

NOODLES & Co
Form 10-Q
August 11, 2017

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended July 4, 2017

or

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

For the transition period from _____ to _____

Commission File Number: 001-35987

NOODLES & COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization) **84-1303469**
(I.R.S. Employer Identification No.)

520 Zang Street, Suite D

Broomfield, CO

80021

(Address of principal executive offices) (Zip Code)

(720) 214-1900

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

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

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

| Class | Outstanding at August 7, 2017 |
|--|-------------------------------|
| Class A Common Stock, \$0.01 par value per share | 39,588,210 shares |
| Class B Common Stock, \$0.01 par value per share | 1,522,098 shares |

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Table of Contents**PART I****Item 1. Financial Statements****Noodles & Company****Condensed Consolidated Balance Sheets****(in thousands, except share and per share data)**

| | July 4, 2017 | January 3, 2017 |
|---|-------------------------|----------------------------|
| | (unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 3,158 | \$ 1,837 |
| Accounts receivable | 2,946 | 5,438 |
| Inventories | 10,075 | 11,285 |
| Prepaid expenses and other assets | 6,882 | 6,972 |
| Income tax receivable | 196 | 256 |
| Total current assets | 23,257 | 25,788 |
| Property and equipment, net | 164,112 | 173,533 |
| Goodwill | 6,400 | 6,400 |
| Intangibles, net | 1,603 | 1,715 |
| Other assets, net | 2,070 | 2,025 |
| Total long-term assets | 174,185 | 183,673 |
| Total assets | \$ 197,442 | \$ 209,461 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 9,350 | \$ 10,601 |
| Accrued payroll and benefits | 10,643 | 10,723 |
| Accrued expenses and other current liabilities | 22,506 | 27,709 |
| Total current liabilities | 42,499 | 49,033 |
| Long-term debt, net | 60,888 | 84,676 |
| Deferred rent | 38,754 | 44,929 |
| Deferred tax liabilities, net | 706 | 435 |
| Other long-term liabilities | 10,663 | 4,570 |
| Total liabilities | 153,510 | 183,643 |
| Convertible Series A preferred stock—\$0.01 par value, 50,000 shares authorized and designated as of July 4, 2017; zero shares issued and outstanding as of July 4, 2017 and zero shares designated, issued or outstanding as of January 3, 2017 | — | — |
| Stockholders' equity: | | |
| Preferred stock—\$0.01 par value, 950,000 shares authorized and undesignated as of July 4, 2017 and 1,000,000 shares authorized and undesignated as of January 3, 2017; zero shares issued and outstanding as of July 4, 2017 and January 3, 2017 | — | — |
| Common stock—\$0.01 par value, authorized 180,000,000 shares as of July 4, 2017 and January 3, 2017; 43,522,430 issued and 41,098,559 outstanding as of July 4, 2017 and 30,300,925 issued and 27,877,054 outstanding as of January 3, 2017 | 435 | 303 |
| Treasury stock, at cost, 2,423,871 shares as of July 4, 2017 and January 3, 2017 | (35,000) | (35,000) |
| Additional paid-in capital | 170,923 | 124,272 |
| Accumulated other comprehensive loss | (60) | (51) |
| Accumulated deficit | (92,366) | (63,706) |
| Total stockholders' equity | 43,932 | 25,818 |
| Total liabilities and stockholders' equity | \$ 197,442 | \$ 209,461 |

See accompanying notes to condensed consolidated financial statements.

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Noodles & Company
Condensed Consolidated Statements of Operations
(in thousands, except share and per share data, unaudited)

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|---|----------------------|------------------|---------------------------|------------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| <i>Revenue:</i> | | | | |
| Restaurant revenue | \$ 111,628 | \$ 120,204 | \$ 227,155 | \$ 233,069 |
| Franchising royalties and fees | 1,164 | 1,203 | 2,352 | 2,324 |
| Total revenue | 112,792 | 121,407 | 229,507 | 235,393 |
| <i>Costs and expenses:</i> | | | | |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): | | | | |
| Cost of sales | 29,598 | 32,164 | 61,685 | 62,353 |
| Labor | 36,430 | 39,316 | 76,024 | 76,750 |
| Occupancy | 12,630 | 13,688 | 26,631 | 27,002 |
| Other restaurant operating costs | 16,194 | 18,596 | 33,341 | 35,488 |
| General and administrative | 9,393 | 9,840 | 20,059 | 19,877 |
| Depreciation and amortization | 6,279 | 7,071 | 12,546 | 13,977 |
| Pre-opening | 246 | 796 | 791 | 1,833 |
| Restaurant impairments, closure costs and asset disposals | 2,830 | 11,248 | 24,884 | 12,264 |
| Total costs and expenses | 113,600 | 132,719 | 255,961 | 249,544 |
| Loss from operations | (808) | (11,312) | (26,454) | (14,151) |
| Interest expense, net | 927 | 598 | 1,935 | 1,226 |
| Loss before income taxes | (1,735) | (11,910) | (28,389) | (15,377) |
| Provision for income taxes | 80 | 2,177 | 271 | 1,083 |
| Net loss | (1,815) | (14,087) | (28,660) | (16,460) |
| Accretion of preferred stock to redemption value | (7,001) | — | (7,967) | — |
| Net loss attributable to common stockholders | \$(8,816) | \$(14,087) | \$(36,627) | \$(16,460) |
| Loss per share of Class A and Class B common stock, combined: | | | | |
| Basic | \$(0.22) | \$(0.51) | \$(1.06) | \$(0.59) |
| Diluted | \$(0.22) | \$(0.51) | \$(1.06) | \$(0.59) |
| Weighted average shares of Class A and Class B common stock outstanding, combined: | | | | |
| Basic | 40,779,277 | 27,776,094 | 34,404,222 | 27,754,615 |
| Diluted | 40,779,277 | 27,776,094 | 34,404,222 | 27,754,615 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Noodles & Company****Condensed Consolidated Statements of Comprehensive Income (Loss)****(in thousands, unaudited)**

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|------------------|---------------------------|------------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Net loss | \$(1,815) | \$(14,087) | \$(28,660) | \$(16,460) |
| Other comprehensive (loss) income: | | | | |
| Foreign currency translation adjustments | (9) | 22 | (9) | 127 |
| Other comprehensive (loss) income | (9) | 22 | (9) | 127 |
| Comprehensive loss | \$(1,824) | \$(14,065) | \$(28,669) | \$(16,333) |

See accompanying notes to condensed consolidated financial statements.

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Noodles & Company
Condensed Consolidated Statements of Cash Flows
(in thousands, unaudited)

| | Two Fiscal Quarters Ended | |
|---|----------------------------------|--------------------------|
| | July 4, 2017 | June 28, 2016 |
| Operating activities | | |
| Net loss | \$(28,660) | \$(16,460) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 12,546 | 13,977 |
| Deferred income taxes | 271 | 1,083 |
| Restaurant impairments, closure costs and asset disposals | 19,441 | 11,889 |
| Amortization of debt issuance costs | 185 | 58 |
| Stock-based compensation | 945 | 849 |
| Non-cash gain on litigation settlement | (421) | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,465 | (383) |
| Inventories | (468) | (301) |
| Prepaid expenses and other assets | 46 | 4,171 |
| Accounts payable | 17 | (4,802) |
| Deferred rent | 1,479 | 2,835 |
| Income taxes | 60 | 42 |
| Accrued expenses and other liabilities | (16,137) | (677) |
| Net cash (used in) provided by operating activities | (8,231) | 12,281 |
| Investing activities | | |
| Purchases of property and equipment | (12,213) | (24,016) |
| Net cash used in investing activities | (12,213) | (24,016) |
| Financing activities | | |
| Net borrowings from swing line loan | 6,947 | 215 |
| Proceeds from issuance of long-term debt | 6,757 | 11,500 |
| Payments on long-term debt | (37,015) | (1,000) |
| Issuance of preferred stock and common stock warrants, net of transaction expenses (see Note 9) | 16,589 | — |
| Issuance of common stock, net of transaction expenses (see Note 9) | 29,110 | — |
| Proceeds from exercise of stock options and employee stock purchase plan | 37 | 876 |
| Debt issuance costs | (662) | (2) |
| Net cash provided by financing activities | 21,763 | 11,589 |
| Effect of exchange rate changes on cash | 2 | 127 |
| Net increase (decrease) in cash and cash equivalents | 1,321 | (19) |
| Cash and cash equivalents | | |
| Beginning of period | 1,837 | 1,912 |
| End of period | \$3,158 | \$1,893 |

See accompanying notes to condensed consolidated financial statements.

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NOODLES & COMPANY

**Notes to Condensed Consolidated Financial Statements
(unaudited)**

1. Business Summary and Basis of Presentation

Business

Noodles & Company (the “Company”), a Delaware corporation, develops and operates fast casual restaurants that serve globally inspired noodle and pasta dishes, soups, salads and appetizers. As of July 4, 2017, the Company had 413 company-owned restaurants and 73 franchise restaurants in 31 states and the District of Columbia. The Company operates its business as one operating and reportable segment.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Noodles & Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments considered necessary for the fair presentation of the Company’s results of operations, financial position and cash flows for the periods presented have been included and are of a normal, recurring nature. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The results of operations for any interim period are not necessarily indicative of results for the full year. Certain information and footnote disclosures normally included in the Company’s annual consolidated financial statements on Form 10-K have been condensed or omitted. The condensed consolidated balance sheet as of January 3, 2017 was derived from audited financial statements. These financial statements should be read in conjunction with the audited financial statements and the related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended January 3, 2017.

Fiscal Year

The Company operates on a 52- or 53-week fiscal year ending on the Tuesday closest to December 31. Fiscal year 2017, which ends on January 2, 2018, contains 52 weeks, and fiscal year 2016, which ended on January 3, 2017, contained 53 weeks. The Company’s 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. The Company’s fiscal quarter that ended July 4, 2017 is referred to as the second quarter of 2017, and the fiscal quarter ended June 28, 2016 is referred to as the second quarter of 2016.

Reclassification

As of January 3, 2017, the Company changed its presentation on the Condensed Consolidated Statements of Cash Flows of borrowings and repayments from its swing line loan to a net basis. Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation, which had no impact on the net change in cash and cash equivalents or the amount of net cash provided by financing activities for the applicable prior period presented. This reclassification had no effect on reported net loss.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606),” which supersedes the revenue recognition requirements in Accounting Standards Codification (“ASC”) 605, “Revenue Recognition.” This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of the new revenue standard by one year, and would allow entities the option

to early adopt the new revenue standard as of the original effective date. There have been multiple standards updates amending this guidance or providing corrections or improvements on issues in the guidance. The requirements for these standards relating to Topic 606 will be effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted for interim and annual periods beginning after December 15, 2016. The Company expects to adopt these standards upon their effective date (the Company's first quarter of fiscal 2018), using one of two retrospective application methods. The

Company does not believe the new revenue recognition standard will materially impact its recognition of revenue from restaurant operations of company-owned restaurants or its recognition of continuing royalty fees from franchisees. The Company believes adoption of the new revenue recognition standard will impact its accounting for initial fees charged to franchisees. Historically, the Company has recognized revenue from initial franchise fees upon the opening of a franchised restaurant when it performed all of its material obligations and initial services. Upon the adoption of Topic 606, the Company will generally recognize initial franchise fees over the term of a franchise agreement. The Company will be finalizing accounting policies, selecting its transition method, quantifying the impact of adopting this standard, and designing internal controls during the fiscal year ended January 2, 2018. The Company is currently evaluating the impact the adoption of this accounting standard will have on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases." The pronouncement amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheet and making targeted changes to lessor accounting. This pronouncement will be effective for interim and annual periods beginning after December 15, 2018 (the Company's first quarter of fiscal 2019), with early adoption permitted. The new lease standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company believes the adoption of ASU No. 2016-02 will have a significant impact on its consolidated balance sheets by significantly increasing its non-current assets and non-current liabilities in order to record the right of use assets and related lease liabilities for its existing operating leases. The Company is currently evaluating the impact the adoption of this accounting standard will have on its results of operations and cash flows and related disclosures.

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory." ASU 2016-16 provide guidance on the income tax consequences of an intra-entity transfer of an asset other than inventory. The guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted for any entity as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. The Company is currently evaluating the impact of the guidance, but does not believe it will materially impact the Company's financial position or results of operations and cash flows.

2. Supplemental Financial Information

Property and equipment, net, consists of the following (in thousands):

| | July 4, 2017 | January 3, 2017 |
|---|-----------------|--------------------|
| Leasehold improvements | \$208,139 | \$205,687 |
| Furniture, fixtures and equipment | 120,910 | 120,248 |
| Construction in progress | 2,060 | 8,044 |
| | 331,109 | 333,979 |
| Accumulated depreciation and amortization | (166,997) | (160,446) |
| | \$164,112 | \$173,533 |

Accrued expenses and other current liabilities consist of the following (in thousands):

| | July 4, 2017 | January 3, 2017 |
|-------------------------|-----------------|--------------------|
| Gift card liability | \$2,987 | \$3,857 |
| Occupancy related | 5,706 | 2,069 |
| Utilities | 1,662 | 1,753 |
| Data breach liabilities | 7,605 | 11,622 |
| Legal settlement | — | 3,000 |
| Other accrued expenses | 4,546 | 5,408 |
| | \$22,506 | \$27,709 |

Table of Contents**3. Long-Term Debt**

The Company has a credit facility consisting of a revolving line of credit of \$100.0 million, expiring in June 2020. As of July 4, 2017, the Company had \$62.1 million of indebtedness and \$3.0 million letters of credit outstanding under the revolving line of credit. The Company's ability to borrow funds pursuant to the revolving line of credit is further limited by the requirement that it comply with the revolving line of credit's financial covenants upon the measurement dates specified therein. These financial covenants include a maximum lease-adjusted leverage ratio and a minimum consolidated fixed charge coverage ratio. The credit agreement also contains other customary covenants, including limitations on additional borrowings, acquisitions, dividend payments and lease commitments.

On February 8, 2017, the Company entered into an amendment to its credit facility. Among other things, giving effect to the equity issuances completed during the first quarter of 2017, the amendment (i) increased the interest rate margin applicable at total lease adjusted leverage levels at and above 4.25:1.00 and from the period of the date of amendment to the delivery of the first following quarterly compliance certificate, (ii) increased capital expenditure amounts related to restaurant growth, and (iii) made certain other changes. The Consolidated EBITDA definition, as revised, permits certain costs to be added back into the Consolidated EBITDA calculation, including costs associated with closing underperforming restaurants in 2017 (fees to landlords resulting from the termination of the Company's leases for such restaurants, the fees to its real estate advisor and brokers related to such terminations and other costs of closing restaurants, such as severance for terminated employees) and liabilities associated with the data security incident that occurred in 2016 (as described in greater detail in Note 11, Commitments and Contingencies). This amendment also revised certain financial covenant levels. Borrowings under this amended and restated agreement bear interest, at the Company's option, at either (i) LIBOR plus 2.00% to 3.25%, based on the lease-adjusted leverage ratio or (ii) the highest of the following rates plus zero to 1.00%: (a) the federal funds rate plus 0.50%; (b) the Bank of America prime rate or (c) the one month LIBOR plus 1.00%. The credit facility includes a commitment fee of 0.30% to 0.50%, based on the lease-adjusted leverage ratio, per year on any unused portion of the credit facility.

The credit facility bore interest between 3.77% and 6.50% during the two quarters of 2017. The Company also maintains outstanding letters of credit to secure obligations under its workers' compensation program and certain lease obligations. The Company was in compliance with all of its debt covenants as of July 4, 2017.

4. Fair Value Measurements

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate their fair values due to their short-term nature. The carrying amounts of borrowings under the credit facility approximate fair value as the line of credit and term borrowings vary with market interest rates and negotiated terms and conditions are consistent with current market rates. The fair value of the Company's line of credit borrowings is measured using Level 2 inputs.

Adjustments to the fair value of non-financial assets measured at fair value on a non-recurring basis as of July 4, 2017 and June 28, 2016 are discussed in Note 7, Restaurant Impairments, Closure Costs and Asset Disposals.

5. Income Taxes

The following table presents the Company's provision (benefit) for income taxes (in thousands):

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|----------------------------|----------------------|---------------|---------------------------|---------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Provision for income taxes | \$80 | \$2,177 | \$271 | \$1,083 |
| Effective tax rate | (4.6)% | (18.3)% | (1.0)% | (7.0)% |

During the first quarter of 2016, the Company recorded a valuation allowance against Canadian deferred tax assets. During the second quarter of 2016, the Company determined that it was appropriate to record a valuation allowance against U.S. deferred tax assets. As a result, the effective tax rates for all periods presented reflect the impact of a

valuation allowance against U.S. and Canadian deferred tax assets. For the remainder of fiscal 2017, the Company does not anticipate material income tax expense or benefit as a result of the valuation allowance recorded. The Company will maintain the valuation allowance against deferred tax assets until there is sufficient evidence to support a full or partial reversal. The reversal of a previously recorded valuation allowance will generally result in a benefit to the effective tax rate.

Table of Contents**6. Stock-Based Compensation**

The Company's Stock Incentive Plan, as amended and restated in May of 2013, authorizes the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units ("RSUs") and incentive bonuses to employees, officers, nonemployee directors and other service providers. The number of shares of common stock available for issuance pursuant to awards granted under the Stock Incentive Plan on or after the IPO shall not exceed 3,750,500 shares.

The following table shows total stock-based compensation expense (in thousands):

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|---------------|---------------------------|---------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Stock-based compensation expense | \$648 | \$564 | \$945 | \$973 |
| Capitalized stock-based compensation expense | \$52 | \$63 | \$102 | \$124 |

7. Restaurant Impairments, Closure Costs and Asset Disposals

The following table presents restaurant impairments, closure costs and asset disposals (in thousands):

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|---------------------------------------|----------------------|---------------|---------------------------|---------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Restaurant impairments ⁽¹⁾ | \$4,037 | \$10,346 | \$5,973 | \$10,541 |
| Closure costs ⁽¹⁾ | (1,471) | 538 | 18,415 | 1,087 |
| Loss on disposal of assets and other | 264 | 364 | 496 | 636 |
| | \$2,830 | \$11,248 | \$24,884 | \$12,264 |

(1) Restaurant impairments and closure costs in all periods presented above include amounts related to restaurants previously impaired or closed.

During the second quarter of 2017, nine restaurants were identified as impaired compared to 11 during the second quarter of 2016. During the first two quarters of 2017, 13 restaurants were identified as impaired compared to 12 restaurants during the first two quarters of 2016. Impairment is based on management's current assessment of the expected future cash flows of various restaurants based on recent results and other specific market factors. Impairment expense is a Level 3 fair value measure and was determined by comparing the carrying value of restaurant assets to the estimated fair market value of the restaurant assets at resale value.

During the second quarter of 2017, a gain of \$3.6 million was recognized related to closures primarily due to adjustments to the liabilities to landlords as lease terminations occurred for 21 of the 55 restaurants closed during the first quarter of 2017, partially offset by \$2.0 million of costs related to the restaurants closed in the first quarter of 2017. During the first two quarters of 2017, \$18.4 million of closure costs were recognized related to the 55 restaurants closed during the first quarter of 2017, as well as ongoing costs of restaurants closed in the fourth quarter of 2015. The closure costs of \$0.5 million recognized during the second quarter of 2016 and \$1.1 million during the first two quarters of 2016 are related to the ongoing costs of restaurants closed in the fourth quarter of 2015. These expenses are included in the "Restaurant impairments, closure costs and asset disposals" line in the Condensed Consolidated Statements of Operations.

8. Earnings (Loss) Per Share

Basic earnings per share ("EPS") is calculated by dividing net income (loss) available to common stockholders by the weighted-average number of shares of common stock outstanding during each period. Diluted EPS is calculated using net income (loss) available to common stockholders divided by diluted weighted-average shares of common stock outstanding during each period. Potentially dilutive securities include shares of common stock underlying stock options, warrants and restricted common stock. 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.

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The following table sets forth the computations of basic and diluted EPS (in thousands, except share and per share data):

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|------------------|---------------------------|------------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Net loss attributable to common stockholders | \$(8,816) | \$(14,087) | \$(36,627) | \$(16,460) |
| Shares: | | | | |
| Basic weighted average shares outstanding | 40,779,272 | 27,776,094 | 34,404,222 | 27,754,615 |
| Effect of dilutive securities | — | — | — | — |
| Diluted weighted average shares outstanding | 40,779,272 | 27,776,094 | 34,404,222 | 27,754,615 |
| Loss per share: | | | | |
| Basic loss per share | \$(0.22) | \$(0.51) | \$(1.06) | \$(0.59) |
| Diluted loss per share | \$(0.22) | \$(0.51) | \$(1.06) | \$(0.59) |

The Company computes the effect of dilutive securities using the treasury stock method and average market prices during the period. Potential common shares are excluded from the computation of diluted earnings (loss) per share when the effect would be anti-dilutive. All potential common shares are anti-dilutive in periods of net loss. The number of shares issuable on the vesting or exercise of share based awards or exercise of outstanding warrants excluded from the calculation of diluted loss per share because the effect of their inclusion would have been anti-dilutive totaled 3,393,950 and 1,561,256 for the second quarters of 2017 and 2016, respectively, and totaled 5,631,982 and 1,559,515 for first two quarters of 2017 and 2016, respectively.

9. Stockholders' Equity***Securities Purchase Agreement with L Catterton***

On February 8, 2017, the Company entered into a securities purchase agreement with *L Catterton*, pursuant to which the Company agreed, in return for aggregate gross proceeds of \$18.5 million, to sell to *L Catterton* an aggregate of 18,500 shares of preferred stock convertible into 4,252,873 shares of the Company's Class A common stock, par value \$0.01 per share, at a price per share of \$1,000, plus warrants exercisable for five years beginning six months following their issuance for the purchase of 1,913,793 shares of the Company's Class A common stock, at a price per share of \$4.35 (such transactions, collectively, the "private placement"). The proceeds have been, and will continue to be used, in conjunction with cash flow from the Company's operations and the proceeds received from the transaction with Mill Road (see below), to satisfy existing and anticipated liabilities and to fund, in part, certain capital expenditures related to business initiatives in its company-owned restaurants. Any remaining proceeds are expected to be used for general corporate purposes. The funding of the private placement occurred on February 9, 2017 and the net proceeds from the transaction were \$16.6 million, after \$1.9 million of transaction expenses.

The Company determined that the preferred stock was more akin to an equity security than debt primarily because the preferred stock was contingently redeemable upon the occurrence of an event that was outside of the Company's control. The proceeds were allocated between the three features of the private placement: the warrants, the embedded beneficial conversion feature in the preferred stock, and the preferred stock itself. The fair values of the warrants of \$3.1 million and the embedded beneficial conversion feature of \$3.1 million were recorded as a discount against the stated value of the preferred stock on the date of issuance. The fair value of the warrants was estimated using a Black-Scholes option pricing model which is a Level 2 estimate of fair value. This discount is amortized, using the interest method, and treated as a deemed dividend through the date of conversion, which results in the accretion of the preferred stock to its full redemption value.

On April 5, 2017, the Company delivered a notice to *L Catterton* of its election to exercise the conversion option with respect to the Series A Convertible Preferred Stock. The terms of the preferred stock provided that the Company could, at its option upon the satisfaction of certain conditions, cause all outstanding shares of preferred stock to be automatically converted into the Company's Class A common stock. The conversion of the preferred stock into

4,252,873 shares of the Company's Class A Common Stock occurred on April 12, 2017. After the conversion, no shares of preferred stock are outstanding.

At the conversion date, all unamortized discounts were recognized immediately as a deemed dividend, which increased the net loss attributable to common stockholders. The amortized discount, which has been treated in the same manner as dividends, was \$7.0 million for the second quarter of 2017 and \$8.0 million for the first two quarters of 2017.

Table of Contents***Securities Purchase Agreement with Mill Road Capital***

On March 13, 2017, the Company entered into a securities purchase agreement with Mill Road Capital II, L.P. (“Mill Road”), pursuant to which the Company agreed, in return for aggregate gross proceeds of \$31.5 million, to issue to Mill Road an aggregate of 8,873,240 shares of its Class A common stock, par value \$0.01 per share, at a price per share of \$3.55, which was equal to the closing sale price for the Company’s Class A common stock on March 10, 2017. On April 3, 2017, such shares were issued and the funding of the private placement occurred. The net proceeds from the transaction were \$29.1 million during the first two quarters of 2017, after \$2.4 million of transaction expenses paid.

10. Supplemental Disclosures to Condensed Consolidated Statements of Cash Flows

The following table presents the supplemental disclosures to the Condensed Consolidated Statements of Cash Flows for the two quarters ended July 4, 2017 and June 28, 2016 (in thousands):

| | July 4, 2017 | June 28, 2016 |
|---|-----------------|------------------|
| Interest paid (net of amounts capitalized) | \$2,216 | \$ 860 |
| Income taxes refunded | (60) | (42) |
| Changes in purchases of property and equipment accrued in accounts payable, net | (1,417) | 873 |
| Conversion of Series A convertible preferred stock to common stock | 18,500 | — |

11. Commitments and Contingencies**Data Security Incident***Overview*

On June 28, 2016, the Company announced that a data security incident compromised the security of the payment information of some customers who used debit or credit cards at certain Noodles & Company locations between January 31, 2016 and June 2, 2016. The malware involved in the incident has been removed, and the Company believes that it no longer poses a risk to credit or debit cards currently being used at affected locations. The Company continues to implement additional security procedures to further secure customers’ debit and credit card information.

Card Company Assessments

In the fourth quarter of 2016, the Company recorded a charge of \$10.6 million for estimated losses, at the low end of an estimated range, associated with claims and anticipated claims by payment card companies for non-ordinary course operating expenses, card issuer losses and card replacement costs for which it expects to be liable (the “Data Breach Liabilities”). However, the Company may ultimately be subject to Data Breach Liabilities that are up to \$5.5 million greater than that amount. The Company has used and intends to use a portion of the net proceeds of the private placement transactions entered into with L Catterton and Mill Road (both discussed in Note 9, Stockholders’ Equity) to fund the Data Breach Liabilities.

Data Security Litigation

In addition to claims by payment card companies with respect to the data security incident, the Company was a defendant in a purported class action lawsuit in the United States District Court for the District of Colorado (the “Court”), Selco Community Credit Union vs. Noodles & Company, alleging that the Company negligently failed to provide adequate security to protect the payment card information of customers of the plaintiffs and those of other similarly situated credit unions, banks and other financial institutions alleged to be part of the putative class, causing those institutions to suffer financial losses (the “Selco Litigation”). The complaint in the Selco Litigation also claimed the Company was negligent per se based on alleged violations of Section 5 of the Federal Trade Commission Act, and sought monetary damages, injunctive relief and attorneys’ fees. On July 21, 2017, the Court granted a Motion to Dismiss in the Selco Litigation in favor of the Company, which is subject to appeal by the plaintiffs. Any appeal must be filed on or before August 21, 2017.

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Fees and Costs

The Company has incurred fees and costs associated with this data security incident, including legal fees, investigative fees, other professional fees and costs of communications with customers, all of which to date have been paid or reimbursed by its data security liability insurer. The Company expects to continue to incur significant fees and costs associated with the data security incident in future periods. Fees and costs related to the data security incident may also include other liabilities to payment card networks, liabilities from future litigation, governmental investigations and enforcement proceedings and capital investments for remediation activities, among others. The aggregate amount of such fees and costs cannot be reasonably estimated by the Company at present, but these fees and costs may be more than the limit that the data security liability insurer will pay or reimburse, in which case the Company will bear these fees and costs.

Insurance Coverage

As discussed above, to limit its exposure to losses arising from matters such as the data security incident, the Company maintained at the time of the incident and continues to maintain data privacy liability insurance coverage. This coverage, and certain other customary business insurance coverage, has reduced the Company's exposure related to the data security incident. The Company will pursue the maximum recoveries available under these policies.

General

It is possible that losses associated with the data security incident could have a material adverse effect on the Company's results of operations in future periods. The Company will continue to evaluate information as it becomes known and will record an estimate for additional losses at the time or times when it is probable that an additional loss, if any, will be incurred and the amount of any such loss is reasonably estimable.

Delaware Gift Card Litigation

As previously disclosed in prior reports filed with the SEC, the Company is named as a defendant in an action filed in the Superior Court of Delaware in New Castle County (the "Court"), entitled The State of Delaware, William French v. Card Compliant, LLC, et. al. The case was filed under seal in June 2013 and was unsealed on March 26, 2014. The complaint in this case alleges that a number of large retailers and restaurant companies, including the Company, knowingly refused to fulfill obligations under Delaware's Abandoned Property Law by failing to report and deliver "unclaimed gift card funds" to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. The complaint seeks an order that the Company cease and desist from violating the Delaware Abandoned Property Law, monetary damages (including treble damages under the False Claims and Reporting Act), penalties, and attorneys' fees and costs. On November 23, 2015, the Court ruled on a motion to dismiss the complaint. While the Court granted the motion to dismiss with respect to a claim alleging that the defendants intended to defraud the government or willfully concealed property owed to the government and for which a certificate or receipt was provided, it did not dismiss the other claims alleging that the defendants knowingly made false statements to avoid transmitting money to the government. The defendants have filed a motion for summary judgment in the case. The trial date with respect to this matter is set for May 21, 2018. In 2015 the Company recorded a loss contingency accrual based on a reasonable estimate of the probable losses that might arise from this matter; this loss contingency accrual did not have a material effect on our results of operations. However, the Company may ultimately be subject to greater losses resulting from the litigation. The Company intends to continue to vigorously defend this action.

Litigation Regarding Classification of Assistant General Managers

In the third quarter of 2016, the Company recorded a charge of \$3.0 million to establish a reserve related to the settlement of a purported collective and class action lawsuit against the Company alleging violations of the Fair Labor Standards Act and certain state laws in connections with the Company's classification of assistant general managers as exempt employees. In the second quarter of 2017, the Company recorded a gain of \$0.4 million related to such settlement because the final amount determined to be owed by the Company under the settlement agreement was \$0.4 million less than the amount reserved.

Other Matters

In the normal course of business, the Company is subject to other proceedings, lawsuits and claims. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the Company is unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters as of July 4, 2017. These matters could affect the operating results of any one financial reporting period when resolved in future periods. The Company believes that an unfavorable outcome with respect to these matters is remote or a potential range of loss is not material to its consolidated financial statements. Significant increases in the number of these claims, or one or more successful claims that result in greater liabilities

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than the Company currently anticipates, could materially and adversely affect its business, financial condition, results of operations or cash flows.

**NOODLES & COMPANY
MANAGEMENT’S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

Noodles & Company is a Delaware corporation that was organized in 2002. Noodles & Company and its subsidiaries are sometimes referred to as “we,” “us,” “our” and the “Company” in this report. The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for our fiscal year ended January 3, 2017. We operate on a 52- or 53-week fiscal year ending on the Tuesday closest to December 31. Our fiscal quarters each contain 13 operating weeks, with the exception of the fourth quarter of a 53-week fiscal year, which contains 14 operating weeks. Fiscal year 2017 contains 52 weeks and fiscal year 2016 contained 53 weeks.

Cautionary Note Regarding Forward-Looking Statements

In addition to historical information, this discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties such as the number of restaurants we intend to open, projected capital expenditures and estimates of our effective tax rates. In some cases, you can identify forward-looking statements by terms such as “may,” “might,” “will,” “objective,” “intend,” “should,” “could,” “can,” “would,” “expect,” “believe,” “design,” “estimate,” “predict,” “potential,” “plan” or the negative of these terms and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on currently available operating, financial and competitive information. Examples of forward-looking statements include all matters that are not historical facts, such as statements regarding estimated costs associated with our closure of underperforming restaurants, the implementation and results of strategic initiatives and our future financial performance. Our actual results may differ materially from those anticipated in these forward-looking statements due to reasons including, but not limited to, our ability to execute our strategy to rebrand restaurants in certain of our markets; our ability to achieve and maintain increases in comparable restaurant sales and to successfully execute our business strategy, including new restaurant initiatives and operational strategies to improve the performance of our restaurant portfolio; costs associated with our data security incident, including legal fees, investigative fees, other professional fees and the cost of communications with customers, as well as potential losses associated with settling payment card networks’ expected claims and litigation associated with the data security breach; the success of our marketing efforts; our ability to open new restaurants on schedule; current economic conditions; price and availability of commodities; our ability to adequately staff our restaurants; changes in labor costs; consumer confidence and spending patterns; consumer reaction to industry related public health issues and perceptions of food safety; seasonal factors; weather; and those discussed in “Special Note Regarding Forward-Looking Statements” and “Risk Factors” as filed in our Annual Report on Form 10-K for our fiscal year ended January 3, 2017.

Key Measures We Use to Evaluate Our Performance

To evaluate the performance of our business, we utilize a variety of financial and performance measures. These key measures include revenue, average unit volumes (“AUVs”), comparable restaurant sales, restaurant contribution, EBITDA and adjusted EBITDA.

Revenue

Restaurant revenue represents sales of food and beverages in company-owned restaurants. Several factors affect our restaurant revenue in any period, including the number of restaurants in operation and per-restaurant sales.

Franchise royalties and fees represent royalty income and initial franchise fees. While we expect that the majority of our revenue and net income growth will be driven by company-owned restaurants, our franchise restaurants remain an important factor impacting our revenue and financial performance.

Seasonal factors cause our revenue to fluctuate from quarter to quarter. Our revenue per restaurant is typically lower in the first and fourth quarters, due to reduced winter and holiday traffic, and is higher in the second and third quarters. As a result of these factors, our quarterly and annual operating results and comparable restaurant sales may fluctuate significantly.

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Average Unit Volumes (“AUVs”)

AUVs consist of the average annualized sales of all company-owned restaurants for the trailing 12 periods. AUVs are calculated by dividing restaurant revenue by the number of operating days within each time period and multiplying by 361, which is the number of operating days we have in a typical year. This measurement allows management to assess changes in consumer traffic and per-person spending patterns at our restaurants.

Comparable Restaurant Sales

Comparable restaurant sales refer to year-over-year sales comparisons for the comparable restaurant base. We define the comparable restaurant base to include restaurants open for at least 18 full periods. This measure highlights performance of existing restaurants, as the impact of new restaurant openings is excluded. Changes in comparable restaurant sales are generated by changes in traffic, which we calculate as the number of entrées sold, or changes in per-person spend, calculated as sales divided by traffic. Per-person spend can be influenced by changes in menu prices and the mix and number of items sold per person.

Measuring our comparable restaurant sales allows us to evaluate the performance of our existing restaurant base.

Various factors impact comparable restaurant sales, including:

• consumer recognition of our brand and our ability to respond to changing consumer preferences;

• overall economic trends, particularly those related to consumer spending;

• our ability to operate restaurants effectively and efficiently to meet consumer expectations;

• pricing;

• the number of restaurant transactions, per-person spend and average check amount;

• marketing and promotional efforts;

• weather;

• food safety and foodborne illness concerns;

• local competition;

• trade area dynamics;

• introduction of new and seasonal menu items and limited time offerings; and

• opening new restaurants in the vicinity of existing locations.

Since opening new company-owned and franchise restaurants is a part of our growth strategy and we anticipate new restaurants will be a component of our revenue growth (albeit to a lesser extent in future periods, as discussed below), comparable restaurant sales are only one measure of how we evaluate our performance.

Restaurant Contribution

Restaurant contribution is defined as restaurant revenue less restaurant operating costs which are cost of sales, labor, occupancy and other restaurant operating costs. Fluctuations in restaurant contribution margin can also be attributed to those factors discussed above for the components of restaurant operating costs.

EBITDA and Adjusted EBITDA

We define EBITDA as net income (loss) before interest expense, provision (benefit) for income taxes and depreciation and amortization. We define adjusted EBITDA as net income (loss) before interest expense, provision (benefit) for income taxes, depreciation and amortization, restaurant impairments, closure costs and asset disposals, litigation settlements, severance costs and stock-based compensation.

Management believes that EBITDA and adjusted EBITDA provide clear pictures of our operating results by eliminating certain non-cash expenses that may vary widely from period to period and are not reflective of the underlying business performance. The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or to be superior to,

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the financial information prepared and presented in accordance with accounting principles generally accepted in the United States of America (“GAAP”). We use these non-GAAP financial measures for financial and operational decision making and as a means to evaluate period-to-period comparisons. We believe that they provide useful information to management and investors about operating results, enhance the overall understanding of past financial performance and future prospects and allow for greater transparency with respect to key metrics used by management in its financial and operational decision making.

Recent Trends, Risks and Uncertainties

Restaurant Development. In 2016, we significantly reduced our rate of company-owned restaurant unit growth, which we anticipate will result in our revenue growing at a slower rate than would be expected if our unit growth rate continued at the historical rate. In 2017, we plan to open 13 company-owned restaurants; 11 openings occurred in the first two quarters of 2017. We do not intend to open restaurants in new markets in 2017, and most of our openings will be in well-established markets where we maintain strong brand awareness and restaurant-level financial performance that exceeds company averages. We believe this more moderate growth strategy will enhance our ability to focus on improving restaurant operations and profitability. We will continue to evaluate our company-owned restaurant growth rate based on our operational and financial performance, capital resources and real estate opportunities. Furthermore, we anticipate pre-opening costs to decrease as a result of the more moderate anticipated growth rate.

Certain Restaurant Closures. We closed 55 restaurants in the first quarter of 2017. These restaurants significantly underperformed our restaurant averages, as measured by AUVs, restaurant contribution margin and cash flow. Many of these restaurants were opened in the last two to three years in newer markets where brand awareness of our restaurants is not as strong and where it has been more difficult to adequately staff our restaurants. We believe closing these restaurants will favorably affect our future restaurant contribution, restaurant contribution margin, adjusted EBITDA, adjusted EBITDA margin and net income.

Comparable Restaurant Sales and Restaurant Contribution Margin. In the second quarter of 2017, comparable restaurant sales decreased 3.4% system-wide, decreased 3.9% for company-owned restaurants, and decreased 0.4% for franchise restaurants. During the first two quarters of 2017, comparable restaurant sales decreased 2.7% system-wide, decreased 3.2% for company-owned restaurants, and increased 0.3% for franchise restaurants. Comparable restaurant sales represent year-over-year sales comparisons for restaurants open for at least 18 full periods. Our comparable restaurant sales decreased primarily as a result of underperformance at company-owned restaurants.

Increased Labor Costs. Similar to much of the restaurant industry, our labor costs have risen in recent periods and we expect that labor costs will continue to rise in future periods as wage rates and benefit costs increase. Some jurisdictions, including some of those in which we operate, have recently increased their minimum wage by a significant amount, and other jurisdictions are considering similar actions. Significant additional government-imposed increases could materially affect our labor costs.

Results of Operations

The following table presents a reconciliation of net loss to EBITDA and adjusted EBITDA:

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|---------------------------|------------------|---------------------------|------------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| | (in thousands, unaudited) | | | |
| Net loss | \$(1,815) | \$(14,087) | \$(28,660) | \$(16,460) |
| Depreciation and amortization | 6,279 | 7,071 | 12,546 | 13,977 |
| Interest expense, net | 927 | 598 | 1,935 | 1,226 |
| Provision for income taxes | 80 | 2,177 | 271 | 1,083 |
| EBITDA | \$5,471 | \$(4,241) | \$(13,908) | \$(174) |
| Restaurant impairments, closure costs and asset disposals ⁽¹⁾ | 2,830 | 11,248 | 24,884 | 12,264 |
| Litigation settlement ⁽²⁾ | (421) | — | (421) | — |
| Fees and costs related to the registration statement and related transactions ⁽³⁾ | 40 | — | 679 | — |
| Severance costs ⁽⁴⁾ | 129 | — | 332 | — |

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| | | | | |
|----------------------------------|---------|---------|----------|----------|
| Stock-based compensation expense | 647 | 501 | 945 | 849 |
| Adjusted EBITDA | \$8,696 | \$7,508 | \$12,511 | \$12,939 |

The first two quarters of 2017 include the closure costs related to the 55 restaurants closed in the first quarter of 2017 and the impairment of 13 restaurants. The (1) first two quarters of 2016 include the impairment of 12 restaurants. All periods include the ongoing closure costs of restaurants closed in the fourth quarter of 2015. See Note 7, Restaurant Impairments, Closure Costs and Asset Disposals.

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- (2) The second quarter of 2017 includes a gain on an employment-related litigation settlement due to final settlement being less than what the Company had previously accrued.
- (3) The first two quarters of 2017 include expenses related to the registration statement the Company filed in the first quarter of 2017, which registration statement was later withdrawn.
- (4) The first two quarters of 2017 include severance costs related to the departure of our Chief Operations Officer and department structural changes.

Restaurant Openings, Closures and Relocations

The following table shows restaurants opened or closed during the periods indicated:

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|---------------|---------------------------|---------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| Company-Owned Restaurant Activity | | | | |
| Beginning of period | 409 | 436 | 457 | 422 |
| Openings | 4 | 8 | 11 | 22 |
| Closures | — | (1) | (55) | (1) |
| Restaurants at end of period | 413 | 443 | 413 | 443 |
| Franchise Restaurant Activity | | | | |
| Beginning of period | 73 | 71 | 75 | 70 |
| Openings | 1 | 1 | 2 | 2 |
| Closures | (1) | (1) | (4) | (1) |
| Restaurants at end of period | 73 | 71 | 73 | 71 |
| Total restaurants | 486 | 514 | 486 | 514 |

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The following table summarizes key components of our results of operations for the periods indicated as a percentage of our total revenue, except for the components of restaurant operating costs, which are expressed as a percentage of restaurant revenue.

| | Fiscal Quarter Ended | | Two Fiscal Quarters Ended | |
|--|----------------------|------------------|---------------------------|------------------|
| | July 4, 2017 | June 28, 2016 | July 4, 2017 | June 28, 2016 |
| <i>Revenue:</i> | | | | |
| Restaurant revenue | 99.0 % | 99.0 % | 99.0 % | 99.0 % |
| Franchising royalties and fees | 1.0 % | 1.0 % | 1.0 % | 1.0 % |
| Total revenue | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| <i>Costs and expenses:</i> | | | | |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): ⁽¹⁾ | | | | |
| Cost of sales | 26.5 % | 26.8 % | 27.2 % | 26.8 % |
| Labor | 32.6 % | 32.7 % | 33.5 % | 32.9 % |
| Occupancy | 11.3 % | 11.4 % | 11.7 % | 11.6 % |
| Other restaurant operating costs | 14.5 % | 15.5 % | 14.7 % | 15.2 % |
| General and administrative | 8.3 % | 8.1 % | 8.7 % | 8.4 % |
| Depreciation and amortization | 5.6 % | 5.8 % | 5.5 % | 5.9 % |
| Pre-opening | 0.2 % | 0.7 % | 0.3 % | 0.8 % |
| Restaurant impairments, closure costs and asset disposals | 2.5 % | 9.3 % | 10.8 % | 5.2 % |
| Total costs and expenses | 100.7 % | 109.3 % | 111.5 % | 106.0 % |
| Loss from operations | (0.7)% | (9.3)% | (11.5)% | (6.0)% |
| Interest expense, net | 0.8 % | 0.5 % | 0.8 % | 0.5 % |
| Loss before income taxes | (1.5)% | (9.8)% | (12.4)% | (6.5)% |
| Provision for income taxes | 0.1 % | 1.8 % | 0.1 % | 0.5 % |
| Net loss | (1.6)% | (11.6)% | (12.5)% | (7.0)% |

(1) As a percentage of restaurant revenue.

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The table below presents our unaudited operating results for the second quarters of 2017 and 2016, and the related quarter-over-quarter changes.

| | Fiscal Quarter Ended | | Increase / (Decrease) | |
|---|----------------------|------------------|-----------------------|---------|
| | July 4, 2017 | June 28, 2016 | \$ | % |
| <i>(in thousands)</i> | | | | |
| <i>Revenue:</i> | | | | |
| Restaurant revenue | \$ 111,628 | \$ 120,204 | \$(8,576) | (7.1)% |
| Franchising royalties and fees | 1,164 | 1,203 | (39) | (3.2)% |
| Total revenue | 112,792 | 121,407 | (8,615) | (7.1)% |
| <i>Costs and expenses:</i> | | | | |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): | | | | |
| Cost of sales | 29,598 | 32,164 | (2,566) | (8.0)% |
| Labor | 36,430 | 39,316 | (2,886) | (7.3)% |
| Occupancy | 12,630 | 13,688 | (1,058) | (7.7)% |
| Other restaurant operating costs | 16,194 | 18,596 | (2,402) | (12.9)% |
| General and administrative | 9,393 | 9,840 | (447) | (4.5)% |
| Depreciation and amortization | 6,279 | 7,071 | (792) | (11.2)% |
| Pre-opening | 246 | 796 | (550) | (69.1)% |
| Restaurant impairments, asset disposals and closure costs | 2,830 | 11,248 | (8,418) | (74.8)% |
| Total costs and expenses | 113,600 | 132,719 | (19,119) | (14.4)% |
| Loss from operations | (808) | (11,312) | 10,504 | 92.9 % |
| Interest expense, net | 927 | 598 | 329 | 55.0 % |
| Loss before income taxes | (1,735) | (11,910) | 10,175 | 85.4 % |
| Provision for income taxes | 80 | 2,177 | (2,097) | (96.3)% |
| Net loss | \$(1,815) | \$(14,087) | \$ 12,272 | 87.1 % |
| <i>Company-owned:</i> | | | | |
| Average unit volumes | \$ 1,065 | \$ 1,092 | \$(27) | (2.5)% |
| Comparable restaurant sales | (3.9)% | (0.9)% | | |

Revenue

Total revenue decreased \$8.6 million in the second quarter of 2017, or 7.1%, to \$112.8 million, compared to \$121.4 million in the second quarter of 2016. This decrease was primarily due to the impact of closing 55 company-owned restaurants in the first quarter of 2017. Additionally, AUVs decreased \$27,000 compared to the prior year. AUV's for the trailing twelve months were \$1,065,000.

Comparable restaurant sales decreased by 3.9% at company-owned restaurants, decreased by 0.4% at franchise-owned restaurants and decreased by 3.4% system-wide in the second quarter of 2017.

Table of Contents***Cost of Sales***

Cost of sales decreased by \$2.6 million, or 8.0%, in the second quarter of 2017 compared to the same period of 2016, due primarily to the decrease in restaurant revenue in the second quarter of 2017. As a percentage of restaurant revenue, cost of sales decreased to 26.5% in the second quarter of 2017 from 26.8% in second quarter of 2016. The decrease as a percentage of restaurant revenue was primarily due to less promotional activity.

Labor Costs

Labor costs decreased by \$2.9 million, or 7.3%, in the second quarter of 2017 compared to the same period of 2016, due primarily to the decrease in restaurant revenue in the second quarter of 2017. As a percentage of restaurant revenue, labor costs decreased to 32.6% in the second quarter of 2017 from 32.7% in the second quarter of 2016. The decrease as a percentage of restaurant revenue was driven by labor savings initiatives.

Occupancy Costs

Occupancy costs decreased by \$1.1 million, or 7.7%, in the second quarter of 2017 compared to the second quarter of 2016. As a percentage of revenue, occupancy costs decreased to 11.3% in the second quarter of 2017, compared to 11.4% in the second quarter of 2016. The decrease was due primarily to the closure of restaurants during the latter part of the first quarter of 2017.

Other Restaurant Operating Costs

Other restaurant operating costs decreased by \$2.4 million, or 12.9%, in the second quarter of 2017 compared to the second quarter of 2016, due primarily to decreased restaurant revenue in the second quarter of 2017 and lower marketing expense. As a percentage of restaurant revenue, other restaurant operating costs decreased to 14.5% in the second quarter of 2017 from 15.5% in the second quarter of 2016, due primarily to a reduction in marketing spend.

General and Administrative Expense

General and administrative expense decreased by \$0.4 million, or 4.5%, in the second quarter of 2017 compared to the second quarter of 2016, primarily attributable to a gain recognized on the employment-related litigation settlement due to final settlement being less than what the Company had previously accrued. As a percentage of revenue, general and administrative expense increased to 8.3% in the second quarter of 2017 from 8.1% in the second quarter of 2016.

Depreciation and Amortization

Depreciation and amortization decreased by \$0.8 million, or 11.2%, in the second quarter of 2017 compared to the second quarter of 2016. As a percentage of revenue, depreciation and amortization decreased to 5.6% in the second quarter of 2017 from 5.8% in the second quarter of 2016, due primarily to restaurants impaired or closed in prior quarters.

Pre-Opening Costs

Pre-opening costs decreased by \$0.6 million, or 69.1%, in the second quarter of 2017 compared to the second quarter of 2016. As a percentage of revenue, pre-opening costs decreased to 0.2% in the second quarter of 2017 from 0.7% in the second quarter of 2016. The decrease in pre-opening costs was due to fewer restaurants under construction compared to the comparable period in the prior year.

Restaurant Impairments, Closure Costs and Asset Disposals

Restaurant impairments, closure costs and asset disposals decreased by \$8.4 million in the second quarter of 2017 compared to the second quarter of 2016. The decrease was primarily due to a net gain recognized during the second quarter of 2017 for closures related to adjustments to the liabilities to landlords as lease terminations occurred, partially offset by ongoing costs of the restaurants closed during the first quarter of 2017. Additionally, the second quarter of 2017 includes the impairment of nine restaurants, compared to 11 restaurants impaired during the second quarter of 2016.

Each quarter we evaluate possible impairment of fixed assets at the restaurant level and record an impairment loss whenever we determine that the fair value of these assets is less than their carrying value. There can be no assurance that such evaluations will not result in additional impairment costs in future periods.

Interest Expense

Interest expense increased by \$0.3 million, or 55.0%, in the second quarter of 2017 compared to the second quarter of 2016. The increase was the result of an increase in the average interest rate on our credit facility in the second quarter of 2017 compared to the second quarter of 2016 and higher amortization of debt issuance costs.

Table of Contents**Provision (Benefit) for Income Taxes**

In the second quarter of 2017, we had a provision for income taxes of \$0.1 million compared to a provision for income taxes of \$2.2 million in the second quarter of 2016. During the first quarter of 2016, the Company recorded a valuation allowance against Canadian deferred tax assets. During the second quarter of 2016, the Company determined that it was appropriate to record a valuation allowance against U.S. deferred tax assets. As a result, the effective tax rate for both the second quarter of 2017 and 2016, reflects the impact of a valuation allowance against U.S. and Canadian deferred tax assets. The provision for income taxes in the second quarter of 2016 was related to the establishment of a valuation allowance against U.S. deferred tax assets. As of July 4, 2017, we continued to maintain a full valuation allowance on our U.S. and Canadian deferred tax assets due to uncertainty regarding the realizability of future tax benefits. As a result, the effective tax rate decreased to (4.6)% for the second quarter of 2017 compared to (18.3)% for the second quarter of 2016. For the remainder of fiscal 2017 we do not anticipate material income tax expense or benefit because of the valuation allowance recorded.

Two Quarters Ended July 4, 2017 Compared to Two Quarters Ended June 28, 2016

The table below presents our unaudited operating results for the first two quarters of 2017 and 2016, and the related period-over-period changes.

| | Two Fiscal Quarters Ended | | Increase / (Decrease) | |
|---|---------------------------|------------------|-----------------------|---------|
| | July 4, 2017 | June 28, 2016 | \$ | % |
| <i>(in thousands, except percentages)</i> | | | | |
| <i>Revenue:</i> | | | | |
| Restaurant revenue | \$227,155 | \$233,069 | \$(5,914) | (2.5)% |
| Franchising royalties and fees | 2,352 | 2,324 | 28 | 1.2 % |
| Total revenue | 229,507 | 235,393 | (5,886) | (2.5)% |
| <i>Costs and expenses:</i> | | | | |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): | | | | |
| Cost of sales | 61,685 | 62,353 | (668) | (1.1)% |
| Labor | 76,024 | 76,750 | (726) | (0.9)% |
| Occupancy | 26,631 | 27,002 | (371) | (1.4)% |
| Other restaurant operating costs | 33,341 | 35,488 | (2,147) | (6.0)% |
| General and administrative | 20,059 | 19,877 | 182 | 0.9 % |
| Depreciation and amortization | 12,546 | 13,977 | (1,431) | (10.2)% |
| Pre-opening | 791 | 1,833 | (1,042) | (56.8)% |
| Restaurant impairments, asset disposals and closure costs | 24,884 | 12,264 | 12,620 | * |
| Total costs and expenses | 255,961 | 249,544 | 6,417 | 2.6 % |
| Loss from operations | (26,454) | (14,151) | (12,303) | (86.9)% |
| Interest expense, net | 1,935 | 1,226 | 709 | 57.8 % |
| Loss before income taxes | (28,389) | (15,377) | (13,012) | (84.6)% |
| Provision for income taxes | 271 | 1,083 | (812) | (75.0)% |
| Net loss | \$(28,660) | \$(16,460) | \$(12,200) | (74.1)% |
| <i>Company owned:</i> | | | | |
| Average unit volumes | \$1,065 | \$1,092 | \$(27) | (2.5)% |
| Comparable restaurant sales | (3.2)% | (0.4)% | | |

* Not meaningful.

Table of Contents**Revenue**

Total revenue decreased by \$5.9 million, or 2.5%, in the first two quarters of 2017, to \$229.5 million compared to \$235.4 million in the same period of 2016. This decrease was primarily due to the impact of closing 55 company-owned restaurants in the first quarter of 2017.

Comparable restaurant sales decreased by 3.2% at company-owned restaurants, increased by 0.3% at franchise-owned restaurants and decreased by 2.7% system-wide in the second quarter of 2017.

Cost of Sales

Cost of sales decreased by \$0.7 million, or 1.1%, in the first two quarters of 2017 compared to the same period of 2016, due primarily to the decrease in restaurant revenue in the first two quarters of 2017. As a percentage of restaurant revenue, cost of sales increased to 27.2% in the first two quarters of 2017 from 26.8% in the first two quarters of 2016. The increase in cost of sales as a percentage of restaurant revenue was the result of modest commodity inflation and increased waste as a result of the elimination of certain menu items and introduction of new items.

Labor Costs

Labor costs decreased by \$0.7 million, or 0.9%, in the first two quarters of 2017 compared to the same period of 2016, due primarily to the decrease in restaurant revenue in the first two quarters of 2017. As a percentage of restaurant revenue, labor costs increased to 33.5% in the first two quarters of 2017 from 32.9% in the first two quarters of 2016, due to increases in wage rates and deleverage on lower AUVs.

Occupancy Costs

Occupancy costs decreased by \$0.4 million, or 1.4%, in the first two quarters of 2017 compared to the first two quarters of 2016, due primarily to the closure of restaurants during the latter part of the first quarter of 2017. As a percentage of revenue, occupancy costs increased to 11.7% in first two quarters of 2017, compared to 11.6% in the first two quarters of 2016, due to deleverage on lower AUVs, partially offset by the closure of restaurants during the latter part of the first quarter of 2017.

Other Restaurant Operating Costs

Other restaurant operating costs decreased by \$2.1 million, or 6.0%, in the first two quarters of 2017 compared to the first two quarters of 2016, due primarily to decreased restaurant revenue in the first two quarters of 2017 and lower marketing expense. As a percentage of restaurant revenue, other restaurant operating costs decreased to 14.7% in the first two quarters of 2017, compared to 15.2% in the first two quarters of 2016, due primarily to a reduction in marketing spend.

General and Administrative Expense

General and administrative expense increased by \$0.2 million, or 0.9%, in the first two quarters of 2017 compared to the first two quarters of 2016. As a percentage of revenue, general and administrative expense increased to 8.7% in the first two quarters of 2017 compared to 8.4% in the first two quarters of 2016. This increase was primarily attributable to professional fees related to the registration statement we filed in the first quarter of 2017, which registration statement was later withdrawn, and severance expenses, partially offset by a gain recognized on the employment-related litigation settlement.

Depreciation and Amortization

Depreciation and amortization decreased by \$1.4 million, or 10.2%, in the first two quarters of 2017 compared to the first two quarters of 2016. As a percentage of revenue, depreciation and amortization decreased to 5.5% in the first two quarters of 2017, compared to 5.9% in the first two quarters of 2016, due to restaurants impaired or closed in prior quarters.

Pre-Opening Costs

Pre-opening costs decreased by \$1.0 million, or 56.8%, in the first two quarters of 2017 compared to the first two quarters of 2016. As a percentage of revenue, pre-opening costs decreased to 0.3% in the first two quarters of 2017 compared to 0.8% in the first two quarters of 2016. The decrease in pre-opening costs was due to fewer restaurants under construction compared to the comparable period in the prior year.

Restaurant Impairments, Closure Costs and Asset Disposals

Restaurant impairments, closure costs and asset disposals increased by \$12.6 million in the first two quarters of 2017 compared to the first two quarters of 2016. The increase was primarily due to the closures of 55 restaurants in the first quarter of 2017 and the impairment of 13 restaurants during the first two quarters of 2017, partially offset by a net gain recognized during the second quarter of 2017 for closures related to adjustments to the liabilities to landlords as lease terminations occurred. The first two quarters

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of 2016 included the impairment of twelve restaurants. Both periods include ongoing costs of restaurants closed in the fourth quarter of 2015.

Interest Expense

Interest expense increased by \$0.7 million, or 57.8%, in the first two quarters of 2017 compared to the same period of 2016. The increase was the result of an increase in the average interest rate on our credit facility in the first two quarters of 2017 compared to the first two quarters of 2016, and higher amortization of debt issuance costs.

Provision for Income Taxes

In the first two quarters 2017, we had a provision for income taxes of \$0.3 million compared to a provision for income taxes of \$1.1 million in the first two quarters of 2016. During the first quarter of 2016, the Company recorded a valuation allowance against Canadian deferred tax assets. During the second quarter of 2016, the Company determined that it was appropriate to record a valuation allowance against U.S. deferred tax assets. As a result, the effective tax rate for the first two quarters of 2017 and the first two quarters of 2016 reflects the impact of a valuation allowance against U.S. and Canadian deferred tax assets. The provision for income tax for the first two quarters of 2016 was primarily related to the establishment of a valuation allowance against U.S. deferred tax assets. As of July 4, 2017, we continued to maintain a full valuation allowance on our U.S. and Canadian deferred tax assets due to uncertainty regarding the realizability of future tax benefits. As a result, the effective tax rate decreased to (1.0)% for the first two quarters of 2017 compared to (7.0)% for the first two quarters of 2016. For the remainder of fiscal 2017 we do not anticipate material income tax expense or benefit because of the valuation allowance recorded.

Liquidity and Capital Resources**Summary of Cash Flows**

Historically, our primary sources of liquidity and cash flows were operating cash flows and borrowings on our revolving line of credit. In the first quarter of 2017, in order to pursue our operational strategies and fund obligations such as the liabilities to landlords from the termination of our leases for the restaurants closed in the first quarter of 2017, fees to be paid to our real estate advisor and brokers related to such terminations and other costs of closing restaurants, such as severance for terminated employees (“Restaurant Closing Liabilities”) and the Data Breach Liabilities, we determined that we needed additional sources of liquidity. We executed the following transactions to provide us with additional liquidity: (i) we completed two private placement transactions for aggregate gross proceeds to us of \$50.0 million, and (ii) we also amended our credit agreement to increase our flexibility under the credit facility.

We have historically used cash to fund capital expenditures for new restaurant openings, reinvest in our existing restaurants, invest in infrastructure and information technology and maintain working capital; however, due to our anticipated modest unit growth, cash required for new restaurant openings has been correspondingly reduced. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day, or in the case of credit or debit card transactions, within several days of the related sale, and we typically have at least 30 days to pay our vendors. We believe that expected cash flow from operations, the proceeds received from the private placement transactions and existing borrowing capacity under our credit facility are adequate to fund debt service requirements, operating lease obligations, capital expenditures, the Restaurant Closing Liabilities, the Data Breach Liabilities and working capital obligations for the remainder of fiscal year 2017.

Cash flows from operating, investing and financing activities are shown in the following table (in thousands):

| | Two Fiscal Quarters | |
|--|----------------------------|-----------------|
| | Ended | |
| | July 4, | June 28, |
| | 2017 | 2016 |
| Net cash (used in) provided by operating activities | \$(8,231) | \$12,281 |
| Net cash used in investing activities | (12,213) | (24,016) |
| Net cash provided by financing activities | 21,763 | 11,589 |
| Effect of exchange rate changes on cash | 2 | 127 |
| Net increase (decrease) in cash and cash equivalents | \$1,321 | \$(19) |

Table of Contents**Operating Activities**

Net cash used in operating activities was \$8.2 million for the first two quarters of 2017, as compared to net cash provided by operating activities of \$12.3 million for the first two quarters of 2016. The decrease resulted primarily from the higher net loss during the first two quarters of 2017 as compared to the first two quarters of 2016, adjusted for non-cash items such as depreciation and amortization, restaurant impairments, closure costs and asset disposals and stock-based compensation expense. Additionally, the first two quarters of 2017 included payments to landlords for lease terminations of \$7.1 million, a litigation settlement payment of \$2.6 million and a payment for the data breach liabilities of \$4.0 million.

Investing Activities

Net cash flows used in investing activities decreased to \$12.2 million for the first two quarters of 2017 from \$24.0 million for the first two quarters of 2016, primarily due to the reduction in new restaurant development during 2017.

Financing Activities

Net cash provided by financing activities was \$21.8 million and \$11.6 million for first the two quarters of 2017 and 2016, respectively. The increase in net cash provided by financing activities is primarily due to the net proceeds received from the private placement transactions that occurred during the first two quarters of 2017, net of repayments on long-term debt.

Capital Resources

Future Capital Expenditure Requirements. Our capital expenditure requirements are primarily dependent upon the pace of our real estate development program and resulting new restaurants opened. We anticipate our real estate development growth to be reduced in upcoming quarters, compared to our historical rates. Our real estate development program is dependent upon many factors, including economic conditions, real estate markets, site locations and the nature of lease agreements. Our capital expenditure outlays are also dependent on costs for maintenance and remodeling of our existing restaurants as well as information technology expenses and other general corporate capital expenditures.

We estimate capital expenditures for the remainder of 2017 to be in the range of approximately \$8.0 million to \$12.0 million for a total of \$19.0 million to \$23.0 million for the fiscal year, of which \$7.0 million to \$9.0 million relates to our construction of new restaurants before any reductions for landlord reimbursements, and the remainder relates primarily to reinvestment in existing restaurants and investments in technology. We expect such capital expenditures to be funded by a combination of cash from operations, funding received from the two private placements that occurred during the first two quarters of 2017, and borrowings under our revolving credit facility.

Current Resources. Our operations have not required significant working capital and, like many restaurant companies, we operate with negative working capital. Restaurant sales are primarily paid for in cash or by credit or debit card, and restaurant operations do not require significant inventories or receivables. In addition, we receive trade credit for the purchase of food, beverages and supplies, therefore reducing the need for incremental working capital to support growth.

Liquidity. We believe that our current cash and cash equivalents, the expected cash flows from company-owned restaurant operations, the expected franchise fees and royalties and borrowings under the credit facility will be sufficient to fund our cash requirements for working capital needs and capital improvements and maintenance of existing restaurants for the next twelve months. Additionally, we expect a significant use of cash in 2017 to be the funding of the Restaurant Closing Liabilities, which we anticipate will total approximately \$18.0 million to \$23.0 million, including (i) \$17.0 million to \$22.0 million relating to the termination of leases, including related fees and expenses. We have paid approximately \$8.0 million to date and the remainder of approximately \$10.0 million to \$15.0 million is expected to be paid out over the next nine to 15 months.

Credit Facility

We maintain a \$100.0 million revolving line of credit under our credit facility. The revolving line of credit includes a swing line loan of \$10.0 million used to fund working capital requirements. The credit facility matures in June 2020. On February 8, 2017, we entered into an amendment to our credit facility, which amendment, giving effect to the equity issuances completed during the first quarter of 2017, (i) increased the interest rate margin applicable at total lease adjusted leverage levels at and above 4.25:1.00 and from the period of the date of the Amendment to the

delivery of the first following quarterly compliance certificate, (ii) increased capital expenditure amounts related to restaurant growth, and (iii) made certain other changes. The Consolidated EBITDA definition, as revised, permits certain costs to be added back into the Consolidated EBITDA calculation, including the costs associated with the Restaurant Closing Liabilities and the Data Breach Liabilities. The amendment also revised certain financial covenant levels.

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As of July 4, 2017, we had \$62.1 million of indebtedness and \$3.0 million of letters of credit outstanding under our revolving line of credit. Borrowings under our most recent amended and restated credit facility bear interest, at our option, at either (i) LIBOR plus 2.00% to 3.25%, based on the lease-adjusted leverage ratio or (ii) the highest of the following rates plus zero to 1.00%: (a) the federal funds rate plus 0.50%; (b) the Bank of America prime rate or (c) the one month LIBOR plus 1.00%. The credit facility includes a commitment fee of 0.30% to 0.50%, based on the lease-adjusted leverage ratio, per year on any unused portion of the facility. We also maintain outstanding letters of credit to secure obligations under our workers' compensation program and certain lease obligations.

Availability of borrowings under the revolving line of credit is conditioned on our compliance with specified covenants, including a maximum lease-adjusted leverage ratio and a minimum consolidated fixed charge coverage ratio. We are subject to a number of other customary covenants, including limitations on additional borrowings, acquisitions, dividend payments and lease commitments. As of July 4, 2017, we were in compliance with all of our debt covenants.

We expect that we will meet all applicable financial covenants in our credit facility, including the maximum lease-adjusted leverage ratio, throughout the fiscal year ending January 2, 2018. However, there can be no assurance we will meet such financial covenants. If such covenants are not met, we would be required to seek a waiver or amendment from the banks participating in the credit facility. There can be no assurance that such waiver or amendment would be granted, which could have a material adverse impact on our liquidity.

Our credit facility is secured by a pledge of stock of substantially all of our subsidiaries and a lien on substantially all of our and our subsidiaries' personal property assets.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements or obligations as of July 4, 2017.

Table of Contents**Critical Accounting Policies and Estimates**

Our condensed consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by the application of our accounting policies. Our significant accounting policies are described in our Annual Report on Form 10-K for the year ended January 3, 2017. Critical accounting estimates are those that require application of management's most difficult, subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods. While we apply our judgment based on assumptions believed to be reasonable under the circumstances, actual results could vary from these assumptions. It is possible that materially different amounts would be reported using different assumptions. Our critical accounting estimates are identified and described in our annual consolidated financial statements and the related notes included in our Annual Report on Form 10-K for our fiscal year ended January 3, 2017.

JOBS Act

We qualify as an "emerging growth company" pursuant to the provisions of the Jumpstart our Business Startups ("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, exemptions from the requirements of holding advisory "say-on-pay" votes on executive compensation and shareholder advisory votes on golden parachute compensation. We could be an "emerging growth company" until the end of our 2018 fiscal year.

In addition, Section 107 of the JOBS Act also provides that an "emerging growth company" can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. An "emerging growth company" can therefore delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. However, we have chosen to "opt out" of such extended transition period and, as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

Item 3. Quantitative and Qualitative Disclosures about Market Risk***Interest Rate Risk***

We are exposed to market risk from changes in interest rates on debt. Our exposure to interest rate fluctuations is limited to our outstanding bank debt, which bears interest at variable rates. As of July 4, 2017, we had \$62.1 million of indebtedness under our revolving line of credit. An increase or decrease of 1.0% in the effective interest rate applied on this loan would have resulted in a pre-tax interest expense fluctuation of approximately \$0.6 million on an annualized basis.

Commodity Price Risk

We purchase certain products that are affected by commodity prices and are, therefore, subject to price volatility caused by weather, market conditions and other factors which are not considered predictable or within our control. Although these products are subject to changes in commodity prices, certain purchasing contracts or pricing arrangements contain risk management techniques designed to minimize price volatility. The purchasing contracts and pricing arrangements we use may result in unconditional purchase obligations, which are not reflected in our consolidated balance sheets. Typically, we use these types of purchasing techniques to control costs as an alternative to directly managing financial instruments to hedge commodity prices. In many cases, we believe we will be able to address material commodity cost increases by adjusting our menu pricing or changing our product delivery strategy. However, increases in commodity prices, without adjustments to our menu prices, could increase restaurant operating costs as a percentage of company-owned restaurant revenue.

Inflation

The primary inflationary factors affecting our operations are food, labor costs, energy costs and materials used in the construction of new restaurants. Increases in the minimum wage directly affect our labor costs. Many of our leases require us to pay taxes, maintenance, repairs, insurance and utilities, all of which are generally subject to inflationary increases. Finally, the cost of constructing our restaurants is subject to inflationary increases in the costs of labor and material. Over the past five years, inflation has not significantly affected our operating results with the exception of increased wage inflation that has affected our results from 2015 through the second quarter of 2017. We expect wage inflation to continue to affect our results in the near future.

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Item 4. Controls and Procedures

Our management carried out an evaluation, under the supervision and with the participation of our chief executive officer and interim chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of July 4, 2017, pursuant to Rule 13a-15 under 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 interim chief financial officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and interim chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during our most recent 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

Item 1. Legal Proceedings

Data Security Litigation

On June 28, 2016, we announced that a data security incident compromised the security of the payment information of some customers who used debit or credit cards at certain Noodles & Company locations between January 31, 2016 and June 2, 2016. In addition to claims by payment card companies with respect to the data security incident, we were a defendant in a purported class action lawsuit in the United States District Court for the District of Colorado (the “Court”), Selco Community Credit Union vs. Noodles & Company, alleging that we negligently failed to provide adequate security to protect the payment card information of customers of the plaintiffs and those of other similarly situated credit unions, banks and other financial institutions alleged to be part of the putative class, causing those institutions to suffer financial losses (the “Selco Litigation”). The complaint in the Selco Litigation also claimed we were negligent per se based on alleged violations of Section 5 of the Federal Trade Commission Act, and it sought monetary damages, injunctive relief and attorneys’ fees. On July 21, 2017, the Court granted a Motion to Dismiss in the Selco Litigation in favor of us, which is subject to appeal by the plaintiffs. Any appeal must be filed on or before August 21, 2017.

Delaware Gift Card Litigation

As previously disclosed in prior reports filed with the SEC, the Company is named as a defendant in an action filed in the Superior Court of Delaware in New Castle County (the “Court”), entitled The State of Delaware, William French v. Card Compliant, LLC, et. al. The case was filed under seal in June 2013 and was unsealed on March 26, 2014. The complaint in this case alleges that a number of large retailers and restaurant companies, including the Company, knowingly refused to fulfill obligations under Delaware’s Abandoned Property Law by failing to report and deliver “unclaimed gift card funds” to the State of Delaware, and knowingly made, used or caused to be made or used, false statements and records to conceal, avoid or decrease an obligation to pay or transmit money to Delaware in violation of the Delaware False Claims and Reporting Act. The complaint seeks an order that we cease and desist from violating the Delaware Abandoned Property Law, monetary damages (including treble damages under the False Claims and Reporting Act), penalties, and attorneys’ fees and costs. On November 23, 2015, the Court ruled on a motion to dismiss the complaint. While the Court granted the motion to dismiss with respect to a claim alleging that the defendants intended to defraud the government or willfully concealed property owed to the government and for which a certificate or receipt was provided, it did not dismiss the other claims alleging that the defendants knowingly made false statements to avoid transmitting money to the government. The defendants have filed a motion for summary judgment in the case. The trial date with respect to this matter is set for May 21, 2018. In 2015 we recorded a loss contingency accrual based on a reasonable estimate of the probable losses that might arise from this matter; this loss contingency accrual did not have a material effect on our results of operations. However, we may ultimately be subject to greater losses resulting from the litigation. We intend to continue to vigorously defend this action.

Litigation Regarding Classification of Assistant General Managers

In the third quarter of 2016, we recorded a charge of \$3.0 million to establish a reserve related to the settlement of a purported collective and class action lawsuit against us alleging violations of the Fair Labor Standards Act and certain state laws in connections with our classification of assistant general managers as exempt employees. In the second quarter of 2017, we recorded a gain of \$0.4 million related to such settlement because the final amount determined to be owed by us under the settlement agreement was \$0.4 million less than the amount reserved.

Other Matters

In the normal course of business, we are subject to other proceedings, lawsuits and claims. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters as of July 4, 2017. These matters could affect the operating results of any one financial reporting period when resolved in future periods.

We believe that an unfavorable outcome with respect to these matters is remote or a potential range of loss is not material to our consolidated financial statements. Significant increases in the number of these claims, or one or more successful claims that result in greater liabilities than we currently anticipate, could materially adversely affect our business, financial condition, results of operations or cash flows.

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Item 1A. Risk Factors

A description of the risk factors associated with our business is contained in the “Risk Factors” section of our Annual Report on Form 10-K for our fiscal year ended January 3, 2017. There have been no material changes to our Risk Factors as previously reported.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

None.

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Item 6. Exhibit Index

| Exhibit Number | Description of Exhibit |
|-----------------------|--|
| 10.1 | <u>Noodles & Company Compensation Plan for Non-Employee Directors Amended and Restated July 26, 2017</u> |
| 10.2 | <u>Interim Chief Financial Officer Letter Agreement, dated June 13, 2017, between Noodles & Company and Susan Daggett</u> |
| 10.3 | <u>Employment Agreement, dated June 13, 2017, between Noodles & Company and Paul Murphy</u> |
| 31.1 | <u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101.INS | XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL 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 |

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SIGNATURES

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

NOODLES & COMPANY

By: /s/ DAVE BOENNIGHAUSEN

Dave Boennighausen

Chief Executive Officer

Date August 11, 2017