

Papa Murphy's Holdings, Inc.  
Form 10-Q  
November 07, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended October 1, 2018

OR

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

For the transition period from to

Commission file number 001-36432

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Papa Murphy's Holdings, Inc.  
(Exact name of registrant as specified in its charter)

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Delaware	27-2349094
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
8000 NE Parkway Drive, Suite 350	98662
Vancouver, WA	(Zip Code)
(Address of principal executive offices)	
(360) 260-7272	
(Registrant's telephone number, including area code)	

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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 every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes . No .

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

At November 2, 2018, there were 17,027,935 shares of the Registrant's common stock, \$0.01 par value, outstanding.



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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

## Papa Murphy's Holdings, Inc. and Subsidiaries

## Unaudited Condensed Consolidated Statements of Operations

	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
(In thousands, except share and per share data)	(unaudited)	(as adjusted)	(unaudited)	(as adjusted)
Revenues				
Franchise related	\$15,872	\$16,171	\$46,876	\$52,961
Company-owned stores	12,958	17,520	47,519	57,010
Total revenues	28,830	33,691	94,395	109,971
Costs and Expenses				
Store operating costs:				
Cost of food and packaging	4,216	5,858	15,657	19,376
Compensation and benefits	4,341	5,478	15,183	17,735
Advertising	1,147	1,604	3,700	5,055
Occupancy and other store operating costs	2,720	3,012	8,925	10,255
Selling, general, and administrative	11,710	12,517	36,146	49,042
Depreciation and amortization	1,662	2,336	5,677	8,359
Loss on disposal or impairment of property and equipment	2,521	6,253	1,808	17,830
Total costs and expenses	28,317	37,058	87,096	127,652
Operating Income (Loss)	513	(3,367)	7,299	(17,681)
Interest expense, net	1,254	1,305	3,842	3,818
Other expense, net	57	57	160	149
(Loss) Income Before Income Taxes	(798)	(4,729)	3,297	(21,648)
(Benefit from) provision for income taxes	(159)	(2,051)	970	(7,678)
Net (Loss) Income	\$(639)	\$(2,678)	\$2,327	\$(13,970)
(Loss) earnings per share of common stock				
Basic	\$(0.04)	\$(0.16)	\$0.04	\$(0.83)
Diluted	\$(0.04)	\$(0.16)	\$0.04	\$(0.83)
Weighted average common stock outstanding				
Basic	16,944,777	16,882,193	16,924,037	17,863,122
Diluted	16,944,777	16,882,193	16,963,084	17,863,122
See accompanying notes.				

Table of ContentsPapa Murphy's Holdings, Inc. and Subsidiaries  
Unaudited Condensed Consolidated Balance Sheets

	October 1, 2018	January 1, 2018
	(unaudited)	(as adjusted)
(In thousands, except par value and share data)		
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 3,359	\$ 2,174
Accounts receivable, net	3,088	3,788
Inventories	590	719
Prepaid expenses and other current assets	2,964	2,281
Total current assets	10,001	8,962
Property and equipment, net	4,988	10,064
Operating lease right of use assets	9,608	16,331
Goodwill	101,763	107,751
Trade name and trademarks	87,002	87,002
Definite-life intangibles, net	28,372	31,655
Assets held for sale	3,415	—
Other assets	678	350
Total assets	\$ 245,827	\$ 262,115
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$ 3,889	\$ 5,389
Accrued expenses and other current liabilities	10,924	12,382
Current portion of lease liabilities	2,115	3,382
Current portion of unearned franchise and development fees	1,747	1,564
Current portion of long-term debt	3,000	8,400
Total current liabilities	21,675	31,117
Long-term debt, net of current portion	81,527	86,994
Lease liabilities, net of current portion	9,580	16,296
Unearned franchise and development fees, net of current portion	8,969	10,037
Deferred tax liability	22,642	21,825
Other long-term liabilities	4,325	1,704
Total liabilities	148,718	167,973
Commitments and contingencies (Note 16)		
Stockholders' Equity		
Preferred stock (\$0.01 par value; 15,000,000 shares authorized; no shares issued)	—	—
Common stock (\$0.01 par value; 200,000,000 shares authorized; 17,031,707 and 16,971,461 shares issued, respectively)	170	170
Additional paid-in capital	121,254	120,614
Accumulated deficit	(24,315 )	(26,642 )
Total stockholders' equity	97,109	94,142
Total liabilities and stockholders' equity	\$ 245,827	\$ 262,115
See accompanying notes.		



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Unaudited Condensed Consolidated Statements of Cash Flows

	Nine Months Ended	
	October 2, 2018	October 2, 2017
(In thousands)	(unaudited)	(as adjusted)
<b>Operating Activities</b>		
Net income (loss)	\$2,327	\$(13,970)
Adjustments to reconcile to cash from operating activities		
Depreciation and amortization	5,677	8,359
Loss on disposal or impairment of property and equipment	1,808	17,830
Deferred taxes	817	(7,831 )
Stock-based compensation	561	489
Other non-cash items	253	341
Change in operating assets and liabilities		
Accounts receivable	714	2,285
Prepaid expenses and other assets	1,025	3,885
Unearned franchise and development fees	(1,011 )	(158 )
Accounts payable	(1,693 )	(2,028 )
Accrued expenses and other liabilities	(5,459 )	(978 )
Net cash from operating activities	5,019	8,224
<b>Investing Activities</b>		
Acquisition of property and equipment	(497 )	(2,957 )
Proceeds from sale of property and equipment	7,586	2,206
Payments received on notes receivable	97	42
Net cash from investing activities	7,186	(709 )
<b>Financing Activities</b>		
Payments on term loan	(11,100)	(7,879 )
Advances on revolver	4,500	12,700
Payments on revolver	(4,500 )	(13,500 )
Repurchases of common stock	—	(6 )
Proceeds from exercise of stock options	80	—
Net cash from financing activities	(11,020)	(8,685 )
Net change in cash and cash equivalents	1,185	(1,170 )
Cash and Cash Equivalents, beginning of period	2,174	2,069
Cash and Cash Equivalents, end of period	\$3,359	\$899
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash paid during the period for interest	\$3,668	\$3,637
Cash paid (received) during the period for income taxes	\$100	\$(246 )
See accompanying notes.		

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Papa Murphy's Holdings, Inc. and Subsidiaries  
Notes to Unaudited Condensed Consolidated Financial Statements

Note 1 — Description of Business and Basis of Presentation

Description of Business

Papa Murphy's Holdings, Inc. ("Papa Murphy's" or the "Company"), together with its subsidiaries, is a franchisor and operator of a Take 'N' Bake pizza chain. The Company franchises the right to operate Papa Murphy's Take 'N' Bake pizza franchises and operates Papa Murphy's Take 'N' Bake pizza stores owned by the Company. As of October 1, 2018, the Company had 1,460 stores consisting of 1,420 domestic stores (1,307 franchised stores and 113 Company-owned stores) across 37 states, plus 40 franchised stores in Canada and the United Arab Emirates. Substantially all of the Company's revenues are derived from retail sales of pizza and other food and beverage products to the general public by Company-owned stores and the collection of franchise royalties and fees associated with franchise and development rights.

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all information and footnotes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. In the Company's opinion, all necessary adjustments, consisting of only normal recurring adjustments, have been made for the fair statement of the results of the interim periods presented. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year. The accompanying interim unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and the related notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2018.

Principles of Consolidation

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

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

Fiscal Year

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

Recently Issued Accounting Standards

Recently Adopted Accounting Standards

Revenue from Contracts with Customers

The Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09") as of January 2, 2018. The Company adopted the new standard using the full retrospective method and elected applicable practical expedients on adoption. Accordingly, previously reported financial information has been restated to reflect the application of the new standard to all comparative periods presented.

Adoption of ASU 2014-09 had a material impact on the Company's interim unaudited condensed consolidated financial statements. The most significant impacts relate to the: (i) accounting for franchise and development fees, and (ii) accounting for the Company's advertising fund (the "Brand Marketing Fund" or "BMF") and Convention Fund (with the BMF, the "Brand Funds"). Specifically, under the new standard the Company recognizes franchise fees ratably over the life of the contract rather than at the time the store is opened or a successive contract commences. Revenue related to the Company's franchise





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royalties, which are based on a percentage of franchise sales, and revenue from Company-owned stores remain substantially unchanged.

The Company has determined that ASU 2014-09 requires a gross presentation on the Company's Condensed Consolidated Statements of Operations for revenues and related expenses of the BMF and Convention Fund, or Brand Funds. These funds exist solely for the purpose of promoting the Papa Murphy's brand in the U.S. While this change materially affects the gross amount of reported revenues and expenses, the effect generally is an offsetting increase to both revenues and expenses with no net effect on reported Operating Income (Loss) and Net (Loss) Income. Refer to Impacts to Reported Results below for more detailed effects of adoption on the Company's financial statements and refer to Note 10 — Revenue for more information on our accounting for revenue.

Leases

The Company early adopted ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02") as of January 2, 2018, concurrent with the adoption of the new revenue standard. The Company adopted this standard using the modified retrospective approach and elected the available practical expedients on adoption. Accordingly, previously reported financial information has been restated to reflect the application of the new standard to all comparative periods presented. Adoption of the new standard has had a material impact on the Company's interim unaudited condensed consolidated financial statements. The most significant impacts related to the (i) recognition of right-of-use ("ROU") assets and lease liabilities for operating leases, and (ii) changes in occupancy costs and impairment losses related to prior year store closures and impairments. ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. A loss is recognized when the ROU asset is impaired in connection with the impairment of a store's assets due to economic or other factors.

Refer to Impacts to Reported Results below for more detailed effects of adoption on the Company's financial statements and refer to Note 11 — Leases for more information on our accounting for leases.

Other standards adopted

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 320) ("ASU 2016-15"), which clarifies the presentation of certain cash receipts and cash payments in the statement of cash flows. The Company adopted the standard on January 2, 2018. Adoption of the new standard did not have a material impact on the Company's consolidated financial statements.

In preparation for the adoption of the above standards, the Company implemented internal controls and key system functionality to enable the preparation of financial information in accordance with the standards.

Recent Accounting Pronouncements Not Yet Adopted

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

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## Impacts to Reported Results

Adoption of the standards related to revenue recognition and leases affected the Company's previously reported results as follows:

Statement of Operations  (in thousands, except earnings per share)	Three Months Ended October 2, 2017 (unaudited)			
	As Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Adjusted
Total revenues <sup>(1)</sup>	\$26,825	\$ 6,866	\$ —	\$33,691
Store operating costs	16,647	(357 )	(338 )	15,952
Selling, general, and administrative <sup>(1)</sup>	5,596	6,929	(8 )	12,517
Loss on disposal or impairment of property and equipment	4,327	—	1,926	6,253
(Benefit from) provision for income taxes	(1,575 )	109	(585 )	(2,051 )
Net (loss) income	(1,869 )	185	(994 )	(2,678 )
Diluted (loss) earnings per share	(0.11 )	0.01	(0.06 )	(0.16 )

Recognition of advertising revenue and expense on a gross basis instead of a net basis by the Brand Funds comprised \$6.6 million of the revenue adjustment and \$6.9 million of the expense adjustment under the revenue standard. The revenue adjustment due to the change in method of recognizing franchise and development fees was \$0.3 million.

Statement of Operations  (in thousands, except earnings per share)	Nine Months Ended October 2, 2017 (unaudited)			
	As Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Adjusted
Total revenues <sup>(1)</sup>	\$87,920	\$ 22,051	\$ —	\$109,971
Store operating costs	54,855	(1,165 )	(1,270 )	52,420
Selling, general, and administrative <sup>(1)</sup>	26,216	22,860	(34 )	49,042
Loss on disposal or impairment of property and equipment	15,377	—	2,453	17,830
(Benefit from) provision for income taxes	(7,384 )	132	(426 )	(7,678 )
Net (loss) income	(13,471 )	224	(723 )	(13,970 )
Diluted (loss) earnings per share	(0.80 )	0.01	(0.04 )	(0.83 )

Recognition of advertising revenue and expense on a gross basis instead of a net basis by the Brand Funds comprised \$21.7 million of the revenue adjustment and \$22.9 million of the expense adjustment under the revenue standard. The revenue adjustment due to the change in method of recognizing franchise and development fees was \$0.4 million.

Balance Sheet  (in thousands)	January 1, 2018			
	As Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Adjusted
Prepaid expenses and other current assets	\$2,671	\$ —	\$ (390 )	\$ 2,281
Operating lease right of use assets	—	—	16,331	16,331
Unearned franchise and development fees	1,702	9,899	—	11,601
Accrued expenses and other current liabilities	13,139	(507 )	(250 )	12,382
Lease liabilities	—	—	19,678	19,678
Deferred tax liability, net	24,457	(2,319 )	(313 )	21,825
Other long-term liabilities	3,922	—	(2,218 )	1,704

Accumulated deficit (18,613)(7,073 ) (956 ) (26,642 )

Adoption of the revenue recognition and lease standards did not materially affect cash from or used in operating, financing, or investing cash flows on the Company's Condensed Consolidated Statements of Cash Flows.

Segment Definitions

As a result of changes in the Company's executive management responsibilities, effective January 2, 2018, the Company changed its reportable segments by combining its domestic and international franchise business into a single Franchise

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segment and separating its Brand Funds into a separate reportable segment. No changes were made to the Company's Company Stores segment. Management believes this change better reflects the priorities and decision making analysis around the allocation of the Company's resources. Prior period results for the affected segments have been retrospectively revised to reflect this change. See Note 17 — Segment Information for additional information.

## Note 2 — Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

(in thousands)	October 1, 2018	January 1, 2018
	(unaudited)	(as adjusted)
Prepaid media production costs	\$ 718	\$ 376
Prepaid software and support	713	223
Prepaid occupancy related costs	271	159
Prepaid insurance	376	377
Taxes receivable	129	182
POS software licenses for resale	368	364
Assets held for sale	241	432
Advertising cooperative assets, restricted	71	4
Other	77	164
Total prepaid expenses and other current assets	\$ 2,964	\$ 2,281

## Note 3 — Property and Equipment

Property and equipment are net of accumulated depreciation of \$18.2 million and \$21.9 million at October 1, 2018, and January 1, 2018, respectively. Depreciation expense amounted to \$0.6 million and \$1.2 million during the three months ended October 1, 2018, and October 2, 2017, respectively. Depreciation expense amounted to \$2.4 million and \$4.8 million during the nine months ended October 1, 2018, and October 2, 2017, respectively.

## Note 4 — Divestitures

On April 23, 2018, the Company completed the sale and refranchise of two Company-owned stores in Arkansas. On May 21, 2018 and June 25, 2018, respectively, the Company completed the sale and refranchise of ten Company-owned stores in the Denver, Colorado area and ten stores in the Colorado Springs, Colorado area. On October 1, 2018 the Company completed the sale and refranchise of seven stores in the Dallas, Texas area. The aggregate sale price for the 29 stores was \$7.7 million, paid in cash and a long-term receivable of \$0.4 million. The Company recognized a pre-tax loss from these dispositions of \$1.1 million. The Company recorded a contingent liability for marketing expenditures of \$1.5 million, of which \$0.4 million is recorded as accrued expenses and other current liabilities and \$1.1 million is recorded as other long-term liabilities on the Company's Condensed Consolidated Balance Sheets. In connection with the sale, the buyers paid \$450,000 in franchise fees. These dispositions did not meet the criteria for accounting as a discontinued operation.

## Note 5 — Goodwill

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

(in thousands)	Company Stores	Franchise	Total
Balance at January 1, 2018	\$26,205	\$ 81,546	\$107,751
Allocated to assets held for sale	(833 )	—	(833 )
Disposition	(5,155 )	—	(5,155 )
Balance at October 1, 2018	\$20,217	\$ 81,546	\$101,763

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There is no goodwill associated with the Brand Funds segment. The Company has determined that during the three months ended October 1, 2018, there were no triggering events that would require an updated impairment review. The goodwill disposal is from the sale of Company-owned stores to franchise owners (see Note 4 — Divestitures).

## Note 6 — Intangible Assets

Definite-lived intangible assets are net of accumulated amortization of \$33.4 million and \$30.2 million as of October 1, 2018, and January 1, 2018, respectively. Amortization expense amounted to \$1.1 million during each of the three months ended October 1, 2018, and October 2, 2017. Amortization expense amounted to \$3.3 million and \$3.5 million during the nine months ended October 1, 2018, and October 2, 2017, respectively.

## Note 7 — Financing Arrangements

Long-term debt consists of the following:

(in thousands)	October 1, 2018	January 1, 2018
Term loan	\$ 81,800	\$ 92,900
Notes payable	3,000	3,000
Total principal amount of long-term debt	84,800	95,900
Unamortized debt issuance costs	(273 )	(506 )
Total long-term debt	84,527	95,394
Less current portion	(3,000 )	(8,400 )
Total long-term debt, net of current portion	\$ 81,527	\$ 86,994

## Senior secured credit facility

On August 28, 2014, PMI Holdings, Inc., a wholly-owned subsidiary of Papa Murphy's Holdings, Inc., entered into a \$132.0 million senior secured credit facility (the "Senior Credit Facility") consisting of a \$112.0 million term loan and a \$20.0 million revolving credit facility, which includes a \$2.5 million letter of credit subfacility and a \$1.0 million swing-line loan subfacility. The term loan and any loans made under the revolving credit facility mature in August 2019. As of October 1, 2018, the term loan bears interest at a rate of 5.5% per annum based on the LIBOR rate option plus the applicable margin.

The weighted average interest rate for all borrowings under the Senior Credit Facility for the third quarter of 2018 was 5.4%.

On November 6, 2018, PMI Holdings, Inc. entered into a second amendment to its Senior Credit Facility. The amendment, among other things, extends the term of the Senior Credit Facility by twelve months to August 2020 and reduces the revolving credit facility from \$20.0 million to \$7.5 million (see Note 18 — Subsequent Events). With an amended maturity date of over one year from October 1, 2018, balances outstanding under the amended Senior Credit Facility are classified as non-current on the Condensed Consolidated Balance Sheets, except for mandatory, minimum term loan amortization payments of \$2.1 million due on the last day of each fiscal quarter.

## Notes payable

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

On October 25, 2018, Papa Murphy's Company Stores, Inc. entered into a second amendment to the note payable which extends the maturity date of the note to January 2019 (see Note 18 — Subsequent Events).

## Note 8 — Fair Value Measurement

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

Level 1 — Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.

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Level 2 — Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

The following table presents information about the fair value of the Company's financial instruments:

(in thousands)	October 1, 2018		January 1, 2018		Fair Value Measurement
	Carrying Value	Fair Value	Carrying Value	Fair Value	
Financial assets					
Notes receivable <sup>(1)</sup>	\$ —	\$ —	-\$ 97	\$ 88	Level 3
Other receivables <sup>(1)</sup>	391	335	—	—	Level 3

The fair value of notes receivable and other receivables were estimated primarily using a discounted cash flow (1) method based on a discount rate, reflecting the applicable credit spread. The notes receivable were paid in full as of October 1, 2018.

Financial instruments not included in the table above consist of cash and cash equivalents, accounts receivable, accounts payable, and long-term debt. The fair values of cash and cash equivalents, accounts receivable, and accounts payable approximate carrying value because of the short-term nature of the accounts. The fair value of long-term debt approximates carrying value because the borrowings are made with variable market rates and negotiated terms and conditions that are consistent with current market rates.

#### Note 9 — Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

(in thousands)	October 1,	January 1,
	2018	2018
	(unaudited)	(as adjusted)
Accrued compensation and related costs	\$ 3,447	\$ 3,902
Accrued legal settlement costs	2,700	3,940
Gift cards payable	1,898	2,676
Accrued interest and non-income taxes payable	384	461
Convention fund balance	765	841
Advertising cooperative liabilities	116	60
Lease liabilities held for sale	758	—
Other	856	502
Total accrued expenses and other current liabilities	\$ 10,924	\$ 12,382

Accrued legal settlement costs decreased since January 1, 2018 due to \$1.8 million in payments to partially settle the TCPA class action lawsuit and \$3.2 million in payments to settle franchise litigation claims that reduced the \$3.7 million accrual for legal settlement costs related to the franchise litigation recorded in the current year. Both lawsuits are discussed in more detail in Note 16 — Commitments and Contingencies. Included in Accounts receivable, net is an insurance receivable equal to 75% of the anticipated settlement of the franchise owner lawsuit.

#### Note 10 — Revenue

The Company owns and franchises Papa Murphy's Take 'N' Bake pizza stores. Revenue is recognized upon the transfer of control of promised goods or services to customers in an amount that reflects the consideration the Company expects to receive for those goods or services. The following are the principal activities from which the Company earns revenue:

##### Company-owned Stores Revenue

Company-owned stores revenue consists of retail sales of food through Company-owned stores located in the United States. Company-owned stores revenue is recognized when the food items are delivered to or carried out by

customers. Customer payments are generally collected at the time of sale. Sales taxes collected from customers are remitted to the appropriate taxing authority and are not recognized as revenue.



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## Franchise Revenues

The franchise arrangement between the Company and each franchise owner of a Papa Murphy's Take 'N' Bake pizza store is documented in the form of a franchise agreement and, in select cases, a development agreement. The franchise arrangement requires the Company as franchisor to perform various activities to support the Papa Murphy's Take 'N' Bake pizza brand and does not involve the direct transfer of goods and services to the franchise owner as a customer. Activities performed by the Company are highly interrelated with the franchise license and are considered to represent a single performance obligation, which is the transfer of the franchise license. The nature of the Company's promise in granting the franchise license is to provide the franchise owner with access to the brand's intellectual property over the term of the franchise arrangement.

The transaction price in a standard franchise arrangement consists of (a) franchise/development fees; (b) continuing franchise fees (royalties); and (c) advertising fees. Since the Company considers the franchise license to be a single performance obligation, no allocation of the transaction price under a standard agreement is performed for revenue recognition purposes. However, if additional separate and distinct goods or services are included with a franchise arrangement and are deemed to be additional performance obligations, the total transaction price of the contract is allocated to each performance obligation based on the stand-alone selling price of each performance obligation.

Franchise revenues are recognized by the Company from the following different sources:

**Royalty revenues.** Royalty revenues, which include advertising fees from domestic franchise stores, are based on a percentage of sales and are recognized when the food items are delivered to or carried out by customers. Payments for domestic royalties and advertising fees are generally due and collected within seven days of the prior week end date.

Payments for international royalties are due and collected within 30 days of month-end.

**Franchise and development fees.** Franchise and development fees are paid in advance of a store opening, typically when entering into a new franchise or development agreement. Fees allocated to the franchise license are recognized as revenue on a straight-line basis over the term of each respective franchise store agreement. Initial franchise agreement terms are typically ten years while successive agreement terms are typically five years. The Company has determined that these fees, which are paid in advance of when they are recognized as revenue, do not contain a significant financing component.

**E-commerce fees.** E-commerce fees include point-of-sale ("POS") support fees and transaction fees for purchases made through the Company's e-commerce platform. POS support fees are due quarterly in advance and recognized as revenue over the respective quarter. Transaction fees are recognized when the food items purchased from a store are delivered to or carried out by customers and are due and collected within seven days of the prior week end date.

**Vendor payments.** Vendor payments are received from vendors that supply franchised and Company-owned stores with products and are typically based on the volume of product purchased by the stores. Revenues from the sale of products are recognized when product is shipped from a distribution center to a store. Payments are due and collected within 30 days after month-end.

**Marketing kits.** The Company charges domestic stores for marketing materials shipped to stores one to three times per quarter. These products are sold at cost and the revenues from their sale are recognized when the product is shipped by the vendors producing the kits. Payments are due and collected within 30 days of shipment.

The timing of revenue recognition may differ from the timing of payment from customers. We record a receivable when revenue is recognized in advance of payment, and a contract liability ("unearned revenue"), when revenue is recognized subsequent to payment. Unearned revenue consists mainly of franchise and development fees paid in advance. A refund liability is recorded when it is known that an amount previously received will be refunded instead of recognized as revenue. The Company does not incur a significant amount of contract acquisition costs in conducting its franchising activities and has not capitalized any such costs.

## Revenue by Category

The following series of tables present revenue disaggregated by several categories for the periods reported.

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Revenues by contract type were as follows:

	Three Months Ended			
	October 1, 2018			
	(unaudited)			
(in thousands)	Franchise	Company	Brand	Total
	Stores	Funds	Funds	
Franchise royalties	\$8,279	\$—	\$3,362	\$11,641
Franchise fees	756	—	—	756
Vendor payments	—	—	1,312	1,312
E-commerce fees	602	—	—	602
Other franchise and brand	29	—	1,532	1,561
Company-owned stores	—	12,958	—	12,958
Total revenues	9,666	12,958	6,206	28,830
Intersegment revenues	695	—	346	1,041
Reconciliation to business segment revenues	\$10,361	\$12,958	\$6,552	\$29,871
	Three Months Ended			
	October 2, 2017			
	(as adjusted)			
(in thousands)	Franchise	Company	Brand	Total
	Stores	Funds	Funds	
Franchise royalties	\$8,539	\$—	\$5,050	\$13,589
Franchise fees	563	—	—	563
Vendor payments	—	—	1,038	1,038
E-commerce fees	435	—	—	435
Other franchise and brand	21	—	525	546
Company-owned stores	—	17,520	—	17,520
Total revenues	9,558	17,520	6,613	33,691
Intersegment revenues	52	—	387	439
Reconciliation to business segment revenues	\$9,610	\$17,520	\$7,000	\$34,130
	Nine Months Ended October 1, 2018			
	(unaudited)			
(in thousands)	Franchise	Company	Brand	Total
	Stores	Funds	Funds	
Franchise royalties	\$26,462	\$—	\$10,740	\$37,202
Franchise fees	2,216	—	—	2,216
Vendor payments	—	—	3,265	3,265
E-commerce fees	1,664	—	—	1,664
Other franchise and brand	64	—	2,465	2,529
Company-owned stores	—	47,519	—	47,519
Total revenues	30,406	47,519	16,470	94,395
Intersegment revenues	2,480	—	1,203	3,683
Reconciliation to business segment revenues	\$32,886	\$47,519	\$17,673	\$98,078

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	Nine Months Ended October 2, 2017 (as adjusted)			
(in thousands)	Franchise	Company Stores	Brand Funds	Total
Franchise royalties	\$27,674	\$—	\$16,319	\$43,993
Franchise fees	2,101	—	—	2,101
Vendor payments	—	—	3,493	3,493
E-commerce fees	1,421	—	—	1,421
Other franchise and brand	67	—	1,886	1,953
Company-owned stores	—	57,010	—	57,010
Total revenues	31,263	57,010	21,698	109,971
Intersegment revenues	169	—	1,233	1,402
Reconciliation to business segment revenues	\$31,432	\$57,010	\$22,931	\$111,373

Revenues by geographic location were as follows:

	Three Months Ended October 1, 2018 (unaudited)			
(in thousands)	Franchise	Company Stores	Brand Funds	Total
United States	\$9,589	\$12,958	\$6,206	\$28,753
International	77	—	—	77
Total revenues	\$9,666	\$12,958	\$6,206	\$28,830

	Three Months Ended October 2, 2017 (as adjusted)			
(in thousands)	Franchise	Company Stores	Brand Funds	Total
United States	\$9,463	\$17,520	\$6,613	\$33,596
International	95	—	—	95
Total revenues	\$9,558	\$17,520	\$6,613	\$33,691

	Nine Months Ended October 1, 2018 (unaudited)			
(in thousands)	Franchise	Company Stores	Brand Funds	Total
United States	\$30,168	\$47,519	\$16,470	\$94,157
International	238	—	—	238
Total revenues	\$30,406	\$47,519	\$16,470	\$94,395

	Nine Months Ended October 2, 2017 (as adjusted)			
(in thousands)	Franchise	Company Stores	Brand Funds	Total
United States	\$30,962	\$57,010	\$21,698	\$109,670
International	301	—	—	301
Total revenues	\$31,263	\$57,010	\$21,698	\$109,971

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## Contract Balances

Changes in the balances of contract liabilities (unearned revenue) during the periods reported were as follows:

(in thousands)	Contract Liabilities
Balance at January 1, 2018	\$ 11,151
Revenue recognized that was included in the balance at the beginning of the period	(2,129 )
Cash received, net of amounts recognized as revenue during the period	1,449
Contract refunds	(305 )
Balance at October 1, 2018	\$ 10,166

The Company had a refund liability of \$0.5 million as of each of October 1, 2018 and January 1, 2018. Receivables from contracts with customers included in Accounts receivable, net were \$2.6 million as of October 1, 2018 and \$3.8 million as of January 1, 2018, respectively.

The following table includes estimated franchise fee revenue expected to be recognized in the future related to performance obligations that were unsatisfied (or partially unsatisfied) as of October 1, 2018 (in thousands):

Fiscal year 2018	\$410
2019	1,598
2020	1,458
2021	1,299
2022	1,135
Thereafter	4,266
Total	\$10,166

## Note 11 — Leases

The Company leases the property for its corporate headquarters, Company-owned stores, and certain office equipment. The Company is not a party to leases for franchise locations except for two locations that operate under a sublease and a few leases assigned to franchisees when stores were refranchised wherein it remains secondarily liable (see Lease guarantees below). The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease ROU assets, current portion of operating lease liabilities, and operating lease liabilities in the Condensed Consolidated Balance Sheets. The Company currently has no finance leases.

ROU assets and operating lease liabilities are recognized based on the present value of lease payments over the lease term at commencement date. Because most of the Company's leases do not provide an implicit rate of return, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Operating lease ROU assets also exclude lease incentives received. The Company has lease agreements with lease and non-lease components, which are accounted for separately. For certain equipment leases, such as copiers, the Company accounts for the lease and non-lease components as a single lease component.

Lease terms for Company-owned stores are generally five years with one or more five-year renewal options and generally require the Company to pay a proportionate share of real estate taxes, insurance, common area, and other operating costs in addition to a base or fixed rent. The Company's leases have remaining lease terms of 0.5 to 10.2 years. For purposes of calculating operating lease liabilities, lease terms may be deemed to include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Economic performance of a store is the primary factor used to estimate whether an option to extend a lease term will be exercised or not.

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Lease expense for lease payments is recognized on a straight-line basis over the lease term. The components of lease expense for the periods reported are as follows:

	Three Months Ended		Nine Months Ended	
	October 2, 2018		October 2, 2017	
(in thousands)	(unaudited)	(as adjusted)	(unaudited)	(as adjusted)
Operating lease cost	\$818	\$ 1,150	\$2,903	\$ 3,609
Short-term lease cost	11	5	36	16
Variable lease cost	2	5	8	26
Sublease income	(16 )	(17 )	(42 )	(53 )
Total lease cost	\$815	\$ 1,143	\$2,905	\$ 3,598

Supplemental cash flow information related to leases for the periods reported is as follows:

(in thousands)	Nine Months Ended	
	October 1, 2018	October 2, 2017
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$3,303	\$ 3,655
Right-of-use assets obtained in exchange for new operating lease liabilities	505	213
Weighted-average remaining lease term of operating leases	4.8 years	6.1 years
Weighted-average discount rate of operating leases	4.5 %	4.8 %

Future minimum lease payments under non-cancelable leases as of October 1, 2018 are as follows (in thousands):

Fiscal year 2018	\$765
2019	4,500
2020	3,736
2021	2,626
2022	1,865
Thereafter	3,382
Total future minimum lease payments	16,874
Less imputed interest	(2,839 )
Less lease liabilities held for sale <sup>(1)</sup>	(2,340 )
Total Lease Liabilities	\$11,695

Lease liabilities held for sale includes \$0.8 million reported in Accrued expenses and other current assets (see Note (1)9 — Accrued Expenses and Other Current Liabilities) and \$1.5 million reported in Other long-term liabilities in the Company's Condensed Consolidated Balance Sheets.

As of October 1, 2018, the Company had no operating leases that had not yet commenced.

Lease guarantees

The Company is the guarantor for operating leases of 37 franchised stores that have terms expiring on various dates from October 2018 to April 2025. The obligations from these leases will generally continue to decrease over time as the leases expire. The applicable franchise owners continue to have primary liability for these operating leases. For the nine months ended October 1, 2018, the Company was required to perform under one of these guarantees when a franchisee declared bankruptcy and defaulted on its obligations. As a result, the Company recorded a loss contingency of \$170,000 for the nine months ended October 1, 2018. As of October 1, 2018, the Company does not believe it probable that it would be required to perform under any of the remaining guarantees.

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## Note 12 — Income Taxes

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

	Three Months Ended October 1, 2018		Nine Months Ended October 2, 2017	
(in thousands)	(unaudited) (as adjusted)	(unaudited) (as adjusted)	(unaudited) (as adjusted)	(unaudited) (as adjusted)
(Benefit from) provision for income taxes	\$(159)	\$(2,051)	\$970	\$(7,678)
(Loss) income before income taxes	(798 )	(4,729 )	3,297	(21,648 )
Effective income tax rate	19.9 %	43.4 %	29.4 %	35.5 %

The effective income tax rate for the three months ended October 1, 2018 includes the effect of certain permanent differences between tax reporting purposes and financial reporting purposes and the relative impact of those differences on a small quarterly (loss) income before income taxes. The effective tax rate for the three months ended October 2, 2017, includes the effect of certain Federal General Business Credits confirmed during the quarter. The effective income tax rate for the nine months ended October 1, 2018 includes the effect of certain permanent differences between tax reporting purposes and financial reporting purposes. The effective tax rate for the nine months ended October 2, 2017, includes the effect of a discrete adjustment for the share-based compensation expense recorded for vesting restricted common shares.

## Note 13 — Share-based Compensation

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

## Restricted common shares

Information with respect to restricted stock awards is as follows:

	Number of Shares of Restricted Common Stock		Weighted Average Award Date Fair Value Per Share
	Time Vesting	Market Condition	
Unvested, January 1, 2018	34,898	40,354	\$ 3.44
Granted	41,000	—	5.33
Vested	(28,898 )	—	4.60
Repurchased	—	(754 )	0.19
Unvested, October 1, 2018	47,000	39,600	\$ 3.97

## Stock options

Information with respect to stock option activity is as follows:

	Number of Shares Subject to Options		Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (thousands)
	Time Vesting	Market Condition			
Outstanding, January 1, 2018	949,115	158,127	\$ 7.60		
Granted	210,700	—	5.12		
Exercised	(20,000 )	—	3.99		
Forfeited	(79,104 )	(578 )	9.26		
Outstanding, October 1, 2018	1,060,711	157,549	\$ 7.12	8.0 years	\$ 428

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Exercisable, October 1, 2018 372,169 — \$ 9.55 6.6 years \$ 103

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## Compensation cost

Stock-based compensation expense recognized in connection with the Incentive Plans for the three months ended October 1, 2018 and October 2, 2017 amounted to \$0.2 million and \$0.1 million, respectively. Stock-based compensation expense recognized in connection with the Incentive Plans for the nine month periods ended October 1, 2018 and October 2, 2017 amounted to \$0.6 million and \$0.5 million, respectively.

As of October 1, 2018, total unrecognized stock-based compensation expense was \$1.5 million, with \$1.2 million associated with time vesting awards and \$0.3 million associated with market condition awards. The remaining weighted average period for unrecognized stock-based compensation expense was 2.2 years as of October 1, 2018.

## Note 14 — Brand Marketing Fund

The Company manages the BMF on behalf of all Papa Murphy's stores in the United States. The Company is committed under its franchise and other agreements to spend revenues of the BMF on marketing, creative efforts, media support, or related purposes specified in the agreements. Contributions to the BMF are recognized as revenue, while expenditures are included in selling, general, and administrative expenses. Expenditures of the BMF are primarily amounts paid to third-parties, but may also include personnel expenses and allocated costs. At each reporting date, to the extent contributions to the BMF exceed expenditures on a cumulative basis, the excess contributions are recorded in accrued expenses in the Company's Condensed Consolidated Balance Sheets. While no profit is recognized on amounts received by the BMF, when expenditures exceed contributions to the BMF on a cumulative basis, income from operations and net income may be affected due to the timing of when revenues are received and expenses are incurred.

Information on the Company's BMF balances for the periods reported is as follows:

	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
(in thousands)	(unaudited)	(as adjusted)	(unaudited)	(as adjusted)
Opening BMF deficit	\$ (5,877)	\$ (6,604 )	\$ (5,461)	\$ (1,071 )
Net activity during the period	461	1,718	45	(3,815 )
Ending BMF deficit	\$ (5,416)	\$ (4,886 )	\$ (5,416)	\$ (4,886 )

As of October 1, 2018, previously recognized expenses of \$5.4 million may be recovered in future periods if subsequent BMF contributions exceed expenditures.

## Note 15 — Earnings per Share (EPS)

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



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

	Three Months		Nine Months	
	Ended		Ended	
	October 1,	October 2,	October 1,	October 2,
	2018	2017	2018	2017
(in thousands, except per share data)	(unaudited) (as adjusted)		(unaudited) (as adjusted)	
<b>Earnings:</b>				
Net (loss) income	\$ (639 )	\$ (2,678 )	\$ 2,327	\$ (13,970)
<b>Shares:</b>				
Weighted average common shares outstanding	16,945	16,882	16,924	16,863
Dilutive effect of restricted equity awards <sup>(1)</sup>	—	—	39	—
Diluted weighted average number of shares outstanding	16,945	16,882	16,963	16,863
<b>(Loss) earnings per share:</b>				
Basic (loss) earnings per share	\$ (0.04)	\$ (0.16 )	\$ 0.04	\$ (0.83 )
Diluted (loss) earnings per share	\$ (0.04)	\$ (0.16 )	\$ 0.04	\$ (0.83 )

The Company's securities that provide a right to receive common stock in the future such as stock options and restricted stock were not included in the computation of diluted EPS for the three months ended October 1, 2018 and the three and nine months ended October 2, 2017, as the effect of including these shares in the calculation would have been anti-dilutive.

For the three months ended October 1, 2018, and October 2, 2017, an aggregated total of 0.6 million shares and 0.8 million shares, respectively, have been excluded from the diluted EPS calculation because their effect would have been anti-dilutive. For the nine months ended October 1, 2018, and October 2, 2017, an aggregated total of 0.6 million shares and 1.0 million shares, respectively, have been excluded from the diluted EPS calculation because their effect would have been anti-dilutive.

#### Note 16 — Commitments and Contingencies

##### Legal proceedings

The Company is from time to time involved in litigation, certain other claims and arbitration matters arising in the ordinary course of business. The Company accrues a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of the probability of a loss and the determination as to whether a loss is reasonably estimable. These accruals are reviewed at least quarterly and adjusted to reflect the effects of negotiations, settlements, rulings, advice of legal counsel and technical experts and other information and events pertaining to a particular matter. To the extent there is a reasonable possibility (within the meaning of Accounting Standards Codification ("ASC") 450) that losses could exceed amounts already accrued, if any, and the additional loss or range of loss is able to be estimated, the Company discloses the additional loss or range of loss.

In some instances, the Company is unable to reasonably estimate any potential loss or range of loss. The nature and progression of litigation can make it difficult to predict the impact a particular lawsuit will have on its business. There are many reasons that the Company cannot make these assessments, including, among others, one or more of the following: the early stages of a proceeding; damages sought that are unspecified, unsupported, unexplained or uncertain; discovery not having been started or incomplete; the complexity of the facts that are in dispute; the difficulty of assessing novel claims; the parties not having engaged in any meaningful settlement discussions; the possibility that other parties may share in any ultimate liability; and/or the often slow pace of litigation.

The Company currently is subject to litigation with a group of its franchise owners. In January 2014, six franchise owner groups claimed that the Company misrepresented its sales volumes, made false representations to them and charged excess advertising fees, among other things. The Company engaged in mediation with these franchise owners, which is required under the terms of their franchise agreements, in order to address and resolve their claims, but was unable to reach a settlement agreement. On April 4, 2014, a total of 12 franchise owner groups, including those franchise owners that previously made the allegations described above, filed a lawsuit against the Company in the

Superior Court in Clark County, Washington, making essentially the same allegations for violation of the Washington Franchise Investment Protection Act, fraud, negligent misrepresentation and breach of contract, and seeking declaratory and injunctive relief, as well as monetary damages. Based on motions filed by the Company in that lawsuit, the court ruled on July 9, 2014, that certain of the plaintiffs' claims under the anti-fraud and nondisclosure provisions of the Washington Franchise Investment Protection Act should be dismissed and that certain other claims in the case would need to be more specifically alleged. The court also ruled that the six franchise owner groups who had not mediated with the Company prior to filing the lawsuit must mediate with the Company in good faith, and that their claims shall be stayed until they have done so.

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

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

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

In June 2017, the parties moved for summary judgment. The Company moved for summary judgment against two of the remaining franchise owner groups, the board of directors members moved for summary judgment on all claims against them, and the plaintiffs moved for summary judgment against all defendants on their Washington Consumer Protection Act and Washington Franchise Investment Protection Act claims. A hearing on the summary judgment motions was held on October 13, 2017.

In July 2017, the Company engaged in mediation with the remaining 15 franchise owner groups in the consolidated lawsuits. As a result of that mediation and other efforts, the Company reached resolutions with six of the remaining franchise owner groups, and their claims have been dismissed.

In April 2018, the Company reached resolution with four of the remaining franchise owner groups, conditioned upon dismissal of their claims.

In June 2018, the Company reached resolution with an additional franchise owner group.

On June 29, 2018, the Court granted the Company's motion to strike the remaining franchise owner groups' jury demand. The Court denied the Company's motion for separate trials, because at the time of the hearing there were only two franchise owner groups remaining in the case, based on tentative settlements with two other groups.

In July 2018, the Company entered into final settlements with two of the aforementioned franchise owner groups.

In September 2018, the Company entered into a final settlement with an additional franchise owner group.

There is one group remaining in the case, with a trial scheduled to start in the spring of 2019 in the Superior Court in Clark County, Washington.

The Company is named as a defendant in a putative class action lawsuit filed by plaintiff John Lennartson on May 7, 2015, in the United States District Court for the Western District of Washington. The lawsuit alleges the Company failed to comply with the requirements of the Telephone Consumer Protection Act ("TCPA") when it sent SMS text messages to consumers. Mr. Lennartson asks that the court certify the putative class and that statutory damages under the TCPA be awarded to plaintiff and each class member. On October 14, 2016, the Federal Communications Commission ("FCC") granted the Company a limited waiver from the TCPA's written consent requirements for certain text messages that it sent up through October 16, 2013 to individuals who, like Mr. Lennartson, provided written consent prior to October 16, 2013. On October 20, 2016, the Company filed a motion for summary judgment seeking dismissal. On October 27, 2016, Mr. Lennartson filed a motion seeking to extend the time to respond to the summary judgment motion on the basis that he intends to appeal the FCC's waiver. On November 4, 2016, the Court granted Mr. Lennartson's motion to continue his response to the Company's summary judgment motion until he could complete his appeal of the FCC's waiver order. In addition, on January 9, 2017, Mr. Lennartson filed an amended complaint adding additional plaintiffs, some of whom provided consent after October 16, 2013, and who are therefore differently situated from Mr. Lennartson, as well as additional Washington state law claims. On October 27, 2017, plaintiffs moved to certify their putative class, which the Company opposed, and on November 22, 2017, the Company moved for summary judgment on all of plaintiffs' claims. The Court issued a stay of the case for 30 days while the parties

pursued settlement negotiations. On April 23, 2018, the parties entered into a Settlement Agreement and Release and plaintiffs filed a Motion and Memorandum for Preliminary Approval of Settlement with the Court. The Court gave preliminary approval to the settlement on May 16, 2018, in its Preliminary Approval Order Approving Settlement, Certifying Settlement Class, Approving Notice Plan, and Setting Fairness Hearing. The Court gave final approval to the settlement on September 28, 2018, in its Amended Final Order Approving Class Action Settlement, which resulted in the settlement and release of all claims, subject to appeal.

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In addition to the foregoing, the Company is subject to routine legal proceedings, claims and litigation in the ordinary course of its business. The Company may also engage in future litigation with franchise owners to enforce the terms of franchise agreements and compliance with brand standards as determined necessary to protect the Company's brand, the consistency of products and the customer experience. Lawsuits require significant management attention and financial resources and the outcome of any litigation is inherently uncertain. The Company does not, however, currently expect that the costs to resolve these routine matters will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

## Note 17 — Segment Information

As a result of changes in the Company's executive management responsibilities, effective January 2, 2018, the Company changed its reportable segments by combining its domestic and international franchise business into a single Franchise segment and separating its Brand Funds business into a separate reportable segment. No changes were made to the Company's Company Stores segment. Management believes this change better reflects the priorities and decision making analysis around the allocation of the Company's resources. Prior period results for the affected segments have been retrospectively revised to reflect this change.

The Company now has the following reportable segments: (i) Franchise; (ii) Company Stores; and (iii) Brand Funds. The Franchise segment includes operations with respect to franchised stores and derives its revenues primarily from franchise and development fees and franchise royalties from franchised stores. The Company Stores segment includes operations with respect to Company-owned stores and derives its revenues from retail sales of pizza and side items to the general public. The Brand Funds segment includes the Brand Marketing Fund and the Company's Convention Fund.

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

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

	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
	(unaudited)	(as adjusted)	(unaudited)	(as adjusted)
(in thousands)				
Revenues				
Franchise segment	\$10,361	\$9,610	\$32,886	\$31,432
Brand Funds segment	6,552	7,000	17,673	22,931
Intersegment eliminations	(1,041 )	(439 )	(3,683 )	(1,402 )
Franchise related	15,872	16,171	46,876	52,961
Company Stores segment	12,958	17,520	47,519	57,010
Total	\$28,830	\$33,691	\$94,395	\$109,971

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	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
(in thousands)	(unaudited)	(as adjusted)	(unaudited)	(as adjusted)
Segment Adjusted EBITDA				
Franchise	\$5,617	\$4,778	\$18,664	\$19,208
Company Stores	(462 )	312	529	1,637
Brand Funds	461	1,718	297	(3,814 )
Total reportable segments adjusted EBITDA	5,616	6,808	19,490	17,031
Corporate and unallocated	(950 )	(1,262 )	(3,108 )	(5,801 )
Depreciation and amortization	(1,662 )	(2,336 )	(5,677 )	(8,359 )
Interest expense, net	(1,254 )	(1,305 )	(3,842 )	(3,818 )
CEO transition and restructuring costs <sup>(1)</sup>	(27 )	(190 )	(390 )	(2,519 )
E-commerce impairment and transition costs <sup>(2)</sup>	—	—	(350 )	(9,124 )
Store divestitures, closures, and impairments <sup>(3)</sup>	(2,521 )	(5,981 )	(1,797 )	(8,595 )
Litigation settlement and reserves <sup>(4)</sup>	—	(463 )	(1,029 )	(463 )
(Loss) Income Before Income Taxes	\$(798 )	\$(4,729 )	\$3,297	\$(21,648 )

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

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

(3) For 2018, represents primarily net losses on the refranchising of Company-owned stores primarily from the recording of contingent liabilities for committed marketing support expenditures in addition to impairments for Company-owned stores held for sale. For 2017, represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores.

(4) Accruals made for litigation settlements.

	October 1, 2018	January 1, 2018
(in thousands)	(unaudited)	(as adjusted)
Total Assets		
Franchise	\$ 119,366	\$ 121,179
Company Stores	38,838	53,226
Brand Funds	492	509
Other <sup>(1)</sup>	87,131	87,201
Total	\$ 245,827	\$ 262,115

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

#### Note 18 — Subsequent Events

##### Senior secured credit facility

On November 6, 2018, PMI Holdings, Inc. entered into a second amendment to its Senior Credit Facility. The amendment, among other things, extends the term of the Senior Credit Facility by twelve months to August 2020 and reduces the revolving credit facility from \$20.0 million to \$7.5 million. In addition, the amendment increases the maximum leverage ratio, requires continuation of quarterly \$2.1 million installment payments through the new maturity date, and increases the applicable interest rate margins.

##### Notes payable

On October 25, 2018, Papa Murphy's Company Stores, Inc. signed a second amendment to its note payable which extends the maturity date of the note to January 2019.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited

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consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. To match our operating cycle, we use a 52- or 53-week fiscal year, ending on the Monday nearest to December 31. Our fiscal quarters each contain 13 operating weeks, with the exception of the fourth quarter of a 53-week fiscal year, which contains 14 operating weeks. Fiscal year 2018 is a 52-week period ending on December 31, 2018, and fiscal year 2017 was a 52-week period ended on January 1, 2018.

### Cautionary Note Regarding Forward-Looking Statements

In addition to historical information, this discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors including, but not limited to, those discussed in the section entitled “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. All statements other than statements of historical fact or relating to present facts or current conditions included in this discussion and analysis are forward-looking statements. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. Examples of forward-looking statements include those regarding our future financial or operating results, cash flows, sufficiency of liquidity, financing resources, business strategies and priorities, shift in mix of marketing efforts, resolution of litigation and claims, expansion and growth opportunities, the mix of new store openings, our refranchising initiative, the reduction in the number of Company-owned stores, adoption of new accounting standards and the estimated effect of those new standards, our qualification as an “emerging growth company,” as well as industry trends and outlooks. These statements may include words such as “anticipate,” “estimate,” “expect,” “project,” “plan,” “intend,” “believe,” “may,” “can have,” “likely” and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events.

The forward-looking statements contained in this discussion and analysis are based on assumptions that we have made in light of our industry experience and our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. As you read and consider this discussion and analysis, you should understand that these statements are not guarantees of performance or results.

They involve risks, uncertainties (many of which are beyond our control) and assumptions. Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual operating and financial performance and cause our performance to differ materially from the performance anticipated in the forward-looking statements. We believe these factors include, but are not limited to, those described under the section entitled “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. Should one or more of these risks or uncertainties materialize, or should any of these assumptions prove incorrect, our actual operating and financial performance may vary in material respects from expectations based on these forward-looking statements.

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

### 2018 Highlights

#### Revenue

Total revenues for the three months ended October 1, 2018, compared to the three months ended October 2, 2017, declined 14.4% from \$33.7 million to \$28.8 million. Total revenues for the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, declined 14.2% from \$110.0 million to \$94.4 million. In both comparative periods, the declines in total revenues were due to (i) a decline in Company-owned store sales attributable to the refranchising of 29 and closure of six Company-owned stores since October 2, 2017, and (ii) a decline in royalties and advertising fees due to negative comparable store sales as noted below and a net decline of 47 franchise stores since October 2, 2017 (14 stores opened, 90 stores closed, and 29 stores refranchised).

Comparable store sales in 2018 compared to 2017 for selected segments were as follows:



	Three Months Ended		Nine Months Ended	
	October 2018	October 2017	October 1, 2018	October 2, 2017
Franchise	(1.8)%	(4.2)%	(2.7)%	(4.2)%
Company Stores	(6.9)%	(2.7)%	(4.5)%	(6.6)%
Total	(2.1)%	(4.1)%	(2.9)%	(4.5)%

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Comparable store sales for the three and nine months ended October 1, 2018 were lower compared to the same periods in the prior year primarily as a result of continued competitive headwinds and both convenience and relevance gaps.

**Refranchising**

In recent years, we had focused our financial resources on accelerating the build out of several markets with Company-owned stores. Consistent with our current strategy, we are now working to refranchise a significant number of our Company-owned stores to experienced and well-capitalized franchisees who can further grow these markets. During the nine months ended October 1, 2018, we refranchised 29 Company-owned stores, 20 in Colorado, seven in Texas, and two in Arkansas. Our target is to continue reducing the number of Company-owned stores to no more than 50 stores by 2020.

**Store Development**

During the three and nine months ended October 1, 2018, our franchise owners opened two and eight stores, respectively, and we did not open any Company-owned stores. While we operate some stores as Company-owned stores, we expect the majority of our new store expansion to continue to come from new franchised store openings.

**E-commerce**

On March 15, 2018, as previously announced, we completed our switchover to a third-party's e-commerce platform to accelerate progress on our convenience strategy. We have seen positive results to date as the average transaction amount continues to be about 20% higher for online orders than for in-store orders. We strategically use online-only promotions communicated through text and email messaging. The new platform enables online and mobile ordering to be fully integrated with third-party marketplace and delivery services, where available. As part of the transition, we incurred \$350,000 in non-recurring conversion costs during the nine months ended October 2, 2017.

**Accounting Standards**

We adopted the new accounting standards for revenue recognition and leases effective January 2, 2018. These new standards had a material impact on our condensed consolidated financial statements. Beginning in fiscal year 2018, our financial results reflect adoption of the standards with prior periods restated accordingly. For the three and nine months ended October 2, 2017, the retrospective adoption of the revenue and lease standards decreased our net income by \$809,000 and \$499,000 and decreased our earnings per diluted share by \$0.05 and \$0.03, respectively. Refer to Recently Adopted Accounting Standards under Note 1 — Description of Business and Basis of Presentation (Part I, Item 1 of this Form 10-Q) for further discussion.

**Key Operating Metrics**

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

	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
Store average weekly sales	\$9,660	\$9,593	\$10,225	\$10,235
Comparable store sales	(2.1 )%	(4.1 )%	(2.9 )%	(4.5 )%
Comparable stores	1,442	1,483	1,442	1,483
System-wide sales (in thousands)	\$184,163	\$192,903	\$594,062	\$623,049
System-wide stores	1,460	1,542	1,460	1,542
Adjusted EBITDA (in thousands)	\$4,666	\$5,546	\$16,382	\$11,230

**Average Weekly Sales**

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

Table of Contents**Comparable Store Sales**

Comparable store sales represents the change in year-over-year sales for comparable stores. A comparable store is a store open for at least 52 full weeks from the comparable date (the Tuesday following the opening date). Comparable store sales reflects changes in the number of transactions and in customer spend per transaction at existing stores. Customer spend per transaction is affected by changes in menu prices, sales mix, and the number of items sold per customer.

**System-Wide Sales**

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

**Store Openings, Closures, Acquisitions, and Divestitures**

We review the number of new stores, the number of closed stores, and the number of acquired and divested stores to assess growth in system-wide sales, royalty revenues, and Company-owned store sales. We operate through a footprint of 1,460 stores as of October 1, 2018, of which 92.3% are franchised, located in 37 states plus Canada and the Middle East. The following table presents the changes in the number of stores in our system for the nine months ended October 1, 2018.

	Franchise		Total Franchise	Company Stores	Total
	Domestic	International			
Store count at January 1, 2018	1,338	40	1,378	145	1,523
Openings	7	1	8	—	8
Closings	(67 )	(1 )	(68 )	(3 )	(71 )
Net transfers <sup>(1)</sup>	29	—	29	(29 )	—
Store count at October 1, 2018	1,307	40	1,347	113	1,460

Net transfers are the number of franchised stores acquired by us, less the number of Company-owned stores (1)refranchised. During this period, the Company refranchised 29 Company-owned stores and did not acquire any franchised stores.

**EBITDA and Adjusted EBITDA**

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

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

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

Management uses Adjusted EBITDA and other similar measures:

in comparing our operating performance on a consistent basis;

to calculate incentive compensation for our employees;

for planning purposes, including the preparation of our internal annual operating budget; and

to evaluate the performance and effectiveness of our operational strategies.

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

Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

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although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect the cash requirements for such replacements; and Adjusted EBITDA does not reflect our tax expense or the cash requirements to pay our taxes.

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

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

	Three Months		Nine Months	
	Ended		Ended	
(in thousands)	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
Net (Loss) Income	\$(639 )	\$(2,678 )	\$2,327	\$(13,970)
Depreciation and amortization	1,662	2,336	5,677	8,359
(Benefit from) provision for income taxes	(159 )	(2,051 )	970	(7,678 )
Interest expense, net	1,254	1,305	3,842	3,818
EBITDA	\$2,118	\$(1,088 )	\$12,816	\$(9,471 )
CEO transition and restructuring costs <sup>(1)</sup>	27	190	390	2,519
E-commerce impairment and transition costs <sup>(2)</sup>	—	—	350	9,124
Store divestitures, closures, and impairments <sup>(3)</sup>	2,521	5,981	1,797	8,595
Litigation settlement and reserves <sup>(4)</sup>	—	463	1,029	463
Adjusted EBITDA	\$4,666	\$5,546	\$16,382	\$11,230

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

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

(3) For 2018, represents primarily net losses on the refranchising of Company-owned stores primarily from the recording of contingent liabilities for committed marketing support expenditures in addition to impairments for Company-owned stores held for sale. For 2017, represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores.

(4) Accruals made for litigation settlements.

#### Our Segments

As a result of changes in our executive management responsibilities, effective January 2, 2018 we changed our reportable segments by combining our domestic and international franchise business into a single Franchise segment and separating the Brand Funds business into a separate reportable segment. Management believes this change better reflects the priorities and decision-making analysis around the allocation of our resources. Prior period results for the affected segments have been retrospectively revised to reflect this change.

We operate in three business segments: Franchise, Company Stores, and Brand Funds. Our Franchise segment consists of our franchised stores, our Company Stores segment consists of our Company-owned stores, and our Brand Funds segment consists of our BMF and our Convention Fund.

Our Chief Operating Decision Maker (“CODM”) uses segment adjusted EBITDA as the primary measure of segment performance to allocate resources. The CODM believes this measure provides an enhanced basis for consistently measuring segment performance against operational objectives and strategies. Segment adjusted EBITDA excludes certain unallocated and corporate expenses, which include costs related to our board of directors, CEO, CFO, and certain legal expenses. Although segment adjusted EBITDA is not a measure of financial condition or performance determined in accordance with GAAP, we use segment adjusted EBITDA to compare the operating performance of our segments on a consistent basis and to evaluate the performance and effectiveness of our operational strategies. Our calculation of segment adjusted EBITDA may not be comparable to that reported by other companies.



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

(in thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
<b>Revenues</b>				
Franchise segment	\$ 10,361	\$ 9,610	\$ 32,886	\$ 31,432
Brand Funds segment	6,552	7,000	17,673	22,931
Intersegment eliminations	(1,041 )	(439 )	(3,683 )	(1,402 )
Franchise related	15,872	16,171	46,876	52,961
Company Stores segment	12,958	17,520	47,519	57,010
Total	\$ 28,830	\$ 33,691	\$ 94,395	\$ 109,971
(in thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
<b>Segment Adjusted EBITDA</b>				
Franchise			\$ 5,617	\$ 4,778
Company Stores			\$ 18,664	\$ 19,208
Brand Funds			(462 )	312
Total reportable segments adjusted EBITDA			529	1,637
Corporate and unallocated			461	1,718
Adjusted EBITDA			297	(3,814 )
Depreciation and amortization			5,616	6,808
Interest expense, net			19,490	17,031
CEO transition and restructuring costs <sup>(1)</sup>			(950 )	(1,262 )
E-commerce impairment and transition costs <sup>(2)</sup>			(3,108 )	(5,801 )
Store divestitures, closures, and impairments <sup>(3)</sup>			4,666	5,546
Litigation settlement and reserves <sup>(4)</sup>			16,382	11,230
(Loss) Income Before Income Taxes			(1,662 )	(2,336 )
			(5,677 )	(8,359 )
			(1,254 )	(1,305 )
			(3,842 )	(3,818 )
			(27 )	(190 )
			(390 )	(2,519 )
			—	—
			(350 )	(9,124 )
			(2,521 )	(5,981 )
			(1,797 )	(8,595 )
			—	(463 )
			(1,029 )	(463 )
			\$(798 )	\$(4,729 )
			\$ 3,297	\$(21,648)

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

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

For 2018, represents primarily net losses on the refranchising of Company-owned stores primarily from the recording of contingent liabilities for committed marketing support expenditures in addition to impairments for Company-owned stores held for sale. For 2017, represents primarily non-cash charges associated with the impairment and disposal of store assets upon the decision to close stores.

(4) Accruals made for litigation settlements.

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## Results of Operations

The following table sets forth our results of operations in dollars and as a percentage of total revenues for the three and nine months ended October 1, 2018, and October 2, 2017. Prior year numbers have been adjusted to reflect the impacts of adopting ASU 2014-09 (the new revenue accounting standard) and ASU 2016-02 (the new lease accounting standard). See Recently Adopted Accounting Standards under Note 1 — Description of Business and Basis of Presentation for more information on these two standards and a reconciliation of results as previously reported to adjusted results as presented below.

(dollars in thousands)	Three Months Ended				Nine Months Ended				
	October 1, 2018		October 2, 2017		October 1, 2018		October 2, 2017		
	Total	% of	Total	% of	Total	% of	Total	% of	
	\$	% of	\$ <sup>(1)</sup>	% of	\$	% of	\$ <sup>(1)</sup>	% of	
		Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	
Revenues									
Franchise related	\$15,872	55.1 %	\$16,171	48.0 %	\$46,876	49.7 %	\$52,961	48.2 %	
Company-owned stores	12,958	44.9 %	17,520	52.0 %	47,519	50.3 %	57,010	51.8 %	
Total revenues	28,830	100.0 %	33,691	100.0 %	94,395	100.0 %	109,971	100.0 %	
Costs and Expenses									
Store operating costs:									
Cost of food and packaging <sup>(2)</sup>	4,216	14.6 %	5,858	17.3 %	15,657	16.5 %	19,376	17.7 %	
Compensation and benefits <sup>(2)</sup>	4,341	15.1 %	5,478	16.3 %	15,183	16.1 %	17,735	16.1 %	
Advertising <sup>(2)</sup>	1,147	4.0 %	1,604	4.8 %	3,700	3.9 %	5,055	4.6 %	
Other store operating costs <sup>(2)</sup>	2,720	9.4 %	3,012	8.9 %	8,925	9.5 %	10,255	9.3 %	
Selling, general, and administrative	11,710	40.6 %	12,517	37.2 %	36,146	38.4 %	49,042	44.6 %	
Depreciation and amortization	1,662	5.8 %	2,336	6.9 %	5,677	6.0 %	8,359	7.6 %	
Loss on disposal or impairment of property and equipment	2,521	8.7 %	6,253	18.6 %	1,808	1.9 %	17,830	16.2 %	
Total costs and expenses	28,317	98.2 %	37,058	110.0 %	87,096	92.3 %	127,652	116.1 %	
Operating Income (Loss)	513	1.8 %	(3,367)	(10.0)%	7,299	7.7 %	(17,681)	(16.1)%	
Interest expense, net	1,254	4.4 %	1,305	3.8 %	3,842	4.0 %	3,818	3.5 %	
Other expense, net	57	0.2 %	57	0.2 %	160	0.2 %	149	0.1 %	
(Loss) Income Before Income Taxes	(798)	(2.8)%	(4,729)	(14.0)%	3,297	3.5 %	(21,648)	(19.7)%	
(Benefit from) provision for income taxes	(159)	(0.6)%	(2,051)	(6.1)%	970	1.0 %	(7,678)	(7.0)%	
Net (Loss) Income	\$(639)	(2.2)%	\$(2,678)	(7.9)%	\$2,327	2.5 %	\$(13,970)	(12.7)%	

Prior year numbers have been adjusted to reflect the impacts of adopting ASU 2014-09 (the new revenue accounting standard) and ASU 2016-02 (the new lease accounting standard). See Recently Adopted Accounting Standards under Note 1 — Description of Business and Basis of Presentation for more information on these two standards and a reconciliation of results as previously reported to adjusted results as presented above.

Please see the table presented under Costs and Expenses below, which presents Company-owned store expenses as a percentage of Company-owned store sales for the three and nine months ended October 1, 2018, and October 2, 2017.

## Revenues

Total revenues. In the three months ended October 1, 2018, total revenues decreased compared to the three months ended October 2, 2017, primarily due to (a) a decline in comparable store sales of 2.1%, (b) a decline in the number of Company-owned and franchise stores period-over-period; and (c) the elimination of an incremental advertising fee of 0.85% of sales charged to all franchise stores only in fiscal year 2017 to help fund the test of national advertising in the first quarter of 2017.



In the nine months ended October 1, 2018, total revenues decreased compared to the nine months ended October 2, 2017, primarily due to (a) a decline in comparable store sales of 2.9%, (b) a decline in the number of Company-owned and franchise stores period-over-period; and (c) the elimination of an incremental advertising fee of 0.85% of sales charged to all franchise stores only in fiscal year 2017 to help fund the test of national advertising in the first quarter of 2017.

Franchise revenues. Franchise revenues decreased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017, primarily due to (a) a decline in Franchise comparable store sales of 1.8%, (b) a net decline of 47 franchise stores period-over-period, and (c) the elimination of an incremental advertising fee of 0.85% of sales charged to all franchise stores only in fiscal year 2017 to help fund the test of national advertising in the first quarter of 2017.

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Franchise revenues decreased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, primarily due to (a) a decline in Franchise comparable store sales of 2.7%, (b) a net decline of 47 franchise stores period-over-period, and (c) the elimination of an incremental advertising fee of 0.85% of sales charged to all franchise stores only in fiscal year 2017 to help fund the test of national advertising in the first quarter of 2017.

Company-owned stores revenue. Company-owned stores revenue decreased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017, primarily due to a decline in comparable store sales of 6.9% and a reduction in the number of Company-owned stores period-over-period due to the refranchising of 29 and closure of six Company-owned stores since October 2, 2017.

Company-owned stores revenue decreased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, primarily due to a decline in comparable store sales of 4.5% in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, and a reduction in the number of Company-owned stores period-over-period due to the refranchising of 29 and closure of six Company-owned stores since October 2, 2017.

**Costs and Expenses**

Total costs and expenses. Total costs and expenses decreased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017, primarily as a result of impairments to our Company-owned store assets recorded in the three months ended October 2, 2017.

Total costs and expenses decreased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, primarily as a result of additional advertising costs incurred during the first quarter of 2017 associated with the national advertising test, impairments to our former e-commerce platform during the second quarter of 2017, and the aforementioned impairments to Company-owned store assets recorded in the three months ended October 2, 2017.

Store operating costs. Store operating costs as a percentage of total revenues increased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017 and decreased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017. The following table presents the components of store operating costs as a percentage of Company-owned store sales for the periods reported:

	Three Months Ended October 1, 2018		Nine Months Ended October 2, 2017	
Store operating costs as a % of Company-owned store sales:				
Cost of food and packaging	32.5%	33.4 %	32.9%	34.0 %
Compensation and benefits	33.5%	31.3 %	32.0%	31.1 %
Advertising	8.9 %	9.2 %	7.8 %	8.9 %
Occupancy and other store operating costs	21.0%	17.2 %	18.8%	18.0 %
Total store operating costs	95.9%	91.1 %	91.5%	92.0 %

Total store operating costs as a percentage of Company-owned store sales increased by 480 basis points overall and decreased by 50 basis points overall, respectively, in the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017, due primarily to the effect of Company-owned store portfolio changes in select markets and as further explained below:

Cost of food and packaging. Food and packaging costs declined during the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017 primarily due to decreases in commodity prices and the closing of six stores since October 2, 2017 that had lower sales and higher food costs as a percentage of store sales than the system average.

Compensation and benefits. Compensation and benefits increased during the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017 primarily due to minimum wage increases in markets where we have Company-owned stores.

Advertising costs. Advertising costs decreased in the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017 primarily due to reduced levels of spending on advertising during the third quarter ended October 1, 2018.

Occupancy and other store operating costs. The increase in occupancy and other store operating costs as a percentage of Company-owned store sales during the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017 was primarily a result of gains on the settlement of lease liabilities recorded during the three months ended October 2, 2017, partially offset by increased repairs and maintenance expenditures during the three months ended October 1, 2018.

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Selling, general, and administrative. Selling, general, and administrative costs decreased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017, primarily as a result of reduced spending on compensation and benefits in the three months ended October 1, 2018 and legal settlement costs recorded in the three months ended October 2, 2017.

Selling, general, and administrative costs decreased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, primarily as a result of Brand Marketing Fund expenses incurred in 2017 associated with our first test of a national media campaign, and severance and restructuring costs incurred in 2017 associated with executive turnover and staff reductions.

Depreciation and amortization. Depreciation and amortization decreased in the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017, due to a reduction in our depreciable asset base as a result of having fewer Company-owned stores period-over-period and the recording of impairment charges for our former e-commerce platform and Company-owned stores in four markets during 2017.

Interest expense, net. Interest expense, net decreased in the three months ended October 1, 2018, compared to the three months ended October 2, 2017, due to a reduction in the total amount of debt outstanding period-over-period, partially offset by increased average interest rates. Interest expense, net increased in the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, due to increased average interest rates, partially offset by a reduction in the total amount of debt outstanding period-over-period.

Income taxes. The (benefit from) provision for income taxes decreased in the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017, primarily due to the Federal corporate tax rate reduction made by the Tax Cuts and Jobs Act (the "2017 Tax Act").

The effective tax rate for the three months ended October 1, 2018, was 19.9% compared to 43.4% for the three months ended October 2, 2017. The effective income tax rate decreased primarily due to the Federal corporate tax rate reduction made by the 2017 Tax Act.

The effective tax rate for the nine months ended October 1, 2018, was 29.4% compared to 35.5% for the nine months ended October 2, 2017. The effective income tax rate decreased primarily as a result of the Federal corporate tax rate reduction made by the 2017 Tax Act and from the negative impact of a discrete adjustment for share-based compensation expense recorded for vesting restricted common shares recorded earlier in the prior year. Our income taxes have varied from what would be expected from the application of prevailing statutory rates mainly due to the effect of meal and entertainment expenses and share-based compensation expenses.

**Segment Results**

Franchise. Total revenues for the Franchise segment increased \$0.8 million and \$1.5 million in the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017, respectively, primarily due to a change in intersegment revenues. Starting in fiscal year 2018, a royalty fee, comparable to what is charged to franchised stores, is charged to each Company-owned store. This royalty fee replaces the corporate overhead allocation that was in place through fiscal year 2017. This change increased Franchise intersegment revenues for the three and nine months ended October 1, 2018 by \$0.6 million and \$2.3 million, respectively, compared to the three and nine months ended October 2, 2017. This increase in Franchise revenues was partially offset by declines in Franchise royalty revenues of \$0.3 million and \$1.2 million for the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017, respectively, as a result of a decline in Franchise comparable store sales of 1.8% and 2.7%, respectively, and a reduction in the number of franchised stores period-over-period.

Adjusted EBITDA for the Franchise segment increased \$0.8 million and decreased \$0.5 million in the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017, respectively, primarily due to the aforementioned changes in the corporate overhead cost allocation methodology and declines in royalty revenues.

Company Stores. Total revenues for the Domestic Company Stores segment decreased \$4.6 million and \$9.5 million in the three and nine months ended October 1, 2018 compared to the three and nine months ended October 2, 2017, respectively, primarily due to declines in comparable store sales of 6.9% and 4.5%, respectively, and a reduction in the number of Company-owned stores period-over-period.

Adjusted EBITDA for the Domestic Company Stores segment decreased \$0.8 million and \$1.1 million in the three and nine months ended October 1, 2018, respectively, compared to the three and nine months ended October 2, 2017, primarily as a result of the aforementioned decline in revenues at Company-owned stores, the closure of six underperforming stores since October 2, 2017 and the aforementioned change to the corporate overhead cost allocation methodology.

Brand Funds. Total revenues for the Brand Funds segment decreased \$0.4 million and \$5.3 million for the three and nine months ended October 1, 2018, compared to the three and nine months ended October 2, 2017, respectively, primarily as a

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result of declines in comparable domestic store sales of 2.2% and 2.8%, respectively, and fewer domestic stores period-over-period. Additionally, for the nine month comparable periods, Brand Funds revenues declined due to the elimination of the incremental advertising fee of 0.85% of sales charged to domestic stores in fiscal year 2017 to partially fund the test of national advertising in the first quarter of 2017.

Adjusted EBITDA from the Brand Funds segment decreased \$1.3 million for the three months ended October 1, 2018, compared to the three months ended October 2, 2017, primarily due to advertising spending patterns in 2017 that were heavily weighted toward the first quarter as a result of our test of national advertising and significantly lower during the third quarter of 2017.

Adjusted EBITDA from the Brand Funds segment increased \$4.1 million for the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, primarily due to the elimination of advertising expenditures associated with our test of national advertising during the nine months ended October 2, 2017.

The table below shows the net impact of the BMF on the Brand Funds segment's adjusted EBITDA and the current fund deficit. The Convention Fund had EBITDA of zero for the three and nine months ended October 1, 2018 and October 2, 2017, respectively, and a fund surplus of \$0.8 million and \$1.1 million as of October 1, 2018 and October 2, 2017, respectively.

(in thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2018	October 2, 2017	October 1, 2018	October 2, 2017
Opening BMF deficit	\$(5,877)	\$(6,604 )	\$(5,461)	\$(1,071 )
Net activity during the period	461	1,718	45	(3,815 )
Ending BMF deficit	\$(5,416)	\$(4,886 )	\$(5,416)	\$(4,886 )

**Liquidity and Capital Resources**

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

As of October 1, 2018, we had Cash and cash equivalents of \$3.4 million and \$20.0 million of available borrowings under a revolving line of credit, of which none was drawn. As of October 1, 2018, we had \$84.8 million of outstanding indebtedness. Principal payments under our Senior Credit Facility are due on the last day of each fiscal quarter through the life of the Senior Credit Facility. On November 6, 2018, we entered into a second amendment to our Senior Credit Facility that, among other things, extended the term of the Senior Credit Facility by twelve months to August 2020 and reduced the revolving line of credit from \$20.0 million to \$7.5 million. We believe that our cash flows from operations, available cash and cash equivalents, and available borrowings under our revolving credit facility will be sufficient to meet our liquidity needs for at least the next 12 months.

As of October 1, 2018, we were in compliance with all of our covenants and other obligations under our Senior Credit Facility.

For more information on the second amendment to our Senior Credit Facility, see Part II, Item 5 of this Quarterly Report on Form 10-Q.

**Cash Flows**

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

(in thousands)	Nine Months Ended	
	October 1, 2018	October 2, 2017
Cash flows from operating activities	\$5,019	\$8,224

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Cash flows from investing activities	7,186	(709	)
Cash flows from financing activities	(11,020)	(8,685	)
Total cash flows	\$1,185	\$(1,170	)

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### Cash Flows from Operating Activities

Net cash provided by operating activities of \$5.0 million for the nine months ended October 1, 2018, resulted primarily from net income of \$2.3 million, adjusted for items such as depreciation and amortization, gains and losses on the disposal or impairment of property and equipment, and changes in operating assets and liabilities. The \$3.2 million decrease for the nine months ended October 1, 2018, compared to the nine months ended October 2, 2017, was primarily driven by reduced spending on marketing during the first quarter of 2018 compared to the first quarter of 2017, which included our test of national advertising. This reduction in advertising spend was partially offset by lower advertising fee revenues due to the elimination of an incremental advertising fee of 0.85% of sales charged to all franchise stores only in fiscal year 2017 to help fund the test of national advertising in the first quarter of 2017.

### Cash Flows from Investing Activities

Net cash provided by investing activities was \$7.2 million for the nine months ended October 1, 2018, compared to net cash used of \$0.7 million for the nine months ended October 2, 2017. The \$7.9 million increase in cash provided by investing activities was due primarily to \$8.1 million in proceeds from the sale and refranchising of 29 stores in the nine months ended October 1, 2018 compared to proceeds of \$2.2 million from the sale and refranchising of seven stores for the nine months ended October 2, 2017, and a period-over-period decrease of \$2.5 million in capital expenditures for property, plant, and equipment.

### Cash Flows from Financing Activities

Net cash used by financing activities was \$11.0 million for the nine months ended October 1, 2018, compared to net cash used of \$8.7 million for the nine months ended October 2, 2017. The \$2.3 million increase in net cash used by financing activities was primarily due to extra payments on our long-term debt and no net borrowings under our revolving credit facility during the nine months ended October 1, 2018.

### Critical Accounting Policies

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

The accounting policies we believe to be most critical to understanding our financial results and condition and that require complex and subjective management judgments and estimates are identified and described in our annual consolidated financial statements and the notes included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. For a discussion of new accounting standards that have been issued by the FASB and have been adopted during the current year, see Note 1 — Description of Business and Basis of Presentation to the interim unaudited condensed consolidated financial statements in Part I, Item 1.

### JOBS Act

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



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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

As a "smaller reporting company", we are not required to provide the information required by this Item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

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**PART II — OTHER INFORMATION**

**Item 1. Legal Proceedings**

Except as set forth below, there have been no material developments in the legal proceedings described in Part I, Item 3, of our Annual Report on Form 10-K for the fiscal year ended January 1, 2018.

**Franchise Owner Litigation**

The Company currently is subject to litigation with a group of its franchise owners described in more detail in Part I, Item 3, of our Annual Report on Form 10-K for the fiscal year ended January 1, 2018 and in Note 16 — Commitments and Contingencies to the financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

In April 2018, the Company reached resolution with four of the remaining franchise owner groups, conditioned upon dismissal of their claims.

In June 2018, the Company reached resolution with an additional franchise owner group.

On June 29, 2018, the Superior Court in Clark County, Washington granted the Company's motion to strike the remaining franchise owner groups' jury demand. The Court denied the Company's motion for separate trials, because at the time of the hearing there were only two franchise owner groups remaining in the case, based on tentative settlements with two other groups.

In July 2018, the Company entered into final settlements with two of the aforementioned franchise owner groups.

In September 2018, the Company entered into a final settlement with an additional franchise owner group.

There is one franchise owner group remaining in the case, with a trial scheduled to start in the spring of 2019 in the Superior Court in Clark County, Washington.

**TCPA Litigation**

The Company currently is named as a defendant in a putative class action lawsuit alleging the Company failed to comply with the requirements of the Telephone Consumer Protection Act ("TCPA") when it sent SMS text messages to consumers. This litigation is described in more detail in Part I, Item 3, of our Annual Report on Form 10-K for the fiscal year ended January 1, 2018 and in Note 16 — Commitments and Contingencies to the financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

On April 23, 2018, the parties entered into a Settlement Agreement and Release and plaintiffs filed a Motion and Memorandum for Preliminary Approval of Settlement with the United States District Court for the Western District of Washington. The Court gave preliminary approval to the settlement on May 16, 2018, in its Preliminary Approval Order Approving Settlement, Certifying Settlement Class, Approving Notice Plan, and Setting Fairness Hearing. The Court gave final approval to the settlement on September 28, 2018, in its Amended Final Order Approving Class Action Settlement, which resulted in the settlement and release of all claims, subject to appeal.

**Item 1A. Risk Factors**

An investment in our common stock involves a high degree of risk. A detailed discussion of our risk factors is included under the section title "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018. If any of these risks, as well as other risks and uncertainties that are not yet identified or that we currently think are immaterial, actually occur, our business, results of operations or financial condition could be materially and adversely affected. In such an event, the trading price of our common stock could decline and you could lose part or all of your investment. The risk factors and other information included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2018, should be carefully considered before making an investment decision relating to our common stock.

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

## Repurchases of Common Stock

During the three months ended October 1, 2018, the Company repurchased the following shares of common stock:

	Total Number of Shares Purchased	Average of Shares Price Paid per Share	Total Number Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 3 to July 31, 2018	—	\$ —	—	N/A
August 1 to August 31, 2018	—	—	—	N/A
September 1 to October 1, 2018	754	(1) 0.19	—	N/A
Total	754	\$ 0.19	—	N/A

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

## Item 5. Other Information

On November 6, 2018, PMI Holdings, Inc. (“PMI”), a wholly-owned subsidiary of the Company, entered into a Second Amendment to Credit Agreement (the “Second Amendment”), by and among PMI, the guarantors party thereto, the lenders party thereto and Wells Fargo Bank, National Association, as administrative agent on behalf of the other lenders under the Credit Agreement (as successor to Antares Capital LP (as successor to General Electric Capital Corporation), the “Administrative Agent”). The Second Amendment amends certain terms of our Credit Agreement that provides for our Senior Credit Facility, dated August 28, 2014, by and among PMI, as the borrower, the guarantors party thereto, the lenders party thereto and the Administrative Agent, as amended.

The Second Amendment provides for, among other things, (a) the extension of the maturity date from August 28, 2019 to August 28, 2020, (b) the continuation of scheduled quarterly principal payments on the outstanding term loan of \$2,100,000 per quarter, (c) the reduction in the revolving line of credit under the Senior Credit Facility from \$20,000,000 to \$7,500,000, (d) an increase in our maximum consolidated leverage ratio of 0.25x for the quarters ending April 1, 2019 and July 1, 2019, and (e) an increase in the applicable margin applicable to borrowings under the Senior Credit Facility of (i) 50 basis points if our maximum consolidated leverage ratio is equal to or less than 4.0x during the applicable measurement period and (ii) 75 basis points if our maximum consolidated leverage ratio is greater than 4.0x during the applicable measurement period.

As a condition to the effectiveness of the Second Amendment, we paid a customary amendment fee to the lenders consenting to the Second Amendment.

The above description of the material terms and conditions of the Second Amendment does not purport to be complete and is qualified in its entirety by reference to the full text of the Second Amendment, a copy of which is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q.

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## Item 6. Exhibits.

Exhibit Number	Description of Exhibits	Form Number	File Number	Exhibit	Filing Date
<u>10.1*</u>	<u>Second Amendment to Credit Agreement, dated as of November 6, 2018, among PMI Holdings, Inc., Wells Fargo Bank, National Association, and the other financial institutions party thereto.</u>				
<u>31.1*</u>	<u>Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>				
<u>31.2*</u>	<u>Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>				
<u>32.1*</u>	<u>Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>				
<u>32.2*</u>	<u>Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>				
101.INS*	XBRL Instance Document				
101.SCH*	XBRL Taxonomy Extension Schema Document				
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document				
* Filed herewith					

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SIGNATURES

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

PAPA MURPHY'S HOLDINGS,  
INC.

By: /s/ Nik Rupp

Name: Nik Rupp

Title: Chief Financial Officer

Date: November 7, 2018

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