net of tax). The franchise revenue adjustment impacted accrued expenses, other long-term liabilities and deferred income taxes. The breakage adjustment impacted accrued expenses and deferred income taxes. Revenue recognized in the first quarter of 2018 was $0.1 million higher than it would have been under the previous methodology.

In February 2016, the FASB issued ASU No. 2016-02, "Leases," which will replace the existing guidance in ASC 840, "Leases." The pronouncement requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use asset and a corresponding lease liability. For finance leases, the lessee would recognize interest expense and amortization of the right-of-use asset while for operating leases, the lessee would recognize a straight-line total lease expense. The pronouncement is effective for fiscal years beginning after December 15, 2018, including annual and interim periods thereafter. In addition, the pronouncement requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. The Company is currently evaluating the impact ASU 2016-02 will have on its financial position, results of operations and cash flows, but expects that it will result in a material increase in its long-term assets and liabilities given the Company has a significant number of leases.

(2) Revenue

Potbelly primarily earns revenue at a point in time through sales at our sandwich shop locations and records such revenue net of sales-related taxes collected from customers. The payment on these sales is due at the time of the customer's purchase. The Company also receives royalties from franchisees on their respective sales, which are recognized at the point in time the sale is made, and invoiced weekly. Potbelly also records revenue from sales over time related to upfront franchise fees, and gift card redemptions and breakage. For the 13 weeks ended April 1, 2018, revenue recognized from all revenue sources on point in time sales was $102.7 million, and revenue recognized from sales over time was $0.2 million.

Franchise Revenue

Potbelly licenses intellectual property and trademarks to franchisees through franchise agreements. As part of these franchise agreements, Potbelly receives an upfront payment from the franchisee, which the Company recognizes over the term of the franchise agreement. The Company records a contract liability for the unearned portion of the upfront franchise payments.

Gift Card Redemptions / Breakage Revenue

Potbelly sells gift cards to customers and records the sale as a contract liability and recognizes the associated revenue as the gift card is redeemed. A portion of these gift cards are not redeemed by the customer (“breakage”), which is recognized by the Company as revenue as a percentage of customers gift card redemptions. The expected breakage amount recognized is determined by a historical data analysis on gift card redemption patterns.

Contract Liabilities

As described above, the Company records current and noncurrent contract liabilities for upfront franchise fees as well as gift cards. There are no other contract liabilities and there are no contract assets recorded by the Company. The opening and closing balances of the Company’s current and noncurrent contract liabilities from contracts with customers were as follows:

	Current Contract Liability (Thousands)	Noncurrent Contract Liability (Thousands)
Beginning balance as of January 1, 2018	$ (2,325)	$ (2,144)
Ending balance as of April 1, 2018	(1,691)	(2,120)
Decrease in contract liability	$ (634)	$ (24)

The aggregate value of remaining performance obligations on outstanding contracts was $3.8 million as of April 1, 2018. The decrease in the liability during the first quarter was a result of gift card redemptions offset by purchases of new gift cards and recognition of franchise fees. The Company expects to recognize revenue related to contract liabilities as follows (in thousands), which may vary based upon franchise activity as well as gift card redemption patterns:

Years Ending	Amount
2018	$ 1,295
2019	373
2020	238
2021	231
2022	223
Thereafter	1,451
Total revenue recognized	$ 3,811

The amount of revenue recognized for the 13 weeks ended April 1, 2018 related to the January 1, 2018 liability ending balance was $0.9 million. This revenue related to the recognition of gift card redemptions and upfront franchise fees. For the 13 weeks ended April 1, 2018, the Company did not recognize any revenue from obligations satisfied (or partially satisfied) in prior periods.

(3) 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, on a quarterly basis or whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Shop-level assets are grouped at the individual shop-level for the purpose of the impairment assessment. Recoverability of an asset is measured by a comparison of the carrying amount of an asset to its estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset. The fair value of the shop assets was determined using the discounted future cash flow method of anticipated cash flows through the shop’s lease-end date using fair value measurement inputs classified as Level 3. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. After performing a periodic review of the Company’s shops during the 13 weeks ended April 1, 2018, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance. The Company performed an impairment analysis related to these shops and recorded an impairment charge of $2.0 million for the 13 weeks ended April 1, 2018. The Company recorded an impairment charge of $0.9 million for the 13 weeks ended March 26, 2017.

(4) Earnings (Loss) Per Share

Basic and diluted income per common share attributable to common stockholders was calculated using the weighted average number of common shares outstanding for the period. Diluted income per common share attributable to common stockholders is computed by dividing the income allocated to common stockholders by the weighted average number of fully diluted common shares outstanding. In periods of a net loss, no potential common shares are included in diluted shares outstanding as the effect is anti-dilutive. For the 13 weeks ended April 1, 2018, the Company had a loss per share, and therefore shares were excluded for potential stock option exercises and warrant exercises.

The following table summarizes the earnings (loss) per share calculation:

	For the 13 Weeks Ended	
	April 1, 2018	March 26, 2017
Net income (loss) attributable to Potbelly Corporation	$(2,194)	$683
Weighted average common shares outstanding-basic	25,144,855	25,099,962
Plus: Effect of potential stock options exercise	—	891,191
Plus: Effect of potential warrant exercise	—	91,325
Weighted average common shares outstanding-diluted	25,144,855	26,082,478
Income (loss) per share available to common stockholders-basic	$(0.09)	$0.03
Income (loss) per share available to common stockholders-diluted	$(0.09)	$0.03
Potentially dilutive shares that are considered anti-dilutive:		
Common share options	3,101,447	980,332

(5) Income Taxes

The Company recognized income tax benefit of $0.5 million on a pre-tax loss of $2.7 million, or an effective tax rate benefit of 19.0%, for the 13 weeks ended April 1, 2018, compared to income tax expense of $0.6 million on pre-tax income of $1.2 million, or an effective tax rate of 44.8%, for the 13 weeks ended March 26, 2017. The effective tax rate differed from the federal statutory rate due to the impact of ASU 2016-09, state income taxes and certain federal and state tax credits.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was enacted into law making significant changes to the U.S. tax code, including: (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) implementing bonus depreciation that will allow for full expensing of qualified property; (3) implementing limitations on the deductibility of certain executive compensation; and (4) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

On that same date, the SEC staff also issued Staff Accounting Bulletin (SAB) 118, which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. A company must reflect the income tax effects of those aspects of the Tax Act for which accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements.

At April 1, 2018, the Company has not completed the accounting for the tax effects of enactment of the Tax Act; however, the Company made a reasonable estimate of the effects and booked a provisional tax expense adjustment in the fiscal year 2017, the period in which the legislation was enacted. During the first quarter, there have been no adjustments made to the provisional amounts previously recorded related to the enactment of the Tax Act.

(6) Capital Stock

On May 8, 2018, the Company announced that its Board of Directors authorized a stock repurchase program for up to $65.0 million of its outstanding common stock. The stock repurchase program replaced the previous program, authorized in September 2016, under which approximately $14.7 million of authorization remained as of April 1, 2018. Under the previous program, during the 13 weeks ended April 1, 2018, the Company repurchased 5,000 shares of its common stock for approximately $0.1 million, including cost and commission, in open market transactions. The new program permits the Company, from time to time, to purchase shares in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934, as amended) or in privately negotiated transactions. The number of common stock actually repurchased, and the timing and price of repurchases, will depend upon market conditions, Securities and Exchange Commission requirements, and other factors. Purchases may be started or stopped at any time without prior notice depending on market conditions and other factors. Repurchased shares are included as treasury stock in the condensed consolidated balance sheets and the condensed consolidated statements of equity.

(7) Stock-Based Compensation

Stock options are awarded under the 2013 Long-Term Incentive Plan to eligible employees and certain non-employee members of the Board of Directors. The fair value of stock options is determined using the Black-Scholes option pricing model. The weighted average fair value of options granted during the 13 weeks ended April 1, 2018 was $5.26 per share, as estimated using the following weighted average assumptions: expected life of options – 6.25 years; volatility – 35.36%; risk-free interest rate – 2.80%; and dividend yield – 0.00%. The Company used the simplified method for determining the expected life of the options. The expected volatility of the options was calculated using the Company's historical data.

A summary of activity for the 13 weeks ended April 1, 2018 is as follows:

Options	Shares (Thousands)	Weighted Average Exercise Price	Aggregate Intrinsic Value (Thousands)	Weighted Average Remaining Term (Years)
Outstanding—December 31, 2017	3,309	$ 10.71	$ 7,699	4.90
Granted	50	13.15		
Exercised	(275)	8.20		
Canceled	(26)	15.04		
Outstanding—April 1, 2018	3,058	$ 10.93	$ 6,118	5.03
Exercisable—April 1, 2018	2,333	$ 10.34	$ 5,965	3.92

Stock-based compensation is measured at the grant date based on the calculated fair value of the award, and is recognized as expense over the requisite employee service period, which is generally the vesting period of the grant with a corresponding increase to additional paid-in-capital. For the 13 weeks ended April 1, 2018 and March 26, 2017, the Company recognized stock-based compensation expense of $0.9 million and $0.8 million, respectively. As of April 1, 2018, unrecognized stock-based compensation expense was $4.4 million, which will be recognized through fiscal year 2022. The Company records stock-based compensation expense within general and administrative expenses in the condensed consolidated statements of operations.

(8) Commitments and Contingencies

The Company is subject to legal proceedings, claims and liabilities, such as employment-related claims and slip and fall cases, which arise in the ordinary course of business and are generally covered by insurance. In the opinion of management, the amount of ultimate liability with respect to those actions should not have a material adverse impact on the Company's financial position or results of operations and cash flows.

In October 2017, plaintiffs filed a purported collective and class action lawsuit in the United States District Court for the Southern District of New York against the Company alleging violations of the Fair Labor Standards Act (FLSA) and New York Labor Law (NYLL). The plaintiffs allege that the Company violated the FLSA and NYLL by not paying overtime compensation to our assistant managers and violated NYLL by not paying spread-of-hours pay. Potbelly believes the assistant managers were properly classified under state and federal law. The Company intends to vigorously defend this action. This case is at an early stage, and Potbelly is therefore unable to make a reasonable estimate of the probable loss or range of losses, if any, that might arise from this matter.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Private Securities Litigation Reform Act of 1995, and involves numerous risks and uncertainties. Forward-looking statements may include, among others, statements relating to: our future financial position and results of operations, business strategy, budgets, projected costs and plans and objectives of management for future operations. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and generally contain words such as "believes," "expects," "may," "will," "should," "seeks," "intends," "plans," "strives," "goal," "estimates," "forecasts," "projects" or "anticipates" and the negative of or similar expressions. Our forward-looking statements are subject to risks and uncertainties, which may cause actual results to differ materially from those projected or implied by the forward-looking statement, due to reasons including, but not limited to, our ability to manage our growth and successfully implement our business strategy; price and availability of commodities; changes in labor costs; consumer confidence and spending patterns; consumer reaction to industry-related public health issues and perceptions of food safety; and weather conditions. Forward-looking statements are based on current expectations and assumptions and currently available data and are neither predictions nor guarantees of future events or performance. You should not place undue reliance on forward-looking statements, which speak only as of the date hereof. See "Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements" included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, for a discussion of factors that could cause our actual results to differ from those expressed or implied by forward-looking statements.

Overview

Potbelly Corporation (the "Company" or "Potbelly") is a neighborhood sandwich concept offering toasty warm sandwiches, signature salads and other fresh menu items served by engaging people in an environment that reflects the Potbelly brand. Our combination of product, people and place is how we deliver on our passion to be "The Best Place for Lunch." Our sandwiches, salads and hand-dipped milkshakes are all made fresh to order and our cookies are baked fresh each day. Our employees are trained to engage with our customers in a genuine way to provide a personalized experience. Our shops feature vintage design elements and locally-themed décor inspired by the neighborhood that we believe create a lively atmosphere. Through this combination, we believe we are creating a devoted base of Potbelly fans that return again and again and that we are expanding one sandwich shop at a time.

We believe that a key to our past and future success is our culture. It is embodied in The Potbelly Advantage, which is an expression of our Vision, Mission, Passion and Values and the foundation of everything we do. Our Vision is for our customers to feel that we are their "Neighborhood Sandwich Shop" and to tell others about their great experience. Our Mission is to make people really happy, to make more money and to improve every day. Our Passion is to be "The Best Place for Lunch." Our Values embody both how we lead and how we behave and form the cornerstone of our culture. We use simple language that resonates from the frontline associate to the most senior levels of the

organization, creating shared expectations and accountabilities in how we approach our day-to-day activities. We strive to be a fun, friendly and hardworking group of people who enjoy taking care of our customers, while at the same time taking care of each other.

The table below sets forth a rollforward of company-operated and franchise operated activities:

	Company-Operated	Franchise-Operated Domestic	Franchise-Operated International	Total	Total Company
Shops as of December 25, 2016	411	30	13	43	454
Shops opened	3	6	2	8	11
Shops closed	(1)	—	—	—	(1)
Shops as of March 26, 2017	413	36	15	51	464
Shops as of December 31, 2017	437	39	16	55	492
Shops opened	2	1	1	2	4
Shops closed	(1)	—	—	—	(1)
Shops as of April 1, 2018	438	40	17	57	495

13 Weeks Ended April 1, 2018 Compared to 13 Weeks Ended March 26, 2017

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

	For the 13 Weeks Ended					
	April 1, 2018	% of Revenues	March 26, 2017	% of Revenues	Increase (Decrease)	Percent Change
Revenues						
Sandwich shop sales, net	$102,247	99.3 %	$100,859	99.2 %	$ 1,388	1.4 %
Franchise royalties and fees	670	0.7	840	0.8	(170)	(20.2)
Total revenues	102,917	100.0	101,699	100.0	1,218	1.2
Expenses						
Sandwich shop operating expenses						
Cost of goods sold, excluding depreciation	26,636	25.9	26,663	26.2	(27)	(0.1)
Labor and related expenses	31,579	30.7	30,462	30.0	1,117	3.7
Occupancy expenses	14,726	14.3	14,169	13.9	557	3.9
Other operating expenses	12,500	12.1	11,633	11.4	867	7.5
General and administrative expenses	12,188	11.8	10,352	10.2	1,836	17.7
Depreciation expense	5,826	5.7	6,199	6.1	(373)	(6.0)
Pre-opening costs	68	*	73	*	(5)	(6.8)
Impairment and loss on disposal of property and equipment	2,024	2.0	885	0.9	1,139	>100
Total expenses	105,547	102.6	100,436	98.8	5,111	5.1
Income (loss) from operations	(2,630)	(2.6)	1,263	1.2	(3,893)	>(100)
Interest expense	27	*	28	*	(1)	(3.6)
Income (loss) before income taxes	(2,657)	(2.6)	1,235	1.2	(3,892)	>(100)
Income tax expense (benefit)	(504)	(0.5)	553	0.5	(1,057)	>(100)
Net income (loss)	(2,153)	(2.1)	682	0.7	(2,835)	>(100)
Net income (loss) attributable to non-controlling interest	41	*	(1)	*	42	>(100)
Net income (loss) attributable to Potbelly Corporation	$(2,194)	(2.1)%	$683	0.7 %	$ (2,877)	>(100)%

* Amount is less than 0.1%

Revenues

Total revenues increased by $1.2 million, or 1.2%, to $102.9 million during the 13 weeks ended April 1, 2018, from $101.7 million during the 13 weeks ended March 26, 2017. The revenue growth was driven by an increase in sales of $7.7 million from shops not yet in our company-operated comparable store sales base. These increases were partially offset by a decrease in sales of $3.5 million, or 3.6%, from company-operated comparable store shops, a decrease in sales of $2.9 million from shops that have closed and a decrease in sales of $0.2 million from franchise royalties and fees. The decrease in company-operated comparable store sales resulted from a decrease in traffic partially offset by an increase in average transaction size.

Cost of Goods Sold

Cost of goods sold decreased by $27 thousand, or 0.1%, to $26.6 million during the 13 weeks ended April 1, 2018, from $26.7 million during the 13 weeks ended March 26, 2017. As a percentage of revenues, cost of goods sold decreased to 25.9% during the 13 weeks ended April 1, 2018, from 26.2% during the 13 weeks ended March 26, 2017, primarily driven by certain menu price increases.

Labor and Related Expenses

Labor and related expenses increased by $1.1 million, or 3.7%, to $31.6 million during the 13 weeks ended April 1, 2018, from $30.5 million during the 13 weeks ended March 26, 2017, primarily due to new shop openings, which was partially offset by a decrease in expense from closed shops. As a percentage of revenues, labor and related expenses increased to 30.7% during the 13 weeks ended April 1, 2018, from 30.0% during the 13 weeks ended March 26, 2017, primarily driven by a decrease in company-operated comparable store shop revenue.

Occupancy Expenses

Occupancy expenses increased by $0.6 million, or 3.9%, to $14.7 million during the 13 weeks ended April 1, 2018, from $14.2 million during the 13 weeks ended March 26, 2017 primarily due to new shop openings, which was partially offset by a decrease in expenses from shops that have closed. As a percentage of revenues, occupancy expenses increased to 14.3% during the 13 weeks ended April 1, 2018, from 13.9% during the 13 weeks ended March 26, 2017, primarily due to a decrease in company-operated comparable store shop revenue, which was partially offset by a decrease in expenses from shops that have closed.

Other Operating Expenses

Other operating expenses increased by $0.9 million, or 7.5%, to $12.5 million during the 13 weeks ended April 1, 2018, from $11.6 million during the 13 weeks ended March 26, 2017. The increase was primarily attributable to new shop openings as well as higher utility costs, information technology costs and shop repairs. As a percentage of revenues, other operating expenses increased to 12.1% during the 13 weeks ended April 1, 2018, from 11.4% during the 13 weeks ended March 26, 2017, primarily driven by a decrease in company-operated comparable store shop revenue as well as higher utility and shop repair costs.

General and Administrative Expenses

General and administrative expenses increased by $1.8 million, or 17.7%, to $12.2 million during the 13 weeks ended April 1, 2018, from $10.4 million during the 13 weeks ended March 26, 2017. The increase was driven primarily by proxy related costs of $0.6 million, Chief Executive Officer (CEO) transition costs of $0.3 million, advertising costs and store closure expenses. As a percentage of revenues, general and administrative expenses increased to 11.8% during the 13 weeks ended April 1, 2018, from 10.2% during the 13 weeks ended March 26, 2017, primarily due to proxy related costs of $0.6 million, CEO transition costs of $0.3 million, advertising costs and store closure expenses.

Depreciation Expense

Depreciation expense decreased by $0.4 million, or 6.0%, to $5.8 million during the 13 weeks ended April 1, 2018, from $6.2 million during the 13 weeks ended March 26, 2017. The decrease was driven primarily by a lower depreciable base related to impairment charges taken subsequent to the 13 weeks ended March 26, 2017, as well as lower depreciation associated with new shops with longer expected useful lives for leasehold improvements and leasehold improvements at legacy shops with shorter expected useful lives being fully depreciated. These decreases were partially offset by new shops, existing shop capital investments and investments in technology such as the mobile application, which increased the depreciable base. As a percentage of revenues, depreciation decreased to 5.7% during the 13 weeks ended April 1, 2018, from 6.1% during the 13 weeks ended March 26, 2017. This decrease was driven by a lower depreciable base related to impairment charges taken subsequent to the 13 weeks ended March 26, 2017, as well as lower depreciation associated with new shops with longer expected useful lives for leasehold

improvements and leasehold improvements at legacy shops with shorter expected useful lives being fully depreciated.

Pre-Opening Costs

Pre-opening costs were $0.1 million during the 13 weeks ended April 1, 2018 and March 26, 2017.

Impairment and Loss on Disposal of Property and Equipment

Impairment and loss on disposal of property and equipment increased to $2.0 million during the 13 weeks ended April 1, 2018, from $0.9 million during the 13 weeks ended March 26, 2017. After performing periodic reviews of Company shops during the first quarter of 2018, it was determined that indicators of impairment were present for certain shops as a result of continued underperformance. The Company performed impairment analyses related to these shops and recorded an impairment charge of $2.0 million for the excess of the carrying amount recorded on the balance sheet over the shops' estimated fair value. The Company performs impairment analyses on a quarterly basis, which involves significant judgment by management including estimates of future cash flows and future growth rates, among other assumptions. Based on the Company's current projections, no impairment beyond what has already been recorded has been identified. However, given the current challenges facing the industry and our business, future evaluations could result in additional impairment charges.

Interest Expense

Interest expense was $27 thousand during the 13 weeks ended April 1, 2018 and $28 thousand during the 13 weeks ended March 26, 2017.

Income Tax Expense

Income tax expense decreased by $1.1 million, or more than 100%, to a benefit of $0.5 million for the 13 weeks ended April 1, 2018, from an expense of $0.6 million for the 13 weeks ended March 26, 2017, primarily attributable to a pre-tax book loss and the change in the federal tax rate from 35 percent to 21 percent. For the 13 weeks ended April 1, 2018, the effective tax rate was a benefit of 19.0%, compared to an expense of 44.8% for the 13 weeks ended March 26, 2017. The change in the effective tax rate was driven by a pre-tax book loss and the change in the federal tax rate from 35 percent to 21 percent.

Liquidity and Capital Resources

General

Potbelly's ongoing primary sources of liquidity and capital resources are cash provided from operating activities, existing cash and cash equivalents and the Company's credit facility. Potbelly's primary requirements for liquidity and capital are new shop openings, existing shop capital investments (maintenance and improvements), repurchases of Company common stock, lease obligations, purchases of existing franchise-operated shops, and working capital and general corporate needs. Potbelly's requirement for working capital is not significant since the Company's customers pay for their food and beverage purchases in cash or payment cards (credit or debit) at the time of sale. Thus, Potbelly is able to sell certain inventory items before the Company needs to pay its suppliers for such items. Company shops do not require significant inventories or receivables. Potbelly believes that these sources of liquidity and capital will be sufficient to finance the Company's continued operations and expansion plans for at least the next twelve months.

The following table presents summary cash flow information for the periods indicated (in thousands):

	For the 13 Weeks Ended	
	April 1, 2018	March 26, 2017
Net cash provided by (used in):		
Operating activities	$6,665	$12,420
Investing activities	(4,939)	(6,927)
Financing activities	1,680	(1,496)
Net increase in cash	$3,406	$3,997

Operating Activities

Net cash provided by operating activities decreased to $6.7 million for the 13 weeks ended April 1, 2018, from $12.4 million for the 13 weeks ended March 26, 2017. The $5.8 million decrease was primarily driven by changes in certain working capital accounts mainly due to timing. The remainder of the difference was primarily attributable to a

decrease of $2.9 million in net income.

Investing Activities

Net cash used in investing activities decreased to $4.9 million for the 13 weeks ended April 1, 2018, from $6.9 million for the 13 weeks ended March 26, 2017. The decrease was primarily due to lower construction costs for new company-operated shops opened for the 13 weeks ended April 1, 2018, compared to new company-operated shops opened for the 13 weeks ended March 26, 2017, as well as capital expenditures for future shop openings, maintaining our existing shops and certain other projects.

Financing Activities

Net cash provided by financing activities was $1.7 million for the 13 weeks ended April 1, 2018, compared to $1.5 million net cash used in financing activities for the 13 weeks ended March 26, 2017. The change in financing cash was driven by $2.3 million in proceeds from the exercise of stock options during the 13 weeks ended April 1, 2018, compared to $0.5 million during the 13 weeks ended March 26, 2017. Additionally, $0.5 million in employee taxes related to stock-based payment arrangements were withheld and paid during the 13 weeks ended April 1, 2018, compared to $0.1 million during the 13 weeks ended March 26, 2017.

Stock Repurchase Program

On May 8, 2018, the Company announced that its Board of Directors authorized a stock repurchase program for up to $65.0 million of its outstanding common stock. The stock repurchase program replaced the previous program, authorized in September 2016, under which approximately $14.7 million of authorization remained as of April 1, 2018. Under the previous program, during the 13 weeks ended April 1, 2018, the Company repurchased 5,000 shares of its common stock for approximately $0.1 million, including cost and commission, in open market transactions. The new program permits the Company, from time to time, to purchase shares in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Securities Exchange Act of 1934, as amended) or in privately negotiated transactions. The number of common stock actually repurchased, and the timing and price of repurchases, will depend upon market conditions, Securities and Exchange Commission requirements, and other factors. Purchases may be started or stopped at any time without prior notice depending on market conditions and other factors. Repurchased shares are included as treasury stock in the condensed consolidated balance sheets and the condensed consolidated statements of equity.

Credit Facility

On December 9, 2015, the Company entered into an amended and restated five-year revolving credit facility agreement that expires in November 2020. The credit agreement provides, among other things, for a revolving credit facility in a maximum principal amount of $50.0 million, with possible future increases to $75.0 million under an expansion feature. Borrowings under the credit facility generally bear interest at our option at either (i) a eurocurrency rate determined by reference to the applicable London Interbank Offered Rate (LIBOR) plus a margin ranging from 1.00% to 1.75% or (ii) a prime rate as announced by JP Morgan Chase plus a margin ranging from 0.00% to 0.50%. The applicable margin is determined based upon our consolidated total leverage ratio. On the last day of each calendar quarter, the Company is required to pay a commitment fee ranging from 0.125% to 0.20% per annum in respect of any unused commitments under the credit facility, with the specific rate determined based upon our consolidated total leverage ratio. So long as the leverage ratios are met, there is no limit on the “restricted payments” (primarily distributions and equity repurchases) that the Company may make. As of April 1, 2018, the Company had no amounts outstanding under the credit facility.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Significant estimates include amounts for long-lived assets and income taxes. Actual results could differ from those estimates. Critical accounting policies are those that management believes are both most important to the portrayal of our financial condition and operating results and require management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company bases estimates on historical experience and other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Judgments and uncertainties affecting the application of those policies may result in materially different amounts being reported under different conditions or using different assumptions. Potbelly had no significant changes in our critical accounting estimates since the last annual report. The Company’s critical accounting estimates are identified and described in our annual consolidated financial statements and related notes.

Off-Balance Sheet Arrangements

As of April 1, 2018, the Company does not have any off-balance sheet arrangements, synthetic leases, investments in special purpose entities or undisclosed borrowings or debt that would be required to be disclosed pursuant to Item 303 of Regulation S-K under the Exchange Act.

New and Revised Financial Accounting Standards

See Note 1 to the Consolidated Financial Statements for a description of recently issued Financial Accounting Standards.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For quantitative and qualitative disclosures about market risk, see Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Our exposures to market risk have not changed materially since December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of April 1, 2018. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of April 1, 2018, our disclosure controls and procedures were effective in ensuring that information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended April 1, 2018 that have materially affected, or are reasonably likely to materially affect internal controls over financial reporting.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits 31.1 and 31.2 to this Quarterly Report on Form 10-Q.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings is provided in Note 8 to the Condensed Consolidated Financial Statements and is incorporated by reference herein.

ITEM 1A. RISK FACTORS

A description of the risk factors associated with our business is contained in Item 1A, “Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. There have been no material changes to our Risk Factors as previously reported.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table contains information regarding purchases of our common stock made by or on behalf of Potbelly Corporation during the 13 weeks ended April 1, 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Program (3)	Maximum Value of Shares that May Yet be Purchased Under the Program (3)
January 1, 2018 - January 28, 2018	5,000	$ 12.57	5,000	$ 14,700,014
January 29, 2018 - February 25, 2018	—	$ —	—	$ 14,700,014
February 26, 2018 - April 1, 2018	8,771	$ 13.20	—	$ 14,700,014
Total:	13,771		5,000	

(1) In accordance with the terms of the Company’s long-term incentive plans, 8,771 shares were delivered back to the Company during the period from February 26, 2018 – April 1, 2018 for payment of withholding taxes from employees for vesting restricted stock units.
(2) Average price paid per share excludes commissions.
(3) On September 8, 2016, the Company announced that its Board of Directors approved a share repurchase program, authorizing us to repurchase up to $30.0 million of our common stock. The program permits the Company, from time to time, to purchase shares in the open market (including in pre-arranged stock trading plans in accordance with the guidelines specified in Rule 10b5-1 under the Exchange Act) or in privately negotiated transactions. No time limit has been set for the completion of the repurchase program and the program may be suspended or discontinued at any time. See Note 6 for further information regarding the Company’s stock repurchase program.

ITEM 6. EXHIBITS

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

Exhibit No.	Description
10.1	Settlement Agreement, by and among Potbelly Corporation, Privet Fund LP, Privet Fund Management LLC, Ryan Levenson and Ben Rosenzweig, dated April 12, 2018 (filed as Exhibit 10.1 to Form 8-K (File No. 001-36104) filed April 13, 2018 and incorporated herein by reference).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer 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.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

SIGNATURE

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

POTBELLY CORPORATION

Date: May 9, 2018 By: /s/ Michael Coyne
Michael Coyne
Chief Financial Officer
(Principal Financial Officer)

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