

PAPA JOHNS INTERNATIONAL INC

Form 10-Q

November 01, 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 September 25, 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 October 25, 2016, there were outstanding 36,889,475 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)	September 25, 2016 (Unaudited)	December 27, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,107	\$ 21,006
Accounts receivable, net	59,046	63,320
Notes receivable, net	4,269	7,816
Income taxes receivable	701	272
Inventories	24,328	21,564
Prepaid expenses	15,633	20,372
Other current assets	8,584	8,941
Assets held for sale	8,784	9,299
Total current assets	140,452	152,590
Property and equipment, net	221,809	214,044
Notes receivable, less current portion, net	9,747	11,105
Goodwill	86,570	79,657
Deferred income taxes	1,428	2,415
Other assets	38,782	34,247
Total assets	\$ 498,788	\$ 494,058
Liabilities and stockholders' (deficit) equity		
Current liabilities:		
Accounts payable	\$ 37,302	\$ 43,492
Income and other taxes payable	11,909	8,527
Accrued expenses and other current liabilities	73,648	80,918
Total current liabilities	122,859	132,937
Deferred revenue	3,772	3,190
Long-term debt, net	311,570	255,146
Deferred income taxes	2,215	4,610
Other long-term liabilities	61,161	47,606
Total liabilities	501,577	443,489
Redeemable noncontrolling interests	8,830	8,363

Stockholders' (deficit) equity:		
Preferred stock (\$0.01 par value per share; no shares issued)	—	—
Common stock (\$0.01 par value per share; issued 44,017 at September 25, 2016 and 43,731 at December 27, 2015)	440	437
Additional paid-in capital	167,626	158,348
Accumulated other comprehensive loss	(9,011)	(1,836)
Retained earnings	193,798	143,789
Treasury stock (7,227 shares at September 25, 2016 and 5,308 shares at December 27, 2015, at cost)	(377,481)	(271,557)
Total stockholders' (deficit) equity, net of noncontrolling interests	(24,628)	29,181
Noncontrolling interests in subsidiaries	13,009	13,025
Total stockholders' (deficit) equity	(11,619)	42,206
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit) equity	\$ 498,788	\$ 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		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
<b>Revenues:</b>				
Domestic Company-owned restaurant sales	\$ 199,041	\$ 180,059	\$ 608,968	\$ 563,308
Domestic franchise royalties and fees	24,776	22,285	76,554	71,185
Domestic commissary and other sales	169,684	159,939	503,623	507,313
International	28,941	27,001	84,856	78,753
Total revenues	422,442	389,284	1,274,001	1,220,559
<b>Costs and expenses:</b>				
Operating costs (excluding depreciation and amortization shown separately below):				
Domestic Company-owned restaurant expenses	161,750	148,536	486,529	450,924
Domestic commissary and other expenses	157,552	148,709	466,616	470,254
International expenses	18,594	16,481	53,936	48,209
General and administrative expenses	40,549	37,660	123,419	124,456
Depreciation and amortization	10,614	10,461	30,389	30,638
Total costs and expenses	389,059	361,847	1,160,889	1,124,481
Operating income	33,383	27,437	113,112	96,078
Legal settlement expense	—	—	—	(12,278)
Net interest expense	(1,756)	(1,180)	(4,876)	(3,576)
Income before income taxes	31,627	26,257	108,236	80,224
Income tax expense	8,977	7,281	33,423	24,541
Net income before attribution to noncontrolling interests	22,650	18,976	74,813	55,683
Income attributable to noncontrolling interests	(1,183)	(1,005)	(4,623)	(4,696)
Net income attributable to the Company	\$ 21,467	\$ 17,971	\$ 70,190	\$ 50,987
<b>Calculation of income for earnings per share:</b>				
Net income attributable to the Company	\$ 21,467	\$ 17,971	\$ 70,190	\$ 50,987
Change in noncontrolling interest redemption value	(157)	49	342	192
Net income attributable to participating securities	(87)	(73)	(288)	(223)
Net income attributable to common shareholders	\$ 21,223	\$ 17,947	\$ 70,244	\$ 50,956
Basic earnings per common share	\$ 0.57	\$ 0.46	\$ 1.88	\$ 1.29
Diluted earnings per common share	\$ 0.57	\$ 0.45	\$ 1.86	\$ 1.27
	36,989	39,394	37,374	39,640

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Basic weighted average common shares outstanding				
Diluted weighted average common shares outstanding	37,359	39,895	37,712	40,210
Dividends declared per common share	\$ 0.200	\$ 0.175	\$ 0.550	\$ 0.455

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		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
Net income before attribution to noncontrolling interests	\$ 22,650	\$ 18,976	\$ 74,813	\$ 55,683
Other comprehensive (loss) income, before tax:				
Foreign currency translation adjustments	(2,038)	(1,700)	(5,551)	(1,125)
Interest rate swaps (1)	210	(1,386)	(5,839)	(2,011)
Other comprehensive loss, before tax	(1,828)	(3,086)	(11,390)	(3,136)
Income tax effect:				
Foreign currency translation adjustments	754	629	2,054	416
Interest rate swaps (2)	(78)	513	2,160	744
Income tax effect	676	1,142	4,214	1,160
Other comprehensive loss, net of tax	(1,152)	(1,944)	(7,176)	(1,976)
Comprehensive income before attribution to noncontrolling interests	21,498	17,032	67,637	53,707
Comprehensive loss, redeemable noncontrolling interests	(684)	(587)	(2,809)	(2,915)
Comprehensive loss, nonredeemable noncontrolling interests	(499)	(418)	(1,814)	(1,781)
Comprehensive income attributable to the Company	\$ 20,315	\$ 16,027	\$ 63,014	\$ 49,011

(1) Amounts reclassified out of accumulated other comprehensive loss into net interest expense included \$296 and \$924 for the three and nine months ended September 25, 2016, respectively, and \$390 and \$1,177 for the three and nine months ended September 27, 2015, respectively.

(2) The income tax effects of amounts reclassified out of accumulated other comprehensive loss into net interest expense were \$110 and \$342 for the three and nine months ended September 25, 2016, respectively, and \$145 and \$436 for the three and nine months ended September 27, 2015, respectively.

See accompanying notes.



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Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Nine Months Ended	
	September 25, 2016	September 27, 2015
Operating activities		
Net income before attribution to noncontrolling interests	\$ 74,813	\$ 55,683
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible accounts and notes receivable	153	813
Depreciation and amortization	30,389	30,638
Deferred income taxes	4,966	(7,625)
Stock-based compensation expense	7,525	7,124
Other	2,811	3,268
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	3,867	(1,994)
Income taxes receivable	(429)	8,731
Inventories	(2,673)	2,178
Prepaid expenses	4,755	2,033
Other current assets	872	367
Other assets and liabilities	(3,085)	819
Accounts payable	(6,290)	(3,380)
Income and other taxes payable	3,381	375
Accrued expenses and other current liabilities	(6,484)	20,508
Deferred revenue	1,411	200
Net cash provided by operating activities	115,982	119,738
Investing activities		
Purchases of property and equipment	(38,954)	(26,508)
Loans issued	(2,216)	(2,497)
Repayments of loans issued	6,449	3,961
Acquisitions, net of cash acquired	(11,202)	(491)
Other	193	406
Net cash used in investing activities	(45,730)	(25,129)
Financing activities		
Net proceeds from issuance of long-term debt	56,375	8,549
Cash dividends paid	(20,523)	(17,950)
Excess tax benefit on equity awards	5,474	9,884

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Tax payments for equity award issuances	(5,999)	(10,947)
Proceeds from exercise of stock options	5,377	4,569
Acquisition of Company common stock	(109,407)	(80,166)
Distributions to noncontrolling interest holders	(3,830)	(4,267)
Other	481	377
Net cash used in financing activities	(72,052)	(89,951)
Effect of exchange rate changes on cash and cash equivalents	(99)	(339)
Change in cash and cash equivalents	(1,899)	4,319
Cash and cash equivalents at beginning of period	21,006	20,122
Cash and cash equivalents at end of period	\$ 19,107	\$ 24,441

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

September 25, 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 nine months ended September 25, 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 September 25, 2016 and 208 restaurants at September 27, 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 nine months ended September 25, 2016 and September 27, 2015 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
Papa John's International, Inc.	\$ 1,879	\$ 1,570	\$ 7,168	\$ 7,240
Noncontrolling interests	1,183	1,005	4,623	4,696
Total income before income taxes	\$ 3,062	\$ 2,575	\$ 11,791	\$ 11,936

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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 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 September 25, 2016, we had a net deferred tax liability of approximately \$800,000.

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 September 25, 2016 and December 27, 2015 are as follows (in thousands):

	Carrying Value	Fair Value Measurements		
		Level 1	Level 2	Level 3
September 25, 2016				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 21,451	\$ 21,451	\$ —	\$ —
Financial liabilities:				
Interest rate swaps (b)	8,130	—	8,130	—
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 nine months ended September 25, 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 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 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 (“ASC”) 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		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
Basic earnings per common share:				
Net income attributable to the Company	\$ 21,467	\$ 17,971	\$ 70,190	\$ 50,987
Change in noncontrolling interest redemption value	(157)	49	342	192
Net income attributable to participating securities	(87)	(73)	(288)	(223)
Net income attributable to common shareholders	\$ 21,223	\$ 17,947	\$ 70,244	\$ 50,956
Weighted average common shares outstanding	36,989	39,394	37,374	39,640
Basic earnings per common share	\$ 0.57	\$ 0.46	\$ 1.88	\$ 1.29
Diluted earnings per common share:				
Net income attributable to common shareholders	\$ 21,223	\$ 17,947	\$ 70,244	\$ 50,956
Weighted average common shares outstanding	36,989	39,394	37,374	39,640
Dilutive effect of outstanding equity awards (a)	370	501	338	570
Diluted weighted average common shares outstanding	37,359	39,895	37,712	40,210
Diluted earnings per common share	\$ 0.57	\$ 0.45	\$ 1.86	\$ 1.27

(a) Excludes 22 and 598 awards for the three and nine months ended September 25, 2016, respectively, and 219 and 234 awards for the three and nine months ended September 27, 2015, 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 purchase price of the acquisitions has been allocated as follows (in thousands):

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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):

	September 25, 2016	December 27, 2015
Outstanding debt	\$ 312,375	\$ 256,000
Debt issuance costs	(805)	(854)
Total long-term debt, net	\$ 311,570	\$ 255,146

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 \$162.4 million as of September 25, 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 September 25, 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 due to the possible failure of the counterparty to perform under the terms of the derivative contract.

As of September 25, 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

Fixed Rates

	Floating Rate 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 2.1% and 2.0% for the three months ended September 25, 2016 and September 27, 2015, respectively, and 2.1% and 2.0% for the nine months ended September 25, 2016 and September 27, 2015, respectively. Interest paid, including payments made or received under the swaps, was \$1.9 million and \$1.3 million for the three months ended September 25, 2016 and September 27, 2015, respectively, and \$5.3 million and \$3.9 million for the nine months ended September 25, 2016 and September 27, 2015, respectively. As of September 25, 2016, the portion of the aggregate \$8.1 million interest rate swap liability that would be reclassified into earnings during the next twelve months as interest expense approximates \$800,000.

## 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



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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 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.

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Our segment information is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
Revenues from external customers:				
Domestic Company-owned restaurants	\$ 199,041	\$ 180,059	\$ 608,968	\$ 563,308
Domestic commissaries	155,208	145,863	462,057	457,203
North America franchising	24,776	22,285	76,554	71,185
International	28,941	27,001	84,856	78,753
All others	14,476	14,076	41,566	50,110
Total revenues from external customers	\$ 422,442	\$ 389,284	\$ 1,274,001	\$ 1,220,559
Intersegment revenues:				
Domestic commissaries	\$ 59,811	\$ 53,398	\$ 175,859	\$ 165,744
North America franchising	688	643	2,140	1,985
International	64	73	196	223
All others	4,129	3,833	12,301	11,459
Total intersegment revenues	\$ 64,692	\$ 57,947	\$ 190,496	\$ 179,411
Income (loss) before income taxes:				
Domestic Company-owned restaurants	\$ 11,576	\$ 8,088	\$ 47,088	\$ 41,185
Domestic commissaries	11,311	10,192	34,539	32,694
North America franchising	21,856	19,172	67,881	61,545
International	3,083	3,184	8,996	6,807
All others	392	(556)	868	(230)
Unallocated corporate expenses	(16,360)	(13,482)	(49,771)	(60,636)
Elimination of intersegment profit	(231)	(341)	(1,365)	(1,141)
Total income before income taxes	\$ 31,627	\$ 26,257	\$ 108,236	\$ 80,224
Property and equipment:				
Domestic Company-owned restaurants	\$ 229,546			
Domestic commissaries	116,237			
International	16,101			
All others	53,902			
Unallocated corporate assets	189,932			
Accumulated depreciation and amortization	(383,909)			
Net property and equipment	\$ 221,809			



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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 September 25, 2016, there were 4,971 Papa John's restaurants (778 Company-owned and 4,193 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, 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		Nine Months Ended	
	September 25, 2016	September 27, 2015	September 25, 2016	September 27, 2015
North America Company-owned:				
Beginning of period	734	693	707	686
Opened	3	4	10	8
Closed	(1)	—	(1)	—
Acquired	—	—	20	3
End of period	736	697	736	697
International Company-owned:				
Beginning of period	42	48	45	49
Closed	—	(1)	(3)	(2)
End of period	42	47	42	47
North America franchised:				

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Beginning of period	2,668	2,653	2,681	2,654
Opened	25	31	66	68
Closed	(18)	(20)	(52)	(55)
Divested	—	—	(20)	(3)
End of period	2,675	2,664	2,675	2,664
International franchised:				
Beginning of period	1,491	1,340	1,460	1,274
Opened	47	50	117	142
Closed	(20)	(12)	(59)	(38)
End of period	1,518	1,378	1,518	1,378
Total restaurants - end of period	4,971	4,786	4,971	4,786

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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 \$19.0 million, or 10.5%, and \$45.7 million, or 8.1%, for the three and nine months ended September 25, 2016, respectively, primarily due to increases of 6.3% and 4.2% in comparable sales and increases of a 5.1% and 4.8% in equivalent units during the three and nine months ended September 25, 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 \$2.5 million, or 11.2%, and \$5.4 million, or 7.5%, for the three and nine months ended September 25, 2016, respectively. The increase was primarily due to increases in comparable sales of 5.1% and 3.0% for the three and nine months, respectively, as well as reduced levels of royalty incentives in 2016. Domestic franchise restaurant sales increased 5.3% to \$525.8 million and 3.2% to \$1.6 billion for the three and nine months ended September 25, 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 \$9.7 million, or 6.1%, and decreased \$3.7 million, or 0.7%, for the three and nine months ended September 25, 2016, respectively. The increase of \$9.7 million for the third quarter was primarily due to an increase in domestic commissary sales from an increase in volumes. The \$3.7 million decrease for the comparable nine month period was primarily due to the prior year inclusion of \$9.8 million of point-of-sale system (“FOCUS”) equipment sales to franchises which had no significant margin and thus no significant impact on 2015 operating results. This decrease was partially offset by an increase in commissary sales of \$4.9 million associated with higher sales volumes.

International revenues increased approximately \$1.9 million, or 7.2% and \$6.1 million, or 7.7% for the three and nine months ended September 25, 2016, respectively, primarily due to the following:

- The three and nine month periods of 2016 include sublease rental revenue in the United Kingdom of approximately \$2.2 million and \$5.6 million, respectively, which was shown net of the rental expenses in the corresponding periods of the prior year.
- Royalties were higher due to an increase in the number of restaurants and an increase in comparable sales of 7.6% and 6.2% for the three and nine months ended September 25, 2016, respectively, calculated on a constant dollar basis. Commissary revenues were higher for the nine month period due to an increase in the number of restaurants and increase in comparable sales. International franchise restaurant sales increased 11.7% to \$151.1 million, and 8.4% to \$454.2 million for the three and nine month periods. The increase is primarily due to the increase in the number of restaurants and comparable sales as noted above. 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 \$1.4 million and \$4.0 million for the three and nine month periods, respectively, primarily due to negative comparable sales and fewer restaurants.

The negative impact of foreign currency exchange rates was approximately \$3.7 million and \$7.7 million on international revenues for the three and nine months ended September 25, 2016.

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Costs and expenses. The operating margin for domestic Company-owned restaurants was 18.7% and 20.1% in the three and nine months ended September 25, 2016, respectively, compared to 17.5% and 20.0% in the corresponding 2015 periods, and consisted of the following (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	Sep. 25, 2016		Sep. 27, 2015		Sep. 25, 2016		Sep. 27, 2015	
Restaurant sales	\$ 199,041		\$ 180,059		\$ 608,968		\$ 563,308	
Cost of sales	45,768	23.0%	42,150	23.4%	139,298	22.9%	132,943	23.6%
Other operating expenses	115,982	58.3%	106,386	59.1%	347,231	57.0%	317,981	56.4%
Total expenses	\$ 161,750 81.3%		\$ 148,536 82.5%		\$ 486,529 79.9%		\$ 450,924 80.0%	
Margin	\$ 37,291	18.7%	\$ 31,523	17.5%	\$ 122,439	20.1%	\$ 112,384	20.0%

Domestic Company-owned restaurants cost of sales were approximately 0.4% and 0.7% lower as a percentage of sales for the three and nine months ended September 25, 2016, respectively, primarily due to lower commodity costs, including meats and dough, as well as cheese for the nine month period. Domestic restaurants other operating expenses were approximately 0.8% lower and 0.6% higher as a percentage of sales for the three and nine months ended September 25, 2016, respectively. The decrease for the three month period was primarily due to lower advertising costs and the benefit of higher sales on fixed costs including rent. The increase for the nine month period was primarily due to higher insurance costs driven by significant adverse automobile claims experience.

The domestic commissary and other operating margins were 7.1% and 7.3% for the three and nine months ended September 25, 2016, respectively, compared to 7.0% and 7.3% in the corresponding periods of the prior year and consisted of the following (dollars in thousands):

Three Months Ended				September 27, 2015			
September 25, 2016							
Revenues	Expenses	Margin	Margin	Revenues	Expenses	Margin	Margin
\$		\$	%	\$		\$	%



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Domestic commissary	\$ 155,208	\$ 144,704	\$ 10,504	6.8%	\$ 145,863	\$ 135,234	\$ 10,629	7.3%
All others	14,476	12,848	1,628	11.2%	14,076	13,475	601	4.3%
Domestic commissary and other	\$ 169,684	\$ 157,552	\$ 12,132	7.1%	\$ 159,939	\$ 148,709	\$ 11,230	7.0%
	Nine Months Ended September 25, 2016				September 27, 2015			
	Revenues	Expenses	Margin \$	Margin %	Revenues	Expenses	Margin \$	Margin %
Domestic commissary	\$ 462,057	\$ 428,893	\$ 33,164	7.2%	\$ 457,203	\$ 422,528	\$ 34,675	7.6%
All others	41,566	37,723	3,843	9.2%	50,110	47,726	2,384	4.8%
Domestic commissary and other	\$ 503,623	\$ 466,616	\$ 37,007	7.3%	\$ 507,313	\$ 470,254	\$ 37,059	7.3%

Domestic commissary margins were 0.5% and 0.4% lower for the three and nine months ended September 25, 2016, respectively, primarily due to the reclassification of certain expenses from general and administrative to operating expenses beginning in the first quarter of 2016, which had no impact on commissary income before income taxes. The “All others” margins were 6.9% and 4.4% higher for the three and nine month periods, respectively. The increase for the

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three month period was primarily due to improved operating results for our print and promotion subsidiary and online and mobile ordering business. The increase for the nine month period was primarily due to improved operating results at our print and promotion subsidiary and significant prior year FOCUS equipment sales to franchisees, which had no significant margin.

The international operating margins were 35.8% and 36.4% for the three and nine months ended September 25, 2016, respectively, compared to 39.0% and 38.8% for the corresponding 2015 periods. The lower margins were primarily due to a decrease in restaurant, commissary and other margins of 6.3% and 3.9% for the three and nine months ended September 25, 2016, primarily due to the gross presentation of certain sublease rental income and expenses related to our lease arrangements in the United Kingdom. These amounts were shown net in the prior year; the change in presentation had no impact on income before income taxes. In addition, we recorded a non-recurring charge of approximately \$800,000 in the current quarter to record these lease arrangements on a straight line basis. This lower margin was partially offset by the benefit of higher royalties and fees.

The international operating margins consisted of the following (dollars in thousands):

	Three Months Ended September 25, 2016				September 27, 2015			
	Revenues	Expenses	Margin \$ (a)	Margin %	Revenues	Expenses	Margin \$	Margin %
Royalties and franchise development fees	\$ 7,749	\$ -	\$ 7,749		\$ 6,755	\$ -	\$ 6,755	
Restaurant, commissary and other	21,192	18,594	2,598	12.3%	20,246	16,481	3,765	18.6%
Total international	\$ 28,941	\$ 18,594	\$ 10,347	35.8%	\$ 27,001	\$ 16,481	\$ 10,520	39.0%
	Nine Months Ended September 25, 2016				September 27, 2015			
	Revenues	Expenses	Margin \$ (a)	Margin %	Revenues	Expenses	Margin \$	Margin %
Royalties and franchise development fees	\$ 22,014	\$ -	\$ 22,014		\$ 19,894	\$ -	\$ 19,894	
Restaurant, commissary and other	62,842	53,936	8,906	14.2%	58,859	48,209	10,650	18.1%
Total international	\$ 84,856	\$ 53,936	\$ 30,920	36.4%	\$ 78,753	\$ 48,209	\$ 30,544	38.8%

(a) The negative impact of foreign currency exchange rates on income before income taxes was approximately \$400,000 and \$1.7 million for the three and nine months ended September 25, 2016, respectively.

General and administrative (G&A) expenses were \$40.5 million, or 9.6% of revenues for the three months ended September 25, 2016, compared to \$37.7 million, or 9.7% of revenues for the same period in 2015. G&A expenses were \$123.4 million, or 9.7% of revenues for the nine months ended September 25, 2016, compared to \$124.5 million, or 10.2% of revenues for the same period in 2015. The increase of \$2.8 million for the three month period was primarily due to higher management incentive bonuses due to higher operating results. The decrease of \$1.1 million for the nine month period was primarily due to the following:

- Domestic Company-owned restaurant supervisor bonuses decreased for the nine month period due to lower comparable sales bonus payouts, primarily in the first quarter of 2016.
- International G&A costs decreased for the nine month period primarily due to lower advertising spending; in the prior year, advertising levels were higher with the launch of the United Kingdom Quality Guarantee in 2015.

Depreciation and amortization. Depreciation and amortization was \$10.6 million, or 2.5% of revenues for the three months ended September 25, 2016, compared to \$10.5 million, or 2.7% of revenues for the same period in 2015, and \$30.4 million, or 2.4% of revenues for the nine months ended September 25, 2016, compared to \$30.6 million, or 2.5% of revenues for the same period in 2015.

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Legal settlement expense. The 2015 legal settlement expense represents a pre-tax expense of \$12.3 million for a collective and class action, Perrin v. Papa John's International, Inc. and Papa John's USA, Inc., including approximately 19,000 drivers, which alleged delivery drivers were not reimbursed in accordance with the Fair Labor Standards Act.

Net interest expense. Net interest expense increased approximately \$600,000 and \$1.3 million for the three and nine months ended September 25, 2016, respectively, primarily due to higher average outstanding debt balances.

Income tax expense. The effective income tax rates were 28.4% and 30.9% for the three and nine months ended September 25, 2016, respectively, representing an increase of 0.7% for the three month period and 0.3% for the nine month period of the prior year. Our effective income tax rates may fluctuate from quarter to quarter for various reasons, including the timing of various deductions and credits.

Diluted earnings per share. Diluted earnings per share were \$0.57 for the three months ended September 25, 2016, compared to \$0.45 in the corresponding prior year period. Diluted earnings per share were \$1.86 for the nine months ended September 25, 2016, compared to \$1.27 in the corresponding prior year period. Diluted earnings per share for the nine months ended September 27, 2015 were negatively impacted by \$0.20 due to the 2015 legal settlement.

Discussion of Operating Results by Segment

See "Review of Consolidated Operating Results" above for revenue highlights.

Income before income taxes is summarized in the following table on a reporting segment basis. Alongside the GAAP income before income taxes data, we have included "adjusted" income before income taxes to exclude the 2015 legal settlement expense previously discussed. We believe this non-GAAP measure is important for purposes of comparing to prior year results. Management uses this metric to evaluate the underlying operating performance of the business. Adjusted income before income taxes should not be construed as a substitute for or a better indicator of our performance than the Company's GAAP measure.

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Third quarter 2016 income before income taxes increased 20.5% or \$5.4 million, as compared to \$26.3 million in the prior comparable year. Income before income taxes was \$108.2 million for the nine months ended September 25, 2016, compared to \$80.2 million for the prior comparable period. Excluding the 2015 legal settlement, income before income taxes increased 17.0%, or \$15.7 million, as compared to \$92.5 million for the nine months ended September 27, 2015.

(In thousands)	Three Months Ended		Increase (Decrease)
	Sep. 25, 2016	Sep. 27 2015	
Domestic Company-owned restaurants	\$ 11,576	\$ 8,088	\$ 3,488
Domestic commissaries	11,311	10,192	1,119
North America franchising	21,856	19,172	2,684
International	3,083	3,184	(101)
All others	392	(556)	948
Unallocated corporate expenses	(16,360)	(13,482)	(2,878)
Elimination of intersegment profits	(231)	(341)	110
Total income before income taxes	\$ 31,627	\$ 26,257	\$ 5,370

(In thousands)	Nine Months Ended				
	Sep. 25, 2016	As Reported Sep. 27, 2015	Legal Settlement Expense	Adjusted Sep. 27, 2015	Adjusted Increase (Decrease)
Domestic Company-owned restaurants	\$ 47,088	\$ 41,185	\$ —	\$ 41,185	\$ 5,903
Domestic commissaries	34,539	32,694	—	32,694	1,845
North America franchising	67,881	61,545	—	61,545	6,336
International	8,996	6,807	—	6,807	2,189
All others	868	(230)	—	(230)	1,098
Unallocated corporate expenses	(49,771)	(60,636)	12,278	(48,358)	(1,413)
Elimination of intersegment profits	(1,365)	(1,141)	—	(1,141)	(224)
Total income before income taxes	\$ 108,236	\$ 80,224	\$ 12,278	\$ 92,502	\$ 15,734

Changes in income before income taxes are summarized on a segment basis as follows excluding the 2015 legal settlement:

- Domestic Company-owned Restaurant Segment. Domestic Company-owned restaurants' income before income taxes increased approximately \$3.5 million and \$5.9 million for the three and nine months ended September 25, 2016, respectively, compared to the corresponding prior year periods. The increase was primarily due to 6.3% and 4.2% increases in comparable sales and 5.1% and 4.8% increase in equivalent units for the three and nine months ended

September 25, 2016, respectively, and lower commodity costs. For the nine month period, these increases were somewhat offset by higher insurance costs primarily due to adverse automobile claims experience.

- Domestic Commissary Segment. Domestic commissaries' income before income taxes increased approximately \$1.1 million and \$1.8 million for the three and nine months ended September 25, 2016, respectively, primarily due to higher sales volumes.
- North America Franchising Segment. North America franchising income before income taxes increased approximately \$2.7 million and \$6.3 million for the three and nine months ended September 25, 2016, respectively. The increases were primarily due to increases of 5.1% and 3.0% in comparable sales for the three and nine months ended September 25, 2016, respectively. In addition, sales and development incentives were lower in 2016.
- International Segment. International income before income taxes decreased approximately \$100,000 and increased approximately \$2.2 million for the three and nine months ended September 25, 2016, respectively. The third quarter \$100,000 decrease is primarily due to a non-recurring charge of approximately \$800,000 to record our United Kingdom lease arrangements on a straight line basis. This decrease was substantially offset by higher royalties from an increase in the number of restaurants and an increase in comparable sales of 7.6%.

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The year to date increase of \$2.2 million is due to higher royalties and commissary revenues driven by an increase in units and higher comparable sales of 6.2%. The United Kingdom profits also increased from lower advertising costs; in the prior year, advertising costs were higher with the launch of the Quality Guarantee in 2015. These increases were partially offset by the straight line rent charge noted above. In addition, foreign currency exchange rates had a negative impact of approximately \$400,000 and \$1.7 million, respectively, for the three and nine month periods in 2016. The negative impact from foreign currency exchange for the quarter was primarily attributable to the United Kingdom.

- All Others Segment. The “All others” segment, increased approximately \$900,000 and \$1.1 million for the three and nine months ended September 25, 2016, respectively. The increases were due to improved operating results, including higher sales and digital mix, for our online and mobile ordering business as well as improved operating results for our wholly-owned print and promotions subsidiary, Preferred Marketing Solutions.

- Unallocated Corporate Segment. Unallocated corporate expenses increased approximately \$2.9 million and \$1.4 million for the three and nine months ended September 25, 2016, respectively. The increases were primarily due to increases in management incentive costs from higher annual operating results and higher interest costs due to an increase in outstanding debt

Liquidity and Capital Resources

Debt

Our debt is comprised entirely of an unsecured revolving line of credit (“Credit Facility”) with outstanding balances of \$312.4 million as of September 25, 2016 and \$256.0 million as of December 27, 2015. 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. The increase in the outstanding debt balance from December 27, 2015 was primarily due to borrowings to fund share repurchases, pay dividends, acquire restaurants and pay the 2015 legal settlement.

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 \$162.4 million as of September 25, 2016.

As of September 25, 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 Debt	Fixed Rates
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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	%



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

	Permitted Ratio	Actual Ratio for the Quarter Ended September 25, 2016
Leverage Ratio	Not to exceed 3.0 to 1.0	1.71 to 1.0
Interest Coverage Ratio	Not less than 3.5 to 1.0	4.68 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 September 25, 2016.

## Cash Flows

Cash flow provided by operating activities was \$116.0 million for the nine months ended September 25, 2016, compared to \$119.7 million for the same period in 2015. The decrease of approximately \$3.7 million was primarily due to the payment of approximately \$12.5 million in the first quarter of 2016 for the previously discussed 2015 legal settlement and unfavorable changes in working capital items, significantly offset by higher net income.

Our free cash flow, a non-GAAP financial measure, was as follows for the nine months ended September 25, 2016 and September 27, 2015 (in thousands):

	Nine Months Ended	
	September 25, 2016	September 27, 2015
Net cash provided by operating activities	\$ 115,982	\$ 119,738
Purchases of property and equipment	(38,954)	(26,508)
Free cash flow (a)	\$ 77,028	\$ 93,230

- (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 measure because it is one factor that management uses in determining the amount of cash available for discretionary investment. 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 similarly titled measures used by other companies. Free cash flow should not be construed as a substitute for or a better indicator of our performance than the Company's GAAP measures.

Cash flow used in investing activities was \$45.7 million for the nine months ended September 25, 2016, compared to \$25.1 million for the same period in 2015, or an increase of \$20.6 million. The increase in cash flow used in investing activities was primarily due to the acquisition of 20 restaurants from franchisees for approximately \$11.2 million in the first quarter of 2016, new restaurant builds, initiatives in our online and mobile ordering business, and construction costs for our new domestic commissary in Georgia, which is expected to open in 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 \$109.4 million and \$80.2 million of common stock for the nine months ended September 25, 2016 and September 27, 2015, respectively. Subsequent to September 25, 2016, through October 25, 2016, we repurchased an additional \$4.4 million of common stock. As of October 25, 2016, \$95.9 million remained available for repurchase under our Board of Directors' authorization.

We paid cash dividends of \$20.5 million (\$0.55 per common share) and \$18.0 million (\$0.455 per common share) for the nine months ended September 25, 2016 and September 27, 2015, respectively. Subsequent to the third quarter on October 25, 2016, our Board of Directors declared a fourth quarter dividend of \$0.20 per common share (approximately

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\$7.4 million based on current shareholders of record). The dividend will be paid on November 18, 2016 to shareholders of record as of the close of business on November 7, 2016. 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, and other financial and operational measures. 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;
- 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;
- 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, 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, and 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 or proposed legislation impacting 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; and
- 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.

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 27, 2015, 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 an unsecured revolving line of credit with outstanding balances of \$312.4 million as of September 25, 2016 and \$256.0 million as of December 27, 2015, and a maturity date of October 31, 2019. On June 8, 2016, we exercised our option under the Credit Facility to increase the amount available to \$500 million from the previous \$400 million availability. 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 September 25, 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	\$ 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 2.1% as of September 25, 2016. An increase in the present interest rate of 100 basis points on the Credit Facility balance outstanding as of September 25, 2016, including the impact of the interest rate swaps, would increase interest expense by \$1.9 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 \$3.7 million and \$2.1 million for the three months ended September 25, 2016 and September 27, 2015, respectively, and \$7.7 million and \$5.9 million for the nine months ended September 25, 2016 and September 27, 2015, respectively. Foreign currency exchange rate fluctuations had a negative impact on our income before income taxes of \$400,000 and \$900,000 for the three months ended September 25, 2016 and September 27, 2015, respectively, and \$1.7 million and \$2.2 million for the nine months ended September 25, 2016 and September 27, 2015, respectively. The recent referendum by United Kingdom voters known as Brexit has resulted in a lower valuation of the British Pound in comparison to the US Dollar. 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 September 25, 2016, 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 third quarter of 2016 and the projected average block price for cheese for the fourth quarter 2016 (based on the October 25, 2016 Chicago Mercantile Exchange cheese futures market prices):

	2016 Projected Block Price	2015 Actual Block Price
Quarter 1	\$ 1.473	\$ 1.538
Quarter 2	1.405	1.630
Quarter 3	1.691	1.684
Quarter 4	1.610	1.602
Full Year	\$ 1.545	* \$ 1.614

\*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 27, 2015.



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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 \$1.525 billion of common stock under a share repurchase program that began on December 9, 1999 and expires on February 28, 2017. Through September 25, 2016, a total of 109.4 million shares with an aggregate cost of \$1.4 billion and an average price of \$13.02 per share have been repurchased under this program. Subsequent to September 25, 2016, through October 25, 2016, we acquired an additional 56,000 shares at an aggregate cost of \$4.4 million. As of October 25, 2016, approximately \$95.9 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 September 25 2016 (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
06/27/2016 - 07/24/2016	63	\$ 67.82	109,326	\$ 109,065
07/25/2016 - 08/21/2016	54	\$ 74.29	109,379	\$ 105,068
08/22/2016 - 09/25/2016	63	\$ 75.84	109,442	\$ 100,274

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 September 25, 2016, the Company acquired approximately 2,200 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 September 25, 2016, filed on November 1, 2016, 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: November 1, 2016      /s/ Lance F. Tucker  
Lance F. Tucker  
Senior Vice President,  
Chief Financial Officer,  
Chief Administrative Officer and Treasurer