



**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 July 1, 2018

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

(State or other jurisdiction of
incorporation or organization)

61-1203323

(I.R.S. Employer Identification
number)

2002 Papa John's 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

Non-accelerated filer

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 31, 2018, there were outstanding 31,619,630 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)	July 1, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 25,719	\$ 22,345
Accounts receivable, net	62,973	64,644
Notes receivable, net	5,180	4,333
Income tax receivable	—	3,903
Inventories	27,109	30,620
Prepaid expenses	26,729	28,522
Other current assets	7,223	9,494
Assets held for sale	2,786	6,133
Total current assets	157,719	169,994
Property and equipment, net	227,722	234,331
Notes receivable, less current portion, net	15,648	15,568
Goodwill	85,064	86,892
Deferred income taxes, net	709	585
Other assets	71,309	48,183
Total assets	\$ 558,171	\$ 555,553
Liabilities and stockholders' (deficit)		
Current liabilities:		
Accounts payable	\$ 33,307	\$ 32,006
Income and other taxes payable	8,904	10,561
Accrued expenses and other current liabilities	81,197	70,293
Deferred revenue current	2,426	—
Current portion of long-term debt	20,000	20,000
Total current liabilities	145,834	132,860
Deferred revenue	15,329	2,652
Long-term debt, less current portion, net	556,387	446,565
Deferred income taxes, net	5,140	12,546
Other long-term liabilities	78,515	60,146
Total liabilities	801,205	654,769
Redeemable noncontrolling interests	7,356	6,738
Stockholders' (deficit):		
Preferred stock (\$0.01 par value per share; no shares issued)	—	—
Common stock (\$0.01 par value per share; issued 44,280 at July 1, 2018 and 44,221 at December 31, 2017)	443	442
Additional paid-in capital	188,026	184,785
Accumulated other comprehensive income (loss)	2,240	(2,117)
Retained earnings	285,460	292,251
Treasury stock (12,733 shares at July 1, 2018 and 10,290 shares at December 31, 2017, at cost)	(742,695)	(597,072)
Total stockholders' (deficit), net of noncontrolling interests	(266,526)	(121,711)
Noncontrolling interests in subsidiaries	16,136	15,757
Total stockholders' (deficit)	(250,390)	(105,954)
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit)	\$ 558,171	\$ 555,553

See accompanying notes.

Papa John's International, Inc. and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
(In thousands, except per share amounts)				
Revenues:				
Domestic Company-owned restaurant sales	\$ 181,379	\$ 202,756	\$ 371,621	\$ 409,652
North America franchise royalties and fees	23,912	26,588	48,718	54,195
North America commissary	153,455	160,059	315,168	331,399
International	29,069	27,245	59,183	52,867
Other revenues	20,144	18,130	40,638	35,931
Total revenues	407,959	434,778	835,328	884,044
Costs and expenses:				
Operating costs (excluding depreciation and amortization shown separately below):				
Domestic Company-owned restaurant expenses	147,781	162,433	305,100	327,852
North America commissary	143,300	149,472	294,981	309,429
International expenses	18,248	17,272	37,278	33,063
Other expenses	20,698	17,482	41,656	35,029
General and administrative expenses	38,712	40,248	78,441	76,662
Depreciation and amortization	11,731	10,654	23,270	21,111
Total costs and expenses	380,470	397,561	780,726	803,146
Refranchising loss, net	(2,122)	—	(1,918)	—
Operating income	25,367	37,217	52,684	80,898
Net Interest expense	(5,662)	(1,759)	(10,617)	(3,569)
Income before income taxes	19,705	35,458	42,067	77,329
Income tax expense	7,040	10,476	12,022	22,448
Net income before attribution to noncontrolling interests	12,665	24,982	30,045	54,881
Income attributable to noncontrolling interests	(874)	(1,444)	(1,517)	(2,915)
Net income attributable to the Company	\$ 11,791	\$ 23,538	\$ 28,528	\$ 51,966
Calculation of income for earnings per share:				
Net income attributable to the Company	\$ 11,791	\$ 23,538	\$ 28,528	\$ 51,966
Change in noncontrolling interest redemption value	—	662	—	1,182
Net income attributable to participating securities	(72)	(99)	(147)	(216)
Net income attributable to common shareholders	<u>\$ 11,719</u>	<u>\$ 24,101</u>	<u>\$ 28,381</u>	<u>\$ 52,932</u>
Basic earnings per common share	<u>\$ 0.37</u>	<u>\$ 0.66</u>	<u>\$ 0.87</u>	<u>\$ 1.44</u>
Diluted earnings per common share	<u>\$ 0.36</u>	<u>\$ 0.65</u>	<u>\$ 0.86</u>	<u>\$ 1.42</u>
Basic weighted average common shares outstanding	31,941	36,732	32,610	36,771
Diluted weighted average common shares outstanding	<u>32,175</u>	<u>37,217</u>	<u>32,860</u>	<u>37,283</u>
Dividends declared per common share	<u>\$ 0.225</u>	<u>\$ 0.200</u>	<u>\$ 0.450</u>	<u>\$ 0.400</u>

See accompanying notes.

Papa John's International, Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

(In thousands)	Three Months Ended		Six Months Ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Net income before attribution to noncontrolling interests	\$ 12,665	\$ 24,982	\$ 30,045	\$ 54,881
Other comprehensive (loss) income, before tax:				
Foreign currency translation adjustments (1)	(5,295)	808	(3,312)	1,421
Interest rate swaps (2)	2,834	(1,857)	9,552	(2,325)
Other comprehensive (loss) income, before tax	(2,461)	(1,049)	6,240	(904)
Income tax effect:				
Foreign currency translation adjustments (1)	1,218	(299)	745	(526)
Interest rate swaps (3)	(627)	687	(2,172)	860
Income tax effect (4)	591	388	(1,427)	334
Other comprehensive (loss) income, net of tax	(1,870)	(661)	4,813	(570)
Comprehensive income before attribution to noncontrolling interests	10,795	24,321	34,858	54,311
Less: comprehensive income, redeemable noncontrolling interests	(319)	(745)	(404)	(1,539)
Less: comprehensive income, nonredeemable noncontrolling interests	(555)	(699)	(1,113)	(1,376)
Comprehensive income attributable to the Company	\$ 9,921	\$ 22,877	\$ 33,341	\$ 51,396

- (1) On June 15, 2018, the Company refranchised 34 Company-owned restaurants and a quality control center located in China. In conjunction with the transaction, approximately \$1,300 of accumulated other comprehensive income and \$300 associated deferred tax related to foreign currency translation were reversed. See "Note 7" of "Notes to Condensed Consolidated Financial Statements" for additional information.
- (2) Amounts reclassified out of accumulated other comprehensive income (loss) into net interest expense included \$89 and \$197 for the three and six months ended July 1, 2018, respectively, and \$126 and \$324 for the three and six months ended June 25, 2017, respectively.
- (3) The income tax effects of amounts reclassified out of accumulated other comprehensive income (loss) were \$20 and \$45 for the three and six months ended July 1, 2018, respectively, and \$47 and \$120 for the three and six months ended June 25, 2017, respectively.
- (4) As of January 1, 2018, we adopted ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," and reclassified stranded tax effects of approximately \$450 to retained earnings in the first quarter of 2018. See "Note 2" of "Notes to Condensed Consolidated Financial Statements" for additional information.

See accompanying notes.

Papa John's International, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(In thousands)	Six Months Ended	
	July 1, 2018	June 25, 2017
Operating activities		
Net income before attribution to noncontrolling interests	\$ 30,045	\$ 54,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible accounts and notes receivable	3,591	(1,091)
Depreciation and amortization	23,270	21,111
Deferred income taxes	(2,511)	158
Stock-based compensation expense	4,929	5,571
Loss on refranchising	1,918	—
Other	3,032	1,978
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(148)	(355)
Income tax receivable	3,678	(45)
Inventories	3,188	550
Prepaid expenses	1,159	2,966
Other current assets	5,524	(372)
Other assets and liabilities	(2,202)	(1,559)
Accounts payable	2,511	(3,950)
Income and other taxes payable	(1,656)	1,275
Accrued expenses and other current liabilities	(2,506)	(3,002)
Deferred revenue	379	(253)
Net cash provided by operating activities	74,201	77,863
Investing activities		
Purchases of property and equipment	(21,562)	(30,457)
Loans issued	(1,904)	(1,476)
Repayments of loans issued	2,720	2,125
Acquisitions, net of cash acquired	—	(21)
Proceeds from divestitures of restaurants	3,690	—
Other	146	25
Net cash used in investing activities	(16,910)	(29,804)
Financing activities		
Repayments of term loan	(10,000)	—
Net proceeds of revolving credit facility	119,400	5,156
Cash dividends paid	(14,762)	(14,703)
Tax payments for equity award issuances	(1,353)	(2,282)
Proceeds from exercise of stock options	2,179	5,218
Acquisition of Company common stock	(148,440)	(33,968)
Distributions to noncontrolling interest holders	(1,110)	(1,389)
Other	231	494
Net cash used in financing activities	(53,855)	(41,474)
Effect of exchange rate changes on cash and cash equivalents	(62)	99
Change in cash and cash equivalents	3,374	6,684
Cash and cash equivalents at beginning of period	22,345	15,563
Cash and cash equivalents at end of period	\$ 25,719	\$ 22,247

See accompanying notes.

Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

July 1, 2018

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 July 1, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 30, 2018. 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 31, 2017.

2. Significant Accounting Policies

Use of Estimates

The preparation of Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant items that are subject to such estimates and assumptions include allowance for doubtful accounts and notes receivable, intangible assets, online customer loyalty program obligation, insurance reserves and tax reserves. Although management bases its estimates on historical experience and assumptions that are believed to be reasonable under the circumstances, actual results could significantly differ from these estimates.

Noncontrolling Interests

At the beginning of 2018, Papa John's had five joint venture arrangements in which there were noncontrolling interests held by third parties. In the first quarter of 2018, one joint venture was divested and an additional joint venture was divested subsequent to the end of the second quarter. That joint venture was classified as held for sale as of July 1, 2018.

As of July 1, 2018, there were 215 restaurants that comprise these joint ventures, including our held for sale joint venture as compared to 223 restaurants at June 25, 2017. As of the beginning of the third quarter of 2018, there were 184 restaurants under these joint venture arrangements. See Note 7 for more information on these related divestitures.

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

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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 holders.

The income before income taxes attributable to these joint ventures for the three and six months ended July 1, 2018 and June 25, 2017 was as follows (in thousands):

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>July 1, 2018</u>	<u>June 25, 2017</u>	<u>July 1, 2018</u>	<u>June 25, 2017</u>
Papa John's International, Inc.	\$ 1,577	\$ 2,341	\$ 2,872	\$ 4,703
Noncontrolling interests	874	1,444	1,517	2,915
Total income before income taxes	<u>\$ 2,451</u>	<u>\$ 3,785</u>	<u>\$ 4,389</u>	<u>\$ 7,618</u>

The following summarizes the redemption feature, location and related accounting within the Condensed Consolidated Balance Sheets for these joint venture arrangements:

<u>Type of Joint Venture Arrangement</u>	<u>Location within the Balance Sheets</u>	<u>Recorded Value</u>
Joint venture with no redemption feature	Permanent equity	Carrying value
Option to require the Company to purchase the noncontrolling interest - not currently redeemable	Temporary equity	Carrying value

Revenue Recognition

Revenue is measured based on consideration specified in contracts with customers and excludes incentives and amounts collected on behalf of third parties, primarily sales tax. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue. Delivery costs, including freight associated with our domestic commissary and other sales are accounted for as fulfillment costs and are included in operating costs.

As further described in Accounting Standards Adopted and Note 3, the Company adopted ASC Topic 606, "Revenue from Contracts with Customers" ("Topic 606"), in the first quarter of 2018. Prior year revenue recognition follows ASC Topic 605, Revenue Recognition.

The following describes principal activities, separated by major product or service, from which the Company generates its revenues:

Company-owned Restaurant Sales

The domestic and international Company-owned restaurants principally generate revenue from retail sales of high-quality pizza, side items including breadsticks, cheesesticks, chicken poppers and wings, dessert items and canned or bottled beverages. Revenues from Company-owned restaurants are recognized when the products are delivered to or carried out by customers.

Our domestic customer loyalty program, Papa Rewards, is a spend-based program that rewards customers with points for each online purchase. Papa Rewards points are accumulated and redeemed online for free products. The accrued liability in the Condensed Consolidated Balance Sheets, and corresponding reduction of Company-owned restaurant sales in the Condensed Consolidated Statements of Income is for the estimated reward redemptions at domestic Company-owned restaurants based upon historical redemption patterns. Currently, the liability related to Papa Rewards is calculated using the estimated selling price of the products for which rewards are expected to be redeemed. Revenue is recognized when the customer redeems points for products. Prior to the adoption of Topic 606, the liability related to Papa Rewards was estimated using the incremental cost accrual model which was based on the expected cost to satisfy the award and the

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corresponding expense was recorded in general and administrative expenses in the Condensed Consolidated Statements of Income.

Commissary Sales

Commissary sales are comprised of food and supplies sold to franchised restaurants and are recognized as revenue upon shipment or delivery of the related products to the franchisees. Payments are generally due within 30 days.

Franchise Royalties and Fees

Franchise royalties which are based on a percentage of franchise restaurant sales are recognized as sales occur. Royalty reductions, offered as part of a new store development incentive or as incentive for other behaviors including acceleration of restaurant remodels or equipment upgrades, are recognized at the same time as the related royalty as they are not separately distinguishable from the full royalty rate. Franchise royalties are billed on a monthly basis.

The majority of initial franchise license fees and area development exclusivity fees are from international locations. Initial franchise license fees are billed at the store opening date. Area development exclusivity fees are billed upon execution of the development agreements which grant the right to develop franchised restaurants in future periods in specific geographic areas. Area development exclusivity fees are included in deferred revenue in the Condensed Consolidated Balance Sheets and allocated on a pro rata basis to all stores opened under that specific development agreement. Franchise license renewal fees for both domestic and international locations, which generally occur every 10 years, are billed before the renewal date.

The pre-opening services provided to franchisees do not contain separate and distinct performance obligations from the franchise right; thus, the fees collected will be amortized on a straight-line basis beginning at the store opening date through the term of the franchise agreement, which is typically 10 years. Fees received for future license renewal periods are amortized over the life of the renewal period. For periods prior to adoption of Topic 606, revenue was recognized when we performed our obligations related to such fees, primarily the store opening date for initial franchise fees and area development fees, or the date the renewal option was effective for license renewal fees.

The Company offers various incentive programs for franchisees including royalty incentives, new restaurant opening incentives (i.e. development incentives) and other support initiatives. Royalties, franchise fees and commissary sales are reduced to reflect any incentives earned or granted under these programs that are in the form of discounts. Other development incentives for opening restaurants are offered in the form of Company equipment through a lease agreement at substantially no cost to the franchisee. This equipment is amortized by us over the term of the lease agreement, which is generally three to five years, and is recognized in general and administrative expenses in our Condensed Consolidated Statements of Income. The equipment lease agreement has separate and distinguishable obligations from the franchise right and is accounted for under ASC Topic 840, Leases.

Other Revenues

Fees for information services, including software maintenance fees, help desk fees and online ordering fees are recognized as revenue as such services are provided and are included in other revenue.

Revenues for printing, promotional items, and direct mail marketing services are recognized upon shipment of the related products to franchisees and other customers. Direct mail advertising discounts are also periodically offered by our Preferred Marketing Solutions subsidiary. Other revenues are reduced to reflect these advertising discounts.

Rental income, primarily derived from properties leased by the Company and subleased to franchisees in the United Kingdom, is recognized on a straight-line basis over the respective operating lease terms, in accordance with ASC Topic 840, Leases.

Franchise Marketing Fund revenues represent contributions collected by various international and domestic marketing funds (“Co-op” or “Co-operative”) where we have determined that we have control over the activities of the fund. Contributions are based on a percentage of monthly restaurant sales. The adoption of Topic 606 revised the principal versus agent determination of these arrangements. When we are determined to be the principal in these arrangements,

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advertising fund contributions and expenditures are reported on a gross basis in the Condensed Consolidated Statements of Income. Our obligation related to these funds is to develop and conduct advertising activities in a specific country, region, or market, including the placement of electronic and print materials. Marketing fund contributions are billed monthly.

For periods prior to the adoption of Topic 606, the revenues and expenses of certain international advertising funds and the Co-op Funds in which we possess majority voting rights, were included in our Condensed Consolidated Statements of Income on a net basis as we previously concluded we were the agent in regard to the funds based upon principal/agent determinations in industry-specific guidance in GAAP that was in effect during those time periods.

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 Papa John's 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 attribute carryforwards (e.g., net operating losses, capital losses, and foreign tax credits). The effect on deferred taxes of changes in tax rates is recognized in the period in which the new tax rate is enacted. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted, significantly decreasing the U.S. federal income tax rate for corporations effective January 1, 2018. As a result, we remeasured our deferred tax assets, liabilities and related valuation allowances in 2017. This remeasurement yielded a one-time benefit of approximately \$7.0 million due to the lower income tax rate in 2017. Given the substantial changes associated with the Tax Act, the estimated financial impacts for 2017 are provisional and subject to further interpretation and clarification of the Tax Act during 2018. As of July 1, 2018, the Company has not made any material adjustments to the December 30, 2017 estimates. Our net deferred income tax liability was approximately \$4.4 million at July 1, 2018.

In February 2018, the FASB issued ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"), that allows for an entity to reclassify disproportionate income tax effects in accumulated other comprehensive income (loss) ("AOCI") caused by the Tax Act to retained earnings. See "Accounting Standards Adopted" section below for additional details.

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 or state 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 and cash equivalents, 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 term debt and revolving credit facility approximates its carrying value due to its variable market-based interest rate (Level 2).

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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.

Our financial assets that were measured at fair value on a recurring basis as of July 1, 2018 and December 31, 2017 are as follows (in thousands):

	Carrying Value	Fair Value Measurements		
		Level 1	Level 2	Level 3
July 1, 2018				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 29,771	\$ 29,771	\$ —	\$ —
Interest rate swaps (b)	10,203	—	10,203	—
December 31, 2017				
Financial assets:				
Cash surrender value of life insurance policies (a)	\$ 28,645	\$ 28,645	\$ —	\$ —
Interest rate swaps (b)	651	—	651	—

(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 December 31, 2017 include assets and liabilities held for sale. The fair value was determined using a market-based approach with unobservable inputs (Level 3) less any estimated selling costs.

There were no transfers among levels within the fair value hierarchy during the six months ended July 1, 2018.

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

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP, including industry-specific requirements, and provides companies with a single revenue recognition framework for recognizing revenue from contracts with customers. In March and April 2016, the FASB issued Topic 606. This update and subsequently issued amendments require companies to recognize revenue at amounts that reflect the consideration to which the companies expect to be entitled in exchange for those goods or services at the time of transfer. Topic 606 requires that we assess contracts to determine each separate and distinct performance obligation. If a contract has multiple performance obligations, we

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allocate the transaction price using our best estimate of the standalone selling price to each distinct good or service in the contract.

The Company adopted Topic 606 as of January 1, 2018. See Note 3 for additional information.

Certain Tax effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU 2018-02, which allows for an entity to reclassify disproportionate income tax in AOCI caused by the Tax Act to retained earnings. The guidance is effective for fiscal years beginning after December 15, 2018 with early adoption permitted, including interim periods within those years. The Company adopted ASU 2018-02 in the first quarter of 2018 by electing to reclassify the income tax effects from AOCI to retained earnings. The impact of the adoption was not material to our condensed consolidated financial statements.

Accounting Standards to be Adopted in Future Periods

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” (“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. In July 2018, the FASB issued the following amendments to clarify the implementation guidance: ASU 2018-10, “Codification Improvements to Topic 842, Leases,” and ASU 2018-11, “Leases (Topic 842): Targeted Improvements.” The amendment allows for a modified retrospective adoption approach and new required lease disclosures for all leases existing or entered into after either the beginning of the year of adoption or the earliest comparative period in the consolidated financial statements. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. The Company has not yet determined the full impact of the adoption on its consolidated financial statements but expects the adoption will result in a significant increase in the non-current assets and liabilities reported on our Consolidated Balance Sheet.

Goodwill

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other,” (“ASU 2017-04”), which simplifies the accounting for goodwill. ASU 2017-04 eliminates the second step of the goodwill impairment test, which requires a hypothetical purchase price allocation. The goodwill impairment is the difference between the carrying value and fair value, not to exceed the carrying amount. ASU 2017-04 is effective for annual and interim periods in fiscal years beginning after December 15, 2019. The Company is currently evaluating this standard and its potential impact on our consolidated financial statements.

Reclassification

Certain prior year amounts have been reclassified in the Condensed Consolidated Statements of Income. See Note 11 for additional information.

3. Adoption of ASU 2014-09, “Revenue from Contracts with Customers”

The Company adopted Topic 606 using the modified retrospective transition method effective January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented in accordance with Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605, Revenue Recognition.

The cumulative effect adjustment of \$21.5 million was recorded as a reduction to retained earnings as of January 1, 2018 to reflect the impact of adopting Topic 606. The impact of applying Topic 606 for the three and six months ended July

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1, 2018, was an increase in revenues of \$1.8 million and \$4.3 million respectively and a decrease in pre-tax income of \$1.4 million and \$1.9 million, respectively.

The adoption of Topic 606 did not impact the recognition and reporting of our three largest sources of revenue: sales from Company-owned restaurants, commissary sales, or continuing royalties or other revenues from franchisees that are based on a percentage of the franchise sales. The items impacted by the adoption include the presentation and amount of our loyalty program costs, the timing of franchise and development fees revenue recognition, and the presentation of various domestic and international advertising funds as further described below.

Cumulative adjustment from adoption

As noted above, an after-tax reduction of \$21.5 million was recorded to retained earnings in the first quarter of 2018 to reflect the cumulative impact of adopting Topic 606. This is comprised of \$10.8 million related to franchise fees, \$8.0 million related to the customer loyalty program and \$2.7 million related to marketing funds.

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The following chart presents the specific line items impacted by the cumulative adjustment.

(In thousands, except per share amounts)	As Reported December 31, 2017	Total Adjustments	Adjusted Balance Sheet at January 1, 2018
Assets			
Current assets:			
Cash and cash equivalents	\$ 22,345	\$ 4,279	\$ 26,624
Accounts receivable, net	64,644	493	65,137
Notes receivable, net	4,333	—	4,333
Income tax receivable	3,903	—	3,903
Inventories	30,620	—	30,620
Prepaid expenses	28,522	(4,959)	23,563
Other current assets	9,494	—	9,494
Assets held for sale	6,133	—	6,133
Total current assets	169,994	(187)	169,807
Property and equipment, net	234,331	—	234,331
Notes receivable, less current portion, net	15,568	—	15,568
Goodwill	86,892	—	86,892
Deferred income taxes, net	585	—	585
Other assets	48,183	(907)	47,276
Total assets	\$ 555,553	\$ (1,094)	\$ 554,459
Liabilities and stockholders' equity (deficit)			
Current liabilities:			
Accounts payable	\$ 32,006	\$ (2,161)	\$ 29,845
Income and other taxes payable	10,561	—	10,561
Accrued expenses and other current liabilities	70,293	15,860	86,153
Deferred revenue current	—	2,400	2,400
Current portion of long-term debt	20,000	—	20,000
Total current liabilities	132,860	16,099	148,959
Deferred revenue	2,652	10,798	13,450
Long-term debt, less current portion, net	446,565	—	446,565
Deferred income taxes, net	12,546	(6,464)	6,082
Other long-term liabilities	60,146	—	60,146
Total liabilities	654,769	20,433	675,202
Redeemable noncontrolling interests	6,738	—	6,738
Stockholders' equity (deficit):			
Preferred stock (\$0.01 par value per share; no shares issued)	—	—	—
Common stock (\$0.01 par value per share; issued 44,221 at December 31, 2017)	442	—	442
Additional paid-in capital	184,785	—	184,785
Accumulated other comprehensive loss	(2,117)	—	(2,117)
Retained earnings	292,251	(21,527)	270,724
Treasury stock (10,290 shares at December 31, 2017, at cost)	(597,072)	—	(597,072)
Total stockholders' (deficit), net of noncontrolling interests	(121,711)	(21,527)	(143,238)
Noncontrolling interests in subsidiaries	15,757	—	15,757
Total stockholders' (deficit)	(105,954)	(21,527)	(127,481)
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit)	\$ 555,553	\$ (1,094)	\$ 554,459

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The impact of adoption for the second quarter of 2018 is as follows:

(In thousands, except per share amounts)	As Reported July 1, 2018	Total Adjustments	Balance Sheet Without Adoption of Topic 606
Assets			
Current assets:			
Cash and cash equivalents	\$ 25,719	\$ (3,130)	\$ 22,589
Accounts receivable, net	62,973	(359)	62,614
Notes receivable, net	5,180	—	5,180
Income tax receivable	—	—	—
Inventories	27,109	—	27,109
Prepaid expenses	26,729	4,827	31,556
Other current assets	7,223	—	7,223
Assets held for sale	2,786	—	2,786
Total current assets	157,719	1,338	159,057
Property and equipment, net	227,722	—	227,722
Notes receivable, less current portion, net	15,648	—	15,648
Goodwill	85,064	—	85,064
Deferred income taxes, net	709	—	709
Other assets	71,309	907	72,216
Total assets	\$ 558,171	\$ 2,245	\$ 560,416
Liabilities and stockholders' equity (deficit)			
Current liabilities:			
Accounts payable	\$ 33,307	\$ 1,493	\$ 34,800
Income and other taxes payable	8,904	—	8,904
Accrued expenses and other current liabilities	81,197	(15,457)	65,740
Deferred revenue current	2,426	(2,426)	—
Current portion of long-term debt	20,000	—	20,000
Total current liabilities	145,834	(16,390)	129,444
Deferred revenue	15,329	(11,157)	4,172
Long-term debt, less current portion, net	556,387	—	556,387
Deferred income taxes, net	5,140	6,682	11,822
Other long-term liabilities	78,515	—	78,515
Total liabilities	801,205	(20,865)	780,340
Redeemable noncontrolling interests	7,356	—	7,356
Stockholders' equity (deficit):			
Preferred stock (\$0.01 par value per share; no shares issued)	—	—	—
Common stock (\$0.01 par value per share; issued 44,280 at July 1, 2018)	443	—	443
Additional paid-in capital	188,026	—	188,026
Accumulated other comprehensive income (loss)	2,240	—	2,240
Retained earnings	285,460	23,091	308,551
Treasury stock (12,733 shares at July 1, 2018, at cost)	(742,695)	—	(742,695)
Total stockholders' (deficit), net of noncontrolling interests	(266,526)	23,091	(243,435)
Noncontrolling interests in subsidiaries	16,136	19	16,155
Total stockholders' (deficit)	(250,390)	23,110	(227,280)
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit)	\$ 558,171	\$ 2,245	\$ 560,416

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(In thousands, except per share amounts)	As Reported Three Months Ended		Income Statement Without Adoption of Topic 606
	July 1, 2018	Total Adjustments	
Revenues:			
Domestic Company-owned restaurant sales	\$ 181,379	\$ 812	\$ 182,191
North America franchise royalties and fees	23,912	82	23,994
North America commissary	153,455	—	153,455
International	29,069	175	29,244
Other revenues	20,144	(2,883)	17,261
Total revenues	407,959	(1,814)	406,145
Costs and expenses:			
Operating costs (excluding depreciation and amortization shown separately below):			
Domestic Company-owned restaurant expenses	147,781	(272)	147,509
North America commissary	143,300	—	143,300
International expenses	18,248	—	18,248
Other expenses	20,698	(2,951)	17,747
General and administrative expenses	38,712	34	38,746
Depreciation and amortization	11,731	—	11,731
Total costs and expenses	380,470	(3,189)	377,281
Refranchising loss, net	(2,122)	—	(2,122)
Operating income	25,367	1,375	26,742
Net Interest expense	(5,662)	—	(5,662)
Income before income taxes	19,705	1,375	21,080
Income tax expense	7,040	306	7,346
Net income before attribution to noncontrolling interests	12,665	1,069	13,734
Income attributable to noncontrolling interests	(874)	—	(874)
Net income attributable to the Company	\$ 11,791	\$ 1,069	\$ 12,860
Calculation of income for earnings per share:			
Net income attributable to the Company	\$ 11,791	\$ 1,069	\$ 12,860
Net income attributable to participating securities	(72)	—	(72)
Net income attributable to common shareholders	\$ 11,719	\$ 1,069	\$ 12,788
Basic earnings per common share	\$ 0.37	\$ 0.03	\$ 0.40
Diluted earnings per common share	\$ 0.36	\$ 0.03	\$ 0.40
Basic weighted average common shares outstanding	31,941	31,941	31,941
Diluted weighted average common shares outstanding	32,175	32,175	32,175

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	As Reported Six Months Ended		Income Statement Without Adoption of Topic 606
	July 1, 2018	Total Adjustments	
(In thousands, except per share amounts)			
Revenues:			
Domestic Company-owned restaurant sales	\$ 371,621	\$ 1,076	\$ 372,697
North America franchise royalties and fees	48,718	120	48,838
North America commissary	315,168	—	315,168
International	59,183	324	59,507
Other revenues	40,638	(5,770)	34,868
Total revenues	835,328	(4,250)	831,078
Costs and expenses:			
Operating costs (excluding depreciation and amortization shown separately below):			
Domestic Company-owned restaurant expenses	305,100	(338)	304,762
North America commissary	294,981	—	294,981
International expenses	37,278	—	37,278
Other expenses	41,656	(6,310)	35,346
General and administrative expenses	78,441	538	78,979
Depreciation and amortization	23,270	—	23,270
Total costs and expenses	780,726	(6,110)	774,616
Refranchising loss, net	(1,918)	—	(1,918)
Operating income	52,684	1,860	54,544
Net Interest expense	(10,617)	—	(10,617)
Income before income taxes	42,067	1,860	43,927
Income tax expense	12,022	418	12,440
Net income before attribution to noncontrolling interests	30,045	1,442	31,487
Income attributable to noncontrolling interests	(1,517)	—	(1,517)
Net income attributable to the Company	\$ 28,528	\$ 1,442	\$ 29,970
Calculation of income for earnings per share:			
Net income attributable to the Company	\$ 28,528	\$ 1,442	\$ 29,970
Net income attributable to participating securities	(147)	—	(147)
Net income attributable to common shareholders	\$ 28,381	\$ 1,442	\$ 29,823
Basic earnings per common share	\$ 0.87	\$ 0.04	\$ 0.91
Diluted earnings per common share	\$ 0.86	\$ 0.04	\$ 0.91
Basic weighted average common shares outstanding	32,610	32,610	32,610
Diluted weighted average common shares outstanding	32,860	32,860	32,860

Transaction Price Allocated to the Remaining Performance Obligations

The following table (in thousands) includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied at the end of the reporting period.

	Performance Obligations by Period						
	Less than 1 Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Thereafter	Total
Franchise Fees	\$ 2,426	\$ 2,179	\$ 1,948	\$ 1,732	\$ 1,503	\$ 3,795	\$ 13,583

An additional \$4.2 million of area development fees related to unopened stores and unearned royalties are included in deferred revenue. Timing of revenue recognition is dependent upon the timing of store openings and franchisee's revenues.

As of July 1, 2018, the amount allocated to the Papa Rewards loyalty program is \$15.8 million and is reflected in the Condensed Consolidated Balance Sheet as part of the contract liability included in accrued expenses and other current

liabilities. This will be recognized as revenue as the points are redeemed, which is expected to occur within the next year.

The Company applies the practical expedient in ASU paragraph 606-10-50-14 and does not disclose information about remaining performance obligations that have original expected durations of one year or less.

4. Revenue Recognition

Disaggregation of Revenue

In the following table (in thousands), revenue is disaggregated by major product line. The table also includes a reconciliation of the disaggregated revenue with the reportable segments.

Major Products/Services Lines	Reportable Segments					
	Three Months Ended July 1, 2018					
	Domestic Company- owned restaurants	North America commissaries	North America franchising	International	All others	Total
Company-owned restaurant sales	\$ 181,379	\$ -	\$ -	\$ 2,783	\$ -	\$ 184,162
Commissary sales	-	204,947	-	17,299	-	222,246
Franchise royalties and fees	-	-	24,928	8,987	-	33,915
Other revenues	-	-	-	5,656	22,139	27,795
Eliminations	-	(51,492)	(1,016)	(73)	(7,578)	(60,159)
Total	\$ 181,379	\$ 153,455	\$ 23,912	\$ 34,652	\$ 14,561	\$ 407,959

Major Products/Services Lines	Reportable Segments					
	Six Months Ended July 1, 2018					
	Domestic Company- owned restaurants	North America commissaries	North America franchising	International	All others	Total
Company-owned restaurant sales	\$ 371,621	\$ -	\$ -	\$ 6,237	\$ -	\$ 377,858
Commissary sales	-	422,534	-	34,978	-	457,512
Franchise royalties and fees	-	-	50,753	17,969	-	68,722
Other revenues	-	-	-	11,143	45,289	56,432
Eliminations	-	(107,366)	(2,035)	(143)	(15,652)	(125,196)
Total	\$ 371,621	\$ 315,168	\$ 48,718	\$ 70,184	\$ 29,637	\$ 835,328

The revenue summarized above is described in Note 2 under the heading “Significant Accounting Policies – Revenue Recognition.”

Contract Balances

The contract liabilities primarily relate to franchise fees which we classify as “Deferred revenue” and customer loyalty program obligations which are classified with “Accrued expenses and other current liabilities.” During the three and six months ended July 1, 2018, the Company recognized \$3.1 million and \$7.0 million in revenue, respectively, related to deferred revenue and customer loyalty program.

The contract liability balances are included in the following (in thousands):

	July 1, 2018	January 1, 2018	Change
Deferred revenue	\$ 17,755	\$ 15,850	\$ 1,905
Customer loyalty program	15,800	14,724	1,076
Total contract liabilities	\$ 33,555	\$ 30,574	\$ 2,981

5. Stockholders' Equity / (Deficit)

Shares Authorized and Outstanding

The Company has authorized 5.0 million shares of preferred stock and 100.0 million shares of common stock. The Company's outstanding shares of common stock, net of repurchased common stock, were 31.5 million shares at July 1, 2018 and 33.9 million shares at December 31, 2017. There were no shares of preferred stock issued or outstanding at July 1, 2018 and December 31, 2017.

Share Repurchase Program

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. Funding for the share repurchase program has been provided through our credit facility, operating cash flow, stock option exercises and cash and cash equivalents.

On March 1, 2018, the Company announced a \$100 million accelerated share repurchase agreement (“ASR Agreement”) with Bank of America, N.A. (“BofAML”). Pursuant to the terms of the ASR Agreement, we paid BofAML \$100.0 million in cash, and on March 6, 2018, we received an initial delivery of approximately 1.3 million shares of common stock for approximately \$78.0 million. The remaining \$22.0 million of the ASR Agreement was completed May 14, 2018 delivering approximately 400,000 additional shares. Under the completed ASR Agreement, approximately 1.7 million shares were repurchased for \$100.0 million.

Cash Dividend

The Company paid dividends of approximately \$14.8 million (\$0.45 per common share) during the six months of 2018. Subsequent to the second quarter on August 1, 2018, our Board of Directors declared a third quarter dividend of \$0.225 per common share (approximately \$7.2 million based on current shareholders of record). The dividend will be paid on August 24, 2018 to shareholders of record as of the close of business on August 13, 2018.

Stockholder Rights Plan

On July 22, 2018, the Board of Directors of the Company approved the adoption of a limited duration stockholder rights plan (the “Rights Plan”) with an expiration date of July 22, 2019 and an ownership trigger threshold of 15% (with a threshold of 31% applied to John H. Schnatter, together with his affiliates and family members). In connection with the Rights Plan, the Board of Directors authorized and declared a dividend to stockholders of record at the close of business on August 2, 2018 of one preferred share purchase right (a “Right”) for each outstanding share of Papa John's common stock. Upon certain triggering events, each Right would entitle the holder to purchase from the Company one one-thousandth (subject to adjustment) of one share of Series A Junior Participating Preferred Stock, \$0.01 par value per share of the Company (“Preferred Stock”) at an exercise price of \$250.00 (the “Exercise Price”) per one one-thousandth of a share of Preferred Stock. In addition, if a person or group acquires beneficial ownership of 15% or more of the

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Company's common stock (or in the case of Mr. Schnatter, 31% or more) without prior board approval, each holder of a Right (other than the acquiring person or group whose Rights will become void) will have the right to purchase, upon payment of the Exercise Price and in accordance with the terms of the Rights Plan, a number of shares of the Company's common stock having a market value of twice the Exercise Price. The complete terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement"), dated as of July 22, 2018, between the Company and Computershare Trust Company, N.A., as rights agent. The Rights expire on July 22, 2019 or upon an earlier redemption or exchange as provided in the Rights Agreement.

6. 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.

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	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Basic earnings per common share:				
Net income attributable to the Company	\$ 11,791	\$ 23,538	\$ 28,528	\$ 51,966
Change in noncontrolling interest redemption value	—	662	—	1,182
Net income attributable to participating securities	(72)	(99)	(147)	(216)
Net income attributable to common shareholders	\$ 11,719	\$ 24,101	\$ 28,381	\$ 52,932
Weighted average common shares outstanding	31,941	36,732	32,610	36,771
Basic earnings per common share	\$ 0.37	\$ 0.66	\$ 0.87	\$ 1.44
Diluted earnings per common share:				
Net income attributable to common shareholders	\$ 11,719	\$ 24,101	\$ 28,381	\$ 52,932
Weighted average common shares outstanding	31,941	36,732	32,610	36,771
Dilutive effect of outstanding equity awards (a)	234	485	250	512
Diluted weighted average common shares outstanding	32,175	37,217	32,860	37,283
Diluted earnings per common share	\$ 0.36	\$ 0.65	\$ 0.86	\$ 1.42

(a) Excludes 1,257 and 1,143 awards for the three and sixth months ended July 1, 2018, respectively, and 325 and 215 awards for the three and six months ended June 25, 2017, respectively, as the effect of including such awards would have been antidilutive.

7. Divestitures

In the first quarter of 2018, the Company refranchised 31 restaurants owned through a joint venture in the Denver, Colorado market. The Company held a 60% ownership share in the restaurants being refranchised. The noncontrolling interest portion of the joint venture arrangement was previously recorded at redemption value within the Condensed Consolidated Balance Sheet. Total consideration for the asset sale of the restaurants was \$4.8 million, consisting of cash proceeds of \$3.7 million, including cash paid for various working capital items, and notes financed by Papa John's for \$1.1 million.

In connection with the divestiture, we wrote off \$700,000 of goodwill. This goodwill was allocated based on the relative fair value of the sales proceeds versus the total fair value of the Company-owned restaurants' reporting unit.

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As a result of assigning our interest in obligations under property leases as a condition of the refranchising of the Denver market, we are contingently liable for payment of the 31 leases. These leases have varying terms, the latest of which expires in 2024. As of July 1, 2018, the estimated maximum amount of undiscounted payments the Company could be required to make in the event of nonpayment by the primary lessees was \$3.6 million. The fair value of the guarantee is not material.

On June 15, 2018, the Company refranchised 34 Company-owned restaurants and a quality control center located in Beijing and Tianjin, China. The assets and liabilities associated with the China operations were previously classified as Held for Sale in the Condensed Consolidated Balance Sheet as of December 31, 2017. We recorded a pre-tax loss of approximately \$1.9 million associated with the sale of the restaurants and reversed \$1.3 million of accumulated other comprehensive income related to foreign currency translation as part of the disposal. The \$1.9 million pre-tax loss is recorded in refranchising losses, net on the Condensed Consolidated Statements of Income. In addition, we also had \$2.4 million of additional tax expense associated with the China refranchise. This additional tax expense is primarily attributable to the required recapture of operating losses previously taken by the Company.

Subsequent to the second quarter on July 2, 2018, the Company completed the refranchising of 31 stores owned through a joint venture in the Minneapolis, Minnesota market for \$3.75 million. The Company holds a 70% ownership share in the stores being refranchised. We do not expect the divestiture to result in a significant refranchising gain or loss. The following summarizes the assets that are held for sale (in thousands) as of July 1, 2018 related to the Minneapolis, Minnesota market:

Property and equipment	\$	1,936
Goodwill		678
Inventory		153
Other		19
Assets held for sale	\$	<u>2,786</u>

8. Debt

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

	July 1, 2018	December 31, 2017
Outstanding debt	\$ 579,400	\$ 470,000
Unamortized debt issuance costs	(3,013)	(3,435)
Current portion of long-term debt	(20,000)	(20,000)
Total long-term debt, less current portion, net	<u>\$ 556,387</u>	<u>\$ 446,565</u>

Our outstanding debt of \$579.4 million at July 1, 2018 represented amounts outstanding under our credit agreement executed in August 2017. Our credit agreement provides for an unsecured revolving credit facility in an aggregate principal amount of \$600.0 million (the "Revolving Facility") and an unsecured term loan facility in an aggregate principal amount of \$400.0 million (the "Term Loan Facility" and together with the Revolving Facility, the "Facilities"). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to \$300.0 million, subject to certain conditions. Our outstanding debt as of July 1, 2018 under the Facilities of \$579.4 million was composed of \$385.0 million outstanding under the Term Loan Facility and \$194.4 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately \$371.8 million as of July 1, 2018. In connection with our credit agreement, the Company capitalized \$3.2 million of debt issuance costs, which are being amortized into interest expense, over the term of the Facilities.

Loans under the Facilities accrue interest at a per annum rate equal to, at the Company's election, either a LIBOR rate plus a margin ranging from 75 to 200 basis points or a base rate (generally determined by a prime rate, federal funds rate or a LIBOR rate plus 1.00%) plus a margin ranging from 0 to 100 basis points. In each case, the actual margin is determined according to a ratio of the Company's total indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA") for the then most recently ended four-quarter period (the "Leverage Ratio"). An unused

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commitment fee at a rate ranging from 15 to 30 basis points per annum, determined according to the Leverage Ratio, applies to the unutilized commitments under the Revolving Facility. Loans outstanding under the credit agreement may be prepaid at any time without premium or penalty, subject to customary breakage costs in the case of borrowings for which a LIBOR rate election is in effect. Up to \$35.0 million of the Revolving Facility may be advanced in certain agreed foreign currencies, including Euros, Pounds Sterling, Canadian Dollars, Japanese Yen, and Mexican Pesos.

The Facilities mature on August 30, 2022. Quarterly amortization payments are required to be made on the Term Loan Facility in the amount of \$5.0 million which began in the fourth quarter of 2017. The obligations under the credit agreement are guaranteed by certain direct and indirect material subsidiaries of the Company.

The credit agreement contains customary affirmative and negative covenants, including financial covenants requiring the maintenance of specified fixed charges and leverage ratios. At July 1, 2018, we were in compliance with these financial 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 that participate in our credit agreement. 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.

We use interest rate swaps to hedge against the effects of potential interest rate increases on borrowings under our Facilities. As of July 1, 2018, we have the following interest rate swap agreements:

Effective Dates	Floating Rate Debt	Fixed Rates
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 %
January 30, 2018 through August 30, 2022	\$ 100 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	2.00 %
January 30, 2018 through August 30, 2022	\$ 25 million	1.99 %

The gain or loss on the swaps is recognized in other comprehensive income/(loss) and reclassified into earnings as adjustments to interest expense in the same period or periods during which the swaps affect earnings. Gains or losses on the swaps representing hedge components excluded from the assessment of effectiveness are recognized in current earnings.

The following table provides information on the location and amounts of our swaps in the accompanying condensed consolidated financial statements (in thousands):

Balance Sheet Location	Interest Rate Swap Derivatives	
	Fair Value July 1, 2018	Fair Value December 31, 2017
Other current and long-term assets	\$ 10,203	\$ 651

There were no derivatives that were not designated as hedging instruments.

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The effect of derivative instruments on the accompanying condensed consolidated financial statements is as follows (in thousands):

Derivatives - Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in AOCI/AOCL on Derivative	Location of Gain or (Loss) Reclassified from AOCI/AOCL into Income	Amount of Gain or (Loss) Reclassified from AOCI/AOCL into Income	Total Interest Expense on Consolidated Statements of Income
Interest rate swaps for the three months ended:				
July 1, 2018	\$ 2,207	Interest expense	\$ (89)	\$ (5,911)
June 25, 2017	\$ (1,170)	Interest expense	\$ (126)	\$ (1,894)
Interest rate swaps for the six months ended:				
July 1, 2018	\$ 7,380	Interest expense	\$ (197)	\$ (11,131)
June 25, 2017	\$ (1,465)	Interest expense	\$ (324)	\$ (3,840)

The weighted average interest rates on our debt, including the impact of the interest rate swap agreements, were 3.6% for the three and six months ended July 1, 2018, compared to 2.3% for the corresponding prior year periods. Interest paid, including payments made or received under the swaps, was \$5.8 million and \$2.1 million for the three months ended July 1, 2018 and June 25, 2017, respectively, and \$10.7 million and \$3.9 million for the six months ended July 1, 2018 and June 25, 2017, respectively. As of July 1, 2018, the portion of the aggregate \$10.2 million interest rate swap asset that would be reclassified into earnings during the next twelve months as interest income approximates \$2.4 million.

9. Commitments and Contingencies

Litigation

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 ASC 450, "Contingencies" the Company makes accruals and or disclosures, with respect to these matters, where appropriate.

Ameranth, Inc. vs Papa John's International, Inc. In August 2011, Ameranth, Inc. ("Ameranth") filed various patent infringement actions against a number of defendants, including the Company, in the U.S. District Court for the Southern District of California (the "California Court"), which were consolidated by the California Court in October 2012 (the "Consolidated Case"). The Consolidated Case was stayed until January 2018 when Ameranth decided to proceed on only one patent, after the Company received a favorable decision by the Patent and Trademark Office on certain other patents. A Markman hearing was held in December 2017, which did not dispose of Ameranth's claims, and the California Court set a jury trial date of November 13, 2018 for the claims against the Company. The Company believes this case lacks merit and that it has strong defenses to all of the infringement claims. The Company intends to defend the suit vigorously. However, the Company is unable to predict the likelihood of success of Ameranth's infringement claims. The Company has not recorded a liability related to this lawsuit as of July 1, 2018, as it does not believe a loss is probable or reasonably estimable.

Durling et al v. Papa John's International, Inc., is a conditionally certified collective action filed in May 2016 in the United States District Court for the Southern District of New York ("the New York Court"), alleging that corporate restaurant delivery drivers were not properly reimbursed for vehicle mileage and expenses in accordance with the Fair Labor Standards Act ("FLSA"). In July 2018, the New York Court granted a motion to certify a conditional corporate collective class. The Company continues to deny any liability or wrongdoing in this matter and intends to vigorously defend this action. The Company has not recorded any liability related to this lawsuit as of July 1, 2018 as it does not believe a loss is probable or reasonably estimable.

Other Matters

Subsequent to the end of the second quarter, the Company has experienced negative publicity and consumer sentiment as a result of statements and actions by the Company's founder and former spokesperson, John H. Schnatter. Mr. Schnatter

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resigned as Chairman of the Board on July 11, 2018 and a Special Committee of the Board of Directors consisting of all of the independent directors was formed on July 15, 2018 to evaluate and take action with respect to all of the Company's relationships and arrangements with Mr. Schnatter. Following its formation, the Special Committee terminated Mr. Schnatter's Founder Agreement, which defined his role in the Company, among other things, as advertising and brand spokesperson for the Company. The Special Committee is also overseeing the previously announced external audit and investigation of all the Company's existing processes, policies and systems related to diversity and inclusion, supplier and vendor engagement and Papa John's culture.

On July 17, 2018, the Company announced that the Special Committee appointed Akin Gump Strauss Hauer & Feld LLP to oversee the cultural audit and investigation. This audit and investigation is ongoing. In addition, on July 27, 2018, the Company announced that the Board's Lead Independent Director, Olivia F. Kirtley, had been unanimously appointed by the Board of Directors to serve as Chairman of the Company's Board of Directors.

The Company experienced, and expects to continue to experience, a decline in sales resulting from the aforementioned negative consumer sentiment. While we are still in the process of gathering and estimating future costs, the Company currently expects to incur costs as a result of the recent events that include, but are not limited to, the following:

- re-imaging costs at nearly all domestic and international restaurants,
- costs to accelerate our replacement of certain branded assets and related marketing efforts,
- financial assistance to domestic franchisees, such as short-term royalty reductions, in an effort to mitigate closings,
- additional costs for branding initiatives, including but not limited to, launching a new advertising and marketing campaign and promotional activities to mitigate negative consumer sentiment and negative sales trend,
- costs associated with a third-party audit of the culture at Papa John's commissioned by the Special Committee as well as costs associated with implementing new policies and procedures to address any findings as a result of the audit, and
- additional legal and advisory costs, including costs associated with the activities of the Special Committee.

The Company expects these costs to be material.

On July 26, 2018, John H. Schnatter filed a complaint in the Court of Chancery of the State of Delaware seeking to inspect certain books and records of the Company. While the Company believes that the request for inspection is not for a proper purpose under Delaware law and includes certain categories of documents relating to the Special Committee to which Mr. Schnatter is not entitled, the Company will comply with any decision of the Court of Chancery of the State of Delaware.

10. 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 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 segment principally consists of distribution sales to franchised Papa John's restaurants located in the United Kingdom and Mexico 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, franchise

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contributions to marketing funds 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		Six Months Ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
Revenues				
Domestic Company-owned restaurants	\$ 181,379	\$ 202,756	\$ 371,621	\$ 409,652
North America commissaries	153,455	160,059	315,168	331,399
North America franchising	23,912	26,588	48,718	54,195
International	34,652	30,230	70,184	58,748
All others	14,561	15,145	29,637	30,050
Total revenues	\$ 407,959	\$ 434,778	\$ 835,328	\$ 884,044
Intersegment revenues:				
North America commissaries	\$ 51,492	\$ 59,202	\$ 107,366	\$ 120,938
North America franchising	1,016	751	2,035	1,515
International	73	68	143	131
All others	7,578	4,084	15,652	9,110
Total intersegment revenues	\$ 60,159	\$ 64,105	\$ 125,196	\$ 131,694
Income (loss) before income taxes:				
Domestic Company-owned restaurants	\$ 8,304	\$ 15,550	\$ 15,533	\$ 31,037
North America commissaries (1)	8,730	12,088	17,340	24,332
North America franchising	21,380	23,999	43,739	48,874
International	2,278	3,265	5,815	7,609
All others (1) (2)	(1,728)	905	(2,638)	1,365
Unallocated corporate expenses (1) (2)	(19,324)	(19,086)	(37,454)	(35,467)
Elimination of intersegment (profits) losses	65	(1,263)	(268)	(421)
Total income before income taxes	\$ 19,705	\$ 35,458	\$ 42,067	\$ 77,329
Property and equipment:				
Domestic Company-owned restaurants	\$ 229,887			
North America commissaries	138,452			
International	17,064			
All others	65,245			
Unallocated corporate assets	195,279			
Accumulated depreciation and amortization	(418,205)			
Net property and equipment	\$ 227,722			

- (1) The Company refined its overhead allocation process in 2018 resulting in transfers of expenses from Unallocated corporate expenses of \$3.4 million to other segments, primarily North America commissaries of \$1.9 million and All others of \$900,000 for the three months ended July 1, 2018. The six months ended July 1, 2018 included transfers of expenses from Unallocated and corporate expenses of \$7.2 million to other segments, primarily North America commissaries of \$4.2 million and All others of \$1.8 million. These allocations were eliminated in consolidation.
- (2) Certain prior year amounts have been reclassified to conform to current year presentation.

Note 11. Reclassifications of Prior Year Balances

As shown in the table below we have reclassified certain prior year amounts within the Condensed Consolidated Statements of Income for the three and six months ended June 25, 2017 in order to conform with current year presentation. These reclassifications had no effect on previously reported total consolidated revenues, total costs and expenses and net income.

Papa John's International, Inc. and Subsidiaries
Condensed Consolidated Statements of Income
Summary of Income Statement Presentation Reclassifications

(In thousands, except per share amounts)	Three Months Ended June 25, 2017		
	As reported	Reclassifications	Adjusted
Revenues:			
North America commissary and other sales (1)	175,204	(15,145)	160,059
International (2)	30,230	(2,985)	27,245
Other revenues (1) (2)	-	18,130	18,130
Costs and expenses:			
North America commissary and other expenses (1)	162,989	(13,517)	149,472
International expenses (2)	19,482	(2,210)	17,272
Other expenses (1) (2) (3)	-	17,482	17,482
General and administrative expenses (3)	42,003	(1,755)	40,248

(In thousands, except per share amounts)	Six Months Ended June 25, 2017		
	As reported	Reclassifications	Adjusted
Revenues:			
North America commissary and other sales (1)	361,449	(30,050)	331,399
International (2)	58,748	(5,881)	52,867
Other revenues (1) (2)	-	35,931	35,931
Costs and expenses:			
North America commissary and other expenses (1)	336,701	(27,272)	309,429
International expenses (2)	37,472	(4,409)	33,063
Other expenses (1) (2) (3)	-	35,029	35,029
General and administrative expenses (3)	80,010	(3,348)	76,662

- (1) Includes reclassification of previous amounts reported in North America commissary and other sales and expenses including print and promotional items, information systems and related services used in restaurant operations, including our point of sale system, online and other technology-based ordering platforms.
- (2) Includes reclassification of previous amounts reported in International related to advertising expenses and rental income and expenses for United Kingdom head leases which are subleased to United Kingdom franchisees.
- (3) Includes reclassification of various technology related expenditures for fee-based services discussed in (1) above and advertising expenses to be consistent with 2018 presentation.

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. As of July 1, 2018, there were 5,247 Papa John’s restaurants (678 Company-owned and 4,569 franchised) operating in all 50 states and 46 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.

Recent Developments and Trends

Background on the Recent Negative Publicity

We have recently experienced negative publicity and consumer sentiment as a result of statements and actions by the Company’s founder and former spokesperson John H. Schnatter, which have materially and negatively impacted our sales. The Company believes that the negative response to Mr. Schnatter’s recent statements and actions has been intensified due to Mr. Schnatter’s previous controversial statements and actions, including his statements in the fourth quarter of 2017 regarding his opinion that the National Football League (“NFL”) mishandled player protests during the national anthem. The Company is working to address these issues through its appointment of the Special Committee (as described below) together with various brand initiatives, including but not limited to, a new advertising and marketing campaign.

Mr. Schnatter resigned as Chairman of the Board on July 11, 2018 and a Special Committee of the Board of Directors consisting of all of the independent directors (the “Special Committee”) was formed on July 15, 2018 to evaluate and take action with respect to all of the Company’s relationships and arrangements with Mr. Schnatter. Following its formation, the Special Committee terminated Mr. Schnatter’s Founder Agreement, which defined his role in the Company, among other things, as advertising and brand spokesperson for the Company. The Special Committee is also overseeing the previously announced external audit and investigation of all the Company’s existing processes, policies and systems related to diversity and inclusion, supplier and vendor engagement and Papa John’s culture. On July 17, 2018, the Company announced that the Special Committee appointed Akin Gump Strauss Hauer & Feld LLP to oversee the cultural audit and investigation. This audit and investigation is ongoing. In addition, on July 27, 2018, the Company announced that the Board’s Lead Independent Director, Olivia F. Kirtley, had been unanimously appointed by the Board of Directors to serve as Chairman of the Company’s Board of Directors. The Company is working to ensure that its corporate values of equity, diversity and inclusion are upheld throughout the organization and to address the challenges created by Mr. Schnatter’s words and actions.

Comparable Sales Trends. In addition to the above actions, the Company is implementing various brand initiatives, including but not limited to, a new advertising and marketing campaign. Still, the recent negative publicity caused by Mr. Schnatter’s statements and actions has impacted the Company’s brand and July sales in North America. Our North America comparable sales for the July period decreased approximately 10.5%. At this time, the Company cannot predict how long and the extent to which the negative customer sentiment will continue to impact future sales.

Future Costs. The Company also expects to incur significant costs as a result of the recent events that include, but are not limited to, the following:

- re-imaging costs at nearly all domestic and international restaurants,
- costs to accelerate our replacement of certain branded assets and related marketing efforts,
- financial assistance to domestic franchisees, such as short-term royalty reductions, in an effort to mitigate closings,
- additional costs for branding initiatives, including but not limited to, launching a new advertising and marketing campaign and promotional activities to mitigate negative consumer sentiment and negative sales trends,

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- costs associated with a third-party audit of the culture at Papa John's commissioned by the Special Committee as well as costs associated with implementing new policies and procedures to address any findings as a result of the audit, and
- additional legal and advisory costs, including costs associated with the activities of the Special Committee.

The Company is still gathering information regarding these costs but has developed a preliminary range of \$30 million to \$50 million for the remainder of 2018.

Presentation of Financial Results

The results of operations for the three and six months ended July 1, 2018 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, 2 and 3" 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	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
North America Company-owned:				
Beginning of period	679	705	708	702
Opened	1	—	5	2
Closed	(2)	—	(4)	—
Acquired from franchisees	—	—	—	1
Sold to franchisees	—	—	(31)	—
End of period	678	705	678	705
International Company-owned:				
Beginning of period	34	41	35	42
Closed	—	(2)	(1)	(3)
Sold to franchisees	(34)	—	(34)	—
End of period	—	39	—	39
North America franchised:				
Beginning of period	2,745	2,723	2,733	2,739
Opened	26	28	44	43
Closed	(42)	(28)	(79)	(58)
Acquired from Company	—	—	31	—
Sold to Company	—	—	—	(1)
End of period	2,729	2,723	2,729	2,723
International franchised:				
Beginning of period	1,754	1,613	1,723	1,614
Opened	61	49	114	87
Closed	(9)	(41)	(31)	(80)
Acquired from Company	34	—	34	—
End of period	1,840	1,621	1,840	1,621
Total restaurants - end of period	5,247	5,088	5,247	5,088

Item Impacting Comparability; Non-GAAP Measures

The following table reconciles our GAAP financial results to the adjusted (non-GAAP) financial results, excluding the Special items detailed below. We present these non-GAAP measures because we believe the Special items impact the comparability of our results of operations. For additional information about the Special items, see “Note 7” of “Notes to Condensed Consolidated Financial Statements.”

	Three Months Ended		Six Months Ended	
	July 1, 2018	June 25, 2017	July 1, 2018	June 25, 2017
(In thousands, except per share amounts)				
GAAP Income before income taxes	\$ 19,705	\$ 35,458	\$ 42,067	\$ 77,329
Special items:				
Refranchising losses, net	2,122	—	1,918	—
Adjusted income before income taxes	\$ 21,827	\$ 35,458	\$ 43,985	\$ 77,329
GAAP Net income	\$ 11,791	\$ 23,538	\$ 28,528	\$ 51,966
Special items:				
Refranchising losses, net (1)	1,647	—	1,488	—
Tax impact of China refranchising	2,435	—	2,435	—
Adjusted net income	\$ 15,873	\$ 23,538	\$ 32,451	\$ 51,966
GAAP Diluted earnings per share	\$ 0.36	\$ 0.65	\$ 0.86	\$ 1.42
Special items:				
Refranchising losses, net	0.05	—	0.05	—
Tax impact of China refranchising	0.08	—	0.07	—
Adjusted diluted earnings per share	\$ 0.49	\$ 0.65	\$ 0.98	\$ 1.42

(1) Tax effect was calculated using the Company’s marginal rate of 22.4%.

On June 15, 2018, we refranchised our China operations including our 34 Company-owned restaurants and the quality control center. The refranchising losses, net of tax, of \$1.6 million for the second quarter of 2018 and \$1.5 million for the six months ended July 1, 2018 primarily occurred due to the China refranchise. We also had \$2.4 million of additional tax expense associated with the China refranchise. This additional tax expense is primarily attributable to the required recapture of operating losses previously taken by the Company. See “Results of Operations” for further analysis regarding the impact of the Special items.

The non-GAAP adjusted results shown above should not be construed as a substitute for or a better indicator of the Company’s performance than the Company’s GAAP results. Management believes presenting the financial information excluding these Special items is important for purposes of comparison to prior year results. In addition, management uses these metrics to evaluate the Company’s underlying operating performance, to analyze trends, and to determine compensation.

Results of Operations

Revenue Recognition and Income Statement Presentation

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP, including industry-specific requirements, and provides companies with a single revenue recognition framework for recognizing revenue from contracts with customers. 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):

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Identifying Performance Obligations and Licensing”. This update and subsequently issued amendments (collectively “Topic 606”) 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. The standard requires that we assess contracts to determine each separate and distinct performance obligation. If a contract has multiple performance obligations, we allocate the transaction price using our best estimate of the standalone selling price to each distinct good or service in the contract.

We adopted Topic 606 using the modified retrospective transition method effective January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605, Revenue Recognition.

The cumulative effect adjustment of \$21.5 million was recorded as a reduction to retained earnings as of January 1, 2018 to reflect the impact of adopting Topic 606. The impact of applying Topic 606 for the three and six months ended July 1, 2018 included the following (dollars in thousands, except for per share amounts):

	Three Months Ended July 1, 2018	Six Months Ended July 1, 2018
Total revenue impact (a)	\$ 1,814	\$ 4,250
Pre-tax income impact (b)	(1,375)	(1,860)
Diluted EPS	(0.03)	(0.04)

- (a) The increase in total revenues of \$1.8 million and \$4.3 million for the three and six months ended July 1, 2018 is primarily due to the requirement to present revenues and expenses related to marketing funds we control on a “gross” basis. This increase was partially offset by lower Company-owned restaurant revenues attributable to the revised method of accounting for the loyalty program. The marketing fund gross up is reported in the new financial statement line items, Other revenues and Other expenses, as discussed further below.
- (b) The \$1.4 million and \$1.9 million decreases in pre-tax income for the three and six months ended July 1, 2018 are primarily due to the revised method of accounting for the loyalty program, marketing fund co-ops we control and franchise fees.

While not required as part of the adoption of Topic 606, our income statement includes newly created Other revenues and Other expenses line items. Other revenues and Other expenses include the Topic 606 “gross up” of respective revenues and expenses derived from certain domestic and international marketing fund co-ops we control, as previously discussed. Additionally, Other revenues and Other expenses include various reclassifications from North America Commissary and Other, International and general and administrative expenses to better reflect and aggregate various domestic and international services provided by the Company for the benefit of franchisees. Related 2017 amounts have also been reclassified to conform to the new 2018 presentation. These reclassifications had no impact on total revenues or total costs and expenses reported.

Review of Consolidated Operating Results

Revenues. Domestic Company-owned restaurant sales decreased \$21.4 million, or 10.5%, and \$38.0 million, or 9.3%, for the three and six months ended July 2018, respectively. These decreases were primarily due to reductions of 7.2% and 6.7% in comparable sales and reductions of 3.6% and 2.4% in equivalent units for the three and six months ended July 1, 2018, respectively, driven by the refranchising of the Denver market in the first quarter of 2018. “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 decreased \$2.7 million, or 10.1%, and \$5.5 million, or 10.1%, for the three and six months ended July 1, 2018, respectively, primarily due to comparable sales decreases of 5.7% and 5.3% for the three and six months ended July 1, 2018, respectively, and an increase in franchise royalty waivers. North America

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franchise restaurant sales decreased 4.6% to \$539.7 million and 4.8% to \$1.1 billion for the three and six months ended July 1, 2018, respectively. North America franchise restaurant sales are not included in Company revenues; however, our North America franchise royalties are derived from these sales.

North America commissary sales decreased \$6.6 million, or 4.1%, and \$16.2 million, or 4.9%, for the three and six months ended July 1, 2018, respectively. The decreases were primarily due to lower sales volumes attributable to lower restaurant sales, partially offset by higher commodity pricing.

International revenues increased \$1.8 million, or 6.7%, and \$6.3 million, or 11.9%, for the three and six months ended July 1, 2018, respectively. These increases were primarily due to an increase in equivalent units and the favorable impact of foreign exchange rates for the three and six months ended July 1, 2018. The favorable impacts of foreign currency exchange rates were approximately \$1.2 million and \$4.0 million for the three and six months ended July 1, 2018 which was primarily attributable to foreign exchange rates in the United Kingdom (“UK”).

International franchise restaurant sales increased 12.7% to \$207.0 million and 12.4% to \$415.5 million in the three and six months ended July 1, 2018, respectively, excluding the impact of foreign currency. The increases for the three and six-month periods were primarily due to an increase in equivalent units. International franchise restaurant sales are not included in Company revenues; however, our international royalty revenue is derived from these sales.

Other revenues increased \$2.0 million, or 11.1%, and \$4.7 million, or 13.1%, for the three and six months ended July 1, 2018, respectively. The increases were primarily due to the required 2018 reporting of franchise marketing fund revenues and expenses on a gross basis for the various funds we control in accordance with Topic 606 guidelines. These amounts were previously reported on a net basis. As we did not restate the 2017 amounts in accordance with our adoption of Topic 606 guidelines using the modified retrospective approach, comparability between 2018 and 2017 amounts is reduced. See “Note 3” of “Notes to Condensed Consolidated Financial Statements” for more details. This increase was partially offset by lower revenues for Preferred Marketing Solutions, our print and promotions subsidiary.

Costs and expenses. The operating margin for domestic Company-owned restaurants was 18.5% and 17.9% for the three and six months ended July 1, 2018, respectively, compared to 19.9% and 20.0% in the corresponding 2017 periods, and consisted of the following (dollars in thousands):

	Three months ended				Six months ended			
	July 1, 2018		June 25, 2017		July 1, 2018		June 25, 2017	
Restaurant sales	\$ 181,379		\$ 202,756		\$ 371,621		\$ 409,652	
Cost of sales	39,438	21.7%	46,202	22.8%	82,583	22.2%	93,114	22.7%
Other operating expenses	108,343	59.7%	116,231	57.3%	222,517	59.9%	234,738	57.3%
Total expenses	<u>\$ 147,781</u>	<u>81.5%</u>	<u>\$ 162,433</u>	<u>80.1%</u>	<u>\$ 305,100</u>	<u>82.1%</u>	<u>\$ 327,852</u>	<u>80.0%</u>
Margin	\$ 33,598	18.5%	\$ 40,323	19.9%	\$ 66,521	17.9%	\$ 81,800	20.0%

Domestic Company-owned restaurants margin decreased \$6.7 million and \$15.3 million in the three and six months ended July 1, 2018, respectively. The margin decreases for the second quarter and six-month period were primarily attributable to lower comparable sales of 7.2% and increased operating costs including higher commodities and minimum wages as well as increased non-owned automobile costs. Additionally, the adoption of Topic 606 reduced restaurant operating margin due to the revised method of accounting for the customer loyalty program.

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North America commissary margins were 6.6% and 6.4% for the three and six months ended July 1, 2018, respectively, compared to 6.6% for both the three and six months ended June 25, 2017 and consisted of the following (dollars in thousands):

	Three months ended			
	July 1, 2018		June 25, 2017	
North America commissary sales	\$	153,455	\$	160,059
North America commissary expenses		143,300		149,472
Margin	\$	10,155	6.6%	\$ 10,587 6.6%

	Six months ended			
	July 1, 2018		June 25, 2017	
North America commissary sales	\$	315,168	\$	331,399
North America commissary expenses		294,981		309,429
Margin	\$	20,187	6.4%	\$ 21,970 6.6%

North America commissary operating margins were consistent as a percentage of sales for the three and six months ended July 1, 2018, compared to the corresponding periods in 2017, but decreased \$400,000 and \$1.8 million, respectively, primarily due to lower sales volumes.

The international operating margins were 37.2% and 37.0% for the three and six months ended July 1, 2018, compared to 36.6% and 37.5% for the corresponding 2017 periods and consisted of the following (dollars in thousands):

	Three months ended							
	July 1, 2018				June 25, 2017			
	Revenues	Expenses	Margin \$	Margin %	Revenues	Expenses	Margin \$	Margin %
Franchise royalties and fees	\$ 8,987	\$ -	\$ 8,987		\$ 8,195	\$ -	\$ 8,195	
Restaurant, commissary and other	20,082	18,248	1,834	9.1%	19,050	17,272	1,778	9.3%
Total international	\$ 29,069	\$ 18,248	\$ 10,821	37.2%	\$ 27,245	\$ 17,272	\$ 9,973	36.6%

	Six months ended							
	July 1, 2018				June 25, 2017			
	Revenues	Expenses	Margin \$	Margin %	Revenues	Expenses	Margin \$	Margin %
Franchise royalties and fees	\$ 17,969	\$ -	\$ 17,969		\$ 16,131	\$ -	\$ 16,131	
Restaurant, commissary and other	41,214	37,278	3,936	9.6%	36,736	33,063	3,673	10.0%
Total international	\$ 59,183	\$ 37,278	\$ 21,905	37.0%	\$ 52,867	\$ 33,063	\$ 19,804	37.5%

The increase in margin of approximately \$800,000 and \$2.1 million for the three and six months ended July 1, 2018, respectively, was primarily attributable to higher royalties on increased franchise restaurant sales, primarily due to an increase in equivalent units and higher income from the United Kingdom Quality Control Center.

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As previously discussed, other revenues and other expenses are new financial statement line items in 2018. The margin from Other operations decreased \$1.2 million and \$1.9 million for the three and six months ended July 1, 2018, respectively, primarily due to higher costs related to various technology initiatives and increased advertising spend in the United Kingdom. The Other revenues and expenses consisted of the following for the three and six months ended July 1, 2018 (dollars in thousands):

	Three months ended			
	July 1, 2018		June 25, 2017	
Other revenues	\$	20,144	\$	18,130
Other expenses		20,698		17,482
Margin (loss)	\$	(554)	-2.8%	\$ 648 3.6%

	Six months ended			
	July 1, 2018		June 25, 2017	
Other revenues	\$	40,638	\$	35,931
Other expenses		41,656		35,029
Margin (loss)	\$	(1,018)	-2.5%	\$ 902 2.5%

Operating margin is not a measurement defined by GAAP and should not be considered in isolation, or as an alternative to evaluation of the Company's financial performance. In addition to an evaluation of GAAP consolidated income before income taxes, we believe the presentation of operating margin is beneficial as it represents an additional measure used by the Company to further evaluate operating efficiency and performance of the various business units. Additionally, operating margin discussion may be helpful for comparison within the industry. The operating margin results detailed herein can be calculated by business unit based on the specific revenue and operating expense line items on the face of the Condensed Consolidated Income Statement. Consolidated income before income taxes reported includes general and administrative expenses, depreciation and amortization, refranchising losses and net interest expense that have been excluded from this operating margin calculation.

General and administrative ("G&A") expenses were \$38.7 million, or 9.5%, and \$78.4 million, or 9.4% of revenues for the three and six months ended July 1, 2018, respectively, compared to \$40.2 million, or 9.3% and \$76.7 million, or 8.7% for the corresponding 2017 periods, respectively. The decrease of \$1.5 million was primarily due to lower management incentive and benefit costs as well as a shift in timing of the annual operators' conference to the third quarter of 2018. These costs were partially offset by an increase in various technology initiative costs and higher bad debt expense. The increase of \$1.8 million for the six months period was due to an increase in various technology initiatives costs, and higher bad debt expenses and legal fees.

Depreciation and amortization. Depreciation and amortization was \$11.7 million, or 2.9% and \$23.3 million, or 2.8% of revenues for the three and six months ended July 1, 2018, respectively, compared to \$10.7 million, or 2.5% and \$21.1 million, or 2.4% of revenues for the corresponding periods in 2017, respectively. These increases are primarily due to additional depreciation on technology related investments and higher depreciation associated with our new Georgia Quality Control Center.

Refranchising losses, net. Refranchising losses of \$2.1 million and \$1.9 million for the three and six months ended July 1, 2017, respectively, were primarily related to the refranchising of China. For additional information on the refranchising loss, net, see "Note 7" of "Notes to Condensed Consolidated Financial Statements."

Interest expense. Interest expense increased approximately \$3.9 million and \$7.0 million for the three and six months ended July 1, 2018, respectively, primarily due to both an increase in average outstanding debt balance, which is primarily due to share repurchases, as well as higher interest rates.

Income before income taxes. For the reasons discussed above, income before income taxes decreased approximately \$15.8 million, or 44.4% for the three months ended July 1, 2018 compared to the same periods in 2017, and decreased approximately \$35.3 million, or 45.6% for the six months ended July 1, 2018 as compared to the same period in 2017.

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Income tax expense. The effective income tax rates were 35.7% and 28.6% for the three and six months ended July 1, 2018, respectively, representing an increase of 6.2% and a decrease of 0.5% from the prior year comparable periods. The increase for the three-month period ending July 1, 2018 was due to the additional income tax from the China refranchising, as previously discussed. See “Note 7” of “Notes to Condensed Consolidated Financial Statements” for additional information. Excluding the China refranchising impact of 12.4% and 5.8%, the effective income tax rates were 23.4% and 22.8% for the three and six months ended July 1, 2018.

Diluted earnings per share. Diluted earnings per share decreased 44.6% to \$0.36 for the second quarter of 2018 and decreased 39.4% to \$0.86 for the six months ended July 1, 2018. Adjusted diluted earnings per share decreased 24.6% to \$0.49 for the second quarter of 2018 and 31.0% to \$0.98 for the six months ended.

Liquidity and Capital Resources

Debt

Our outstanding debt of \$579.4 million at July 1, 2018 represented amounts outstanding under our credit agreement executed in August 2017. The credit agreement provides for an unsecured revolving credit facility in an aggregate principal amount of \$600.0 million (the “Revolving Facility”) and an unsecured term loan facility in an aggregate principal amount of \$400.0 million (the “Term Loan Facility” and together with the Revolving Facility, the “Facilities”). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to \$300.0 million, subject to certain conditions. Our outstanding debt of \$579.4 million as of July 1, 2018 under the Facilities was composed of \$385.0 million outstanding under the Term Loan Facility and \$194.4 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately \$371.8 million as of July 1, 2018. In connection with the credit agreement, the Company capitalized \$3.2 million of debt issuance costs, which are being amortized into interest expense, over the term of the Facilities.

Loans under the Facilities accrue interest at a per annum rate equal to, at the Company’s election, either a LIBOR rate plus a margin ranging from 75 to 200 basis points or a base rate (generally determined by a prime rate, federal funds rate or a LIBOR rate plus 1.00%) plus a margin ranging from 0 to 100 basis points. In each case, the actual margin is determined according to a ratio of the Company’s total indebtedness to earnings before interest, taxes, depreciation and amortization (“EBITDA”) for the then most recently ended four-quarter period (the “Leverage Ratio”). An unused commitment fee at a rate ranging from 15 to 30 basis points per annum, determined according to the Leverage Ratio, applies to the unutilized commitments under the Revolving Facility. Loans outstanding under the credit agreement may be prepaid at any time without premium or penalty, subject to customary breakage costs in the case of borrowings for which a LIBOR rate election is in effect. Up to \$35.0 million of the Revolving Facility may be advanced in certain agreed foreign currencies, including Euros, Pounds Sterling, Canadian Dollars, Japanese Yen, and Mexican Pesos.

We use interest rate swaps to hedge against the effects of potential interest rate increases on borrowings under our Facilities. As of July 1, 2018, we have the following interest rate swap agreements, including three forward starting swaps executed in 2015 that became effective on April 30, 2018 upon expiration of the two existing swaps for \$125 million. In addition, in 2017 we executed an additional four interest rate swaps for \$275 million that became effective on January 30, 2018.

Effective Dates	Floating Rate Debt	Fixed Rates
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 %
January 30, 2018 through August 30, 2022	\$ 100 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	2.00 %
January 30, 2018 through August 30, 2022	\$ 25 million	1.99 %

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Our credit agreement contains affirmative and negative covenants, including the following financial covenants, as defined by the credit agreement:

	<u>Permitted Ratio</u>	<u>Actual Ratio for the Quarter Ended July 1, 2018</u>
Leverage Ratio	Not to exceed 4.5 to 1.0	3.4 to 1.0
Interest Coverage Ratio	Not less than 2.75 to 1.0	3.4 to 1.0

As stated above, our leverage ratio is defined as outstanding debt divided by consolidated EBITDA for the most recent four fiscal quarters. Subsequent to the end of the second quarter of 2018, the Leverage Ratio permitted decreased to 4.25 to 1.00 in accordance with the terms of the credit agreement. The Leverage Ratio permitted by the credit agreement will decrease over time to 3.75 to 1.00.

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 financial covenants as of July 1, 2018. Based on our revised lower financial forecast, we plan to work with the banks within our Credit Facility to evaluate options with the covenants to mitigate the possibility of violating a financial covenant in the future. If a covenant violation occurs or is expected to occur, we would be required to seek a waiver or amendment from the lenders under the credit agreement. The failure to obtain a waiver or amendment on a timely basis would result in our inability to borrow additional funds or obtain letters of credit under our credit agreement and allow the lenders under our credit agreement to declare our loan obligations due and payable, require us to cash collateralize outstanding letters of credit or increase our interest rate. If any of the foregoing events occur, we would need to refinance our debt, or renegotiate or restructure, the terms of the credit agreement.

Cash Flows

Cash flow provided by operating activities was \$74.2 million in the six months ending July 1, 2018 compared to \$77.9 million in the corresponding period in 2017. The decrease of approximately \$3.7 million was primarily due to lower net income somewhat offset by favorable changes in working capital items.

Our free cash flow, a non-GAAP financial measure, was as follows in the second quarter of 2018 and 2017 (in thousands):

	<u>Six Months Ended</u>	
	<u>July 1, 2018</u>	<u>June 25, 2017</u>
Net cash provided by operating activities	\$ 74,201	\$ 77,863
Purchases of property and equipment	(21,562)	(30,457)
Free cash flow (a)	<u>\$ 52,639</u>	<u>\$ 47,406</u>

- (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 discretionary 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 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 or performance than the Company's GAAP measures.

Cash flow used in investing activities was \$16.9 million in the six months ending July 1, 2018 compared to \$29.8 million for the same period in 2017, or a decrease of \$12.9 million. The decrease in cash flow used in investing activities was primarily lower capital spend as 2017 included construction costs for our commissary in Georgia, which opened in July of 2017. We also received \$3.7 million in proceeds from the refranchising of our joint venture in Denver, Colorado which was completed in the first quarter of 2018.

We also require capital for share repurchases and the payment of cash dividends, which are funded by cash flow from operations and borrowings from our credit agreement. In the six months ending July 1, 2018, we had net proceeds of \$109.4 million from the issuance of long-term debt and spent \$148.4 million on share repurchases. In the six months ending June 25, 2017, we had net proceeds of \$5.2 million from issuance of long-term debt and spent \$34.0 million of share repurchases.

On March 1, 2018 the Company announced a \$100 million accelerated share repurchase agreement (“ASR Agreement”) with Bank of America, N.A. (“BofAML”). Pursuant to the terms of the ASR Agreement, we paid BofAML \$100 million in cash. On March 6, 2018, we received an initial delivery of approximately 1.3 million shares of common stock for approximately \$78.0 million, or 78% of the total ASR Agreement. The remaining \$22.0 million of the ASR Agreement was completed May 14, 2018, delivering approximately 400,000 additional shares. Under the completed ASR Agreement, approximately 1.7 million shares were repurchased for \$100.0 million.

The Company does not expect to repurchase any more shares in 2018 after the current trading plan expires in early August.

We paid cash dividends of approximately \$14.8 million (\$0.45 per common share) and \$14.7 million (\$0.40 per common share) for the six months ended July 1, 2018 and June 25, 2017, respectively. Subsequent to the second quarter on August 1, 2018, our Board of Directors declared a third quarter dividend of \$0.225 per common share (approximately \$7.2 million based on the number of shares outstanding). The dividend will be paid on August 24, 2018 to shareholders of record as of the close of business on August 13, 2018. 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,” “forecast,” “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, cash flow, contingent liabilities, resolution of litigation, commodity costs, profit margins, unit growth, unit level performance, capital expenditures, ability of the Company to mitigate negative consumer sentiment through advertising, marketing and promotional activity, corporate governance, shareholder and other stakeholder engagement, strategic decisions and actions, the ongoing cultural audit and investigation, share repurchases, dividends, effective tax rates, the impact of the Tax Cuts and Job Act and the adoption of new accounting standards, 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:

- negative publicity and consumer sentiment as a result of statements and actions by the Company’s founder and former spokesperson, which may continue to cause sales to decline and/or change consumers’ acceptance of and enthusiasm for our brand;
- the results of the previously announced external audit and investigation the Special Committee is overseeing regarding the Company’s existing processes, policies and systems related to diversity and inclusion, supplier and vendor engagement and the Company’s culture;
- costs the Company expects to incur as a result of the recent negative publicity and negative consumer sentiment, including costs related to the audit and investigation, costs associated with the operations of the Special Committee, any costs associated with related litigation, legal fees, and increased costs for branding initiatives and launching a new advertising and marketing campaign and promotions to mitigate negative consumer sentiment and negative sales trends;
- costs the Company expects to incur relating to franchisee financial assistance to mitigate store closings;

- the ability of the Company to mitigate the negative consumer sentiment through advertising, marketing and promotional activities;
- the Company's ability to regain lost customers;
- 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 the growing popularity of delivery aggregators, as well as 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;
- the effectiveness of our initiatives to improve our brand proposition and operating results, including marketing, advertising and public relations initiatives, technology investments and changes in unit-level operations;
- the risk that any new advertising or marketing campaign may not be effective in increasing sales;
- 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 vehicles, 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 and our ability to comply with current, proposed or future legislation that could impact our business including compliance with the European Union General Data Protection Regulation;
- maintaining compliance with debt covenants under our credit agreement if restaurant sales and operating results continue to decline, and our ability to obtain a waiver or modification to the credit agreement from our lenders if we are unable to maintain compliance;
- failure to effectively execute succession planning;
- 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;
- changes in Federal or state income, general and other tax laws, rules and regulations, including changes from the Tax Cuts and Jobs Act and any related Treasury regulations, rules or interpretations if and when issued; and
- changes in generally accepted accounting principles including new standards for revenue recognition and leasing.

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 fiscal year ended December 31, 2017, as updated by "Part II. Item 1A. – Risk Factors" in this Quarterly Report on Form 10-Q, 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our outstanding debt of \$579.4 million at July 1, 2018 represented amounts outstanding under our credit agreement executed in August 2017. Our credit agreement provides for an unsecured revolving credit facility in an aggregate

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principal amount of \$600.0 million (the “Revolving Facility”) and an unsecured term loan facility in an aggregate principal amount of \$400.0 million (the “Term Loan Facility” and together with the Revolving Facility, the “Facilities”). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to \$300.0 million, subject to certain conditions. Our outstanding debt as of July 1, 2018 under the Facilities of \$579.4 million was composed of \$385.0 million outstanding under the Term Loan Facility and \$194.4 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately \$371.8 million as of July 1, 2018.

Loans under the Facilities accrue interest at a per annum rate equal to, at the Company’s election, either a LIBOR rate plus a margin ranging from 75 to 200 basis points or a base rate (generally determined by a prime rate, federal funds rate or a LIBOR rate plus 1.00%) plus a margin ranging from 0 to 100 basis points. In each case, the actual margin is determined according to a ratio of the Company’s total indebtedness to earnings before interest, taxes, depreciation and amortization (“EBITDA”) for the then most recently ended four quarter period (the “Leverage Ratio”). An unused commitment fee at a rate ranging from 15 to 30 basis points per annum, determined according to the Leverage Ratio, applies to the unutilized commitments under the Revolving Facility. Loans outstanding under the credit agreement may be prepaid at any time without premium or penalty, subject to customary breakage costs in the case of borrowings for which a LIBOR rate election is in effect. Up to \$35.0 million of the Revolving Facility may be advanced in certain agreed foreign currencies, including Euros, Pounds Sterling, Canadian Dollars, Japanese Yen, and Mexican Pesos.

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 that participate in our credit agreement. 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 July 1, 2018, we have the following interest rate swap agreements, including three forward starting swaps executed in 2015 that became effective in April 2018 upon expiration of the two existing swaps for \$125 million. In addition, we executed four additional interest rate swaps for \$275 million that became effective on January 30, 2018.

Effective Dates	Floating Rate Debt	Fixed Rates
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 %
January 30, 2018 through August 30, 2022	\$ 100 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	1.99 %
January 30, 2018 through August 30, 2022	\$ 75 million	2.00 %
January 30, 2018 through August 30, 2022	\$ 25 million	1.99 %

The weighted average interest rate on the borrowings under the credit agreement, including the impact of the interest rate swap agreements, was 3.6% as of July 1, 2018. An increase in the present interest rate of 100 basis points on the line of credit balance outstanding as of July 1, 2018 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 distribution sales to franchised Papa John’s restaurants located in the United Kingdom and Mexico 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 favorable impact on our International revenues of approximately \$1.2 million and \$4.0 million for the three and six months ended July 1, 2018 and a \$2.5 million and \$5.6 million unfavorable impact for the three months and six months ended June 25, 2017. Foreign currency exchange rate fluctuations had no significant impact on income before income taxes for the three and six months ended July 1, 2018 and June 25, 2017.

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The outcome of the June 2016 referendum in the United Kingdom was a vote for the United Kingdom to cease to be a member of the European Union (known as “Brexit”). This resulted in a lower valuation, on a historical basis, 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 July 1, 2018, 29.9% of our total international restaurants are in countries within the European Union.

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 second quarter of 2018 and the projected average block price for cheese by quarter through 2018 (based on the July 31, 2018 Chicago Mercantile Exchange cheese futures market prices):

	<u>2018</u>	<u>2017</u>
	<u>Projected</u>	<u>Actual</u>
	<u>Block Price</u>	<u>Block Price</u>
Quarter 1	\$ 1.522	\$ 1.613
Quarter 2	1.607	1.566
Quarter 3	1.573	1.642
Quarter 4	1.682	1.639
Full Year	<u>\$ 1.596 *</u>	<u>\$ 1.615</u>

*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. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition on our financial statements to facilitate their adoption on January 1, 2018. There were no changes to our internal control over financial reporting that materially affected the Company’s internal control over financial reporting due to the adoption of the new standards.

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 Financial Accounting Standards Board 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. The legal proceedings described in "Note 9" of "Notes to the Condensed Consolidated Financial Statements" are incorporated herein by reference.

Item 1A. Risk Factors

Except as set forth below, there have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017:

We have recently experienced negative publicity and consumer sentiment as a result of statements and actions by the Company's founder and former spokesperson John H. Schnatter, which may continue to negatively impact our results of operations.

In July 2018, the Company was the subject of significant negative media reports as a result of certain statements and actions by Mr. Schnatter, who resigned as Chairman of the Board on July 11, 2018.

As a result of the negative publicity and consumer sentiment, the Company experienced, and expects to continue to experience, a decline in sales. The negative consumer sentiment and declining sales compound the adverse financial and operating impacts the Company has been experiencing since Mr. Schnatter's controversial statements in November 2017. If Mr. Schnatter continues to make statements that harm the Company's reputation, if the negative publicity and negative consumer sentiment toward the Company continues or worsens, or if we are unable to improve the reputation and perception of our brand, our sales can be directly and negatively impacted as a result.

We will incur costs related to addressing and remediating the impact of recent negative publicity surrounding our brand as a result of John H. Schnatter, which will adversely impact our financial performance.

In connection with the controversy surrounding Mr. Schnatter, a Special Committee of the Board of Directors, consisting of all of the independent directors, was formed to evaluate and take action with respect to all of the Company's relationships and arrangements with Mr. Schnatter. Following its formation, the Special Committee terminated Mr. Schnatter's Founder Agreement, which defined his role in the Company, among other things, as advertising and brand spokesperson for the Company. The Special Committee is also overseeing the previously announced external audit and investigation of all the Company's existing processes, policies and systems related to diversity and inclusion, supplier and vendor engagement and Papa John's culture.

In connection with these and other actions, the Company also expects to incur significant non-recurring costs, including costs related to branding initiatives, marketing and advertising expenses and increased professional fees. In addition, the Company expects to materially increase its franchisee financial assistance in an effort to mitigate store closings. These costs and any additional costs we may be required to incur are expected to adversely affect our profitability and financial performance. There is no guarantee that our actions will be effective in attracting customers back to our restaurants and mitigating negative sales trends.

The recent negative publicity has had a negative impact on our business, and we cannot assure it will not have a long-term effect on our business or our relationships with customers, partners and franchisees.

Our business and reputation has been negatively affected by the recent negative publicity resulting from Mr. Schnatter's statements and actions. If we are unable to rebuild the trust of our customers, franchisees, business partners and suppliers, and if further negative publicity continues, we could experience a substantial negative impact on our business. We could also experience additional claims or litigation as a consequence of these recent events.

Our Board of Directors has adopted a limited duration stockholder rights agreement, which could delay or discourage a merger, tender offer, or assumption of control of the Company not approved by our Board of Directors.

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On July 22, 2018, the Board of Directors approved the adoption of a limited duration stockholder rights plan (the “Rights Plan”) with an expiration date of July 22, 2019 and an ownership trigger threshold of 15% (with a threshold of 31% applied to John H. Schnatter, together with his affiliates and family members). In connection with the Rights Plan, the Board of Directors authorized and declared a dividend to stockholders of record at the close of business on August 2, 2018 of one preferred share purchase right (a “Right”) for each outstanding share of common stock of the Company. Upon certain triggering events, each Right entitles the holder to purchase from the Company one one-thousandth (subject to adjustment) of one share of Series A Junior Participating Preferred Stock, \$0.01 par value per share (“Preferred Stock”) of the Company at an exercise price of \$250.00 (the “Exercise Price”) per one one-thousandth of a share of Preferred Stock. In addition, if a person or group acquires beneficial ownership of 15% or more of the Company’s common stock (or in the case of Mr. Schnatter, 31% or more) without prior board approval, each holder of a Right (other than the acquiring person or group whose Rights will become void) will have the right to purchase, upon payment of the Exercise Price and in accordance with the terms of the Rights Plan, a number of shares of the Company’s common stock having a market value of twice the Exercise Price.

The adoption of the Rights Plan is intended to enable all of our stockholders to realize the full potential value of their investment in the Company and to protect the interests of the Company and its stockholders by reducing the likelihood that any person or group gains control of the Company through open market accumulation or other tactics without paying an appropriate control premium. The Rights Plan could render more difficult, or discourage, a merger, tender offer, or assumption of control of the Company that is not approved by our Board of Directors. The Rights Plan, however, should not interfere with any merger, tender or exchange offer or other business combination approved by our Board of Directors. In addition, the Rights Plan does not prevent our Board of Directors from considering any offer that it considers to be in the best interest of the Company’s stockholders.

We are subject to debt covenant restrictions.

Our credit agreement contains affirmative and negative covenants, including financial covenants. Based on our revised lower financial forecast, we plan to work with the banks within our Credit Facility to evaluate options with the covenants to mitigate the possibility of violating a financial covenant in the future. If a covenant violation occurs or is expected to occur, we would be required to seek a waiver or amendment from the lenders under the credit agreement. The failure to obtain a waiver or amendment on a timely basis would result in our inability to borrow additional funds or obtain letters of credit under our credit agreement and allow the lenders under our credit agreement to declare our loan obligations due and payable, require us to cash collateralize outstanding letters of credit or increase our interest rate. If any of the foregoing events occur, we would need to refinance our debt, or renegotiate or restructure, the terms of the credit agreement.

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. Through July 1, 2018, a total of 115.0 million shares with an aggregate cost of \$1.8 billion and an average price of \$15.61 per share have been repurchased under this program. Subsequent to July 1, 2018, through July 31, 2018, we acquired an additional 133,900 shares at an aggregate cost of \$6.5 million. As of July 31, 2018, approximately \$272.8 million remained available for repurchase of common stock under this authorization.

The following table summarizes our repurchases by fiscal period during the second quarter of 2018 (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
4/2/2018 - 4/29/2018	29	\$ 60.24	114,591	\$ 306,033
4/30/2018 - 5/27/2018	371	\$ 59.40	114,962	\$ 284,015

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5/28/2018 - 7/1/2018	90	\$ 52.01	115,052	\$ 279,324
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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. The Company does not expect to repurchase any more shares in 2018 after the current trading plan expires in early August.

During the fiscal quarter ended July 1, 2018, the Company acquired approximately 300 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
3.1	Certificate of Designation of Series A Junior Participating Preferred Stock of Papa John's International, Inc. Exhibit 3.1 to our report on Form 8-K as filed on July 23, 2018 is incorporated herein by reference.
4.1	Rights Agreement dated as of July 22, 2018, by and between Papa John's International, Inc. and Computershare Trust Company, N.A., as rights agent. Exhibit 4.1 to our report on Form 8-K as filed on July 23, 2018 is incorporated herein by reference.
4.2	Form of Rights Certificate. Exhibit 4.2 to our report on Form 8-K as filed on July 23, 2018 is incorporated herein by reference.
10.1	Amendment to Employment Agreement between Papa John's International, Inc. and Steve M. Ritchie effective May 3, 2018.
10.2	Employment Agreement between Papa John's International, Inc. and Joseph H. Smith IV effective May 3, 2018.
10.3	Papa John's International, Inc. 2018 Omnibus Plan. Registration Statement on Form S-8 (Registration No. 333-224770) dated May 9, 2018 is incorporated herein by reference.
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.
101	Financial statements from the quarterly report on Form 10-Q of Papa John's International, Inc. for the quarter ended July 1, 2018, filed on August 7, 2018, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed 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 7, 2018

/s/ Joseph H. Smith, IV
Joseph H. Smith, IV
Senior Vice President, Chief Financial Officer

This Amendment to Employment Agreement (the "Amendment") is entered into as of May 3rd, 2018 by and between Papa John's International, Inc., a Delaware corporation (the "Company") and Stephen M. Ritchie, a resident of the Commonwealth of Kentucky (the "Executive").

RECITALS

A. The Executive and the Company have previously entered into an employment agreement dated March 1, 2015 (the "Employment Agreement").

B. The Executive and the Company now desire to make certain amendments to the Employment Agreement to change the amount of severance payments under the Employment Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing premises and the respective agreements of the Company and the Executive set forth below, the Company and the Executive intending to be legally bound, agree as follows:

1. The reference to "nine months" in Section 10(b)(iii) of the Employment Agreement shall be replaced with "18 months."

2. The reference to "nine months" in Section 10(c) of the Employment Agreement shall be replaced with "18 months."

3. Except as provided in this Amendment, the Employment Agreement will remain in full force and effect.

[Signatures on the following page]

IN WITNESS WHEREOF, Executive and the Company have executed this Amendment on the 3rd day of May, 2018.

PAPA JOHN'S INTERNATIONAL, INC.

By: /s/ Joseph H. Smith

Title: Senior Vice President &

Chief Financial Officer

/s/ Stephen M. Ritchie

Stephen M. Ritchie

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "*Agreement*") is entered into as of May 3, 2018 by and between PAPA JOHN'S INTERNATIONAL, INC., a Delaware corporation (the "*Company*"), and Joseph H. Smith, a resident of Louisville, Kentucky (*Executive*").

RECITALS

A. The Executive has been offered the position of Senior Vice President and Chief Financial Officer of the Company.

B. The Company desires to employ Executive, and Executive wishes to be employed as Senior Vice President and Chief Financial Officer, to be governed by the terms and conditions set forth in this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing premises and the respective agreements of the Company and Executive set forth below, the Company and Executive, intending to be legally bound, agree as follows:

1. *Effective Date.* The terms and conditions of Executive's employment hereunder shall become effective upon May 1, 2018 (the "*Effective Date*").

2. *Employment.* Subject to all the terms and conditions of this Agreement, Executive's period of employment under this Agreement shall be the period commencing on the Effective Date and ending on May 1, 2021 (the "*Third Anniversary Date*"), which term, unless otherwise agreed to by the parties, shall be extended on the Third Anniversary Date and on each anniversary of that date thereafter, for a period of one year (which term together with such extensions, if any, shall be hereinafter defined as the "*Term*"), unless the Executive's employment terminates earlier in accordance with Section 9 hereof. Either party may elect not to renew the Agreement by providing written notice to the other party at least sixty (60) days prior to the expiration of the Term. Thereafter, if Executive continues in the employ of the Company, the employment relationship shall continue to be at will, terminable by either Executive or the Company at any time and for any reason, with or without cause, and subject to such terms and conditions established by the Company from time to time.

3. *Position and Duties.*

(a) *Employment with the Company.* Executive shall be employed as the Senior Vice President and Chief Financial Officer of the Company, and/or such other titles as the Company reasonably may designate, and shall perform such duties and responsibilities as the Company shall reasonably assign to Executive from time to time, including duties and responsibilities relating to the Company's wholly-owned and partially owned subsidiaries and other affiliates.

(b) *Performance of Duties and Responsibilities.* Executive shall serve the Company faithfully and to the best of Executive's ability and shall devote full working time, attention and efforts to the business of the Company during Executive's employment with the Company hereunder. While Executive is employed by the Company during the Term, Executive shall report to the President and Chief Executive Officer of the Company or to such other person as designated by the Chief Executive Officer, Chief Operating Officer or the Board of Directors of the Company (the "*Board*"). Executive hereby represents and confirms that Executive is under no contractual or legal commitments that would prevent Executive from fulfilling Executive's duties and responsibilities as set forth in this Agreement. During Executive's employment with the Company, Executive shall not accept other employment or engage in other material business activity, except as may be approved in writing by the Board. Executive may participate in charitable activities and personal investment activities to a reasonable extent, and Executive may serve as a director of business organizations as approved by the Board, so long as such activities and directorships do not interfere with the performance of Executive's duties and responsibilities hereunder.

4. *Compensation.*

(a) *Base Salary.* As of the Effective Date, the Company shall pay to Executive an annual base salary at the rate of Three Hundred Fifty Thousand (\$350,000) per year, less deductions and withholdings, which base salary shall be paid in accordance with the Company's normal payroll policies and procedures. Executive's base salary shall be reviewed on an annual basis by the Compensation Committee of the Board, at the same time and in the same manner as compensation is reviewed by the Compensation Committee for other officers of the Company generally, to determine whether it should be increased.

(b) *Incentive Bonus and Equity Awards.* Executive shall be entitled to participate in such incentive-based compensation plans or equity-based compensation plans of the Company and its affiliates in effect from time to time for executives of the Company, and as approved by and at the discretion of the Compensation Committee.

In the event of a termination of Executive's Employment by the Company other than for Cause (as defined below), and contingent upon Executive's execution of a full release of claims in the manner set forth in Section 10(g), all options and other equity awards, other than performance-based awards (which shall be governed by the terms of the applicable award agreement) granted under any stock option and stock incentive plans of the Company that are outstanding as of the date of termination shall be credited with an additional 6 months of Service (as defined in the Company's 2011 Omnibus Incentive Plan, referred to herein as the "Plan") for purposes of vesting in such award. Except as specifically set forth herein, all equity awards held by Executive shall continue to be governed by the applicable plan and award agreements, including with respect to Corporate Transactions (as defined in the Plan) and post-termination exercisability of awards.

(c) *Benefits.* Executive shall be entitled to participate in all employee benefit plans and programs of the Company that are available to executive officers generally to the extent that Executive meets the eligibility requirements for each individual plan or program. The Company provides no assurance as to the adoption or continuance of any particular employee benefit plan or program, and Executive's participation in any such plan or program shall be subject to the provisions, rules and regulations applicable thereto.

(d) *Expenses.* The Company shall reimburse Executive for all reasonable and necessary out-of-pocket business, travel and entertainment expenses incurred by Executive in the performance of Executive's duties and responsibilities hereunder, subject to the Company's normal policies and procedures for expenses, expense verification and documentation.

(e) *Vacations and Holidays.* Executive shall be entitled to such vacation and holiday benefits as provided to officers generally, as the Company establishes by policy from time to time. Executive shall coordinate Executive's vacation schedule with the Company so as not to impose an undue burden on the Company.

5. *Affiliated Entities.* As used in this Agreement, "*Company*" shall include the Company and each corporation, limited liability company, partnership, or other entity that is controlled by the Company, or is under common control with the Company (in each case "control" meaning the direct or indirect ownership of 50% or more of all outstanding equity interests), *provided, however*, that the Executive's title need not be identical for each of the affiliated entities nor the same as that for the Company.

6. *Confidential Information and Other Agreements.* Executive agrees to abide by the terms of any and all agreements and obligations to the Company regarding confidentiality, including but not limited to any offer letter, Code of Ethics provision, policy, or the Executive's December 12, 2015 Confidentiality, Non-Disparagement and Dispute Resolution Agreement, all the terms of which are reiterated and incorporated by reference herein, and any successor agreements of similar nature executed by Executive from time to time.

7. *Noncompetition Covenant.* Executive agrees to abide by the terms of Executive's April 26, 2018 Confidentiality and Non-Competition Agreement, which is reiterated and incorporated by reference herein, and any successor agreements of similar nature executed by Executive from time to time.

8. *Intellectual Property.*

(a) *Disclosure and Assignment.* As of the Effective Date, Executive hereby transfers and assigns to the Company (or its designee) all right, title, and interest of Executive in and to every idea, concept, invention, trade secret and improvement (whether patented, patentable or not) conceived or reduced to practice by Executive whether solely or in collaboration with others while Executive is employed by the Company, whether or not conceived or reduced to practice during the regular hours of Executive's employment (collectively, "Creations") and all copyrighted or copyrightable matter created by Executive whether solely or in collaboration with others Executive he is employed by the Company that relates to the Company's business (collectively, "Works") whether or not created during the regular hours of Executive's employment. Executive shall communicate promptly and disclose to the Company, in such form as the Company may request, all information, details, and data pertaining to each Work and Creation. Every copyrightable Work, regardless of whether copyright protection is sought or preserved by the Company, shall be a "work made for hire" as defined in 17 U.S.C. § 101, and the Company shall own all rights in and to such matter throughout the world, without the payment of any royalty or other consideration to Executive or anyone claiming through Executive.

(b) *Trademarks.* All right, title, and interest in and to any and all trademarks, trade names, service marks, and logos adopted, used, or considered for use by the Company during Executive's employment (whether or not developed by Executive) to identify the Company's business or other goods or

services (collectively, the "*Marks*"), together with the goodwill appurtenant thereto, and all other materials, ideas, or other property conceived, created, developed, adopted, or improved by Executive solely or jointly during Executive's employment by the Company and relating to its business shall be owned exclusively by the Company. Executive shall not have, and will not claim to have, any right, title, or interest of any kind in or to the Marks or such other property.

(c) *Documentation.* Executive shall execute and deliver to the Company such formal transfers and assignments and such other documents as the Company may request to permit the Company (or its designee) to file and prosecute, defend and enforce such registration applications and other documents it deems useful to protect or enforce its rights hereunder.

9. *Termination of Employment.*

(a) Executive's employment with the Company shall terminate immediately upon:

(i) Executive's receipt of written notice from the Company of the termination of Executive's employment;

(ii) the Company's receipt of Executive's written or oral resignation from the Company;

(iii) Executive's Disability (as defined in the Plan); or

(iv) Executive's death.

(b) The date upon which Executive's termination of employment with the Company occurs shall be the "*Termination Date*."

10. *Payments upon Termination of Employment.*

(a) If Executive's employment with the Company is terminated by reason of:

(i) Executive's abandonment of Executive's employment or Executive's resignation for any reason (whether or not such resignation is set forth in writing or otherwise communicated to the Company);

(ii) termination of Executive's employment by the Company for Cause (as defined below); or

(iii) termination of Executive's employment by the Company without Cause following expiration of the Term;

the Company shall pay to Executive his or her then-current base salary through the Termination Date and any and all other benefits to which Executive may be entitled under any applicable Company policy, plan or procedure (without duplication of benefits).

(b) Except in the case of a Change in Control, which is governed by Section 10(c) below, if Executive's employment with the Company is terminated by the Company pursuant to Section 9(a)(i) effective prior to the expiration of the Term for any reason other than for Cause (as defined below), then the Company shall pay to Executive, subject to Section 10(g) of this Agreement and in addition to the consideration described in Section 4(b) above, the following amounts:

- (i) Executive's then-current base salary through the Termination Date;
- (ii) pro rata portions of any quarterly and annual non-equity bonus payouts under any non-equity incentive-based compensation plans then in effect (provided that any applicable performance measures are achieved); and
- (iii) the amount of Executive's then current base salary that Executive would have received from the Termination Date through the date that is nine months following such Termination Date.

Any amount payable to Executive pursuant to Section 10(b)(iii) shall be subject to deductions and withholdings and shall be paid to Executive by the Company in the same periodic installments in accordance with the Company's regular payroll practices commencing on the first normal payroll date of the Company following the expiration of all applicable rescission periods provided by law. Any amount payable to Executive pursuant to Section 10(b)(ii) shall be subject to deductions and withholdings and shall be paid to Executive by the Company in the same manner and at the same time that incentive bonus payments are made to current employees of the Company, but no earlier than the first normal payroll date of the Company following the expiration of all applicable rescission periods provided by law and no later than March 15th of the year following the year in which the Termination Date occurs.

(c) If Executive's employment is terminated by the Company without Cause following a Change in Control as defined in this Agreement and before the end of the Term, or if the Executive's employment is terminated by the Executive for Good Reason following a Change in Control and before the end of the Term, then the Company shall pay to Executive, subject to Executive's compliance with Section 10(g) of this Agreement, the lesser of the total of Executive's then current base salary and prorated non-equity incentive bonus payouts as referenced above through the end of the Term of the Agreement, or nine months of Executive's current base salary.

(i) A "*Change of Control*" shall mean that a "Corporate Transaction" as defined in the Plan has taken place during the Term.

(ii) A termination by Executive for "Good Reason" shall mean a termination based on:

(A) the assignment to Executive of different job responsibilities that results in a substantial decrease in the level of responsibility from those in effect immediately prior to the Change of Control;

(B) a material reduction by the Company or the surviving company in Executive's base pay as in effect immediately prior to the Change of Control;

(C) a material reduction by the Company or the surviving company in total benefits available to Executive under cash incentive and other employee benefit plans after the Change

of Control compared to the total package of such benefits as in effect prior to the Change of Control;

(D) the requirement by the Company or the surviving company that Executive be based more than 50 miles from where Executive's office is located immediately prior to the Change of Control, except for required travel on company business to an extent substantially consistent with the business travel obligations which Executive undertook on behalf of the Company prior to the Change of Control; or

(E) the failure by the Company to obtain from any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company ("*Successor*") the assent to this Agreement contemplated by Section 13(g) hereof.

(d) If Executive's employment with the Company is terminated effective prior to the expiration of the Term by reason of Executive's death or Disability, the Company shall pay to Executive or Executive's beneficiary or estate, as the case may be, Executive's then-current base salary through the Termination Date, any earned and unpaid quarterly non-equity incentive bonus for the fiscal quarter preceding the fiscal quarter in which the Termination Date occurs and a pro-rated portion of any quarterly and annual non-equity incentive bonus for the fiscal quarter in which the Termination Date occurs (provided that any applicable performance measures are achieved), based on the number of days during such fiscal quarter that Executive was employed by the Company, payable in the same manner and at the same time that Incentive Bonus payments are made to current employees of the Company but in no event no later than March 15th of the year following the calendar year in which the Termination Date occurs.

(e) "*Cause*" hereunder shall mean:

(i) gross negligence or willful misconduct in connection with the performance of duties;

(ii) conviction of a criminal offense (other than minor traffic offenses) that is, or may reasonably be expected to be, injurious to the Company, its business, reputation, prospects, or otherwise;

(iii) material breach of any term of any agreement between the Executive and the Company, including any employment, consulting or other services, confidentiality, intellectual property, non-competition or non-disparagement agreement;

(iv) acts or omissions involving willful or intentional malfeasance or misconduct that is, or may reasonably be expected to be, injurious to the Company, its business, reputation, prospects, or otherwise; or

(v) commission of any act of fraud or embezzlement against the Company.

(f) "*Disability*" hereunder shall have the same meaning as contained in the Company's Plan.

(g) Notwithstanding any other provision hereof, the Company shall not be obligated to make any payments under Section 10 of this Agreement or any accelerated vesting in equity under Section 4(b) of this Agreement unless Executive has signed a full release of claims against the Company, in a form and scope to be prescribed by the Company, all applicable consideration periods and rescission periods provided by law shall have expired, and Executive is in strict compliance with the terms of this Agreement and any other agreements between the Executive and the Company as of the dates of the payments. Within five business days of the Termination Date, the Employer shall deliver to the Executive the release for the Executive to execute. The Executive will forfeit all rights to accelerated vesting in equity pursuant to Section 4(b) and to the payments provided pursuant to Section 10(b)(ii) and (iii) unless the Executive executes and delivers to the Company the release within 30 days of delivery of the release by the Company to the Executive and such release has become irrevocable by virtue of the expiration of the revocation period without the release having been revoked (the first such date, the "Release Effective Date"). The Company shall have no obligation to provide the payments pursuant to Section 10(b)(ii) and (iii) or the acceleration of equity pursuant to Section 4(b) prior to the Release Effective Date. Payments will commence with the next regular payroll date that occurs more than three business days after the Release Effective Date, with any payment that would have been made but for the Release Effective Date not having occurred being made at that time, provided, however, that if the length of the five business day release delivery date, plus the 30 day or any other applicable review period, plus any revocation period, each as described above or in the release described above, begins in one taxable year and ends in the next taxable year, the Release Effective Date will not occur until the next taxable year.

(h) To the extent the Executive would be subject to the additional 20% tax imposed on certain deferred compensation arrangements pursuant to Section 409A of the Internal Revenue Code of 1986, as amended (the "Code")("Section 409A"), as a result of any provision of this Agreement, such provision shall be deemed amended to the minimum extent necessary to avoid application of such tax and preserve to the maximum extent possible the original intent and economic benefit to the Executive and the Company, and the parties shall promptly execute any amendment reasonably necessary to implement this Section 10(h).

(i) For purposes of Section 409A, the Executive's right to receive installment payments pursuant to this Agreement including, without limitation, each severance shall be treated as a right to receive a series of separate and distinct payments.

(ii) The Executive will be deemed to have a Termination Date for purposes of determining the timing of any payments or benefits hereunder that are classified as deferred compensation only upon a "separation from service" within the meaning of Section 409A.

(iii) Notwithstanding any other provision hereof, to the extent the Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code and the final regulations promulgated thereunder, and any portion of Executive's severance pay is not exempt from Section 409A of the Internal Revenue Code, but would otherwise be payable within the first six (6) months following the date of the Executive's date of termination, such severance pay will not be paid to the Executive until the first payroll date of the seventh (7th) month following the date of termination.

(iv) (A) Any amount that the Executive is entitled to be reimbursed under this Agreement will be reimbursed to the Executive as promptly as practical and in any event not later than the last day of the calendar year after the calendar year in which the expenses are incurred, (B) any right to reimbursement or

in kind benefits will not be subject to liquidation or exchange for another benefit, and (C) the amount of the expenses eligible for reimbursement during any taxable year will not affect the amount of expenses eligible for reimbursement in any other taxable year.

(v) Whenever a payment under this Agreement specifies a payment period with reference to a number of days (e.g., "payment shall be made within thirty (30) days following the date of termination"), the actual date of payment within the specified period shall be within the sole discretion of the Company.

11. *Return of Property.* Upon termination of Executive's employment with the Company, Executive shall deliver promptly to the Company all records, files, manuals, books, forms, documents, letters, memoranda, data, customer lists, tables, photographs, video tapes, audio tapes, computer disks and other computer storage media, and copies thereof, that are the property of the Company, or that relate in any way to the business, products, services, personnel, customers, prospective customers, suppliers, practices, or techniques of the Company, and all other property of the Company (such as, for example, computers, cellular telephones, pagers, credit cards, and keys), whether or not containing Confidential Information, that are in Executive's possession or under Executive's control.

12. *Remedies.* Executive acknowledges that it would be difficult to fully compensate the Company for monetary damages resulting from any breach by Executive of the provisions of Sections 6, 7, 8, and 11 hereof. Accordingly, in the event of any actual or threatened breach of any such provisions, the Company shall, in addition to any other remedies it may have, be entitled to injunctive and other equitable relief to enforce such provisions, and such relief may be granted without the necessity of proving actual monetary damages. Any such action shall only be brought in a court of competent jurisdiction in the Commonwealth of Kentucky, and the parties consent to the jurisdiction, venue and convenience of such courts.

13. *Miscellaneous.*

(a) *Governing Law.* This Agreement shall be governed by, subject to, and construed in accordance with the laws of the Commonwealth of Kentucky without regard to conflict of law principles.

(b) *Dispute Resolution.* The parties agree that to the extent permitted by law, any dispute arising between Executive and Company, including whether any provision of this Agreement has been breached, shall be resolved through confidential mediation or confidential binding arbitration. Any such dispute shall initially be submitted for resolution to a neutral mediator, mutually selected by the parties. If such dispute is not resolved to the satisfaction of the parties, or the parties cannot agree upon a mediator, then it shall be submitted for resolution by a neutral arbitrator, to be mutually selected by the parties from a list provided by the American Arbitration Association, with such resolution to be made pursuant to that organization's then-current Employment (or other applicable) Arbitration Rules and Mediation Procedures. The parties agree that Company shall bear the costs of any mediation or arbitration arising under this Agreement, although each party shall be responsible for its own attorneys' fees. The parties agree to keep confidential both the fact that any mediation/arbitration has or will take place between them, all facts related thereto, and any resolution thereunder. Any resolution reached via mediation or award of an arbitrator shall be final and binding on the parties.

(c) *Entire Agreement.* This Agreement contains the entire agreement of the parties relating to Executive's employment with the Company and supersedes all prior agreements and understandings with

respect to such subject matter, and the parties hereto have made no agreements, representations or warranties relating to the subject matter of this Agreement that are not set forth herein.

(d) *No Violation of Other Agreements.* Executive hereby represents and agrees that neither (i) Executive's entering into this Agreement, (ii) Executive's employment with the Company, nor (iii) Executive's carrying out the provisions of this Agreement, will violate any other agreement (oral, written or other) to which Executive is a party or by which Executive is bound.

(e) *Amendments.* No amendment or modification of this Agreement shall be deemed effective unless made in writing and signed by the parties hereto.

(f) *No Waiver.* No term or condition of this Agreement shall be deemed to have been waived, except by a statement in writing signed by the party against whom enforcement of the waiver is sought. Any written waiver shall not be deemed a continuing waiver unless specifically stated, shall operate only as to the specific term or condition waived and shall not constitute a waiver of such term or condition for the future or as to any act other than that specifically waived.

(g) *Assignment.* This Agreement shall not be assignable, in whole or in part, by either party without the prior written consent of the other party, except that the Company may, without the consent of Executive, assign its rights and obligations under this Agreement (i) to any entity with which the Company may merge or consolidate, or (ii) to any corporation or other person or business entity to which the Company may sell or transfer all or substantially all of its assets. Upon Executive's written request, the Company will seek to have any Successor by agreement assent to the fulfillment by the Company of its obligations under this Agreement. After any assignment by the Company pursuant to this Section 13(g), the Company shall be discharged from all further liability hereunder and such assignee shall thereafter be deemed to be the "Company" for purposes of all terms and conditions of this Agreement.

(h) *Counterparts.* This Agreement may be executed in any number of counterparts, and such counterparts executed and delivered, each as an original, shall constitute but one and the same instrument.

(i) *Severability.* To the extent that any portion of any provision of this Agreement shall be invalid or unenforceable, it shall be considered deleted herefrom and the remainder of such provision and of this Agreement shall be unaffected and shall continue in full force and effect.

(j) *Survival.* The terms and conditions set forth in Sections 6, 7, 8, 9, 11, 12, and 13 of this Agreement, and any other provision that continues by its terms, shall survive expiration of the Term or termination of Executive's employment for any reason.

(k) *Captions and Headings.* The captions and paragraph headings used in this Agreement are for convenience of reference only and shall not affect the construction or interpretation of this Agreement or any of the provisions hereof.

(l) *Notices.* Any notice required or permitted to be given under this Agreement shall be sufficient if in writing and either delivered in person or sent by first class certified or registered mail, postage prepaid, if to the Company, to the Chief Executive Officer at the Company's principal place of business, and if

to Executive, at Executive's home address most recently filed with the Company, or to such other address or addresses as either party shall have designated in writing to the other party hereto.

IN WITNESS WHEREOF, Executive and the Company have executed this Agreement on this 3rd day of May 2018.

PAPA JOHN'S INTERNATIONAL, INC.

By: /s/ Robert W. Smith Jr.

Title: SVP, Human Resources

EXECUTIVE

/s/ Joseph H. Smith

Joseph H. Smith

SECTION 302
CERTIFICATION

I, Steve M. Ritchie, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Papa John's International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2018

/s/ Steve M. Ritchie

Steve M. Ritchie
President and Chief Executive Officer

**SECTION 302
CERTIFICATION**

I, Joseph H. Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Papa John's International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2018

/s/ Joseph H. Smith, IV
Joseph H. Smith, IV
Senior Vice President, Chief Financial Officer

**SECTION 906
CERTIFICATION**

I, Steve M. Ritchie, President and Chief Executive Officer of Papa John's International, Inc. (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The Report on Form 10-Q of the Company for the quarterly period ended July 1, 2018 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 7, 2018

/s/ Steve M. Ritchie
Steve M. Ritchie
President and Chief Executive Officer

**SECTION 906
CERTIFICATION**

I, Joseph H. Smith, Senior Vice President, Chief Financial Officer of Papa John's International, Inc. (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The Report on Form 10-Q of the Company for the quarterly period ended July 1, 2018 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 7, 2018

/s/ Joseph H. Smith, IV
Joseph H. Smith, IV
Senior Vice President, Chief Financial Officer
