

Papa Murphy's Holdings, Inc.
Form 10-Q
November 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 28, 2015

OR

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

For the transition period from to
Commission file number 001-36432

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

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)
8000 NE Parkway Drive, Suite 350
Vancouver, WA
(Address of principal executive offices)
(360) 260-7272
(Registrant's telephone number, including area code)

27-2349094
(IRS Employer
Identification No.)
98662
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No . Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes . No .

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

At October 30, 2015, there were 16,949,720 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

| (In thousands, except share and per share data) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Revenues | | | | |
| Franchise royalties | \$9,124 | \$ 8,965 | \$29,557 | \$ 28,349 |
| Franchise and development fees | 1,123 | 1,088 | 3,092 | 3,119 |
| Company-owned store sales | 17,604 | 11,626 | 52,927 | 35,121 |
| Lease and other | 281 | 490 | 845 | 2,543 |
| Total revenues | 28,132 | 22,169 | 86,421 | 69,132 |
| Costs and Expenses | | | | |
| Store operating costs: | | | | |
| Cost of food and packaging | 6,409 | 4,667 | 18,942 | 13,756 |
| Compensation and benefits | 4,918 | 3,000 | 13,994 | 8,935 |
| Advertising | 1,806 | 1,286 | 5,227 | 3,531 |
| Occupancy | 1,210 | 715 | 3,386 | 2,049 |
| Other store operating costs | 2,061 | 1,069 | 5,362 | 3,145 |
| Selling, general and administrative | 6,038 | 5,915 | 21,083 | 22,938 |
| Depreciation and amortization | 2,641 | 2,007 | 7,380 | 5,815 |
| Loss (gain) on disposal of property and equipment | 4 | (15 |) 66 | 27 |
| Total costs and expenses | 25,087 | 18,644 | 75,440 | 60,196 |
| Operating Income | 3,045 | 3,525 | 10,981 | 8,936 |
| Interest expense | 1,137 | 1,539 | 3,429 | 6,966 |
| Interest income | (4 |) (14 |) (23 |) (67 |
| Loss on early retirement of debt | — | 3,428 | — | 4,619 |
| Loss on disposal or impairment of investments | — | — | 4,500 | — |
| Other expense, net | 44 | 63 | 90 | 118 |
| Income (Loss) Before Income Taxes | 1,868 | (1,491 |) 2,985 | (2,700 |
| Provision for (benefit from) income taxes | 746 | (703 |) 1,206 | (1,124 |
| Net Income (Loss) | 1,122 | (788 |) 1,779 | (1,576 |
| Net loss attributable to noncontrolling interests | — | — | 500 | — |
| Net Income (Loss) Attributable to Papa Murphy's | \$1,122 | \$ (788 |) \$2,279 | \$ (1,576 |
| Earnings (loss) per share of common stock | | | | |
| Basic | \$0.07 | \$ (0.05 |) \$0.14 | \$ (0.35 |
| Diluted | \$0.07 | \$ (0.05 |) \$0.13 | \$ (0.35 |
| Weighted average common stock outstanding | | | | |
| Basic | 16,672,327 | 16,584,724 | 16,635,400 | 10,603,339 |
| Diluted | 16,919,504 | 16,584,724 | 16,893,575 | 10,603,339 |
| See accompanying notes. | | | | |

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Unaudited Condensed Consolidated Balance Sheets

| (In thousands, except par value and share data) | September 28, 2015 | December 29, 2014 |
|---|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 5,483 | \$ 5,056 |
| Accounts receivable, net of allowance for doubtful accounts of \$30 and \$60, respectively | 2,692 | 5,661 |
| Current portion of notes receivable | 71 | 62 |
| Inventories | 840 | 640 |
| Prepaid expenses and other current assets | 3,484 | 3,423 |
| Advertising cooperative assets, restricted | 284 | 149 |
| Current deferred tax asset | 1,969 | 1,338 |
| Total current assets | 14,823 | 16,329 |
| Property and equipment, net | 19,208 | 12,120 |
| Notes receivable, net of current portion | 168 | 225 |
| Goodwill | 106,740 | 101,082 |
| Trade name and trademarks | 87,002 | 87,002 |
| Definite-life intangibles, net | 42,683 | 44,515 |
| Other assets | 289 | 4,191 |
| Total assets | \$ 270,913 | \$ 265,464 |
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 8,396 | \$ 3,057 |
| Accrued expenses and other current liabilities | 9,217 | 9,600 |
| Advertising cooperative liabilities | 375 | 253 |
| Current portion of unearned franchise and development fees | 1,985 | 2,848 |
| Current portion of long-term debt | 3,500 | 2,800 |
| Total current liabilities | 23,473 | 18,558 |
| Long-term debt, net of current portion | 108,156 | 110,715 |
| Unearned franchise and development fees, net of current portion | 656 | 640 |
| Deferred tax liability | 41,668 | 42,069 |
| Other long-term liabilities | 2,263 | 1,740 |
| Total liabilities | 176,216 | 173,722 |
| Commitments and contingencies (Note 15) | | |
| Equity | | |
| Papa Murphy's Holdings, Inc. Shareholders' Equity | | |
| Preferred stock (\$0.01 par value; 15,000,000 shares authorized; no shares issued) | — | — |
| Common stock (\$0.01 par value; 200,000,000 shares authorized; 16,940,228 and 16,944,308 shares issued, respectively) | 169 | 169 |
| Additional paid-in capital | 118,473 | 117,354 |
| Stock subscriptions receivable | (100) | (100) |
| Accumulated deficit | (23,845) | (26,125) |
| Total Papa Murphy's Holdings, Inc. shareholders' equity | 94,697 | 91,298 |
| Noncontrolling interests | — | 444 |
| Total equity | 94,697 | 91,742 |
| Total liabilities and equity | \$ 270,913 | \$ 265,464 |

See accompanying notes.

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Unaudited Condensed Consolidated Statements of Cash Flows

| (In thousands) | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 28, 2015 | September 29, 2014 |
| Operating Activities | | |
| Net income (loss) | \$ 1,779 | \$ (1,576) |
| Net loss attributable to noncontrolling interests | 500 | — |
| Net income (loss) attributable to Papa Murphy's | 2,279 | (1,576) |
| Adjustments to reconcile to cash from operating activities | | |
| Depreciation and amortization | 7,380 | 5,815 |
| Loss on disposal of property and equipment | 66 | 27 |
| Loss on early retirement of debt | — | 4,619 |
| Bad debt expense | 325 | 12 |
| Non-cash employee equity compensation | 858 | 1,739 |
| Amortization of deferred finance charges | 241 | 470 |
| Loss on impairment of cost-method investment | 4,000 | — |
| Change in operating assets and liabilities | | |
| Accounts receivable | 2,652 | (2,778) |
| Prepaid expenses and other current assets | (101) | 867) |
| Unearned franchise and development fees | (847) | (76) |
| Accounts payable | 2,360 | (21) |
| Accrued expenses and other current liabilities | (356) | (2,385) |
| Deferred taxes | (1,032) | (1,217) |
| Other assets and liabilities | 112 | 61 |
| Cash from operating activities | 17,937 | 5,557 |
| Investing Activities | | |
| Acquisition of property and equipment | (5,502) | (3,036) |
| Acquisition of stores, less cash acquired | (9,524) | (647) |
| Proceeds from sale of stores | — | 153 |
| Issuance of notes receivable | (250) | — |
| Payments received on notes receivable | 49 | 960 |
| Investment in cost-method investee | (500) | (1,500) |
| Cash from investing activities | (15,727) | (4,070) |
| Financing Activities | | |
| Proceeds from issuance of long-term debt | — | 112,000 |
| Payments on long-term debt | (2,100) | (169,900) |
| Issuance of common stock, net of underwriting fees | — | 59,675 |
| Repurchases of common stock | (10) | (1,518) |
| Debt issuance and modification costs, including prepayment penalties | — | (2,626) |
| Payments received on subscription receivables | — | 1,097 |
| Costs associated with initial public offering | — | (3,490) |
| Proceeds from exercise of stock options | 271 | — |
| Investment by noncontrolling interest holders | 56 | 167 |
| Cash from financing activities | (1,783) | (4,595) |
| Net change in cash and cash equivalents | 427 | (3,108) |

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| | | |
|--|---------|----------|
| Cash and Cash Equivalents, beginning of year | 5,056 | 3,705 |
| Cash and Cash Equivalents, end of period | \$5,483 | \$ 597 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the period for interest | \$2,516 | \$ 6,667 |
| Cash paid during the period for income taxes | 2,178 | 110 |
| Deferred offering costs paid in 2013 reclassified to equity | — | 1,537 |
| Noncash Supplemental Disclosures of Investing and Financing Activities | | |
| Issuance of note payable for acquisition of stores | \$— | \$ 2,900 |
| Acquisition of property and equipment in accounts payable | \$3,206 | \$ 310 |
| See accompanying notes. | | |

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Papa Murphy's Holdings, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

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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 Take 'N' Bake pizza franchises and operates Take 'N' Bake pizza stores owned by the Company. As of September 28, 2015, the Company had 1,500 stores consisting of 1,466 domestic stores (1,340 franchised stores and 126 Company-owned stores) across 38 states, plus 34 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.

Public offering and stock split

On May 7, 2014, the Company completed an initial public offering (the "IPO") of 5,833,333 shares of common stock at a price to the public of \$11.00 per share. The Company received net proceeds from the offering of approximately \$54.6 million after offering fees and expenses. The net proceeds, along with additional cash on hand, were used to repay \$55.5 million of the Company's loans outstanding under the Company's then existing senior secured credit facility, after which the Company had \$112.1 million outstanding under the facility with the revolver undrawn.

Immediately prior to the IPO, the Company amended and restated its certificate of incorporation to reflect the conversion of all outstanding Series A Preferred Stock and Series B Preferred Stock (together, the "Preferred Shares") to 3,054,318 shares of common stock. In connection with the IPO, on May 1, 2014, the Company amended its certificate of incorporation to effect a 2.2630 for 1 stock split of its common stock. As a result of the stock split, all previously reported share and option amounts in these interim unaudited condensed consolidated financial statements and accompanying notes have been retrospectively restated to reflect the stock split. After the conversion of the Preferred Shares and the stock split, but before the shares were sold in the IPO, the Company had 11,134,070 common shares outstanding.

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 presentation 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 year ended December 29, 2014.

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 ("VIEs"). The Company reports noncontrolling interests in consolidated entities as a component of equity separate from shareholders' equity. 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 2015 and 2014 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 2015 and 2014 are references to fiscal years ending December 28, 2015, and ended December 29, 2014, respectively.

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Recent Accounting Pronouncements

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”). This update requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying value of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs were not affected by this update. The Company early-adopted ASU 2015-03 during the three months ended June 29, 2015. Applying the adoption retroactively, the Company reclassified unamortized debt issuance costs of \$1.2 million as of September 28, 2015, and \$1.5 million as of December 29, 2014, from Deferred finance charges, net to Long-term debt, net of current portion on the Condensed Consolidated Balance Sheets. Adoption of this standard did not affect the Company’s results of operations or cash flows in either the current or previous interim and annual reporting periods.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), a new standard to achieve a consistent application of revenue recognition within the U.S., resulting in a single revenue model to be applied by reporting companies under GAAP. ASU 2014-09 is effective for the Company in the first quarter of fiscal 2017 with early adoption prohibited. The standard is required to be applied retroactively to each prior reporting period presented or retroactively with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company has not yet selected a transition method. The standard will not affect the Company’s recognition of revenue from Company-owned restaurants or its recognition of franchise royalties, which are based on a percentage of franchise sales. The Company is continuing to evaluate the effect the adoption of this standard will have on the recognition of other less significant revenue transactions such as franchise and development fees as well as refranchising of Company-owned restaurants.

Note 2 — Acquisitions and Disposals

Project Pie Investment and Disposal

The Company, through a non-wholly owned subsidiary, Project Pie Holdings, LLC (“PPH”), made investments in Project Pie, LLC (“Project Pie”) in the form of Series A Convertible Preferred Units (the “Preferred Units”). Project Pie is a fast casual custom-pizza restaurant chain with stores located throughout the United States, the Philippines and Scotland.

In connection with its investment in Project Pie, PPH had committed as of December 29, 2014, to fund, upon demand, up to an additional \$0.5 million prior to December 2016 through the purchase of additional Series A Preferred Units of Project Pie. During the nine months ended September 28, 2015, PPH invested the additional \$0.5 million and satisfied its commitment to Project Pie.

The Company disposed of its ownership interests in PPH on June 29, 2015. Prior to the Company’s disposal of its ownership interests in PPH, it recorded a pre-tax impairment of \$4.5 million to its investment in Project Pie during the three months ended June 29, 2015.

Earlier in 2015, the Company determined that Project Pie was a VIE as a result of Project Pie having insufficient equity at risk, but that the Company did not have a variable interest in Project Pie and did not have control. The Company did not account for its investment in Project Pie as an equity method investment since the Company’s investment was in preferred units with subordination characteristics substantially different from the common units and were determined not to be in-substance common stock. The Company’s investment was classified as a cost method investment in Other assets.

Acquisitions in 2015

M2AD Acquisition

On March 9, 2015, Papa Murphy’s Company Stores, Inc. (“PMCSI”), a wholly-owned subsidiary of the Company, acquired certain assets used in the operation of six Papa Murphy’s stores in the Seattle, Washington, area from M2AD Management, Inc., the previous operator of the six Papa Murphy’s stores (the “M2AD Acquisition”). Transaction costs of \$30,000 associated with the M2AD Acquisition were recognized as Other store operating costs in the Condensed Consolidated Statements of Operations. The total purchase price was \$4.1 million, which included a holdback of \$6,000. As of September 28, 2015, PMCSI retained \$5,000 of the holdback amount. The M2AD Acquisition was funded through existing cash and was accounted for using the acquisition method of accounting, whereby operating

results subsequent to the acquisition date are included in the interim unaudited condensed consolidated financial statements.

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The fair values of the assets acquired are summarized below (in thousands):

| | |
|---|---------|
| Cash and cash equivalents | \$5 |
| Inventories | 39 |
| Prepaid expenses and other current assets | 38 |
| Property and equipment | 406 |
| Reacquired franchise rights | 1,139 |
| Asset retirement obligation | (75) |
| Total identifiable net assets acquired | 1,552 |
| Goodwill | 2,554 |
| Total consideration | \$4,106 |

Reacquired franchise rights have weighted average useful lives of 6.6 years. Goodwill represents the excess of the purchase price over the net tangible and intangible assets acquired and is expected to be fully deductible for income tax purposes. This goodwill is primarily attributable to the acquired customer bases and, to a lesser extent, economies of scale expected from combining the operations of the acquired entities with the operations of the Company.

Unaudited pro forma information—The following unaudited pro forma consolidated revenues and net income (loss) of the Company give effect to the M2AD Acquisition as if it had occurred as of the beginning of 2014:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|-----------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Pro forma revenues | \$28,132 | \$ 23,333 | \$87,500 | \$ 72,868 |
| Pro forma net income (loss) | \$1,122 | \$ (808) | \$2,311 | \$ (1,544) |

The pro forma information presented in this note includes adjustments for amortization of acquired intangible assets, depreciation of acquired property and equipment and income tax expense. The pro forma information is presented for informational purposes and may not be indicative of the results that would have been obtained had the M2AD Acquisition actually occurred at the beginning of 2014, nor is it intended to be indicative of future operating performance.

Revenues and net income from the acquired stores from the closing date of the M2AD Acquisition included in the Company's Condensed Consolidated Statements of Operations for the three and nine months ended September 28, 2015, are as follows:

| (in thousands) | Three Months Ended | Nine Months Ended |
|----------------|--------------------|--------------------|
| | September 28, 2015 | September 28, 2015 |
| Revenues | \$1,259 | \$2,824 |
| Net income | 74 | 188 |

Other Acquisitions

PMCSI also acquired all of the assets of 16 stores through seven individually immaterial acquisitions during the nine months ended September 28, 2015: eight stores in Tennessee, three in Washington, two in Texas, one in Idaho, one in Oregon, and one in Colorado. The Tennessee stores were acquired on January 26, 2015, the Idaho store on January 12, 2015, the Oregon store on March 2, 2015, the Texas stores on March 9, 2015 and July 27, 2015, respectively, the Colorado store on May 4, 2015, and the Washington stores on May 11, 2015 (collectively, the "Other Acquisitions"). The Company incurred transaction costs of \$31,000 associated with the Other Acquisitions that were recognized as Other store operating costs in the Condensed Consolidated Statements of Operations. The aggregate purchase price for the Other Acquisitions was approximately \$5.4 million, which included holdbacks totaling \$84,000 in the aggregate. As of September 28, 2015, PMCSI retained \$13,000 of the aggregate holdback amount. The Other Acquisitions were funded through existing cash and were accounted for using the acquisition method of accounting, whereby operating results subsequent to the acquisition date are included in the interim unaudited condensed consolidated financial statements.

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The fair values of the assets acquired are summarized below (in thousands):

| | |
|---|---------|
| Cash and cash equivalents | \$9 |
| Inventories | 81 |
| Prepaid expenses and other current assets | 67 |
| Property and equipment | 1,280 |
| Reacquired franchise rights | 1,041 |
| Asset retirement obligation | (176) |
| Total identifiable net assets acquired | 2,302 |
| Goodwill | 3,104 |
| Total consideration | \$5,406 |

Reacquired franchise rights have weighted average useful lives of 3.4 years. Goodwill represents the excess of the purchase price over the net tangible and intangible assets acquired and is expected to be fully deductible for income tax purposes. This goodwill is primarily attributable to the acquired customer bases and, to a lesser extent, economies of scale expected from combining the operations of the acquired entities with the operations of the Company.

Unaudited pro forma information—The following unaudited pro forma consolidated revenues and net income (loss) of the Company give effect to the Other Acquisitions as if they had occurred as of the beginning of 2014:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|-----------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Pro forma revenues | \$28,158 | \$ 23,906 | \$88,092 | \$ 74,492 |
| Pro forma net income (loss) | \$1,125 | \$ (840) | \$2,296 | \$ (1,639) |

The pro forma information presented in this note includes adjustments for amortization of acquired intangible assets, depreciation of acquired property and equipment and income tax expense. The pro forma information is presented for informational purposes and may not be indicative of the results that would have been obtained had the Other Acquisitions actually occurred at the beginning of 2014, nor is it intended to be indicative of future operating performance.

Revenues and net loss from the acquired stores from the closing date of the Other Acquisitions included in the Company's Condensed Consolidated Statements of Operations for the three and nine months ended September 28, 2015, are as follows:

| (in thousands) | Three Months Ended | Nine Months Ended |
|----------------|--------------------|--------------------|
| | September 28, 2015 | September 28, 2015 |
| Revenues | \$1,929 | \$4,306 |
| Net loss | (76) | (197) |

Note 3 — Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

| (in thousands) | September 28, 2015 | December 29, 2014 |
|---|--------------------|-------------------|
| Prepaid media development costs ⁽¹⁾ | \$ 238 | \$ 593 |
| Prepaid rents and insurance | 1,277 | 620 |
| POS software licenses for resale | 1,175 | 1,800 |
| Other | 794 | 410 |
| Total prepaid expenses and other current assets | \$ 3,484 | \$ 3,423 |

(1) Prepaid media development costs represent costs incurred for advertisements that have not aired.

The Company recognizes software license revenue upon the resale of Point of Sale ("POS") software licenses to franchise owners at cost. The income from the sale is included in Lease and other revenues and the related expense is recorded in

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Selling, general and administrative costs on the Condensed Consolidated Statements of Operations. POS software license revenue during the periods reported was as follows:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| POS software license revenue | \$258 | \$444 | \$559 | \$2,370 |

Note 4 — Property and Equipment

Property and equipment are net of accumulated depreciation of \$12.6 million and \$9.3 million at September 28, 2015, and December 29, 2014, respectively. Depreciation expense during the periods reported was as follows:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|----------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Depreciation expense | \$1,288 | \$747 | \$3,367 | \$2,079 |

Note 5 — Goodwill

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

| (in thousands) | DOMESTIC COMPANY STORES | DOMESTIC FRANCHISE | TOTAL |
|-------------------------------|-------------------------------|-----------------------|-----------|
| Balance at December 29, 2014 | \$19,536 | \$81,546 | \$101,082 |
| Acquisitions | 5,658 | — | 5,658 |
| Balance at September 28, 2015 | \$25,194 | \$81,546 | \$106,740 |

There is no goodwill associated with the International Segment. The Company has determined that during the three months ended September 28, 2015, there were no triggering events that would require an updated impairment review.

Note 6 — Intangible Assets

Intangible assets are net of accumulated amortization of \$21.7 million and \$19.3 million as of September 28, 2015, and December 29, 2014, respectively. Amortization expense during the periods reported was as follows:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|----------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Amortization expense | \$1,353 | \$1,260 | \$4,013 | \$3,736 |

Note 7 — Notes Receivable

Notes receivable consist of the following:

| (in thousands) | September 28, 2015 | December 29, 2014 |
|--|--------------------|-------------------|
| Note maturing in 2020 bearing interest at 9.0% and collateralized by store assets. | \$239 | \$287 |
| Total notes receivable | 239 | 287 |
| Less current portion | (71) | (62) |
| Notes receivable, net of current portion | \$168 | \$225 |

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Note 8 — Financing Arrangements

Long-term debt consists of the following:

| (in thousands) | September 28, 2015 | December 29, 2014 |
|--|-----------------------|----------------------|
| 2014 Credit Facility | | |
| Term loan | \$ 109,900 | \$ 112,000 |
| Revolving line of credit | — | — |
| Notes payable | 3,000 | 3,000 |
| Total principal amount of long-term debt | 112,900 | 115,000 |
| Unamortized debt issuance costs | (1,244) | (1,485) |
| Total long-term debt | 111,656 | 113,515 |
| Less current portion | (3,500) | (2,800) |
| Total long-term debt, net of current portion | \$ 108,156 | \$ 110,715 |
| 2014 senior secured credit facility | | |

On August 28, 2014, PMI Holdings, Inc., a wholly-owned subsidiary of the Company, entered into a \$132.0 million senior secured credit facility (the “2014 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 September 28, 2015, the 2014 Credit Facility bore interest under the LIBOR rate option at 3.45%.

With a maturity date of over one year from September 28, 2015, balances outstanding under the 2014 Credit Facility are classified as non-current on the Condensed Consolidated Balance Sheets, except for mandatory, minimum term loan amortization payments due on the last day of each fiscal quarter. Minimum term loan amortization payments are \$0.7 million, increasing to \$1.4 million in the third fiscal quarter of 2016.

The weighted average interest rate for all borrowings under our 2014 Credit Facility for the third quarter of 2015 was 3.45%.

2013 senior secured credit facility

In August 2014, the borrowings under the 2014 Credit Facility refinanced the \$177.0 million senior secured credit facility entered into in October 2013 (the “2013 Credit Facility”), which included a \$167.0 million senior secured term loan and a \$10.0 million revolving credit facility, including a \$2.5 million letter of credit subfacility.

On May 7, 2014, the Company prepaid \$55.5 million of its long-term debt under the 2013 Credit Facility in connection with the IPO. A proportionate share of deferred financing costs of \$1.2 million was expensed as a Loss on early retirement of debt on the Company’s Condensed Consolidated Statements of Operations at the time of this debt prepayment.

Notes payable

PMCSI has a \$3.0 million note payable which bears interest at 5% and matures in December 2018. This note is subordinated to the 2014 Credit Facility.

Note 9 — Fair Value Measurement

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

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

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

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

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

| (in thousands) | September 28, 2015 | | December 29, 2014 | | FAIR VALUE MEASUREMENTS |
|--|--------------------|------------|-------------------|------------|-------------------------|
| | CARRYING VALUE | FAIR VALUE | CARRYING VALUE | FAIR VALUE | |
| Financial assets | | | | | |
| Notes receivable ⁽¹⁾ | \$239 | \$242 | \$287 | \$302 | Level 3 |
| Cost-method investments ⁽²⁾ | — | — | 4,000 | 5,055 | Level 3 |
| Financial liabilities | | | | | |
| Long-term debt, including current portion thereof ⁽³⁾ | 112,900 | 114,100 | 115,000 | 113,880 | Level 3 |

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

(2) The fair value of cost-method investments was estimated primarily using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

(3) The fair value of long-term debt was estimated using a discounted cash flow method based on a discount rate, reflecting the applicable credit spread.

Financial instruments not included in the table above consist of cash and cash equivalents, accounts receivable and accounts payable. The fair value of cash and cash equivalents, accounts receivable and accounts payable approximates carrying value because of the short-term nature of the accounts.

Note 10 — Accrued and Other Liabilities

Accrued and other liabilities consist of the following:

| (in thousands) | September 28, 2015 | December 29, 2014 |
|---|--------------------|-------------------|
| Accrued compensation and related costs | 3,988 | 3,670 |
| Gift cards and certificates payable | 1,989 | 2,912 |
| Accrued interest and non-income taxes payable | 693 | 745 |
| Convention fund balance | 746 | 271 |
| Advertising and development fund | 5 | 507 |
| Unearned product rebates | 1,407 | 791 |
| Other | 389 | 704 |
| | \$ 9,217 | \$ 9,600 |

Note 11 — Income Taxes

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

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Provision for (benefit from) income taxes | \$746 | \$(703) | \$1,206 | \$(1,124) |
| Income (loss) before income taxes | 1,868 | (1,491) | 2,985 | (2,700) |
| Effective income tax rate | 39.9 | % 47.1 | % 40.4 | % 41.6 |

The effective income tax rate for the three months ended September 28, 2015, 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 income. The effective income tax rate for the three months ended September 29, 2014, includes the effect

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of certain permanent differences between tax reporting purposes and financial reporting purposes and the relative impact of those differences on a small quarterly loss.

The effective income tax rate for the first nine months of 2015 includes the effect of a discrete adjustment for the cumulative share-based compensation expense adjustment for certain awards previously considered unlikely to vest. The effective tax rate for the first nine months ended September 29, 2014, includes the effect of a separate unfavorable discrete adjustment for an accelerated restricted stock vesting event recorded in early 2014.

Note 12 — Shareholders' Equity

Preferred stock

Prior to the IPO, the Company's preferred stock consisted of Series A Preferred Shares and Series B Preferred Shares. The Preferred Shares had a cumulative preferred dividend of 6.00% per year based on an original liquidation value of \$36.68 per share. Upon liquidation of the Company, the holders of the Preferred Shares were entitled to receive the unpaid liquidation value plus accreted dividends before any distribution could be made to the holders of common stock. In addition, the Preferred Shares participated in 20% of all remaining earnings if distributed to common stockholders. The unpaid liquidation value of the Series A and Series B Preferred Shares was \$21.14 and \$26.80 per share, respectively, as of the IPO. At the IPO, the Preferred Shares were converted into 3,054,318 shares of common stock.

Noncontrolling interests

The Company received the following additional investments by noncontrolling interest holders in PPH during the periods reported:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Additional investment by noncontrolling interest holders in PPH | \$— | \$— | \$56 | \$167 |

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"). With the adoption of the 2014 Plan, the Company has discontinued selling stock and issuing awards under the 2010 Plan, but stock previously purchased and awards previously granted under the 2010 Plan remain outstanding.

The Incentive Plans reserve 2,116,747 common shares for equity incentive awards, which can be awarded as incentive stock options, non-qualified stock options, restricted stock awards, and unrestricted stock awards. Under the Incentive Plans, the Company has awarded 584,017 and 610,084 shares of restricted common stock to eligible employees as of September 28, 2015, and December 29, 2014, respectively. In addition, the Company has issued 1,051,929 and 945,149 stock options under the Incentive Plans to eligible employees as of September 28, 2015, and December 29, 2014, respectively.

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Restricted common shares

Information with respect to restricted stock activity is as follows:

| | Number of Shares of Restricted Common Stock | | Weighted Average Sale/Grant Date Fair Value Per Share |
|------------------------------|--|------------------------|--|
| | Time Vesting | Performance Vesting | |
| Unvested, December 29, 2014 | 127,650 | 215,556 | \$2.27 |
| Granted | 7,877 | — | 19.05 |
| Vested | (70,930 |) — | 1.94 |
| Repurchased | (7,542 |) (29,041 |) 0.70 |
| Unvested, September 28, 2015 | 57,055 | 186,515 | \$3.15 |

The weighted average fair value of share-based compensation awards granted and the fair values of awards granted and vested during the period were as follows:

| (in thousands, except per share amounts) | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Weighted average grant date fair value per share | \$19.41 | \$ 8.80 | \$19.05 | \$ 8.80 |
| Total fair value of shares granted | 60 | 60 | 150 | 60 |
| Total fair value of shares vested | 86 | 26 | 137 | 458 |

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 (in thousands) |
|---|--|------------------------|---|---|--|
| | Time Vesting | Performance Vesting | | | |
| Outstanding, December 29, 2014 | 722,307 | 222,842 | \$11.16 | | |
| Granted | 192,000 | — | 13.43 | | |
| Exercised | (24,626 |) — | 11.00 | | |
| Forfeited | (38,233 |) (22,361 |) 11.76 | | |
| Outstanding, September 28, 2015 | 851,448 | 200,481 | \$11.55 | 8.7 years | \$3,516 |
| Exercisable, September 28, 2015 | 428,646 | — | \$11.19 | 8.6 years | \$1,588 |
| Vested and expected to vest at September 28, 2015 | 788,028 | 170,409 | \$11.52 | 8.7 years | \$3,227 |

Fair value information for options granted and vested and the intrinsic value of options exercised during the periods reported are as follows:

| (in thousands, except per share amounts) | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Weighted average grant date fair value per share | N/A | N/A | \$5.41 | \$ 4.27 |
| Total fair value of awards granted | \$— | \$ — | 1,039 | 4,151 |
| Total fair value of awards vested | 23 | 87 | 346 | 1,519 |
| Total intrinsic value of options exercised | 121 | — | 154 | — |

N/A = not applicable

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Compensation cost and valuation

Total compensation costs recognized in connection with the Incentive Plans during the periods reported were as follows:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|--------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Stock compensation expense | \$202 | \$ 193 | \$858 | \$ 1,738 |
| Associated income tax benefits | 64 | 68 | 282 | 578 |

As of September 28, 2015, the total unrecognized stock-based compensation expense, net of estimated forfeitures, was \$2.8 million, with \$1.9 million associated with time vesting awards and \$0.9 million associated with performance vesting awards. The remaining weighted average contractual life for unrecognized stock-based compensation expense was 3.4 years as of September 28, 2015.

Prior to the IPO, the valuation of the Company's common stock and Preferred Shares was based on the principles of option-pricing theory. This approach is based on modeling the value of the various components of an entity's capital structure as a series of call options on the proceeds expected from the sale of the entity or the liquidation of its assets at some future date. Specifically, each of the preferred and common equity is modeled as a call option on the aggregate value of the Company with an exercise price equal to the liquidation preferences of the more senior securities. Both the income and market approaches were considered when estimating the fair value of the Company. The Company's valuation was performed under both an IPO and non-IPO scenario with each value weighted based on an estimated probability of occurrence. The key inputs required to calculate the value of the common stock using the option-pricing model included the risk free rate, the volatility of the underlying assets, and the estimated time until a liquidation event. The Company applied a marketability discount to the value of common stock based on facts and circumstances at each valuation date.

During the reported periods prior to the IPO, the Company assumed the following:

| | Three Months Ended | |
|--|-------------------------------|------------------|
| | March 31, 2014 ⁽¹⁾ | |
| | IPO Scenario | Non-IPO Scenario |
| Risk free rate | 0.36% | 0.36% |
| Volatility of the underlying assets | 45% | 45% |
| Estimated time until a liquidation event | 0.58 years | 1.75 years |
| Marketability discount—common stock | 10% | 25% |
| Marketability discount—preferred stock | 8% | 15% |
| Weight applied to scenario | 95% | 5% |

(1) The last pre-IPO valuation of the Company was performed as of March 31, 2014.

The fair value of the stock option awards granted during the periods reported was estimated with the following weighted-average assumptions.

| | Three Months Ended | | Nine Months Ended | |
|-------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Risk free rate | N/A | N/A | 1.9% | 2.0% |
| Expected volatility | N/A | N/A | 37.9% | 35.0% |
| Expected term | N/A | N/A | 6.3 years | 6.3 years |
| Expected dividend yield | N/A | N/A | 0.0% | 0.0% |

N/A = not applicable

Note 14 — Earnings per Share (EPS)

The number of shares and earnings per share (“EPS”) data for all periods presented are based on the historical weighted-average shares of common stock outstanding. Prior to the IPO, the Company’s cumulative preferred stockholders were entitled to participate in 20% of all remaining earnings or dividends if distributed to common stockholders. As such, the

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Company calculated EPS using the two-class method. The two-class method determines EPS for common stock and participating securities according to dividends and dividend equivalents and their respective participation rights in undistributed earnings.

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 potential common shares would have an anti-dilutive effect.

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

| (in thousands, except per share data) | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Earnings: | | | | |
| Net income (loss) | \$ 1,122 | \$ (788) | \$ 1,779 | \$ (1,576) |
| Less: Net loss attributable to noncontrolling interests | — | — | 500 | — |
| Net income (loss) attributable to Papa Murphy's | 1,122 | (788) | 2,279 | (1,576) |
| Less: cumulative Series A and B Preferred dividends | — | — | — | (2,150) |
| Net income (loss) available to common shareholders | \$ 1,122 | \$ (788) | \$ 2,279 | \$ (3,726) |
| Shares: | | | | |
| Weighted average common shares outstanding | 16,672 | 16,585 | 16,635 | 10,603 |
| Dilutive effect of restricted equity awards ⁽¹⁾ | 247 | — | 258 | — |
| Diluted weighted average number of shares outstanding | 16,920 | 16,585 | 16,894 | 10,603 |
| Earnings (loss) per share: | | | | |
| Basic earnings (loss) per share | \$0.07 | \$ (0.05) | \$0.14 | \$ (0.35) |
| Diluted earnings (loss) per share | \$0.07 | \$ (0.05) | \$0.13 | \$ (0.35) |

The Company's potential common stock instruments such as stock options and restricted stock were not included in (1) the computation of diluted EPS for the three and nine months ended September 29, 2014 as the effect of including these shares in the calculation would have been anti-dilutive.

For the three months ended September 28, 2015, and September 29, 2014, an aggregated total of 70,000 shares and 128,000 shares, respectively, have been excluded from the diluted income per share calculation because their effect would have been anti-dilutive. For the nine months ended September 28, 2015, and September 29, 2014, an aggregated total of 69,000 shares and 170,000 shares, respectively, have been excluded from the diluted income per share calculation because their effect would have been anti-dilutive.

Note 15 — Commitments and Contingencies

Operating lease commitments

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

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

Lease guarantees

The Company is the guarantor for operating leases of eight franchised stores that have terms expiring on various dates from August 2016 to July 2020. The obligations from these leases will generally continue to decrease over time as the leases expire. The applicable franchise owners continue to have primary liability for these operating leases. As of

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September 28, 2015, the Company does not believe it is probable it would be required to perform under the outstanding guarantees.

Legal proceedings

The Company is currently subject to litigation with a group of our franchise owners, initially filed by twelve franchise owners and their individual stakeholders on April 11, 2014, in the Superior Court in Clark County, Washington, claiming that the Company misrepresented sales volumes, made false representations to them and charged excess advertising fees, among other things, and alleging 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. On June 18, 2014, an additional 16 franchise owners and their individual stakeholders, represented by the same counsel as the plaintiffs described above, filed a lawsuit with the Superior Court in Clark County, Washington, making essentially the same claims and 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. The Company reached resolution with eleven of the franchise owners (and those owners' individual stakeholders) involved in the consolidated lawsuits, and their claims have either been dismissed or dismissal is pending. The Company believes the allegations in these consolidated lawsuits lack merit and, for those plaintiffs with whom the Company is unable to reach resolution, the Company will continue to vigorously defend its interests, including by asserting a number of affirmative defenses and, where appropriate, counterclaims. The Company provides no assurance that it will be successful in its defense of these lawsuits; however, the Company does not currently expect the cost of resolving them to have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

On May 8, 2015, the Company was named as a defendant in a class action lawsuit in United States District Court for the Western District of Washington claiming a violation of the federal Telephone Consumer Protection Act, which prohibits companies from making telemarketing calls to numbers listed in the Federal Do-Not-Call Registry and imposes other obligations and limitations on making phone calls and sending text messages to consumers. The lawsuit alleges that the Company did not comply with the statutory requirements for obtaining consumers' consent to receive text messages from the Company, and seeks statutory penalties for those alleged deficiencies. The Company believes the plaintiff's interpretation of the applicable law is incorrect, and it will vigorously defend itself in the lawsuit, but provides no assurance that it will be successful. An adverse judgment or settlement could have an adverse effect on the Company's profitability and could cause variability in its results compared to expectations.

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 its 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, 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 16 — Related Party Transactions

Advisory services and monitoring agreement

Prior to the IPO, the Company was a party to an advisory services and monitoring agreement with affiliates of Lee Equity Partners, LLC ("Lee Equity"). In accordance with the terms of the agreement, the Company paid Lee Equity for ongoing advisory and monitoring services, such as management consulting, financial analysis, and other related services. As compensation, the Company paid an annual fee of \$0.5 million in four equal quarterly installments, plus direct expenses incurred, which are included in Selling, general and administrative costs. The agreement did not call for a minimum level of services to be furnished and provided that fees paid to Lee Equity could be deferred at the discretion of Lee Equity or to the extent required under the Company's 2014 Credit Facility.

On May 7, 2014, the Company completed the IPO and paid Lee Equity \$1.5 million in accordance with the terms of the agreement. With the completion of the IPO, the advisory services and monitoring agreement between the Company and Lee Equity was terminated.

Employee loans related to share purchases

In connection with share-based compensation, the Company previously made several loans to certain officers and non-officer employees of the Company (see Note 13 — Share-based Compensation). Loans made in connection with the issuance of the Company's equity have been recognized in Stock subscriptions receivable as a reduction of total equity.

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In March 2014, the Company entered into agreements with certain executive officers to repurchase an aggregate of 109,779 shares of common stock at a price of \$11.85 per share for a total purchase price of \$1.3 million. Included among the repurchased shares were 31,707 shares of common stock for which vesting terms were accelerated in connection with the repurchase. The Company received a payment of \$1.0 million from the same executive officers to repay their outstanding stock subscription receivables. Concurrent with the share repurchase, the Company entered into agreements with the same executive officers to issue stock options to purchase an aggregate of 109,779 shares at an exercise price of \$11.85 per share, including 78,072 fully vested options and 31,707 options subject to time-based or performance-based vesting provisions. In connection with the acceleration of vesting and the issuance of the fully vested options, the Company recorded stock-based compensation expense of \$0.5 million for the nine months ended September 29, 2014.

All loans made to officers of the Company were repaid prior to the IPO. Some loans made to non-officer employees of the Company were still outstanding at the time of the IPO. As of September 28, 2015, and December 29, 2014, the Company had stock subscription receivables of \$0.1 million.

Related party revenue

The Company was party to transactions to sell services to Project Pie during the period Project Pie was a cost-method investee. Revenue from these transactions are recorded as Lease and other revenues on the Condensed Consolidated Statements of Operations. Related party revenue during the periods reported was as follows:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|-----------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Related party revenue | \$— | \$ 24 | \$4 | \$ 108 |

As of September 28, 2015, and December 29, 2014, the Company had an Accounts receivable balance from Project Pie of \$0 and \$66,000, respectively.

Notes receivable

On March 13, 2015, the Company loaned Project Pie, a cost-method investee, \$250,000, in exchange for a note receivable which bore interest at 13% and matured in June 2015. This note was written off as a bad debt in the three months ended June 29, 2015.

In June 2015, the Company entered into an agreement with Project Pie under which the Company, at its sole discretion, may advance funds not to exceed \$0.8 million in exchange for a subordinated note receivable. As of September 28, 2015, no funds were outstanding under the agreement.

Note 17 — Segment Information

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

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The following tables summarize information on profit or loss and assets for each of the Company's reportable segments:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Revenues | | | | |
| Domestic Franchise | \$10,445 | \$ 10,139 | \$33,258 | \$ 33,510 |
| Domestic Company Stores | 17,604 | 11,627 | 52,927 | 35,121 |
| International | 83 | 403 | 236 | 501 |
| Total | \$28,132 | \$ 22,169 | \$86,421 | \$ 69,132 |
| Segment Operating Income (Loss) | | | | |
| Domestic Franchise | \$4,901 | \$ 4,713 | \$15,036 | \$ 14,941 |
| Domestic Company Stores | (516 |) (178 |) 1,172 | 501 |
| International | 76 | 252 | 154 | 28 |
| Corporate and unallocated | (1,416 |) (1,262 |) (5,381 |) (6,534 |
| Total | \$3,045 | \$ 3,525 | \$10,981 | \$ 8,936 |
| Depreciation and amortization | | | | |
| Domestic Franchise | \$1,416 | \$ 1,262 | \$4,005 | \$ 3,692 |
| Domestic Company Stores | 1,217 | 737 | 3,352 | 2,100 |
| International | 8 | 8 | 23 | 23 |
| Total | \$2,641 | \$ 2,007 | \$7,380 | \$ 5,815 |
| (in thousands) | | | September 28, 2015 | December 29, 2014 |
| Total Assets | | | | |
| Domestic Franchise | | | \$ 134,639 | \$ 137,417 |
| Domestic Company Stores | | | 46,416 | 34,953 |
| International | | | 415 | 447 |
| Other ⁽¹⁾ | | | 89,443 | 92,647 |
| Total | | | \$ 270,913 | \$ 265,464 |

(1) Other assets which are not allocated to the individual segments primarily include trade names and trademarks, unamortized deferred financing charges, and an intercompany note.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K. 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 years 2015 and 2014 are 52-week periods ending on December 28, 2015, and ended on December 29, 2014, respectively.

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 Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2015. 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, business strategies and priorities, resolution of litigation and claims, expectations for reducing operating costs and increasing sales through the use of our POS system terminals, future benefits of implementing POS system terminals, deductibility of goodwill for income tax purposes, potential efficiencies and synergies created by store acquisitions, expansion and growth opportunities, the number, timing and mix of new store openings, exposure to foreign currency and interest rate risk, as well as industry trends and outlooks. These statements may include words such as "anticipate," "estimate," "expect," "project," "plan," "intend," "believe," "may," "should," "can have," "likely" and other 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 under 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 Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2015. 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.

Overview

Papa Murphy's is a franchisor and operator of the largest Take 'N' Bake pizza chain in the United States and the fifth largest pizza chain overall. We were founded in 1981 and have grown our footprint to a total of 1,500 system-wide stores as of September 28, 2015, of which 91.6% are franchised, located in 38 states plus Canada and the Middle East. We have been repeatedly rated the #1 pizza chain in the United States by multiple third-party consumer studies. In 2015, Technomic awarded us the 2015 Chain Restaurant Consumers' Choice award and named us the Quick Serve

concept most likely to be recommended by consumers. Nation's Restaurant News rated us the #1 limited service restaurant in the Pizza/Italian Category for 2015. We were rated #1 in the Pizza Category by Market Force Information in 2015, including the top spot in food quality, healthy food, and friendly service. We were also rated the #1 pizza chain overall by Nation's Restaurant

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News in 2014, 2013, 2012 and 2011. When compared to broader restaurant chain competition, we were recognized by Technomic in 2015, 2014 and 2013 as the #1 chain overall among all restaurants and all food categories and by Nation's Restaurant News in 2013 and 2012 as one of the Top 5 Overall limited service restaurant chains across all food categories.

Our financial results are driven largely by system-wide sales at our franchised and Company-owned stores.

System-wide sales are driven by comparable store sales growth and store count, which translate into royalty payments from franchise owners, as well as Company-owned store revenues. We strive to consistently increase both comparable store sales and our store counts. Total revenues can also be impacted by acquisitions of franchised stores by our Domestic Company Stores segment or the refranchising of Company-owned stores.

The Take 'N' Bake model offers operating advantages that differentiate us from other restaurant concepts. Our domestic stores (i) do not require ovens, freezers or other expensive cooking equipment because our customers bake their customized pizzas at home; (ii) do not require delivery, thereby reducing operational complexity for franchise owners and their employees; (iii) maintain shorter opening hours (typically 11:00 a.m. to 9:00 p.m.) that are attractive to franchise owners and their employees; (iv) require fewer employees during each shift compared to most other restaurant concepts, resulting in lower labor costs; and (v) do not require dining areas, resulting in lower occupancy and operating costs.

The relatively small initial and ongoing investments required to own and operate a Papa Murphy's store creates the opportunity for higher margins and attractive returns for franchisees. We believe these favorable investment requirements coupled with simple operations, a strong brand message supported by high levels of advertising spending and high-quality menu offerings drive attractive store-level economics, which, in turn, drives demand for new stores.

2015 Highlights**Revenue Growth**

Total revenues for the three months ended September 28, 2015, compared to the three months ended September 29, 2014, grew 26.9% from \$22.2 million to \$28.1 million due primarily to the strategic acquisition of franchised stores by our Domestic Company Stores segment, new store openings, and comparable store sales growth.

Total revenues for the nine months ended September 28, 2015, compared to the nine months ended September 29, 2014, grew 25.0% from \$69.1 million to \$86.4 million due primarily to the strategic acquisition of franchised stores by our Domestic Company Stores segment, new store openings, and comparable store sales growth.

System-wide sales for the three months ended September 28, 2015, compared to the three months ended September 29, 2014, increased 4.7% from \$194.0 million to \$203.1 million. System-wide sales for the nine months ended September 28, 2015, compared to the nine months ended September 29, 2014, increased 7.0% from \$610.7 million to \$653.5 million.

Comparable store sales growth in 2015 compared to 2014 for selected segments was as follows:

| | Three Months Ended | | Nine Months Ended | | | |
|-------------------------|--------------------|---------------|-------------------|---------------|---|--|
| | September 28, | September 29, | September 28, | September 29, | | |
| | 2015 | 2014 | 2015 | 2014 | | |
| Domestic Franchise | 1.5 | % 4.4 | % 3.9 | % 3.0 | % | |
| Domestic Company Stores | 0.0 | % 8.4 | % 3.7 | % 7.1 | % | |
| Total domestic stores | 1.4 | % 4.6 | % 3.9 | % 3.2 | % | |

As of September 28, 2015, we had achieved 19 straight quarters of comparable store sales growth and 42 of the last 47 quarters had positive comparable store sales growth. In the nine months ended September 28, 2015, we also had 24 weeks in which we recorded all-time highs for system-wide sales.

Store Development

We and our franchise owners opened 23 stores, all in the United States, in the three months ended September 28, 2015. In the nine months ended September 28, 2015, we and our franchise owners opened 65 stores, including 59 in the United States. While we plan to strategically expand our Company-owned store base in select markets, we may also refranchise select Company-owned stores over time as opportunities arise. We expect the majority of our new store expansion will continue to be from new franchised store openings.

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Acquisitions

During the three months ended September 28, 2015, we acquired one store in the Dallas, Texas, market. During the nine months ended September 28, 2015, we acquired 22 Papa Murphy's stores from franchise owners in six different markets across the country. Nine stores were acquired in the Seattle, Washington, market, eight stores in the Knoxville, Tennessee, market, two stores in the Dallas, Texas, market, and one store each in the Boise, Idaho; Portland, Oregon; and Colorado Springs, Colorado, markets.

Technology Investments

Our POS system is an important technology platform and tool for our future growth. Future precision marketing tools and mobile coupon capabilities necessitate POS system terminals in our stores. We have rolled out POS system terminals to 1,125 stores as of September 28, 2015. We believe that an opportunity remains for many of our franchise owners to reduce their operating costs by using the POS system terminals.

We continue to roll out an integrated online ordering platform coupled with the latest version of our POS system software, which was in 807 stores as of September 28, 2015. An additional 19 stores were still on our original, non-integrated online ordering platform pending conversion as of September 28, 2015.

Our Segments

We operate in three business segments: Domestic Franchise, Domestic Company Stores and International. Our Domestic Franchise segment consists of our domestic franchised stores, which represent the majority of our system-wide stores. Our Domestic Company Stores segment consists of our Company-owned stores in the United States. Our International segment consists of our stores outside of the United States, all of which are franchised. The following table sets forth our Revenues, Operating Income and Depreciation and amortization for each of our segments for the periods presented:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Revenues | | | | |
| Domestic Franchise | \$10,445 | \$ 10,139 | \$33,258 | \$ 33,510 |
| Domestic Company Stores | 17,604 | 11,627 | 52,927 | 35,121 |
| International | 83 | 403 | 236 | 501 |
| Total | \$28,132 | \$ 22,169 | \$86,421 | \$ 69,132 |
| Segment Operating Income (Loss) | | | | |
| Domestic Franchise | \$4,901 | \$ 4,713 | \$15,036 | \$ 14,941 |
| Domestic Company Stores | (516) | (178) | 1,172 | 501 |
| International | 76 | 252 | 154 | 28 |
| Corporate and unallocated | (1,416) | (1,262) | (5,381) | (6,534) |
| Total | \$3,045 | \$ 3,525 | \$10,981 | \$ 8,936 |
| Depreciation and amortization | | | | |
| Domestic Franchise | \$1,416 | \$ 1,262 | \$4,005 | \$ 3,692 |
| Domestic Company Stores | 1,217 | 737 | 3,352 | 2,100 |
| International | 8 | 8 | 23 | 23 |
| Total | \$2,641 | \$ 2,007 | \$7,380 | \$ 5,815 |

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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 | | |
|--|--------------------|--------------------|---|--------------------|--------------------|---|
| | September 28, 2015 | September 29, 2014 | | September 28, 2015 | September 29, 2014 | |
| Domestic store average weekly sales (AWS) | \$10,568 | \$10,487 | | \$11,431 | \$11,026 | |
| Domestic comparable store sales growth | 1.4 | % 4.6 | % | 3.9 | % 3.2 | % |
| Domestic comparable stores | 1,366 | 1,315 | | 1,366 | 1,315 | |
| System-wide sales (in thousands) | \$203,078 | \$194,033 | | \$653,462 | \$610,734 | |
| Number of system-wide stores at period end | 1,500 | 1,437 | | 1,500 | 1,437 | |
| Adjusted EBITDA (in thousands) | \$6,144 | \$5,633 | | \$20,591 | \$18,855 | |

Average Weekly Sales

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

Comparable Store Sales Growth

Comparable store sales growth represents the change in year-over-year sales for comparable stores. A comparable store is a store that has been open for at least 52 full weeks from the comparable date (the Tuesday following the opening date). This measure highlights the performance of existing stores, while excluding the effect of newly opened or closed stores. Comparable store sales growth reflects changes in the number of transactions and in customer spend per transaction at existing stores. Customer spend per transaction is affected by changes in menu prices, sales mix and the number of items sold per customer.

System-Wide Sales

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

Store Openings, Closures, Acquisitions and Divestitures

We review the number of new stores, the number of closed stores, and the number of acquisitions and divestitures of stores to assess growth in system-wide sales, royalty revenues and Company-owned store sales.

The following table sets forth the changes in the number of stores in our system as well as the rate of new store openings for the nine months ended September 28, 2015.

| | Domestic Company Stores | Domestic Franchise | Total Domestic | International | Total | Annualized New Store Opening Rate |
|-----------------------------------|-------------------------|--------------------|----------------|---------------|-------|-----------------------------------|
| Store count at December 29, 2014 | 91 | 1,342 | 1,433 | 28 | 1,461 | |
| Openings | 14 | 45 | 59 | 6 | 65 | 5.9 % |
| Closings | (1) | (25) | (26) | — | (26) | |
| Net transfers | 22 | (22) | — | — | — | |
| Store count at September 28, 2015 | 126 | 1,340 | 1,466 | 34 | 1,500 | |

EBITDA and Adjusted EBITDA

To supplement our condensed consolidated financial statements presented in accordance with generally accepted accounting principles in the U.S. (“GAAP”), we consider certain financial measures that are not prepared in accordance with

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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 income (loss) before interest expense, income taxes, depreciation and amortization (“EBITDA”) as adjusted for:

all non-cash losses or expenses (including non-cash share-based compensation expenses and the non-cash portion of rent expenses relating to the difference between GAAP and cash rent expenses), excluding any non-cash loss or expense that is an accrual of a reserve for a cash expenditure or payment to be made, or anticipated to be made, in a future period;

non-recurring or unusual cash fees, costs, charges, losses and expenses;

fees, costs and expenses related to acquisitions;

pre-opening costs with respect to new stores;

historical management fees and expenses incurred under our advisory services and monitoring agreement with Lee Equity, which terminated in connection with the IPO; and

fees and expenses incurred in connection with the issuance of debt.

Adjusted EBITDA eliminates 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 income (loss), 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 income (loss), provides additional information to investors about certain material non-cash items and about 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, as well as 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:

as a measurement used 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;

Adjusted EBITDA excludes pre-opening costs and non-cash GAAP rent expense with respect to new stores, which we will continue to incur in the future as we open new stores consistent with our growth strategy;

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

Adjusted EBITDA does not reflect our tax expense or the cash requirements to pay our taxes.

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

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

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| Net Income (Loss) | \$ 1,122 | \$ (788) | \$ 1,779 | \$ (1,576) |
| Net loss attributable to noncontrolling interests | — | — | 500 | — |
| Net Income (Loss) Attributable to Papa Murphy's | 1,122 | (788) | 2,279 | (1,576) |
| Depreciation and amortization | 2,641 | 2,007 | 7,380 | 5,815 |
| Income tax provision (benefit) | 746 | (703) | 1,206 | (1,124) |
| Interest expense, net | 1,133 | 1,525 | 3,406 | 6,899 |
| EBITDA | 5,642 | 2,041 | 14,271 | 10,014 |
| Loss (gain) on disposal of property and equipment ⁽¹⁾ | 4 | (15) | 66 | 27 |
| Expenses not indicative of future operations: | | | | |
| Secondary offering and IPO preparation costs ⁽²⁾ | — | (29) | 345 | 623 |
| Loss on Project Pie impairment and disposal ⁽³⁾ | — | — | 4,325 | — |
| Management fees and related expenses ⁽⁴⁾ | — | — | — | 1,678 |
| Transaction costs ⁽⁵⁾ | 1 | 10 | 64 | 73 |
| New store pre-opening expenses ⁽⁶⁾ | 218 | — | 464 | 11 |
| Non-cash expenses and non-income based state taxes ⁽⁷⁾ | 279 | 198 | 1,056 | 1,810 |
| Loss on early retirement of debt ⁽⁸⁾ | — | 3,428 | — | 4,619 |
| Adjusted EBITDA | \$ 6,144 | \$ 5,633 | \$ 20,591 | \$ 18,855 |

(1) Represents non-cash losses (gains) resulting from disposal of property and equipment, including divested Company-owned stores.

For the 2015 periods, represents offering costs related to the secondary offering of the Company's common stock;

(2) for the 2014 periods, represents non-recurring advisory expenses in connection with our IPO and non-recurring recruitment, relocation and other costs related to the recruitment of a new CFO.

(3) Represents a \$4 million loss recognized upon impairment of Project Pie, a cost-method investment, and its subsequent disposal, and the write-off as bad debt receivables totaling \$325,000.

(4) Represents the elimination of management fees and related costs paid to Lee Equity for advisory services provided pursuant to an advisory services and monitoring agreement. More information can be found in Financial Statements in Note 16 — Related Party Transactions of the accompanying Notes to Unaudited Condensed Consolidated Financial Statements

(5) Represents transaction costs relating to the acquisition of multiple franchised stores and the investments in and divestment of Project Pie.

(6) Represents expenses directly associated with the opening of new stores and incurred primarily in advance of the store opening, including wages, benefits, and travel for training of opening teams, grand opening marketing costs and other store operating costs.

(7) Represents (i) non-cash expenses related to equity-based compensation; (ii) non-cash expenses related to the difference between GAAP and cash rent expense; and (iii) state revenue taxes levied in lieu of an income tax.

(8) Represents losses resulting from refinancing of long-term debt.

Key Financial Definitions

Revenues

Substantially all of our revenues are derived from 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. Franchise and development fees include initial franchise fees charged for opening a new franchised store, successive fees for the renewal of expiring franchise agreements, transfer fees for transferring ownership of a franchise and fee forfeitures. "Lease and other," as used in this report, includes revenues earned from the sublease of real estate under a master lease agreement with a national retailer and revenues derived from the resale of POS system licenses to franchise owners at cost, plus revenue from POS support agreements. Lease income is

recognized in the period earned, which coincides with the period the expense is due to the master leaseholder. See Selling, General and Administrative Costs below for the related offsetting expense to the POS system licenses resold to franchise owners.

Store Operating Costs

Store operating costs relate to our Domestic Company Stores segment and consist of Cost of food and packaging, Compensation and benefits, Advertising, Occupancy costs and Other store operating costs. We expect all of our Store operating costs to vary as our store count changes from constructing or acquiring new Company-owned stores. Cost of food

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and packaging and Advertising can be expected to fluctuate predominantly with the increases or decreases in Revenues of our Domestic Company Stores segment.

Selling, General and Administrative Costs

Selling, general and administrative costs consist of wages, benefits and other compensation, franchise development expenses, travel, marketing, accounting and legal fees, the costs of POS system software licenses sold to franchise owners at cost, sponsor management fees and other expenses related to the infrastructure required to support our franchised and Company-owned stores. See Revenues above for a discussion of the related offsetting revenue from the POS system software licenses resold to franchise owners. Selling, general and administrative costs also include net advertising expenses of an advertising fund we manage on behalf of all domestic stores.

Depreciation and Amortization

Depreciation and amortization constitute non-cash charges related to the depreciation of fixed assets, including leasehold improvements and equipment, and the amortization of franchise relationships and reacquired franchise rights relating to our acquisition of certain franchised stores.

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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 September 28, 2015, and September 29, 2014.

| (in thousands) | Three Months Ended | | | September 29, 2014 | | | Nine Months Ended | | | September 29, 2014 | | |
|---|--------------------|---------------------------|----------|--------------------|---------------------------|----------|--------------------|---------------------------|----------|--------------------|---------------------------|----------|
| | September 28, 2015 | | % | September 29, 2014 | | % | September 28, 2015 | | % | September 29, 2014 | | % |
| | \$ | TOTAL % OF REVENUES | | \$ | TOTAL % OF REVENUES | | \$ | TOTAL % OF REVENUES | | \$ | TOTAL % OF REVENUES | |
| Revenues | | | | | | | | | | | | |
| Franchise royalties | \$9,124 | 32.4 | % | \$8,965 | 40.5 | % | \$29,557 | 34.2 | % | \$28,349 | 41.0 | % |
| Franchise and development fees | 1,123 | 4.0 | % | 1,088 | 4.9 | % | 3,092 | 3.6 | % | 3,119 | 4.5 | % |
| Company-owned store sales | 17,604 | 62.6 | % | 11,626 | 52.4 | % | 52,927 | 61.2 | % | 35,121 | 50.8 | % |
| Lease and other | 281 | 1.0 | % | 490 | 2.2 | % | 845 | 1.0 | % | 2,543 | 3.7 | % |
| Total revenues | 28,132 | 100.0 | % | 22,169 | 100.0 | % | 86,421 | 100.0 | % | 69,132 | 100.0 | % |
| Costs and Expenses | | | | | | | | | | | | |
| Store operating costs: | | | | | | | | | | | | |
| Cost of food and packaging ⁽¹⁾ | 6,409 | 22.8 | % | 4,667 | 21.1 | % | 18,942 | 22.0 | % | 13,756 | 20.0 | % |
| Compensation and benefits ⁽¹⁾ | 4,918 | 17.5 | % | 3,000 | 13.5 | % | 13,994 | 16.2 | % | 8,935 | 12.9 | % |
| Advertising ⁽¹⁾ | 1,806 | 6.4 | % | 1,286 | 5.8 | % | 5,227 | 6.0 | % | 3,531 | 5.1 | % |
| Occupancy ⁽¹⁾ | 1,210 | 4.3 | % | 715 | 3.2 | % | 3,386 | 3.9 | % | 2,049 | 3.0 | % |
| Other store operating costs ⁽¹⁾ | 2,061 | 7.3 | % | 1,069 | 4.8 | % | 5,362 | 6.2 | % | 3,145 | 4.5 | % |
| Selling, general and administrative | 6,038 | 21.5 | % | 5,915 | 26.7 | % | 21,083 | 24.4 | % | 22,938 | 33.2 | % |
| Depreciation and amortization | 2,641 | 9.4 | % | 2,007 | 9.1 | % | 7,380 | 8.5 | % | 5,815 | 8.4 | % |
| Loss (gain) on disposal of property and equipment | 4 | 0.0 | % | (15) | (0.1) | % | 66 | 0.1 | % | 27 | 0.0 | % |
| Total costs and expenses | 25,087 | 89.2 | % | 18,644 | 84.1 | % | 75,440 | 87.3 | % | 60,196 | 87.1 | % |
| Operating Income | 3,045 | 10.8 | % | 3,525 | 15.9 | % | 10,981 | 12.7 | % | 8,936 | 12.9 | % |
| Interest expense | 1,137 | 4.0 | % | 1,539 | 6.9 | % | 3,429 | 3.9 | % | 6,966 | 10.0 | % |
| Interest income | (4) | 0.0 | % | (14) | (0.1) | % | (23) | 0.0 | % | (67) | (0.1) | % |
| Loss on early retirement of debt | — | — | % | 3,428 | 15.5 | % | — | — | % | 4,619 | 6.7 | % |
| Loss on disposal or impairment of investments | — | — | % | — | — | % | 4,500 | 5.2 | % | — | — | % |
| Other expense, net | 44 | 0.2 | % | 63 | 0.3 | % | 90 | 0.1 | % | 118 | 0.2 | % |
| Income (Loss) Before Income Taxes | 1,868 | 6.6 | % | (1,491) | (6.7) | % | 2,985 | 3.5 | % | (2,700) | (3.9) | % |
| Provision for (benefit from) income taxes | 746 | 2.6 | % | (703) | (3.1) | % | 1,206 | 1.4 | % | (1,124) | (1.6) | % |
| Net Income (Loss) | \$1,122 | 4.0 | % | \$(788) | (3.6) | % | \$1,779 | 2.1 | % | \$(1,576) | (2.3) | % |
| Net loss attributable to noncontrolling interests | — | — | % | — | — | % | 500 | (0.5) | % | — | — | % |
| | \$1,122 | 4.0 | % | \$(788) | (3.6) | % | \$2,279 | 2.6 | % | \$(1,576) | (2.3) | % |

Net Income (Loss)
 Attributable to Papa
 Murphy's

Please see the table presented in Costs and Expenses below, which presents company-owned store expenses as a (1) percentage of company-owned store revenue for the three and nine months ended September 28, 2015, and September 29, 2014.

Revenues

Total revenues. The following table presents Total revenues for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|----------------|--------------------|--------------------|--------|--------------------|--------------------|--------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Total revenues | \$28,132 | \$ 22,169 | 26.9 % | \$86,421 | \$ 69,132 | 25.0 % |

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In the three months ended September 28, 2015, Total revenues grew primarily from the acquisition of franchised stores and construction of new stores by our Domestic Company Stores segment, plus domestic comparable store sales growth of 1.4%. Excluding the year-over-year impact of POS licenses resold to franchisees at cost, total revenue increased 28.3% compared to the three months ended September 29, 2014.

In the nine months ended September 28, 2015, Total revenues grew primarily from the acquisition of franchised stores by our Domestic Company Stores segment, net new store openings and domestic comparable store sales growth of 3.9%. Excluding the year-over-year impact of POS licenses resold to franchisees at cost, total revenue increased 28.6% compared to the nine months ended September 29, 2014.

Franchise royalties. The following table presents Franchise royalties for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|--------|--------------------|--------------------|--------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Franchise royalties | \$9,124 | \$ 8,965 | 1.8 % | \$29,557 | \$ 28,349 | 4.3 % |
| Percentage of total revenues | 32.4 % | 40.5 % | | 34.2 % | 41.0 % | |

Franchise royalties increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, primarily due to Domestic Franchise comparable store sales growth of 1.5%. Franchise royalties increased in the nine months ended September 28, 2015, compared to the nine months ended September 29, 2014 primarily due to Domestic Franchise comparable store sales growth of 3.9%.

The decrease in Franchise royalties as a percentage of Total revenues was the result of increases in the number of Company-owned stores which generated Company-owned store sales increases of 51.4% and 50.7% in the three and nine months ended September 28, 2015, respectively, compared to the respective three and nine months ended September 29, 2014.

Franchise and development fees. The following table presents Franchise and development fees for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|--------------------------------|--------------------|--------------------|--------|--------------------|--------------------|---------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Franchise and development fees | \$1,123 | \$ 1,088 | 3.2 % | \$3,092 | \$ 3,119 | (0.9) % |
| Percentage of total revenues | 4.0 % | 4.9 % | | 3.6 % | 4.5 % | |

Franchise and development fees increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, due to opening three more domestic franchised stores in addition to an increase in transfer fees and forfeitures, partially offset by a reduction in international fees compared to the three months ended September 29, 2014. For the nine months ended September 28, 2015, Franchise and development fees decreased, compared to the nine months ended September 29, 2014, due to the opening of six fewer franchised stores in the nine months ended September 28, 2015, than in the nine months ended September 29, 2014.

Company-owned store sales. The following table presents Company-owned store sales for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|--------|--------------------|--------------------|--------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Company-owned store sales | \$17,604 | \$ 11,626 | 51.4 % | \$52,927 | \$ 35,121 | 50.7 % |
| Percentage of total revenues | 62.6 % | 52.4 % | | 61.2 % | 50.8 % | |

Company-owned store sales increased in the three months ended September 28, 2015 compared to the three months ended September 29, 2014, due to the acquisition of 35 Company-owned stores and the opening of 16 new stores, partially offset by the closure of one store.

In the nine months ended September 28, 2015, Company-owned store sales increased due to the acquisition of 44 Company-owned stores, the opening of 16 stores, and comparable store sales growth of 3.7%, which was partially offset by the closure of two stores and the divestiture of one store. The comparable store sales increases resulted primarily from improved product mix.

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Lease and other. The following table presents Lease and other revenue for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|---------------|----------|-------------------|---------------|----------|
| | September 28, | September 29, | Change | September 28, | September 29, | Change |
| | 2015 | 2014 | | 2015 | 2014 | |
| Lease and other | \$281 | \$ 490 | (42.7)% | \$845 | \$ 2,543 | (66.8)% |
| Percentage of total revenues | 1.0 | % 2.2 | % | 1.0 | % 3.7 | % |

Lease and other revenues decreased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, due to a reduction of \$186,000 from the resale of POS software licenses to franchise owners at cost. Lease and other revenue decreased in the nine months ended September 28, 2015, compared to the nine months ended September 29, 2014, due to a reduction of \$1.8 million from the resale of POS software licenses to franchise owners at cost. An equal and offsetting cost related to the resale of the POS software licenses is included in Selling, general and administrative expenses as discussed below.

Costs and Expenses

Total costs and expenses. The following table presents Total costs and expenses for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|---------------|--------|-------------------|---------------|--------|
| | September 28, | September 29, | Change | September 28, | September 29, | Change |
| | 2015 | 2014 | | 2015 | 2014 | |
| Total costs and expenses | \$25,087 | \$ 18,644 | 34.6 % | \$75,440 | \$ 60,196 | 25.3 % |
| Percentage of total revenues | 89.2 | % 84.1 | % | 87.3 | % 87.1 | % |

Total costs and expenses increased in the three and nine months ended September 28, 2015, compared to the respective three and nine months ended September 29, 2014, primarily as the result of store acquisitions from franchise owners and the opening of new Company-owned stores.

Store operating costs. The following table presents Store operating costs for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|---------------|--------|-------------------|---------------|--------|
| | September 28, | September 29, | Change | September 28, | September 29, | Change |
| | 2015 | 2014 | | 2015 | 2014 | |
| Store operating costs | \$16,404 | \$ 10,737 | 52.8 % | \$46,911 | \$ 31,416 | 49.3 % |
| Percentage of total revenues | 58.3 | % 48.4 | % | 54.3 | % 45.4 | % |

Store operating costs as a percentage of total revenues increased in the three and nine months ended September 28, 2015, compared to the respective three and nine months ended September 29, 2014, primarily as a result of the acquisition of stores from franchise owners and the construction of new stores.

The following table presents a break-out of Store operating costs as a percentage of Company-owned store sales for the periods reported:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 | September 28, 2015 | September 29, 2014 |
| As a % of Company-owned store revenue: | | | | |
| Cost of food and packaging | 36.4 | % 40.1 | % 35.8 | % 39.2 |
| Compensation and benefits | 27.9 | % 25.8 | % 26.4 | % 25.4 |
| Advertising | 10.3 | % 11.1 | % 9.9 | % 10.1 |
| Occupancy | 6.9 | % 6.2 | % 6.4 | % 5.8 |
| Other store operating costs | 11.7 | % 9.2 | % 10.1 | % 9.0 |
| Total store operating costs | 93.2 | % 92.4 | % 88.6 | % 89.5 |

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Total store operating costs as a percentage of Company-owned store sales increased 80 basis points in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, due to increases in compensation and benefits, occupancy and other store operating costs partially offset by decreases in cost of food and packaging and advertising. For the nine months ended September 28, 2015, total store operating costs as a percentage of company-owned store revenues decreased 90 basis points compared to the nine months ended September 29, 2014, due to decreased cost of food and packaging and advertising, partially offset by increases in compensation and benefits, occupancy and other store operating costs

Effect of Store Portfolio Changes. We acquired 44 stores, opened 16 new stores, closed two stores and refranchised one store since December 30, 2013. This shift in our store portfolio is the primary driver behind the increase in Compensation and benefits and Occupancy as a percentage of Company-owned store sales for the three and nine months ended September 28, 2015, compared to the respective three and nine months ended September 29, 2014, as store sales volumes in the newly constructed and acquired stores are currently lower than the segment's average sales. In addition, Occupancy costs are increased as a percentage of sales due to rent expense recorded during new store construction prior to the store's opening in accordance with GAAP.

Cost of food and packaging. Lower cheese prices are positively affecting our Cost of food and packaging in total and as a percentage of Company-owned store sales for the three and nine months ended September 28, 2015, compared to the respective three and nine months ended September 29, 2014. Our average cheese price in the three and nine months ended September 28, 2015, declined by 19.4% and 17.7%, respectively, over our average cheese price in the three and nine months ended September 29, 2014.

Other store operating costs. New store pre-opening costs of \$218,000 and \$464,000 were recognized in Other store operating costs for the three and nine months ended September 28, 2015, respectively, compared to \$0 and \$11,000 in the three and nine months ended September 29, 2014, respectively. Pre-opening costs have historically averaged around \$35,000 per store with the majority of the costs incurred in the two months immediately prior to a new store opening. In 2015 the Company opened 14 new stores as of September 28, 2015, with more nearing completion. Excluding the impact of pre-opening costs in 2015, Other store operating costs as a percentage of Company-owned store sales would have been 10.5% and 9.3% for the three and nine months ended September 28, 2015, respectively.

Selling, general and administrative. The following table presents Selling, general and administrative costs for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|-------------------------------------|-----------------------|-----------------------|--------|-----------------------|-----------------------|---------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Selling, general and administrative | \$6,038 | \$ 5,915 | 2.1 % | \$21,083 | \$ 22,938 | (8.1) % |
| Percentage of total revenues | 21.5 % | 26.7 % | | 24.4 % | 33.2 % | |

Selling, general and administrative costs increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, primarily due to higher incentive compensation expenses. For the nine months ended September 28, 2015, Selling, general and administrative costs decreased compared to the nine months ended September 29, 2014, primarily due to non-recurring costs related to an advisory services and monitoring agreement, including its termination at the time of the IPO, stock-based compensation and other costs incurred in connection with the IPO, and costs related to the resale of POS system licenses to franchise owners at cost in the prior year.

As a percentage of Total revenues, Selling, general and administrative costs decreased in the three and nine months ended September 28, 2015, compared to the respective three and nine months ended September 29, 2014, due mainly to higher company store revenues as a result of the store portfolio changes discussed above and higher franchise royalties.

Excluding the revenues and expenses related to the resale of the POS system software licenses sold to franchise owners at cost and the costs incurred in preparation for the IPO, Selling, general and administrative costs as a percent of revenues would have been 20.7% and 23.9% for the three and nine months ended September 28, 2015, respectively, compared to the respective three and nine months ended September 29, 2014.

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Depreciation and amortization. The following table presents Depreciation and amortization for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|-------------------------------|--------------------|--------------------|--------|--------------------|--------------------|--------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Depreciation and amortization | \$2,641 | \$ 2,007 | 31.6 % | \$7,380 | \$ 5,815 | 26.9 % |
| Percentage of total revenues | 9.4 % | 9.1 % | | 8.5 % | 8.4 % | |

Depreciation and amortization increased in the three and nine months ended September 28, 2015, due primarily to the amortization of reacquired franchise rights and depreciation associated with increasing company-owned store counts and increased capital expenditures on property and equipment for business technology projects.

Interest expense. The following table presents Interest expense for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|----------|--------------------|--------------------|----------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Interest expense | \$1,137 | \$ 1,539 | (26.1) % | \$3,429 | \$ 6,966 | (50.8) % |
| Percentage of total revenues | 4.0 % | 6.9 % | | 3.9 % | 10.0 % | |

Interest expense decreased in the three and nine months ended September 28, 2015, as a result of a reduction in outstanding debt through the application of net proceeds from the IPO in May 2014 and an interest rate reduction achieved concurrently with the IPO, and through an August 2014 refinancing.

Loss on early retirement of debt. The Loss on early retirement of debt was a result of prepayment penalties and expenses associated with the \$55.5 million prepayment made in May 2014 using proceeds from the IPO.

Loss on disposal or impairment of investments. The Loss on disposal or impairment of investments for the nine months ended September 28, 2015, was a result of an impairment recognized on the investment in Project Pie prior to its disposal.

Income Taxes. The following table presents income taxes for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|---|--------------------|--------------------|--------|--------------------|--------------------|--------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Provision for (benefit from) income taxes | \$746 | \$ (703) | N/M | \$1,206 | \$ (1,124) | N/M |
| Percentage of total revenues | 2.6 % | (3.1) % | | 1.4 % | (1.6) % | |
| Effective tax rate | 39.9 % | 47.1 % | | 40.4 % | 41.6 % | |

N/M = not meaningful

The Provision for (benefit from) income taxes increased in the three months ended September 28, 2015, due primarily to a change in Income (Loss) Before Income Taxes. For the nine months ended September 28, 2015, the provision for income taxes increased due primarily to a change in Income (Loss) Before Income Taxes.

The effective tax rate for the three months ended September 28, 2015, decreased primarily due to discrete adjustments related to share-based compensation in 2014. The effective tax rate for the nine months ended September 28, 2015, decreased primarily due to discrete adjustments related to share-based compensation in 2014. Our income taxes have varied from what would be expected through the application of prevailing statutory rates mainly due to the impact of meal and entertainment expenses and share-based compensation expenses.

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Segment Results

Domestic Franchise. The following table presents Domestic Franchise Total revenues and Operating Income for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|--------|--------------------|--------------------|---------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Total revenues | \$10,445 | \$ 10,139 | 3.0 % | \$33,258 | \$ 33,510 | (0.8) % |
| Percentage of total revenues | 37.1 % | 45.8 % | | 38.5 % | 48.5 % | |
| Operating Income | 4,901 | 4,713 | 4.0 % | 15,036 | 14,941 | 0.6 % |

Total revenues for the Domestic Franchise segment increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, due mainly to comparable store sales growth of 1.5%. For the nine months ended September 28, 2015, Total revenues for the Domestic Franchise segment decreased compared to the nine months ended September 29, 2014, due to lower revenue related to the POS system software licenses of \$1.8 million, partially offset by segment comparable store sales growth of 3.9%.

Operating Income for the Domestic Franchise segment increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, due to increased Total revenues, partially offset by an increase in Selling, general and administrative costs. For the nine months ended September 28, 2015, Operating Income for the Domestic Franchise segment increased compared to the nine months ended September 29, 2014, due to decreased Domestic Franchise Total revenues, partially offset by an increase in Depreciation and amortization.

Domestic Company Stores. The following table presents Domestic Company Stores Total revenues and Operating Income for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|-----------|--------------------|--------------------|---------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Total revenues | \$17,604 | \$ 11,627 | 51.4 % | \$52,927 | \$ 35,121 | 50.7 % |
| Percentage of total revenues | 62.6 % | 52.4 % | | 61.2 % | 50.8 % | |
| Operating (Loss) Income | (516) | (178) | (189.9) % | 1,172 | 501 | 133.9 % |

Total revenues for the Domestic Company Stores segment increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, as a result of the acquisition of 35 stores from franchise owners and the opening of 16 stores, partially offset by the closure of one store. For the nine months ended September 28, 2015, Total revenues for the Domestic Company Stores segment increased, compared to the nine months ended September 29, 2014, due primarily to the acquisition of 44 stores from franchise owners, the opening of 16 stores, and segment comparable store sales growth of 3.7%, partially offset by the closure of two stores and the divestiture of one store.

Operating Loss for the Domestic Company Stores segment increased in the three months ended September 28, 2015, compared to the three months ended September 29, 2014, as a result of an increase in depreciation and amortization related to Company-owned stores portfolio changes. For the nine months ended September 28, 2015, Operating Income for the Domestic Company Stores segment increased, compared to the nine months ended September 29, 2014, as a result of a 3.7% increase in comparable store sales and increased operating margins, partially offset by an increase in depreciation and amortization related to Company-owned stores portfolio changes.

International. The following table presents International Total revenues and Operating Income for the periods reported:

| (in thousands) | Three Months Ended | | | Nine Months Ended | | |
|------------------------------|--------------------|--------------------|----------|--------------------|--------------------|----------|
| | September 28, 2015 | September 29, 2014 | Change | September 28, 2015 | September 29, 2014 | Change |
| Total revenues | \$83 | \$ 403 | (79.4) % | \$236 | \$ 501 | (52.9) % |
| Percentage of total revenues | 0.3 % | 1.8 % | | 0.3 % | 0.7 % | |
| Operating Income | 76 | 252 | (69.8) % | 154 | 28 | 450.0 % |

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Total revenues for the International segment decreased for the three and nine months ended September 28, 2015, compared to the three and nine months ended September 29, 2014, respectively, largely as a result of decreased franchise fees and other revenues.

Operating Income for the International segment decreased for the three months ended September 28, 2015, compared to the three months ended September 29, 2014, primarily as a result of reduced revenues, which was partially offset by lower Selling, general and administrative costs. Operating Income for the International segment increased for the nine months ended September 28, 2015, compared to the nine months ended September 29, 2014, primarily as a result of lower Selling, general and administrative costs, which was partially offset by reduced revenues.

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. As a public company, we may also raise additional capital through the sale of equity, but such additional capital may not be available on favorable terms, if at all. As of September 28, 2015, we had negative net working capital of \$8.7 million as a result of the relatively quick sales-to-cash cycle and low levels of inventory required to operate our business.

As of September 28, 2015, we had cash and cash equivalents of \$5.5 million and \$20.0 million of available borrowings under a revolving credit facility, of which none was drawn. As of September 28, 2015, we had \$112.9 million of outstanding indebtedness. Principal payments under our 2014 Credit Facility are due on the last day of each fiscal quarter through the life of the 2014 Credit Facility. We believe that our cash flows from operations, available cash and cash equivalents and available borrowings under our revolving credit facility will be sufficient to meet our liquidity needs for at least the next 12 months.

As of September 28, 2015, we were in compliance with all of our covenants and other obligations under our 2014 Credit Facility.

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 | |
|--------------------------------------|--------------------|--------------------|
| | September 28, 2015 | September 29, 2014 |
| Cash flows from operating activities | \$ 17,937 | \$ 5,557 |
| Cash flows from investing activities | (15,727) | (4,070) |
| Cash flows from financing activities | (1,783) | (4,595) |
| Total cash flows | \$ 427 | \$ (3,108) |

Cash Flows from Operating Activities

Net cash provided by operating activities of \$17.9 million for the nine months ended September 28, 2015, resulted primarily from net income of \$1.8 million, adjusted for items such as depreciation and amortization and working capital changes. The \$12.4 million increase over the nine months ended September 29, 2014 was primarily driven by the \$3.4 million increase in net income and a net increase of \$8.3 million from changes in operating assets and liabilities compared to the nine months ended September 29, 2014.

Cash Flows from Investing Activities

Net cash used by investing activities was \$15.7 million in the nine months ended September 28, 2015, compared to net cash used of \$4.1 million in the nine months ended September 29, 2014. The \$11.6 million increase in cash used by investing activities was due primarily to an increase of \$8.9 million for the acquisition of stores, \$2.5 million of additional acquisition costs for property, plant, and equipment and a decrease of \$0.9 million received from payments on notes receivable compared to the nine months ended September 29, 2014.

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Cash Flows from Financing Activities

Net cash used by financing activities was \$1.8 million in the nine months ended September 28, 2015, compared to net cash used of \$4.6 million in the nine months ended September 29, 2014. The \$2.8 million decrease in net cash used compared to the nine months ended September 29, 2014 was primarily due to costs associated with the IPO of \$3.5 million in the nine months ended September 29, 2014.

Contractual Obligations

In connection with its investment in Project Pie, PPH had committed as of December 29, 2014, to fund, upon demand, up to an additional \$0.5 million prior to December 2016 through the purchase of additional Series A Preferred Units of Project Pie. During the nine months ended September 28, 2015, PPH invested the additional \$0.5 million and satisfied its commitment to Project Pie.

Critical Accounting Policies

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

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

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.

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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Commodity Price Risk

We are exposed to market risks from changes in commodity prices. During the normal course of the year, we enter into national pricing commitments for cheese and other food products that are affected by changes in commodity prices and, as a result, our franchise and Company-owned stores are subject to volatility in food costs. We also maintain relationships with multiple suppliers for certain key products, such as cheese. We do not engage in speculative transactions nor do we hold or issue financial instruments for trading purposes. In instances when we use fixed pricing agreements with our suppliers, these agreements cover our physical commodity needs, are not net-settled and are accounted for as normal purchases.

Interest Rate Risk

We are subject to interest rate risk on indebtedness under our 2014 Credit Facility. Interest rates on loans made under our 2014 Credit Facility are based on LIBOR, and under specified circumstances we may be required by our lenders to enter into interest rate swap arrangements. A hypothetical 1.0% increase or decrease in the interest rate associated with our 2014 Credit Facility would have resulted in a \$1.1 million impact to interest expense on an annualized basis.

Foreign Currency Exchange Rate Risk

Our international franchise owners use the local currency as their functional currency. Royalty payments from our franchise owners in the Middle East are generally remitted to us in U.S. dollars and royalty payments from our Canadian franchise owners are generally remitted to us in Canadian dollars. Because our international activities do not account for a significant portion of our revenues, we believe our exposure to foreign currency risk is minimal.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have not engaged an independent registered accounting firm to perform an audit of our internal control over financial reporting as of any balance sheet date or for any period reported in our financial statements. Our independent public registered accounting firm will first be required to attest to the effectiveness of our internal control over financial reporting for our Annual Report on Form 10-K for the first year we are no longer an “emerging growth company.”

This Quarterly Report on Form 10-Q does not include a report of management’s assessment regarding internal control over financial reporting or an attestation report of the Company’s registered public accounting firm due to a transition period established by rules of the SEC for newly public companies.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, 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”). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

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 were 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.

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Changes in Internal Control over Financial Reporting

There have been no significant 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

We currently are subject to litigation with a group of our franchise owners, initially filed by twelve franchise owners and their individual stakeholders on April 11, 2014, in the Superior Court in Clark County, Washington, claiming that we misrepresented our sales volumes, made false representations to them and charged excess advertising fees, among other things, and alleging 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. On June 18, 2014, an additional 16 franchise owners and their individual stakeholders, represented by the same counsel as the plaintiffs described above, filed a lawsuit with the Superior Court in Clark County, Washington, making essentially the same claims and 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. We have reached resolution with eleven of the franchise owners (and those owners' individual stakeholders) involved in the consolidated lawsuits, and their claims have either been dismissed or dismissal is pending. We believe the allegations in these consolidated lawsuits lack merit and, for those plaintiffs with whom we are unable to reach resolution, we will continue to vigorously defend our interests, including by asserting a number of affirmative defenses and, where appropriate, counterclaims. We provide no assurance that we will be successful in our defense of these lawsuits; however, we do not currently expect the cost of resolving them to have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

On May 8, 2015, we were named as a defendant in a class action lawsuit in United States District Court for the Western District of Washington claiming a violation of the federal Telephone Consumer Protection Act, which prohibits companies from making telemarketing calls to numbers listed in the Federal Do-Not-Call Registry and imposes other obligations and limitations on making phone calls and sending text messages to consumers. The lawsuit alleges that we did not comply with the statutory requirements for obtaining consumers' consent to receive text messages from us, and seeks statutory penalties for those alleged deficiencies. We believe the plaintiff's interpretation of the applicable law is incorrect, and we will vigorously defend ourselves in the lawsuit, but provide no assurance that we will be successful. An adverse judgment or settlement could have an adverse effect on our profitability and could cause variability in our results compared to expectations.

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

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. Before making an investment decision, you should carefully consider the risks and uncertainties described in our Quarterly Report on Form 10-Q for the quarterly period ended June 29, 2015, under the section titled "Risk Factors" as well as the other information in this Quarterly Report on Form 10-Q. 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 the Quarterly Report on Form 10-Q for the quarterly period ended June 29, 2015, include any material changes to and supersede the description of the risk factors associated with our business previously disclosed in our Annual Report on Form 10-K for the year ended December 29, 2014, and 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 September 28, 2015, the Company repurchased the following shares:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------------------------------|---|------------------------------------|--|--|
| June 30 to July 31, 2015 | — | \$— | — | N/A |
| August 1 to August 31, 2015 | 2,639 | (1) 0.19 | — | N/A |
| September 1 to September 28, 2015 | — | — | — | N/A |
| Total | 2,639 | \$0.19 | — | N/A |

The Company repurchased unvested restricted shares from former employees whose employment with the

- (1) Company had terminated. The unvested shares were repurchased by the Company at the historical price paid by the former employees for the unvested shares.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits.

| EXHIBIT NUMBER | DESCRIPTION OF EXHIBITS | INCORPORATED BY REFERENCE | |
|-------------------|--|---------------------------|-----------------------|
| | | FILE FORMNUMBER | FILING EXHIBITDATE |
| 31.1* | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | |
| 31.2* | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | |
| 32.1* | Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | |
| 32.2* | Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | |
| 101.INS* | XBRL Instance Document | | |
| 101.SCH* | XBRL Taxonomy Extension Schema Document | | |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document | | |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document | | |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document | | |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document | | |
| * | Filed herewith | | |

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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/ Mark Hutchens
Name: Mark Hutchens
Title: Chief Financial Officer

Date: November 4, 2015

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