

PAPA JOHNS INTERNATIONAL INC

Form 10-Q

August 01, 2017

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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 25, 2017

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.

(Exact name of registrant as specified in its charter)

Delaware

61-1203323

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(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, a smaller reporting company or an emerging growth 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

Emerging growth company

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

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

At July 27, 2017, there were outstanding 36,416,998 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 25,<br>2017<br>(Unaudited) | December 25,<br>2016 |
|--|---------------------------------|----------------------|
| Assets   |                                 |                      |
| Current assets:                                |                                 |                      |
| Cash and cash equivalents                      | \$ 22,247                       | \$ 15,563            |
| Accounts receivable, net                       | 59,882                          | 59,691               |
| Notes receivable, net                          | 3,680                           | 3,417                |
| Income taxes receivable                        | 2,417                           | 2,372                |
| Inventories                                    | 24,586                          | 25,132               |
| Prepaid expenses                               | 21,142                          | 24,105               |
| Other current assets                           | 9,363                           | 9,038                |
| Assets held for sale                           | 6,272                           | 6,257                |
| Total current assets                           | 149,589                         | 145,575              |
| Property and equipment, net                    | 234,524                         | 230,473              |
| Notes receivable, less current portion net     | 10,709                          | 10,141               |
| Goodwill                                       | 85,922                          | 85,529               |
| Deferred income taxes                          | 315                             | 769                  |
| Other assets                                   | 44,583                          | 40,078               |
| Total assets                                   | \$ 525,642                      | \$ 512,565           |
| Liabilities and stockholders' equity           |                                 |                      |
| Current liabilities:                           |                                 |                      |
| Accounts payable                               | \$ 38,653                       | \$ 42,701            |
| Income and other taxes payable                 | 9,815                           | 8,540                |
| Accrued expenses and other current liabilities | 67,772                          | 76,789               |
| Total current liabilities                      | 116,240                         | 128,030              |
| Deferred revenue                               | 3,060                           | 3,313                |
| Long-term debt, net                            | 305,149                         | 299,820              |
| Deferred income taxes                          | 9,416                           | 10,047               |
| Other long-term liabilities                    | 60,179                          | 53,093               |
| Total liabilities                              | 494,044                         | 494,303              |
| Redeemable noncontrolling interests            | 8,819                           | 8,461                |

|   |            |            |
|---|------------|------------|
| Stockholders' equity:   |            |            |
| Preferred stock (\$0.01 par value per share; no shares issued)  | —          | —          |
| Common stock (\$0.01 par value per share; issued 44,197 at June 25, 2017 and 44,066 at December 25, 2016) | 442        | 441        |
| Additional paid-in capital  | 179,180    | 172,573    |
| Accumulated other comprehensive loss  | (6,457)    | (5,887)    |
| Retained earnings   | 257,742    | 219,278    |
| Treasury stock (7,757 shares at June 25, 2017 and 7,383 shares at December 25, 2016, at cost)             | (421,828)  | (390,316)  |
| Total stockholders' equity (deficit), net of noncontrolling interests                                     | 9,079      | (3,911)    |
| Noncontrolling interests in subsidiaries  | 13,700     | 13,712     |
| Total stockholders' equity  | 22,779     | 9,801      |
| Total liabilities, redeemable noncontrolling interests and stockholders' equity                           | \$ 525,642 | \$ 512,565 |

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 25, 2017      | June 26, 2016 | June 25, 2017    | June 26, 2016 |
| Revenues:   |                    |               |                  |               |
| Domestic Company-owned restaurant sales   | \$ 202,756         | \$ 204,248    | \$ 409,652       | \$ 409,927    |
| North America franchise royalties and fees  | 26,588             | 25,302        | 54,195           | 51,778        |
| North America commissary and other sales  | 175,204            | 164,954       | 361,449          | 333,939       |
| International   | 30,230             | 28,460        | 58,748           | 55,915        |
| Total revenues  | 434,778            | 422,964       | 884,044          | 851,559       |
| Costs and expenses:   |                    |               |                  |               |
| Operating costs (excluding depreciation and amortization shown separately below): |                    |               |                  |               |
| Domestic Company-owned restaurant expenses  | 162,433            | 163,469       | 327,852          | 324,779       |
| North America commissary and other expenses                                       | 162,989            | 152,258       | 336,701          | 309,064       |
| International expenses  | 19,482             | 17,752        | 37,472           | 35,342        |
| General and administrative expenses   | 42,003             | 42,623        | 80,010           | 82,870        |
| Depreciation and amortization   | 10,654             | 10,031        | 21,111           | 19,775        |
| Total costs and expenses  | 397,561            | 386,133       | 803,146          | 771,830       |
| Operating income  | 37,217             | 36,831        | 80,898           | 79,729        |
| Net interest expense  | (1,759)            | (1,631)       | (3,569)          | (3,120)       |
| Income before income taxes  | 35,458             | 35,200        | 77,329           | 76,609        |
| Income tax expense  | 10,476             | 11,088        | 22,448           | 24,446        |
| Net income before attribution to noncontrolling interests                         | 24,982             | 24,112        | 54,881           | 52,163        |
| Income attributable to noncontrolling interests                                   | (1,444)            | (1,571)       | (2,915)          | (3,440)       |
| Net income attributable to the Company  | \$ 23,538          | \$ 22,541     | \$ 51,966        | \$ 48,723     |
| Calculation of income for earnings per share:                                     |                    |               |                  |               |
| Net income attributable to the Company  | \$ 23,538          | \$ 22,541     | \$ 51,966        | \$ 48,723     |
| Change in noncontrolling interest redemption value                                | 662                | 279           | 1,182            | 499           |
| Net income attributable to participating securities                               | (99)               | (91)          | (216)            | (201)         |
| Net income attributable to common shareholders                                    | \$ 24,101          | \$ 22,729     | \$ 52,932        | \$ 49,021     |
| Basic earnings per common share   | \$ 0.66            | \$ 0.61       | \$ 1.44          | \$ 1.30       |
| Diluted earnings per common share   | \$ 0.65            | \$ 0.61       | \$ 1.42          | \$ 1.29       |
| Basic weighted average common shares outstanding                                  | 36,732             | 37,203        | 36,771           | 37,567        |
| Diluted weighted average common shares outstanding                                | 37,217             | 37,507        | 37,283           | 37,904        |
| Dividends declared per common share   | \$ 0.20            | \$ 0.175      | \$ 0.40          | \$ 0.35       |

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 25, 2017      | June 26, 2016 | June 25, 2017    | June 26, 2016 |
| Net income before attribution to noncontrolling interests           | \$ 24,982          | \$ 24,112     | \$ 54,881        | \$ 52,163     |
| Other comprehensive income (loss), before tax:                      |                    |               |                  |               |
| Foreign currency income (loss) adjustments                          | 808                | (1,441)       | 1,421            | (3,513)       |
| Interest rate swaps (1)   | (1,857)            | (2,760)       | (2,325)          | (6,049)       |
| Other comprehensive loss, before tax                                | (1,049)            | (4,201)       | (904)            | (9,562)       |
| Income tax effect:  |                    |               |                  |               |
| Foreign currency translation adjustments                            | (299)              | 533           | (526)            | 1,300         |
| Interest rate swaps (2)   | 687                | 1,021         | 860              | 2,238         |
| Income tax effect   | 388                | 1,554         | 334              | 3,538         |
| Other comprehensive loss, net of tax                                | (661)              | (2,647)       | (570)            | (6,024)       |
| Comprehensive income before attribution to noncontrolling interests | 24,321             | 21,465        | 54,311           | 46,139        |
| Comprehensive loss, redeemable noncontrolling interests             | (745)              | (881)         | (1,539)          | (2,125)       |
| Comprehensive loss, nonredeemable noncontrolling interests          | (699)              | (690)         | (1,376)          | (1,315)       |
| Comprehensive income attributable to the Company                    | \$ 22,877          | \$ 19,894     | \$ 51,396        | \$ 42,699     |

(1) Amounts reclassified out of accumulated other comprehensive loss into net interest expense included \$126 and \$324 for the three and six months ended June 25, 2017, respectively, and \$311 and \$628 for the three and six months ended June 26, 2016, respectively.

(2) The income tax effects of amounts reclassified out of accumulated other comprehensive loss into net interest expense were \$47 and \$120 for the three and six months ended June 25, 2017, respectively, and \$115 and \$232 for the three and six months ended June 26, 2016, 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 25, 2017    | June 26, 2016 |
| Operating activities  |                  |               |
| Net income before attribution to noncontrolling interests                         | \$ 54,881        | \$ 52,163     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |               |
| Provision for uncollectible accounts and notes receivable                         | (1,091)          | 247           |
| Depreciation and amortization   | 21,111           | 19,775        |
| Deferred income taxes   | 158              | 3,786         |
| Stock-based compensation expense  | 5,571            | 4,893         |
| Other   | 1,978            | 1,883         |
| Changes in operating assets and liabilities, net of acquisitions:                 |                  |               |
| Accounts receivable   | (355)            | 6,680         |
| Income taxes receivable   | (45)             | 4,018         |
| Inventories   | 550              | (877)         |
| Prepaid expenses  | 2,966            | 2,548         |
| Other current assets  | (372)            | 1,269         |
| Other assets and liabilities  | (1,559)          | (1,724)       |
| Accounts payable  | (3,950)          | (8,654)       |
| Income and other taxes payable  | 1,275            | 3,703         |
| Accrued expenses and other current liabilities                                    | (3,002)          | (11,425)      |
| Deferred revenue  | (253)            | 1,328         |
| Net cash provided by operating activities   | 77,863           | 79,613        |
| Investing activities  |                  |               |
| Purchases of property and equipment   | (30,457)         | (24,001)      |
| Loans issued  | (1,476)          | (1,630)       |
| Repayments of loans issued  | 2,125            | 5,382         |
| Acquisitions, net of cash acquired  | (21)             | (11,202)      |
| Other   | 25               | 165           |
| Net cash used in investing activities   | (29,804)         | (31,286)      |
| Financing activities  |                  |               |
| Net proceeds from issuance of long-term debt                                      | 5,156            | 61,375        |
| Cash dividends paid   | (14,703)         | (13,130)      |
| Tax payments for equity award issuances   | (2,282)          | (5,831)       |
| Proceeds from exercise of stock options   | 5,218            | 2,812         |
| Acquisition of Company common stock   | (33,968)         | (96,355)      |
| Distributions to noncontrolling interest holders                                  | (1,389)          | (3,200)       |
| Other   | 494              | 391           |
| Net cash used in financing activities   | (41,474)         | (53,938)      |

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|  |           |           |
|--|-----------|-----------|
| Effect of exchange rate changes on cash and cash equivalents | 99        | (129)     |
| Change in cash and cash equivalents                          | 6,684     | (5,740)   |
| Cash and cash equivalents at beginning of period             | 15,563    | 21,006    |
| Cash and cash equivalents at end of period                   | \$ 22,247 | \$ 15,266 |

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

June 25, 2017

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 25, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2017. 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 25, 2016.

2. Significant Accounting Policies

Noncontrolling Interests

Papa John's has five joint venture arrangements in which there are noncontrolling interests held by third parties. These joint ventures include 223 restaurants at June 25, 2017 and 215 restaurants at June 26, 2016. 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 25, 2017 and June 26, 2016 was as follows (in thousands):

|                                  | Three Months Ended |                  | Six Months Ended |                  |
|----------------------------------|--------------------|------------------|------------------|------------------|
|                                  | June 25,<br>2017   | June 26,<br>2016 | June 25,<br>2017 | June 26,<br>2016 |
| Papa John's International, Inc.  | \$ 2,341           | \$ 2,529         | \$ 4,703         | \$ 5,289         |
| Noncontrolling interests         | 1,444              | 1,571            | 2,915            | 3,440            |
| Total income before income taxes | \$ 3,785           | \$ 4,100         | \$ 7,618         | \$ 8,729         |

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The following summarizes the redemption feature, location and related accounting within the condensed consolidated balance sheets for these joint venture arrangements:

| Type of Joint Venture Arrangement  | Location within the Balance Sheets | Recorded Value    |
|--|------------------------------------|-------------------|
| Joint venture with no redemption feature   | Permanent equity                   | Carrying value    |
| Option to require the Company to purchase the noncontrolling interest - currently redeemable     | Temporary equity                   | Redemption value* |
| Option to require the Company to purchase the noncontrolling 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 25, 2017, we had a net deferred tax liability of approximately \$9.1 million.

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 25, 2017 and December 25, 2016 are as follows (in thousands):

|   | Carrying<br>Value | Fair Value Measurements |         |         |
|---|-------------------|-------------------------|---------|---------|
|   |                   | Level 1                 | Level 2 | Level 3 |
| June 25, 2017                                       |                   |                         |         |         |
| Financial assets:                                   |                   |                         |         |         |
| Cash surrender value of life insurance policies (a) | \$ 25,396         | \$ 25,396               | \$ —    | \$ —    |
| Financial liabilities:                              |                   |                         |         |         |
| Interest rate swaps (b)                             | 3,095             | —                       | 3,095   | —       |
| December 25, 2016                                   |                   |                         |         |         |
| Financial assets:                                   |                   |                         |         |         |
| Cash surrender value of life insurance policies (a) | \$ 21,690         | \$ 21,690               | \$ —    | \$ —    |
| Financial liabilities:                              |                   |                         |         |         |
| Interest rate swaps (b)                             | 770               | —                       | 770     | —       |

(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”).

Our assets and liabilities that were measured at fair value on a non-recurring basis as of June 25, 2017 and December 25, 2016 include assets held for sale. The fair value was determined using a discounted cash flow model with unobservable inputs (Level 3) less estimated selling costs. No impairment loss was recorded for these assets held for sale for the three and six months ended June 25, 2017.

There were no transfers among levels within the fair value hierarchy during the six months ended June 25, 2017.

#### 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

#### Employee Share-Based Payments

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, “Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). The guidance simplified the accounting and financial reporting of the income tax impact of stock-based compensation arrangements. This guidance requires excess tax benefits to be recorded as a discrete item within income tax expense rather than additional paid-in capital. In addition, excess tax benefits are required to be classified as cash from operating activities rather than cash from financing activities.

The Company adopted this guidance as of the beginning of fiscal 2017. The Company elected to apply the cash flow guidance of ASU 2016-09 retrospectively to all prior periods. The impact of retrospectively applying this guidance to the consolidated statement of cash flows for the six months ended June 26, 2016 was a \$4.5 million increase in net cash

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provided by operating activities and a corresponding increase in net cash used in financing activities. The Company elected to continue to estimate forfeitures, as permitted by ASU 2016-09, rather than electing to account for forfeitures as they occur.

### Accounting Standards to be Adopted in Future Periods

#### 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 Contracts 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 existing guidance. Such areas 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. In March and April 2016, the FASB issued the following amendments to clarify the implementation guidance: ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” and ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing”.

We are required to adopt ASU 2014-09 in the first quarter of 2018. We do not expect the adoption will significantly impact our recognition of revenue from Company-owned restaurants, commissary sales or our continuing royalties or other fees from franchisees that are based on a percentage of the franchise sales. We are continuing to evaluate the impact on other less significant transactions including our loyalty program (including a change to a deferred revenue approach from the incremental cost accrual model), the impact on local cooperative advertising funds (including a

change to gross revenue and expense presentation from net presentation), and the timing of recognizing franchise and development fees. We preliminarily expect to use the modified retrospective method of adoption. However, the adoption method is subject to change as we continue to evaluate the impact of the standard.

### 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, 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 25,<br>2017   | June 26,<br>2016 | June 25,<br>2017 | June 26,<br>2016 |
| Basic earnings per common share:                    |                    |                  |                  |                  |
| Net income attributable to the Company              | \$ 23,538          | \$ 22,541        | \$ 51,966        | \$ 48,723        |
| Change in noncontrolling interest redemption value  | 662                | 279              | 1,182            | 499              |
| Net income attributable to participating securities | (99)               | (91)             | (216)            | (201)            |
| Net income attributable to common shareholders      | \$ 24,101          | \$ 22,729        | \$ 52,932        | \$ 49,021        |
|   |                    |                  |                  |                  |
| Weighted average common shares outstanding          | 36,732             | 37,203           | 36,771           | 37,567           |
| Basic earnings per common share                     | \$ 0.66            | \$ 0.61          | \$ 1.44          | \$ 1.30          |
|   |                    |                  |                  |                  |
| Diluted earnings per common share:                  |                    |                  |                  |                  |
| Net income attributable to common shareholders      | \$ 24,101          | \$ 22,729        | \$ 52,932        | \$ 49,021        |
|   |                    |                  |                  |                  |
| Weighted average common shares outstanding          | 36,732             | 37,203           | 36,771           | 37,567           |
| Dilutive effect of outstanding equity awards (a)    | 485                | 304              | 512              | 337              |
| Diluted weighted average common shares outstanding  | 37,217             | 37,507           | 37,283           | 37,904           |
| Diluted earnings per common share                   | \$ 0.65            | \$ 0.61          | \$ 1.42          | \$ 1.29          |

(a) Excludes 325 and 215 awards for the three and six months ended June 25, 2017, respectively, and 689 and 566 awards for the three and six months ended June 26, 2016, respectively, 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 final purchase price of the 2016 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.

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## 5. Debt

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

|                           | June 25,<br>2017 | December 25,<br>2016 |
|---------------------------|------------------|----------------------|
| Outstanding debt          | \$ 305,731       | \$ 300,575           |
| Debt issuance costs       | (582)            | (755)                |
| Total long-term debt, net | \$ 305,149       | \$ 299,820           |

Our outstanding debt is comprised entirely of a \$500 million unsecured revolving line of credit (“Credit Facility”) with an expiration date of October 31, 2019. Including outstanding letters of credit, the remaining availability under the Credit Facility was approximately \$164.2 million as of June 25, 2017.

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 25, 2017, 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 due to the possible failure of the counterparty to perform under the terms of the derivative contract.

As of June 25, 2017, 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

Fixed Rates

|  | Floating Rate<br>Debt |      |   |
|--|-----------------------|------|---|
| July 30, 2013 through April 30, 2018     | \$ 75 million         | 1.42 | % |
| December 30, 2014 through April 30, 2018 | \$ 50 million         | 1.36 | % |
| April 30, 2018 through April 30, 2023    | \$ 55 million         | 2.33 | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million         | 2.36 | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million         | 2.34 | % |

The weighted average interest rates on the Credit Facility, including the impact of the interest rate swap agreements, were 2.3% and 2.1% for the three and six months ended June 25, 2017 and June 26, 2016, respectively. Interest paid, including payments made or received under the swaps, was \$2.1 million and \$1.8 million for the three months ended June 25, 2017 and June 26, 2016, respectively, and \$3.9 million and \$3.4 million for the six months ended June 25, 2017 and June 26, 2016, respectively. As of June 25, 2017, the portion of the aggregate \$3.1 million interest rate swap liability that would be reclassified into earnings during the next twelve months as interest expense approximates \$200,000.

## 6.Segment Information

We have five reportable segments: domestic Company-owned restaurants, North America 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 North America 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 in the United States and Canada. The North America franchising segment consists of our franchise sales and support activities



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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 printing and promotional items, 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.

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Our segment information is as follows (in thousands):

(In thousands)

|   | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 25, 2017      | June 26, 2016 | June 25, 2017    | June 26, 2016 |
| Revenues from external customers:             |                    |               |                  |               |
| Domestic Company-owned restaurants            | \$ 202,756         | \$ 204,248    | \$ 409,652       | \$ 409,927    |
| North America commissaries                    | 160,059            | 150,895       | 331,399          | 306,849       |
| North America franchising                     | 26,588             | 25,302        | 54,195           | 51,778        |
| International                                 | 30,230             | 28,460        | 58,748           | 55,915        |
| All others                                    | 15,145             | 14,059        | 30,050           | 27,090        |
| Total revenues from external customers        | \$ 434,778         | \$ 422,964    | \$ 884,044       | \$ 851,559    |
| Intersegment revenues:                        |                    |               |                  |               |
| North America commissaries                    | \$ 59,202          | \$ 57,722     | \$ 120,938       | \$ 116,048    |
| North America franchising                     | 751                | 739           | 1,515            | 1,452         |
| International                                 | 68                 | 67            | 131              | 132           |
| All others                                    | 4,084              | 4,075         | 9,110            | 8,172         |
| Total intersegment revenues                   | \$ 64,105          | \$ 62,603     | \$ 131,694       | \$ 125,804    |
| Income (loss) before income taxes:            |                    |               |                  |               |
| Domestic Company-owned restaurants            | \$ 15,550          | \$ 15,325     | \$ 31,037        | \$ 35,512     |
| North America commissaries                    | 12,088             | 11,682        | 24,331           | 23,228        |
| North America franchising                     | 23,999             | 22,445        | 48,874           | 46,025        |
| International                                 | 3,265              | 2,875         | 7,609            | 5,913         |
| All others                                    | 22                 | 425           | (144)            | 476           |
| Unallocated corporate expenses                | (18,203)           | (17,079)      | (33,958)         | (33,411)      |
| Elimination of intersegment profit and losses | (1,263)            | (473)         | (420)            | (1,134)       |
| Total income before income taxes              | \$ 35,458          | \$ 35,200     | \$ 77,329        | \$ 76,609     |
| Property and equipment:                       |                    |               |                  |               |
| Domestic Company-owned restaurants            | \$ 227,191         |               |                  |               |
| North America commissaries                    | 133,607            |               |                  |               |
| International                                 | 17,411             |               |                  |               |
| All others                                    | 57,264             |               |                  |               |
| Unallocated corporate assets                  | 197,720            |               |                  |               |
| Accumulated depreciation and amortization     | (398,669)          |               |                  |               |
| Net property and equipment                    | \$ 234,524         |               |                  |               |

7. Subsequent Event

Subsequent to the second quarter on July 27, 2017, our Board of Directors approved a \$500 million increase in the Company's share repurchase authorization and extended the program to February 27, 2019. This approval increased the Company's authorization for the repurchase of common stock from \$1.575 billion to \$2.075 billion. As of July 27, 2017, \$590.2 million was available for repurchase of common stock under this authorization.

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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 25, 2017, there were 5,088 Papa John's restaurants (744 Company-owned and 4,344 franchised) operating in all 50 states and 44 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, 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 25, 2017      | June 26, 2016 | June 25, 2017    | June 26, 2016 |
| North America Company-owned: |                    |               |                  |               |
| Beginning of period          | 705                | 729           | 702              | 707           |
| Opened                       | —                  | 5             | 2                | 7             |
| Acquired                     | —                  | —             | 1                | 20            |
| End of period                | 705                | 734           | 705              | 734           |
| International Company-owned: |                    |               |                  |               |
| Beginning of period          | 41                 | 44            | 42               | 45            |
| Closed                       | (2)                | (2)           | (3)              | (3)           |
| End of period                | 39                 | 42            | 39               | 42            |
| North America franchised:    |                    |               |                  |               |
| Beginning of period          | 2,723              | 2,661         | 2,739            | 2,681         |
| Opened                       | 28                 | 23            | 43               | 41            |
| Closed                       | (28)               | (16)          | (58)             | (34)          |
| Divested                     | —                  | —             | (1)              | (20)          |

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|                                   |       |       |       |       |
|-----------------------------------|-------|-------|-------|-------|
| End of period                     | 2,723 | 2,668 | 2,723 | 2,668 |
| International franchised:         |       |       |       |       |
| Beginning of period               | 1,613 | 1,469 | 1,614 | 1,460 |
| Opened                            | 49    | 46    | 87    | 70    |
| Closed                            | (41)  | (24)  | (80)  | (39)  |
| End of period                     | 1,621 | 1,491 | 1,621 | 1,491 |
| Total restaurants - end of period | 5,088 | 4,935 | 5,088 | 4,935 |

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Results of Operations

Review of Consolidated Operating Results

Revenues. Domestic Company-owned restaurant sales decreased \$1.5 million, or 0.7% and \$300,000, or 0.1% for the three and six months ended June 25, 2017, respectively. These decreases were primarily due to a reduction of 3.6% and 3.0% in equivalent units for the three and six month periods primarily due to the refranchising of 42 restaurants in the fourth quarter of 2016. This was somewhat offset by increases of 2.3% and 2.7% in comparable sales for the three and six month periods, respectively. “Comparable sales” represents the change in year-over-year sales for the same base of restaurants for the same fiscal periods. “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.

North America franchise royalties and fees increased \$1.3 million, or 5.1% and \$2.4 million, or 4.7% for the three and six months ended June 25, 2017, respectively, primarily due to comparable sales increases of 1.1% and 1.4% for the three and six months, respectively, and equivalent units increases of 2.4% and 2.5% for the three and six month periods, respectively. North America franchise restaurant sales increased 3.7% to \$566.0 million and 3.9% to \$1.2 billion for the three and six months ended June 25, 2017, respectively. The increases are primarily due to the increases in comparable sales and equivalent units noted above. Franchise restaurant sales are not included in Company revenues; however, our North America franchise royalties are derived from these sales.

North America commissary and other sales increased \$10.3 million or 6.2% and increased \$27.5 million, or 8.2% for the three and six months ended June 25, 2017, respectively. The increases were primarily due to higher commissary sales from an increase in volumes and the impact of higher commodity costs.

International revenues increased \$1.8 million, or 6.2% and increased \$2.8 million, or 5.1% for the three and six months ended June 25, 2017, respectively. The increases were primarily due to an increase in the number of franchised restaurants and increases of 3.9% and 4.9% in comparable sales for the three and six month periods, respectively, calculated on a constant dollar basis. These increases were partially offset by lower China Company-owned restaurant revenues primarily due to negative comparable sales and fewer restaurants. The negative impact of foreign currency exchange rates was approximately \$2.5 million and \$5.6 million on international revenues for the three and six months ended June 25, 2017, respectively, which was primarily attributable to our operations in the United Kingdom.

International franchise restaurant sales increased 11.9% to \$181.1 million and 12.9% to \$357.0 million in the three and six months ended June 25, 2017, respectively. International franchise restaurant sales are not included in Company revenues; however, our international royalty revenue is derived from these sales.

Costs and expenses. The operating margin for domestic Company-owned restaurants was 19.9% and 20.0% for the three and six months ended June 25, 2017, respectively, compared to 20.0% and 20.8% in the corresponding 2016 periods, and consisted of the following (dollars in thousands):

|                          | Three months ended<br>June 25, 2017 |       | June 26, 2016 |       | Six months ended<br>June 25, 2017 |       | June 26, 2016 |       |
|--------------------------|-------------------------------------|-------|---------------|-------|-----------------------------------|-------|---------------|-------|
| Restaurant sales         | \$ 202,756                          |       | \$ 204,248    |       | \$ 409,652                        |       | \$ 409,927    |       |
| Cost of sales            | 46,202                              | 22.8% | 46,329        | 22.7% | 93,114                            | 22.7% | 93,530        | 22.8% |
| Other operating expenses | 116,231                             | 57.3% | 117,140       | 57.3% | 234,738                           | 57.3% | 231,249       | 56.4% |
| Total expenses           | \$ 162,433                          |       | 80.1%         |       | \$ 163,469                        |       | 80.0%         |       |
|                          | \$ 162,433                          |       | 80.1%         |       | \$ 327,852                        |       | 80.0%         |       |
| Margin                   | \$ 40,323                           | 19.9% | \$ 40,779     | 20.0% | \$ 81,800                         | 20.0% | \$ 85,148     | 20.8% |

Domestic Company-owned restaurants margin, as a percentage of restaurant sales decreased 0.1% and 0.8% for the three and six months ended June 25, 2017, respectively. The decrease for the three month period was primarily due to a slight increase in cost of sales and increased mileage reimbursement costs from higher fuel prices, partially offset by decreased

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advertising costs. The decrease for the six month period was primarily due to higher non-owned automobile insurance claims costs and increased mileage reimbursement costs.

North America commissary and other operating margins were 7.0% and 6.8% for the three and six months ended June 25, 2017, respectively, compared to 7.7% and 7.4% in the corresponding 2016 periods and consisted of the following (dollars in thousands):

|                                    | Three months ended<br>June 25, 2017 |            |           |          | June 26, 2016 |            |           |          |
|------------------------------------|-------------------------------------|------------|-----------|----------|---------------|------------|-----------|----------|
|                                    | Revenues                            | Expenses   | Margin \$ | Margin % | Revenues      | Expenses   | Margin \$ | Margin % |
| North America commissary           | \$ 160,059                          | \$ 149,472 | \$ 10,587 | 6.6%     | \$ 150,895    | \$ 139,616 | \$ 11,279 | 7.5%     |
| All others                         | 15,145                              | 13,517     | 1,628     | 10.7%    | 14,059        | 12,642     | 1,417     | 10.1%    |
| North America commissary and other | \$ 175,204                          | \$ 162,989 | \$ 12,215 | 7.0%     | \$ 164,954    | \$ 152,258 | \$ 12,696 | 7.7%     |

|                                    | Six months ended<br>June 25, 2017 |            |           |          | June 26, 2016 |            |           |          |
|------------------------------------|-----------------------------------|------------|-----------|----------|---------------|------------|-----------|----------|
|                                    | Revenues                          | Expenses   | Margin \$ | Margin % | Revenues      | Expenses   | Margin \$ | Margin % |
| North America commissary           | \$ 331,399                        | \$ 309,429 | \$ 21,970 | 6.6%     | \$ 306,849    | \$ 284,189 | \$ 22,660 | 7.4%     |
| All others                         | 30,050                            | 27,272     | 2,778     | 9.2%     | 27,090        | 24,875     | 2,215     | 8.2%     |
| North America commissary and other | \$ 361,449                        | \$ 336,701 | \$ 24,748 | 6.8%     | \$ 333,939    | \$ 309,064 | \$ 24,875 | 7.4%     |

North America commissary operating margins were 0.9% and 0.8% lower for the three and six months ended June 25, 2017, respectively, primarily due to start-up costs related to our new commissary in Georgia. The “All others” operating margin was 1.0% higher for the six month period primarily due to improved operating results for our online and mobile ordering business.

The international operating margins were 35.6% and 36.2% for the three and six months ended June 25, 2017, respectively, compared to 37.6% and 36.8% for the corresponding 2016 periods and consisted of the following (dollars in thousands):

|  | Three months ended<br>June 25, 2017 |          |           |          | June 26, 2016 |          |           |          |
|--|-------------------------------------|----------|-----------|----------|---------------|----------|-----------|----------|
|  | Revenues                            | Expenses | Margin \$ | Margin % | Revenues      | Expenses | Margin \$ | Margin % |



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|                                  |           |           |           |       |           |           |           |       |
|----------------------------------|-----------|-----------|-----------|-------|-----------|-----------|-----------|-------|
| Franchise royalties and fees     | \$ 8,195  | \$ -      | \$ 8,195  |       | \$ 7,397  | \$ -      | \$ 7,397  |       |
| Restaurant, commissary and other | 22,035    | 19,482    | 2,553     | 11.6% | 21,063    | 17,752    | 3,311     | 15.7% |
| Total international              | \$ 30,230 | \$ 19,482 | \$ 10,748 | 35.6% | \$ 28,460 | \$ 17,752 | \$ 10,708 | 37.6% |

Six months ended

June 25, 2017

June 26, 2016

|                                  | Revenues  | Expenses  | Margin \$ | Margin % | Revenues  | Expenses  | Margin \$ | Margin % |
|----------------------------------|-----------|-----------|-----------|----------|-----------|-----------|-----------|----------|
| Franchise royalties and fees     | \$ 16,131 | \$ -      | \$ 16,131 |          | \$ 14,265 | \$ -      | \$ 14,265 |          |
| Restaurant, commissary and other | 42,617    | 37,472    | 5,145     | 12.1%    | 41,650    | 35,342    | 6,308     | 15.1%    |
| Total international              | \$ 58,748 | \$ 37,472 | \$ 21,276 | 36.2%    | \$ 55,915 | \$ 35,342 | \$ 20,573 | 36.8%    |

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The decrease in international operating margins of 2.0% and 0.6% for the three and six month periods, respectively, were primarily due to lower UK commissary margins in 2017 from higher commodity costs. These decreases were partially offset by increases in franchise royalties and fees due to an increase in the number of restaurants and comparable sales of 3.9% and 4.9% for the three and six month periods, respectively.

General and administrative (“G&A”) expenses were \$42.0 million, or 9.7% of revenues for the three months ended June 25, 2017 compared to \$42.6 million, or 10.1% of revenues for the same period in 2016. G&A expenses were \$80.0 million, or 9.1% of revenues for the six months ended June 25, 2017, compared to \$82.9 million, or 9.7% of revenues for the same period in 2016. The decreases of \$600,000 and \$2.9 million for the three and six month periods were primarily due to the following:

- Corporate G&A costs decreased primarily due to lower management incentive costs and a decrease in bad debt expense, partially offset by higher legal and professional fees.
- Domestic Company-owned restaurant supervisor bonuses decreased due to lower operating results.

In addition, for the six month period, International G&A costs decreased primarily due to the timing of advertising spend.

Depreciation and amortization. Depreciation and amortization was \$10.7 million, or 2.5% of revenues for the three months ended June 25, 2017, compared to \$10.0 million, or 2.4% of revenues for the same period in 2016, and \$21.1 million, or 2.4% of revenues for the six months ended June 25, 2017, compared to \$19.8 million, or 2.3% of revenues for the same period in 2016.

Net interest expense. Net interest expense increased approximately \$100,000 and \$400,000 for the three and six months ended June 25, 2017, respectively primarily due to higher interest rates and a decrease in interest income on lower notes receivable.

Total income before income taxes. Total income before income taxes increased approximately \$300,000, or 0.7% for the three months ended June 25, 2017 compared to the same period in 2016, and increased approximately \$700,000, or 0.9% for the six months ended June 25, 2017 as compared to the same period in 2016.

Income tax expense. The effective income tax rates were 29.5% and 29.0% for the three and six months ended June 25, 2017, respectively, representing decreases of 2.0% and 2.9% from the prior year comparable periods. These decreases were primarily due to the adoption of new accounting guidance for share-based compensation in the first quarter of 2017. This guidance requires excess tax benefits recognized on stock based awards to be recorded as a reduction of income tax expense rather than equity. The impact of this adoption decreased our effective tax rate by

1.1% and 2.2% for the three and six months ended June 25, 2017, respectively.

Diluted earnings per share. Diluted earnings per share increased 6.6% to \$0.65 for the three months ended June 25, 2017, compared to \$0.61 in the corresponding prior year period. Diluted earnings per share increased 10.1% to \$1.42 for the six months ended June 25, 2017, compared to \$1.29 in the corresponding prior year period. These increases were primarily due to an increase in net income attributable to common shareholders and a decrease in shares outstanding from share repurchases. Diluted earnings per share was also favorably impacted by approximately \$0.01 and \$0.04 for the three and six months ended June 25, 2017, respectively, due to the adoption of the new guidance for accounting for share-based compensation. Excluding the impact of this adoption, diluted earnings per share would have increased 4.9% and 7.0% for the three and six months ended June 25, 2017, respectively.

## Liquidity and Capital Resources

### Debt

At June 25, 2017, our debt is comprised entirely of a \$500 million unsecured revolving line of credit (“Credit Facility”) with outstanding balances of \$305.7 million as of June 25, 2017 and \$300.6 million as of December 25, 2016. On July 27, 2017, our Board of Directors approved a \$500 million increase in the Company’s share repurchase authorization,

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which will be funded via planned new debt facilities. These debt facilities are expected to be executed before the end of 2017.

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 spread over LIBOR and the commitment fee are determined quarterly based upon the ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (“EBITDA”), as defined by the Credit Facility. The remaining availability under the Credit Facility, reduced for outstanding letters of credit, was approximately \$164.2 million as of June 25, 2017.

As of June 25, 2017, 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     | \$ 75 million | 1.42        | % |
| December 30, 2014 through April 30, 2018 | \$ 50 million | 1.36        | % |
| April 30, 2018 through April 30, 2023    | \$ 55 million | 2.33        | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million | 2.36        | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million | 2.34        | % |

Our Credit Facility contains affirmative and negative covenants, including the following financial covenants, as defined by the Credit Facility:

| Leverage Ratio          | Permitted Ratio          | Actual Ratio for the           |
|-------------------------|--------------------------|--------------------------------|
|                         |                          | Quarter Ended<br>June 25, 2017 |
|                         | Not to exceed 3.0 to 1.0 | 1.6 to 1.0                     |
| Interest Coverage Ratio | Not less than 3.5 to 1.0 | 4.8 to 1.0                     |

Our leverage ratio is defined as outstanding debt divided by consolidated EBITDA for the most recent four fiscal quarters. Our interest coverage ratio is defined as the sum of consolidated EBITDA and consolidated rental expense for the most recent four fiscal quarters divided by the sum of consolidated interest expense and consolidated rental expense for the most recent four fiscal quarters. We were in compliance with all covenants as of June 25, 2017.

## Cash Flows

Cash flow provided by operating activities was \$77.9 million for the six months ended June 25, 2017, compared to \$79.6 million for the same period in 2016. The decrease of approximately \$1.7 million was primarily due to changes in working capital amounts.

Our free cash flow, a non-GAAP financial measure, was as follows for the six months ended June 25, 2017 and June 26, 2016 (in thousands):

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 25,<br>2017 | June 26,<br>2016 |
| Net cash provided by operating activities | \$ 77,863        | \$ 79,613        |
| Purchases of property and equipment       | (30,457)         | (24,001)         |
| Free cash flow (a)                        | \$ 47,406        | \$ 55,612        |

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(a) Free cash flow, a non-GAAP measure, is defined as net cash provided by operating activities (from the consolidated statements of cash flows) less the purchases of property and equipment. We view free cash flow as an important liquidity measure because it is one factor that management uses in determining the amount of cash available for investment, however, it does not represent residual cash flows available for discretionary expenditures. Free cash flow is not a term defined by GAAP and as a result our measure of free cash flow might not be comparable to

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similarly titled measures used by other companies. Free cash flow should not be construed as a substitute for or a better indicator of our liquidity than the Company's GAAP measures.

Cash flow used in investing activities was \$29.8 million for the six months ended June 25, 2017, compared to \$31.3 million for the same period in 2016, or a decrease of \$1.5 million. The decrease in cash flow used in investing activities was primarily due to the acquisition of 20 restaurants from franchisees in the first quarter of 2016 offset by construction costs for our new domestic commissary in Georgia, which opened in July 2017.

We also require capital for share repurchases and the payment of cash dividends, which are funded by cash flow from operations and borrowings on our Credit Facility. We repurchased \$34.0 million and \$96.4 million of common stock for the six months ended June 25, 2017 and June 26, 2016, respectively. Subsequent to June 25, 2017, through July 27, 2017, we repurchased an additional \$13.2 million of common stock.

Subsequent to the second quarter on July 27, 2017, our Board of Directors approved a \$500 million increase in the Company's share repurchase authorization, which previously had \$90.2 million authorization remaining. The Company expects to repurchase the full amount of the increased authorization within approximately 12-18 months of the date of this approval, and plans to enter into new debt facilities to finance the increased capital return program. As of July 27, 2017, \$590.2 million remained available for repurchase under our Board of Directors' authorization.

We paid cash dividends of \$14.7 million (\$0.40 per common share) and \$13.1 million (\$0.35 per common share) for the six months ended June 25, 2017 and June 26, 2016, respectively. Subsequent to the second quarter on July 27, 2017, our Board of Directors approved a 12.5% increase in the company's dividend rate per common share, from \$0.80 on an annual basis to \$0.90 on an annual basis, and declared a third quarter dividend of \$0.225 per common share (approximately \$8.2 million based on current shareholders of record). The dividend will be paid on August 18, 2017 to shareholders of record as of the close of business on August 7, 2017. The declaration and payment of any future dividends will be at the discretion of our Board of Directors, subject to the Company's financial results, cash requirements, and other factors deemed relevant by our Board of Directors.

## Forward-Looking Statements

Certain matters discussed in this report, including information within Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the federal securities laws. Generally, the use of words such as "expect," "intend," "estimate," "believe," "anticipate," "will," "foresee," "plan," "project," or similar words identify forward-looking statements that we intend to be included within the safe harbor protections provided by the federal securities laws. Such forward-looking statements may relate to projections or guidance concerning business performance, revenue, earnings, contingent liabilities, resolution of litigation, commodity costs, profit margins, unit growth, unit level performance, capital expenditures, other financial and operational measures and our plans to increase our existing credit facility or enter into new debt facilities to finance

the increased capital return program. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are beyond our control. Therefore, actual outcomes and results may differ materially from those matters expressed or implied in such forward-looking statements. The risks, uncertainties and assumptions that are involved in our forward-looking statements include, but are not limited to:

- aggressive changes in pricing or other marketing or promotional strategies by competitors, which may adversely affect sales and profitability; and new product and concept developments by food industry competitors;
- changes in consumer preferences or consumer buying habits, including changes in general economic conditions or other factors that may affect consumer confidence and discretionary spending;
- changes in our liquidity or debt markets in general, which may adversely affect our ability to increase our existing credit facility or enter into a new credit facility on favorable terms;
- the adverse impact on the company or our results caused by product recalls, food quality or safety issues, incidences of foodborne illness, food contamination and other general public health concerns about our company-owned or franchised restaurants or others in the restaurant industry;
- failure to maintain our brand strength, quality reputation and consumer enthusiasm for our better ingredients marketing and advertising strategy;

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- the ability of the company and its franchisees to meet planned growth targets and operate new and existing restaurants profitably, including difficulties finding qualified franchisees, store level employees or suitable sites;
- increases in food costs or sustained higher other operating costs. This could include increased employee compensation, benefits, insurance, tax rates, new regulatory requirements or increasing compliance costs;
- increases in insurance claims and related costs for programs funded by the company up to certain retention limits, including medical, owned and non-owned automobiles, workers' compensation, general liability and property;
- disruption of our supply chain or commissary operations which could be caused by our sole source of supply of cheese or limited source of suppliers for other key ingredients or more generally due to weather, natural disasters including drought, disease, or geopolitical or other disruptions beyond our control;
- increased risks associated with our international operations, including economic and political conditions, instability or uncertainty in our international markets, especially emerging markets, fluctuations in currency exchange rates, difficulty in meeting planned sales targets and new store growth;
- the impact of current or future claims and litigation, including labor and employment-related claims;
- current, proposed or future legislation that could impact our business;
  - failure to effectively execute succession planning, and our reliance on the multiple roles of our founder, chairman and chief executive officer, who also serves as our brand spokesperson;
- disruption of critical business or information technology systems, or those of our suppliers, and risks associated with systems failures and data privacy and security breaches, including theft of confidential company, employee and customer information, including payment cards; and
- changes in GAAP, including new standards for accounting for share-based compensation that may result in changes to our net income. Based on recent share prices, the impact of the 2017 adoption of this guidance will be favorable throughout 2017.

For a discussion of these and other risks that may cause actual results to differ from expectations, refer to "Part I. Item 1A. – Risk Factors" in our Annual Report on Form 10-K for the year ended December 25, 2016, as well as subsequent filings. We undertake no obligation to update publicly any forward-looking statements, whether as a result of future events, new information or otherwise, except as required by law.



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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

## Interest Rate Risk

Our debt is comprised entirely of a \$500 million Credit Facility with outstanding balances of \$305.7 million as of June 25, 2017 and \$300.6 million as of December 25, 2016, and a maturity date of October 31, 2019. 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.

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 25, 2017, 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<br>Debt | Fixed Rates |   |
|--|-----------------------|-------------|---|
| July 30, 2013 through April 30, 2018     | \$ 75 million         | 1.42        | % |
| December 30, 2014 through April 30, 2018 | \$ 50 million         | 1.36        | % |
| April 30, 2018 through April 30, 2023    | \$ 55 million         | 2.33        | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million         | 2.36        | % |
| April 30, 2018 through April 30, 2023    | \$ 35 million         | 2.34        | % |

The weighted average interest rate on the Credit Facility, including the impact of the interest rate swap agreements, was 2.3% as of June 25, 2017. An increase in the present interest rate of 100 basis points on the Credit Facility balance outstanding as of June 25, 2017, including the impact of the interest rate swaps, would increase annual interest expense by \$1.8 million.

## Foreign Currency Exchange Rate Risk

We are exposed to foreign currency exchange rate fluctuations from our operations outside of the United States, which can adversely impact our revenues, net income and cash flows. Our international operations principally consist 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. For each of the periods presented, between 6% and 7% of our revenues were derived from these operations.

We have not historically hedged our exposure to foreign currency fluctuations. Foreign currency exchange rate fluctuations had a negative impact on our revenues of approximately \$2.5 million and \$2.2 million for the three months ended June 25, 2017 and June 26, 2016, respectively, and \$5.6 million and \$4.0 million for the six months ended June 25, 2017 and June 26, 2016, respectively. Foreign currency exchange rate fluctuations had no significant impact in income before income taxes for the three and six month periods ended June 25, 2017. Foreign currency exchange rates had a negative impact on our income before income taxes of \$500,000 and \$1.2 million for the three and six months ended June 26, 2016, respectively.

The referendum in the United Kingdom, the outcome of which was a vote to leave the European Union known as Brexit, has resulted in exchange rate fluctuations. The future impact of Brexit on our franchise operations included in the European Union could also include but may not be limited to additional currency volatility and future trade, tariff, and regulatory changes. As of June 25, 2017, six of our 44 international country operations are included in the European Union.

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## Commodity Price Risk

In the ordinary course of business, the food and paper products we purchase, including cheese (our largest individual food cost item), are subject to seasonal fluctuations, weather, availability, demand and other factors that are beyond our control. We have pricing agreements with some of our vendors, including forward pricing agreements for a portion of our cheese purchases for our domestic Company-owned restaurants, which are accounted for as normal purchases; however, we still remain exposed to on-going commodity volatility.

The following table presents the actual average block price for cheese by quarter through the first quarter of 2017 and the projected average block price for cheese by quarter through 2017 (based on the July 27, 2017 Chicago Mercantile Exchange cheese futures market prices):

|           | 2017<br>Projected<br>Block Price | 2016<br>Actual<br>Block Price |
|-----------|----------------------------------|-------------------------------|
| Quarter 1 | \$ 1.613                         | \$ 1.473                      |
| Quarter 2 | 1.566                            | 1.405                         |
| Quarter 3 | 1.647                            | 1.691                         |
| Quarter 4 | 1.737                            | 1.718                         |
| Full Year | \$ 1.641                         | * \$ 1.572                    |

\*The full year estimate is based on futures prices and does not include the impact of forward pricing agreements we have for a portion of our cheese purchases for our domestic Company-owned restaurants. Additionally, the price charged to restaurants can vary somewhat by quarter from the actual block price based upon our monthly pricing mechanism.

## Item 4. Controls and Procedures

Under the supervision and with the participation of the Company's management, including its chief executive officer and chief financial officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon this evaluation, the chief executive officer and chief financial officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

During the most recently completed fiscal quarter, there was no change made in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is involved in a number of lawsuits, claims, investigations and proceedings consisting of intellectual property, employment, consumer, commercial and other matters arising in the ordinary course of business. In accordance with Accounting Standards Codification 450, "Contingencies", the Company has made accruals with respect to these matters, where appropriate, which are reflected in the Company's consolidated financial statements. We review these provisions at least quarterly and adjust these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case.

### Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 25, 2016.

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

Our Board of Directors has authorized the repurchase of up to \$2.075 billion of common stock under a share repurchase program that began on December 9, 1999 and expires on February 27, 2019. This includes an additional \$500 million authorized on July 27, 2017. Through June 25, 2017, a total of 110.0 million shares with an aggregate cost of \$1.5 billion and an average price of \$13.38 per share have been repurchased under this program. Subsequent to June 25, 2017, through July 27, 2017, we acquired an additional 177,000 shares at an aggregate cost of \$13.2 million. As of July 27, 2017, approximately \$590.2 million remained available for repurchase of common stock under this authorization.

The following table summarizes our repurchases by fiscal period during the three months ended June 25, 2017 (in thousands, except per-share amounts):

| Fiscal Period         | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------------------|----------------------------------|------------------------------|--|--|
| 3/27/2017 - 4/23/2017 | 44                               | \$ 78.79                     | 109,804  | \$ 120,737   |
| 4/24/2017 - 5/21/2017 | 76                               | \$ 80.39                     | 109,880  | \$ 114,647   |
| 5/22/2017 - 6/25/2017 | 142                              | \$ 79.84                     | 110,022  | \$ 103,333   |

The Company utilizes a written trading plan under Rule 10b5-1 under the Exchange Act from time to time to facilitate the repurchase of shares of our common stock under this share repurchase program. There can be no assurance that we will repurchase shares of our common stock either through a Rule 10b5-1 trading plan or otherwise.

During the fiscal quarter ended June 25, 2017, the Company acquired approximately 400 shares of its common stock from employees to satisfy minimum tax withholding obligations that arose upon (i) vesting of restricted stock granted pursuant to approved plans and (ii) distribution of shares of common stock issued pursuant to deferred compensation obligations.

## Item 6. Exhibits

| Exhibit Number | Description |
|----------------|-------------|
|----------------|-------------|

- 31.1 Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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101 Financial statements from the quarterly report on Form 10-Q of Papa John's International, Inc. for the quarter ended June 25, 2017, filed on August 1, 2017, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Condensed Consolidated Financial Statements.

SIGNATURE

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

PAPA JOHN'S INTERNATIONAL, INC.  
(Registrant)

Date: August 1, 2017      /s/ Lance F. Tucker  
Lance F. Tucker  
Senior Vice President,  
Chief Financial Officer,  
Chief Administrative Officer and Treasurer