

PAPA JOHNS INTERNATIONAL INC

Form 10-Q

August 02, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 26, 2016

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-21660

PAPA JOHN'S INTERNATIONAL, INC.

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(Exact name of registrant as specified in its charter)

Delaware	61-1203323
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification number)

2002 Papa Johns Boulevard

Louisville, Kentucky 40299-2367

(Address of principal executive offices)

(502) 261-7272

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

At July 26, 2016, there were outstanding 36,984,132 shares of the registrant's common stock, par value \$0.01 per share.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## Papa John's International, Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(In thousands, except per share amounts)	June 26, 2016 (Unaudited)	December 27, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 15,266	\$ 21,006
Accounts receivable, net	56,357	63,320
Notes receivable, net	4,715	7,816
Income taxes receivable	744	272
Inventories	22,531	21,564
Prepaid expenses	17,841	20,372
Other current assets	8,148	8,941
Assets held for sale	8,823	9,299
Total current assets	134,425	152,590
Property and equipment, net	217,528	214,044
Notes receivable, less current portion, net	9,906	11,105
Goodwill	87,266	79,657
Deferred income taxes	1,713	2,415
Other assets	36,385	34,247
Total assets	\$ 487,223	\$ 494,058
Liabilities and stockholders' (deficit) equity		
Current liabilities:		
Accounts payable	\$ 34,928	\$ 43,492
Income and other taxes payable	12,231	8,527
Accrued expenses and other current liabilities	68,887	80,918
Total current liabilities	116,046	132,937
Deferred revenue	3,965	3,190
Long-term debt, net	316,484	255,146
Deferred income taxes	2,002	4,610
Other long-term liabilities	58,019	47,606
Total liabilities	496,516	443,489
Redeemable noncontrolling interests	7,989	8,363

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Stockholders' (deficit) equity:		
Preferred stock (\$0.01 par value per share; no shares issued)	—	—
Common stock (\$0.01 par value per share; issued 43,940 at June 26, 2016 and 43,731 at December 27, 2015)	440	437
Additional paid-in capital	161,849	158,348
Accumulated other comprehensive loss	(7,850)	(1,836)
Retained earnings	179,882	143,789
Treasury stock (7,054 shares at June 26, 2016 and 5,308 shares at December 27, 2015, at cost)	(364,742)	(271,557)
Total stockholders' (deficit) equity, net of noncontrolling interests	(30,421)	29,181
Noncontrolling interests in subsidiaries	13,139	13,025
Total stockholders' (deficit) equity	(17,282)	42,206
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit) equity	\$ 487,223	\$ 494,058

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)	Three months ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Revenues:				
Domestic Company-owned restaurant sales	\$ 204,248	\$ 185,962	\$ 409,927	\$ 383,249
Domestic franchise royalties and fees	25,302	23,276	51,778	48,900
Domestic commissary and other sales	164,954	163,427	333,939	347,374
International	28,460	26,326	55,915	51,752
Total revenues	422,964	398,991	851,559	831,275
Costs and expenses:				
Operating costs (excluding depreciation and amortization shown separately below):				
Domestic Company-owned restaurant expenses	163,469	147,356	324,779	302,388
Domestic commissary and other expenses	152,258	151,206	309,064	321,545
International expenses	17,752	16,250	35,342	31,728
General and administrative expenses	42,623	43,047	82,870	86,796
Depreciation and amortization	10,031	10,136	19,775	20,177
Total costs and expenses	386,133	367,995	771,830	762,634
Operating income	36,831	30,996	79,729	68,641
Legal settlement expense	—	(12,278)	—	(12,278)
Net interest expense	(1,631)	(1,187)	(3,120)	(2,396)
Income before income taxes	35,200	17,531	76,609	53,967
Income tax expense	11,088	5,063	24,446	17,260
Net income before attribution to noncontrolling interests	24,112	12,468	52,163	36,707
Income attributable to noncontrolling interests	(1,571)	(1,688)	(3,440)	(3,691)
Net income attributable to the Company	\$ 22,541	\$ 10,780	\$ 48,723	\$ 33,016
Calculation of income for earnings per share:				
Net income attributable to the Company	\$ 22,541	\$ 10,780	\$ 48,723	\$ 33,016
Change in noncontrolling interest redemption value	279	73	499	143
Net income attributable to participating securities	(91)	(50)	(201)	(150)
Net income attributable to common shareholders	\$ 22,729	\$ 10,803	\$ 49,021	\$ 33,009
Basic earnings per common share	\$ 0.61	\$ 0.27	\$ 1.30	\$ 0.83
Diluted earnings per common share	\$ 0.61	\$ 0.27	\$ 1.29	\$ 0.82
Basic weighted average common shares outstanding	37,203	39,692	37,567	39,764
Diluted weighted average common shares outstanding	37,507	40,217	37,904	40,368

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Dividends declared per common share	\$ 0.175	\$ 0.140	\$ 0.350	\$ 0.280
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See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)	Three Months Ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Net income before attribution to noncontrolling interests	\$ 24,112	\$ 12,468	\$ 52,163	\$ 36,707
Other comprehensive (loss) income, before tax:				
Foreign currency translation adjustments	(1,441)	2,116	(3,513)	575
Interest rate swaps (1)	(2,760)	459	(6,049)	(625)
Other comprehensive (loss) income, before tax	(4,201)	2,575	(9,562)	(50)
Income tax effect:				
Foreign currency translation adjustments	533	(783)	1,300	(213)
Interest rate swaps (2)	1,021	(170)	2,238	231
Income tax effect	1,554	(953)	3,538	18
Other comprehensive (loss) income, net of tax	(2,647)	1,622	(6,024)	(32)
Comprehensive income before attribution to noncontrolling interests	21,465	14,090	46,139	36,675
Comprehensive loss, redeemable noncontrolling interests	(881)	(1,015)	(2,125)	(2,328)
Comprehensive loss, nonredeemable noncontrolling interests	(690)	(673)	(1,315)	(1,363)
Comprehensive income attributable to the Company	\$ 19,894	\$ 12,402	\$ 42,699	\$ 32,984

(1) Amounts reclassified out of accumulated other comprehensive loss into net interest expense included \$311 and \$628 for the three and six months ended June 26, 2016, respectively and \$393 and \$787 for the three and six months ended June 28, 2015.

(2) The income tax effects of amounts reclassified out of accumulated other comprehensive loss into net interest expense were \$115 and \$232 for the three and six months ended June 26, 2016, respectively and \$145 and \$291 for the three and six months ended June 28, 2015, respectively.

See accompanying notes.



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Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Six Months Ended June 26, 2016	June 28, 2015
Operating activities		
Net income before attribution to noncontrolling interests	\$ 52,163	\$ 36,707
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible accounts and notes receivable	247	631
Depreciation and amortization	19,775	20,177
Deferred income taxes	3,786	(3,064)
Stock-based compensation expense	4,893	4,985
Other	1,883	2,239
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	6,680	1,682
Income taxes receivable	(472)	(1,281)
Inventories	(877)	3,474
Prepaid expenses	2,548	999
Other current assets	1,269	293
Other assets and liabilities	(1,724)	(773)
Accounts payable	(8,654)	(3,877)
Income and other taxes payable	3,703	72
Accrued expenses and other current liabilities	(11,425)	15,495
Deferred revenue	1,328	223
Net cash provided by operating activities	75,123	77,982

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Investing activities		
Purchases of property and equipment	(24,001)	(16,501)
Loans issued	(1,630)	(1,571)
Repayments of loans issued	5,382	2,787
Acquisitions, net of cash acquired	(11,202)	(491)
Other	165	348
Net cash used in investing activities	(31,286)	(15,428)
Financing activities		
Net proceeds from issuance of long-term debt	61,375	3,549
Cash dividends paid	(13,130)	(11,083)
Excess tax benefit on equity awards	4,490	9,488
Tax payments for equity award issuances	(5,831)	(10,654)
Proceeds from exercise of stock options	2,812	3,915
Acquisition of Company common stock	(96,355)	(52,083)
Distributions to noncontrolling interest holders	(3,200)	(3,667)
Other	391	319
Net cash used in financing activities	(49,448)	(60,216)
Effect of exchange rate changes on cash and cash equivalents	(129)	(13)
Change in cash and cash equivalents	(5,740)	2,325
Cash and cash equivalents at beginning of period	21,006	20,122
Cash and cash equivalents at end of period	\$ 15,266	\$ 22,447

See accompanying notes.



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Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

June 26, 2016

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 26, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ended December 25, 2016. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for Papa John's International, Inc. (referred to as the "Company", "Papa John's" or in the first person notations of "we", "us" and "our") for the year ended December 27, 2015.

2. Significant Accounting Policies

Noncontrolling Interests

Papa John's has four joint venture arrangements in which there are noncontrolling interests held by third parties. These joint ventures include 215 restaurants at June 26, 2016 and 206 restaurants at June 28, 2015. We are required to report the consolidated net income at amounts attributable to the Company and the noncontrolling interests. Additionally, disclosures are required to clearly identify and distinguish between the interests of the Company and the interests of the noncontrolling owners, including a disclosure on the face of the condensed consolidated statements of income attributable to the noncontrolling interest holder.

The income before income taxes attributable to these joint ventures for the three and six months ended June 26, 2016 and June 28, 2015 was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Papa John's International, Inc.	\$ 2,529	\$ 2,660	\$ 5,289	\$ 5,670
Noncontrolling interests	1,571	1,688	3,440	3,691
Total income before income taxes	\$ 4,100	\$ 4,348	\$ 8,729	\$ 9,361

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The following summarizes the redemption feature, location and related accounting within the condensed consolidated balance sheets:

Type of Joint Venture Arrangement	Location within the Condensed Consolidated Balance Sheets	Recorded Value
Joint venture with no redemption feature	Permanent equity	Carrying value
Option to require the Company to purchase their interest - currently redeemable	Temporary equity	Redemption value*
Option to require the Company to purchase their interest - not currently redeemable	Temporary equity	Carrying value

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\*The change in redemption value is recorded as an adjustment to “Redeemable noncontrolling interests” and “Retained earnings” in the condensed consolidated balance sheets.

#### Deferred Income Tax Accounts and Tax Reserves

We are subject to income taxes in the United States and several foreign jurisdictions. Significant judgment is required in determining our provision for income taxes and the related assets and liabilities. The provision for income taxes includes income taxes paid, currently payable or receivable and those deferred. We use an estimated annual effective rate based on expected annual income to determine our quarterly provision for income taxes. Discrete items are recorded in the quarter in which they occur.

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax loss carryforwards. The effect on deferred taxes of changes in tax rates is recognized in the period in which the new tax rate is enacted. As a result, our effective tax rate may fluctuate. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize. As of June 26, 2016, we had a net deferred tax liability of approximately \$300,000.

Tax authorities periodically audit the Company. We record reserves and related interest and penalties for identified exposures as income tax expense. We evaluate these issues on a quarterly basis to adjust for events, such as statute of limitations expirations, court rulings or audit settlements, which may impact our ultimate payment for such exposures.



Fair Value Measurements and Disclosures

The Company is required to determine the fair value of financial assets and liabilities based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. Fair value is a market-based measurement, not an entity specific measurement. The fair value of certain assets and liabilities approximates carrying value because of the short-term nature of the accounts, including cash, accounts receivable and accounts payable. The carrying value of our notes receivable net of allowances also approximates fair value. The fair value of the amount outstanding under our revolving credit facility approximates its carrying value due to its variable market-based interest rate. These assets and liabilities are categorized as Level 1 as defined below.

Certain assets and liabilities are measured at fair value on a recurring basis and are required to be classified and disclosed in one of the following categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
  - Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are not corroborated by market data.

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Our financial assets and liabilities that were measured at fair value on a recurring basis as of June 26, 2016 and December 27, 2015 are as follows (in thousands):

	Carrying Value	Fair Value Measurements		
		Level 1	Level 2	Level 3
June 26, 2016				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 19,838	\$ 19,838	\$ —	\$ —
Financial liabilities:				
Interest rate swaps (b)	8,331	—	8,331	—
December 27, 2015				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 17,916	\$ 17,916	\$ —	\$ —
Financial liabilities:				
Interest rate swaps (b)	2,262	—	2,262	—

(a) Represents life insurance policies held in our non-qualified deferred compensation plan.

(b) The fair value of our interest rate swaps are based on the sum of all future net present value cash flows. The future cash flows are derived based on the terms of our interest rate swaps, as well as considering published discount factors, and projected London Interbank Offered Rates (“LIBOR”).

There were no transfers among levels within the fair value hierarchy during the six months ended June 26, 2016.

## Variable Interest Entity

Papa John’s domestic restaurants, both Company-owned and franchised, participate in Papa John’s Marketing Fund, Inc. (“PJMF”), a nonstock corporation designed to operate at break-even for the purpose of designing and administering advertising and promotional programs for all participating domestic restaurants. PJMF is a variable interest entity as it does not have sufficient equity to fund its operations without ongoing financial support and contributions from its members. Based on the ownership and governance structure and operating procedures of PJMF, we have determined that we do not have the power to direct the most significant activities of PJMF and therefore are not the primary beneficiary. Accordingly, consolidation of PJMF is not appropriate.

## Accounting Standards Adopted

#### Deferred Debt Issuance Costs

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-03 “Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs” (“ASU 2015-03”). The update requires that deferred debt issuance costs be reported as a reduction to long-term debt (previously reported in other noncurrent assets). We adopted ASU 2015-03 in the first quarter of 2016 and for all retrospective periods, as required. The impact of the adoption was not material to our condensed consolidated financial statements. See Debt Footnote for more details.

#### Accounting Standards to be Adopted in Future Periods

#### Employee Share-Based Payments

In March 2016, the FASB issued ASU 2016-09, “Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). The guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax

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withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for the Company beginning in fiscal 2017, with early application permitted. Based on the significance of our employee stock compensation program, we expect the adoption could have a material impact to our condensed consolidated statements of income.

## Leases

In February 2016, the FASB issued ASU 2016-02, “Leases,” (“ASU 2016-02”) which amends leasing guidance by requiring companies to recognize a right-of-use asset and a lease liability for all operating and capital leases (financing) with lease terms greater than twelve months. The lease liability will be equal to the present value of lease payments. The lease asset will be based on the lease liability, subject to adjustment, such as for initial direct costs. For income statement purposes, leases will continue to be classified as operating or capital (financing) with lease expense in both cases calculated substantially the same as under the prior leasing guidance. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018 (fiscal 2019 for the Company), and early adoption is permitted. The Company has not yet determined the effect of the adoption on its condensed consolidated financial statements.

## Revenue from Contract with Customers

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contracts with Customers” (“ASU 2014-09”), a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP. This update requires companies to recognize revenue at amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services at the time of transfer. In doing so, companies will need to use more judgment and make more estimates than under today’s guidance. Such estimates may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Companies can either apply a full retrospective adoption or a modified retrospective adoption.

We are required to adopt ASU 2014-09 in the first quarter of 2018. We are currently evaluating the method of adoption and impact of the new requirements on our condensed consolidated financial statements. We currently do not believe the impact will be significant.

## Reclassifications

Certain prior year captions have been combined in the condensed consolidated statement of income and certain amounts within the consolidated statement of cash flows have been reclassified to conform to the current year presentation.

### 3. Calculation of Earnings Per Share

We compute earnings per share using the two-class method. The two-class method requires an earnings allocation formula that determines earnings per share for common shareholders and participating security holders according to dividends declared and participating rights in undistributed earnings. We consider time-based restricted stock awards to be participating securities because holders of such shares have non-forfeitable dividend rights. Under the two-class method, undistributed earnings allocated to participating securities are subtracted from net income attributable to the Company in determining net income attributable to common shareholders.

Additionally, in accordance with Accounting Standards Codification 480, "Distinguishing Liabilities from Equity", the change in the redemption value for the noncontrolling interest of one of our joint ventures increases or decreases income attributable to common shareholders.

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The calculations of basic and diluted earnings per common share are as follows (in thousands, except per-share data):

	Three Months Ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Basic earnings per common share:				
Net income attributable to the Company	\$ 22,541	\$ 10,780	\$ 48,723	\$ 33,016
Change in noncontrolling interest redemption value	279	73	499	143
Net income attributable to participating securities	(91)	(50)	(201)	(150)
Net income attributable to common shareholders	\$ 22,729	\$ 10,803	\$ 49,021	\$ 33,009
Weighted average common shares outstanding	37,203	39,692	37,567	39,764
Basic earnings per common share	\$ 0.61	\$ 0.27	\$ 1.30	\$ 0.83
Diluted earnings per common share:				
Net income attributable to common shareholders	\$ 22,729	\$ 10,803	\$ 49,021	\$ 33,009
Weighted average common shares outstanding	37,203	39,692	37,567	39,764
Dilutive effect of outstanding equity awards (a)	304	525	337	604
Diluted weighted average common shares outstanding	37,507	40,217	37,904	40,368
Diluted earnings per common share	\$ 0.61	\$ 0.27	\$ 1.29	\$ 0.82

(a) Excludes 689 and 566 awards for the three and six months ended June 26, 2016 and 292 and 198 awards for the three and six months ended June 28, 2015, as the effect of including such awards would have been antidilutive.

#### 4. Acquisition of Restaurants

In the first quarter of 2016, we completed the acquisition of 20 franchised Papa John's restaurants located in Alabama, Florida and Kentucky in two separate transactions with an aggregate purchase price of \$11.2 million. These acquisitions were accounted for by the purchase method of accounting, whereby operating results subsequent to the acquisition date are included in our consolidated financial results.

The aggregate purchase price of the acquisitions has been allocated as follows (in thousands):

Property and equipment	\$ 1,028
Franchise rights	1,230

Goodwill	8,837
Other	107
Total purchase price	\$ 11,202

The excess of the purchase price over the aggregate fair value of net assets acquired was allocated to goodwill for the domestic Company-owned restaurants segment and is eligible for deduction over 15 years under U.S. tax regulations.

## 5. Debt

Long-term debt consists of the following (in thousands):

	June 26, 2016	December 27, 2015
Outstanding debt	\$ 317,375	\$ 256,000
Debt issuance costs	(891)	(854)
Total long-term debt	\$ 316,484	\$ 255,146

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Our outstanding debt is comprised entirely of an unsecured revolving line of credit (“Credit Facility”) with an expiration date of October 31, 2019. On June 8, 2016, we exercised our option to increase the amount available under our Credit Facility to \$500 million from the previous \$400 million availability. Including outstanding letters of credit, the remaining availability under the Credit Facility was approximately \$157.7 million as of June 26, 2016.

The interest rate charged on outstanding balances is LIBOR plus 75 to 175 basis points. The commitment fee on the unused balance ranges from 15 to 25 basis points.

The Credit Facility contains customary affirmative and negative covenants, including financial covenants requiring the maintenance of specified fixed charges and leverage ratios. At June 26, 2016, we were in compliance with these covenants.

We attempt to minimize interest risk exposure by fixing our rate through the utilization of interest rate swaps, which are derivative financial instruments. Our swaps are entered into with financial institutions and have reset dates and critical terms that match those of our existing debt and the anticipated critical terms of future debt. By using a derivative instrument to hedge exposures to changes in interest rates, we expose ourselves to credit risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract.

As of June 26, 2016, we have the following interest rate swap agreements, including three forward starting swaps executed in 2015 that become effective in 2018 upon expiration of the two existing swaps for \$125 million:

Effective Dates	Floating Rate	Fixed Rates	
	Debt		%
July 30, 2013 through April 30, 2018	\$ 75million	1.42	%
December 30, 2014 through April 30, 2018	\$ 50million	1.36	%
April 30, 2018 through April 30, 2023	\$ 55million	2.33	%
April 30, 2018 through April 30, 2023	\$ 35million	2.36	%
April 30, 2018 through April 30, 2023	\$ 35million	2.34	%

The weighted average interest rates on the Credit Facility, including the impact of the interest rate swap agreements, were 2.1% and 2.0% for the three months ended June 26, 2016 and June 28, 2015, respectively, and 2.1% and 2.0% for the six months ended June 26, 2016 and June 28, 2015, respectively. Interest paid, including payments made or received under the swaps, was \$1.8 million and \$1.3 million for the three months ended June 26, 2016 and June 28, 2015, respectively, and \$3.4 million and \$2.6 million for the six months ended June 26, 2016 and June 28, 2015, respectively. As of June 26, 2016, the portion of the \$8.3 million interest rate swap liability that would be reclassified into earnings during the next twelve months as interest expense approximates \$1.0 million.



## 6. Segment Information

We have five reportable segments: domestic Company-owned restaurants, domestic commissaries, North America franchising, international operations and “all other” units. The domestic Company-owned restaurant segment consists of the operations of all domestic (“domestic” is defined as contiguous United States) Company-owned restaurants and derives its revenues principally from retail sales of pizza and side items, including breadsticks, cheesesticks, chicken poppers and wings, dessert items and canned or bottled beverages. The domestic commissary segment consists of the operations of our regional dough production and product distribution centers and derives its revenues principally from the sale and distribution of food and paper products to domestic Company-owned and franchised restaurants. The North America franchising segment consists of our franchise sales and support activities and derives its revenues from sales of franchise and development rights and collection of royalties from our franchisees located in the United States and Canada. The international operations segment principally consists of Company-owned restaurants in China and distribution sales to franchised Papa John’s restaurants located in the United Kingdom, Mexico and China and our franchise sales and support activities, which derive revenues from sales of franchise and development rights and the collection of royalties from our international franchisees. International franchisees are defined as all franchise operations outside of the United States and Canada. All other business units that do not meet the quantitative thresholds for determining reportable segments, which are not operating segments, we refer to as our “all other” segment, which consists of operations that derive revenues from the sale, principally to Company-owned and franchised restaurants, of

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printing and promotional items, risk management services, and information systems and related services used in restaurant operations, including our point-of-sale system, online and other technology-based ordering platforms.

Generally, we evaluate performance and allocate resources based on profit or loss from operations before income taxes and intercompany eliminations. Certain administrative and capital costs are allocated to segments based upon predetermined rates or actual estimated resource usage. We account for intercompany sales and transfers as if the sales or transfers were to third parties and eliminate the activity in consolidation.

Our reportable segments are business units that provide different products or services. Separate management of each segment is required because each business unit is subject to different operational issues and strategies. No single external customer accounted for 10% or more of our consolidated revenues.

Our segment information is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Revenues from external customers:				
Domestic Company-owned restaurants	\$ 204,248	\$ 185,962	\$ 409,927	\$ 383,249
Domestic commissaries	150,895	149,007	306,849	311,340
North America franchising	25,302	23,276	51,778	48,900
International	28,460	26,326	55,915	51,752
All others	14,059	14,420	27,090	36,034
Total revenues from external customers	\$ 422,964	\$ 398,991	\$ 851,559	\$ 831,275
Intersegment revenues:				
Domestic commissaries	\$ 57,722	\$ 54,459	\$ 116,048	\$ 112,346
North America franchising	739	671	1,452	1,342
International	67	75	132	150
All others	4,075	3,694	8,172	7,626
Total intersegment revenues	\$ 62,603	\$ 58,899	\$ 125,804	\$ 121,464
Income (loss) before income taxes:				
Domestic Company-owned restaurants	\$ 15,325	\$ 14,617	\$ 35,512	\$ 33,097
Domestic commissaries	11,682	10,702	23,228	22,502
North America franchising	22,445	20,054	46,025	42,373
International	2,875	2,279	5,913	3,623
All others	425	(117)	476	326
Unallocated corporate expenses	(17,079)	(29,949)	(33,411)	(47,154)
Elimination of intersegment profit	(473)	(55)	(1,134)	(800)

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Total income before income taxes	\$ 35,200	\$ 17,531	\$ 76,609	\$ 53,967
Property and equipment:				
Domestic Company-owned restaurants	\$ 227,023			
Domestic commissaries	112,666			
International	16,854			
All others	50,949			
Unallocated corporate assets	186,922			
Accumulated depreciation and amortization	(376,886)			
Net property and equipment	\$ 217,528			

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

## Overview

Papa John's International, Inc. (referred to as the "Company," "Papa John's" or in the first person notations of "we," "us" and "our") began operations in 1984. At June 26, 2016, there were 4,935 Papa John's restaurants (776 Company-owned and 4,159 franchised) operating in all 50 states and 43 international countries and territories. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, risk management services, and information systems and related services used in their operations.

The results of operations are based on the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP"). The preparation of consolidated financial statements requires management to select accounting policies for critical accounting areas and make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions in our critical accounting policies could materially impact our operating results. See "Notes 1 and 2" of "Notes to Condensed Consolidated Financial Statements" for a discussion of the basis of presentation and the significant accounting policies.

## Restaurant Progression

	Three Months Ended		Six Months Ended	
	June 26, 2016	June 28, 2015	June 26, 2016	June 28, 2015
Papa John's Restaurant Progression:				
North America Company-owned:				
Beginning of period	729	691	707	686
Opened	5	1	7	4
Acquired	—	1	20	3
End of period	734	693	734	693
International Company-owned:				
Beginning of period	44	48	45	49
Closed	(2)	—	(3)	(1)
End of period	42	48	42	48
North America franchised:				

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Beginning of period	2,661	2,650	2,681	2,654
Opened	23	19	41	37
Closed	(16)	(15)	(34)	(35)
Divested	—	(1)	(20)	(3)
End of period	2,668	2,653	2,668	2,653
International franchised:				
Beginning of period	1,469	1,310	1,460	1,274
Opened	46	42	70	92
Closed	(24)	(12)	(39)	(26)
End of period	1,491	1,340	1,491	1,340
Total restaurants - end of period	4,935	4,734	4,935	4,734

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Results of Operations

Income Statement Presentation

We have streamlined our income statement presentation by combining certain income statement captions in the condensed consolidated statements of income and have conformed prior year amounts to this new presentation.

Review of Consolidated Operating Results

Revenues. Domestic Company-owned restaurant sales increased \$18.3 million, or 9.8%, and \$26.7 million, or 7.0%, for the three and six months ended June 26, 2016, respectively, primarily due to increases of 5.6% and 3.2% in comparable sales and increases of 5.1% and 4.6% in equivalent units during the three and six months ended June 26, 2016, including 20 restaurants acquired from franchisees during the first quarter. “Equivalent units” represents the number of restaurants open at the beginning of a given period, adjusted for restaurants opened, closed, acquired or sold during the period on a weighted average basis. “Comparable sales” represents the change in year-over-year sales for the same base of restaurants for the same fiscal periods.

Domestic franchise royalties and fees increased \$2.0 million, or 8.7% and \$2.9 million, or 5.9% for the three and six months ended June 26, 2016, respectively. The increase was primarily due to increases in comparable sales of 4.5% and 2.1% for the three and six months, respectively, as well as reduced levels of royalty incentives in 2016. Domestic franchise restaurant sales increased 4.3% to \$545.5 million and 2.2% to \$1.1 billion for the three and six months ended June 26, 2016, respectively. The increase is primarily due to the increase in comparable sales noted above. Franchise restaurant sales are not included in Company revenues; however, our domestic royalty revenue is derived from these sales.

Domestic commissary and other sales increased \$1.5 million, or 0.9% and decreased \$13.4 million, or 3.9% for the three and six months ended June 26, 2016, respectively. The increase of \$1.5 million for the second quarter was primarily due to a \$1.9 million increase in domestic commissary sales from an increase in volumes, partially offset by lower pricing for certain commodities, including cheese, and an increase in online fee revenue for our online and mobile ordering business. These increases were partially offset by the prior year inclusion of approximately \$1.3 million for point-of-sale system (“FOCUS”) equipment sales to franchisees which had no significant impact on 2015 operating results. The decrease for the comparable six month period was due to a \$9.8 million decrease in FOCUS equipment sales and a decrease in commissary sales of \$4.5 million associated with lower pricing for certain commodities, partially offset by higher domestic commissary sales volumes.

International revenues increased approximately \$2.1 million, or 8.1% and \$4.2 million, or 8.0% for the three and six months ended June 26, 2016, respectively, primarily due to the following:

- The three and six month periods of 2016 include sublease rental revenue in the United Kingdom of approximately \$1.7 million and \$3.3 million, respectively, which was shown net of the rental expenses in the corresponding periods of the prior year. The change had no impact on income before income taxes.
- Higher royalties and commissary revenues resulted from an increase in the number of restaurants and an increase in comparable sales of 5.3% and 5.5% for the three and six months ended June 26, 2016, calculated on a constant dollar basis. International franchise restaurant sales increased 7.7% to \$161.8 million, and 8.0% to \$316.1 million for the three and six month periods. International franchise restaurant sales are not included in Company revenues; however, our international royalty revenue is derived from these sales.
- These increases were somewhat offset by lower China Company-owned restaurant revenues of \$1.3 million and \$2.6 million for the three and six month periods, respectively, primarily due to negative comparable sales and fewer restaurants.

The negative impact of foreign currency exchange rates was approximately \$2.2 million and \$4.0 million on international revenues for the three and six months ended June 26, 2016.

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Costs and expenses. The operating margin for domestic Company-owned restaurants was 20.0% and 20.8% in the three and six months ended June 26, 2016, respectively, compared to 20.8% and 21.1% in the corresponding 2015 periods, and consisted of the following (dollars in thousands):