

PAPA JOHNS INTERNATIONAL INC  
Form 10-Q  
November 01, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 25, 2011  
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 Johns Boulevard  
Louisville, Kentucky 40299-2367  
(Address of principal executive offices)

(502) 261-7272  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

At October 26, 2011, there were outstanding 24,375,854 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)  | September 25, 2011<br>(Unaudited) | December 26,<br>2010<br>(Note) |
|---|-----------------------------------|--------------------------------|
| Assets  |                                   |                                |
| Current assets:   |                                   |                                |
| Cash and cash equivalents                                   | \$ 23,695                         | \$ 46,225                      |
| Accounts receivable, net                                    | 27,492                            | 25,357                         |
| Inventories   | 17,201                            | 17,402                         |
| Prepaid expenses  | 6,503                             | 10,009                         |
| Other current assets  | 3,839                             | 3,732                          |
| Deferred income taxes                                       | 10,343                            | 9,647                          |
| Total current assets  | 89,073                            | 112,372                        |
| Investments   | 1,681                             | 1,604                          |
| Net property and equipment                                  | 183,184                           | 186,594                        |
| Notes receivable, net                                       | 15,516                            | 17,354                         |
| Goodwill  | 74,871                            | 74,697                         |
| Other assets  | 21,930                            | 23,320                         |
| Total assets  | \$ 386,255                        | \$ 415,941                     |
| Liabilities and stockholders' equity                        |                                   |                                |
| Current liabilities:  |                                   |                                |
| Accounts payable  | \$ 35,465                         | \$ 31,569                      |
| Income and other taxes payable                              | 9,218                             | 6,140                          |
| Accrued expenses  | 53,864                            | 52,978                         |
| Total current liabilities                                   | 98,547                            | 90,687                         |
| Unearned franchise and development fees                     | 6,502                             | 6,596                          |
| Long-term debt  | 50,000                            | 99,017                         |
| Other long-term liabilities                                 | 11,542                            | 12,100                         |
| Deferred income taxes                                       | 7,110                             | 341                            |
| Stockholders' equity:                                       |                                   |                                |
| Preferred stock   | -                                 | -                              |
| Common stock  | 366                               | 361                            |
| Additional paid-in capital                                  | 257,854                           | 245,380                        |
| Accumulated other comprehensive income                      | 1,355                             | 849                            |
| Retained earnings   | 282,826                           | 243,152                        |
| Treasury stock  | (338,092 )                        | (291,048 )                     |
| Total stockholders' equity, net of noncontrolling interests | 204,309                           | 198,694                        |
| Noncontrolling interests in subsidiaries                    | 8,245                             | 8,506                          |
| Total stockholders' equity                                  | 212,554                           | 207,200                        |
| Total liabilities and stockholders' equity                  | \$ 386,255                        | \$ 415,941                     |

Note: The balance sheet at December 26, 2010 has been derived from the audited consolidated financial statements at that date, but does not include all information and footnotes required by accounting principles generally accepted in

the United States for a complete set of financial statements.

See accompanying notes.

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

Consolidated Statements of Income  
(Unaudited)

| (In thousands, except per share amounts)   | Three Months Ended |                | Nine Months Ended |                |
|--|--------------------|----------------|-------------------|----------------|
|  | Sept. 25, 2011     | Sept. 26, 2010 | Sept. 25, 2011    | Sept. 26, 2010 |
| North America revenues:  |                    |                |                   |                |
| Domestic Company-owned restaurant sales  | \$ 128,787         | \$ 120,414     | \$ 395,099        | \$ 374,652     |
| Franchise royalties  | 17,967             | 16,653         | 55,801            | 52,138         |
| Franchise and development fees   | 155                | 149            | 464               | 460            |
| Domestic commissary sales  | 130,870            | 111,884        | 379,569           | 338,460        |
| Other sales  | 12,368             | 12,138         | 38,185            | 39,674         |
| International revenues:  |                    |                |                   |                |
| Royalties and franchise and development fees   | 4,054              | 3,316          | 11,865            | 9,635          |
| Restaurant and commissary sales  | 11,467             | 8,572          | 30,686            | 24,540         |
| Total revenues   | 305,668            | 273,126        | 911,669           | 839,559        |
| Costs and expenses:  |                    |                |                   |                |
| Domestic Company-owned restaurant expenses:  |                    |                |                   |                |
| Cost of sales  | 32,229             | 27,245         | 94,491            | 81,551         |
| Salaries and benefits  | 35,012             | 33,320         | 107,028           | 102,915        |
| Advertising and related costs  | 11,790             | 11,264         | 36,477            | 33,817         |
| Occupancy costs  | 8,496              | 8,494          | 24,304            | 24,264         |
| Other operating expenses   | 18,858             | 18,184         | 57,265            | 54,218         |
| Total domestic Company-owned restaurant expenses   | 106,385            | 98,507         | 319,565           | 296,765        |
| Domestic commissary and other expenses:  |                    |                |                   |                |
| Cost of sales  | 110,387            | 94,422         | 320,359           | 284,909        |
| Salaries and benefits  | 8,840              | 8,533          | 26,502            | 25,833         |
| Other operating expenses   | 13,381             | 12,002         | 40,050            | 35,543         |
| Total domestic commissary and other expenses   | 132,608            | 114,957        | 386,911           | 346,285        |
| Loss (income) from the franchise cheese-purchasing program, net of noncontrolling interest | -                  | 409            | -                 | (4,573 )       |
| International operating expenses   | 9,634              | 7,627          | 26,118            | 21,833         |
| General and administrative expenses  | 27,332             | 27,133         | 84,023            | 83,983         |
| Other general expenses   | 4,777              | 2,643          | 7,017             | 6,620          |
| Depreciation and amortization  | 7,974              | 8,067          | 24,711            | 24,122         |

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|   |           |          |           |           |
|---|-----------|----------|-----------|-----------|
| Total costs and expenses                              | 288,710   | 259,343  | 848,345   | 775,035   |
| Operating income                                      | 16,958    | 13,783   | 63,324    | 64,524    |
| Investment income                                     | 170       | 173      | 552       | 601       |
| Interest expense                                      | (282 )    | (1,416 ) | (1,183 )  | (3,993 )  |
| Income before income taxes                            | 16,846    | 12,540   | 62,693    | 61,132    |
| Income tax expense                                    | 4,906     | 4,020    | 20,151    | 20,545    |
| Net income, including noncontrolling interests        | 11,940    | 8,520    | 42,542    | 40,587    |
| Less: income attributable to noncontrolling interests | (817 )    | (672 )   | (2,868 )  | (2,672 )  |
| Net income, net of noncontrolling interests           | \$ 11,123 | \$ 7,848 | \$ 39,674 | \$ 37,915 |
| Basic earnings per common share                       | \$ 0.45   | \$ 0.30  | \$ 1.57   | \$ 1.43   |
| Earnings per common share - assuming dilution         | \$ 0.44   | \$ 0.30  | \$ 1.55   | \$ 1.42   |
| Basic weighted average shares outstanding             | 24,964    | 25,951   | 25,302    | 26,586    |
| Diluted weighted average shares outstanding           | 25,146    | 26,081   | 25,528    | 26,743    |

See accompanying notes.

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

Consolidated Statements of Stockholders' Equity  
(Unaudited)

| (In thousands)  | Common Stock       |              | Papa John's International, Inc.<br>Accumulated |                                   |                   | Treasury Stock | Noncontrolling Interests<br>in Subsidiaries | Total Stockholders' Equity |
|---|--------------------|--------------|--|-----------------------------------|-------------------|----------------|---|----------------------------|
|   | Shares Outstanding | Common Stock | Additional Paid-In Capital                     | Other Comprehensive Income (Loss) | Retained Earnings |                |   |                            |
| Balance at December 27, 2009  | 26,930             | \$ 358       | \$ 231,720                                     | \$ (1,084 )                       | \$ 191,212        | \$ (245,337)   | \$ 8,168                                    | \$ 185,037                 |
| Comprehensive income:   |                    |              |  |                                   |                   |                |   |                            |
| Net income  | -                  | -            | -  | -                                 | 37,915            | -              | 2,672                                       | 40,587                     |
| Change in valuation of interest rate swap agreements, net of tax of \$973 | -                  | -            | -  | 1,730                             | -                 | -              | -   | 1,730                      |
| Foreign currency translation  | -                  | -            | -  | 34                                | -                 | -              | -   | 34                         |
| Comprehensive income  |                    |              |  |                                   |                   |                |   | 42,351                     |
| Exercise of stock options   | 283                | 2            | 5,017  | -                                 | -                 | 285            | -   | 5,304                      |
| Tax effect of equity awards   | -                  | -            | (63 )  | -                                 | -                 | -              | -   | (63 )                      |
| Acquisition of Company common stock                                       | (1,738 )           | -            | -  | -                                 | -                 | (43,215 )      | -   | (43,215 )                  |
| Net contributions (distributions) - noncontrolling interests              | -                  | -            | -  | -                                 | -                 | -              | (2,907 )                                    | (2,907 )                   |
| Stock-based compensation expense  | -                  | -            | 4,491  | -                                 | -                 | -              | -   | 4,491                      |
| Issuance of restricted stock  | 34                 | -            | (880 )   | -                                 | -                 | 880            | -   | -                          |
| Other   | -                  | -            | 2,206  | -                                 | -                 | 58             | -   | 2,264                      |
| Balance at September 26, 2010   | 25,509             | \$ 360       | \$ 242,491                                     | \$ 680                            | \$ 229,127        | \$ (287,329)   | \$ 7,933                                    | \$ 193,262                 |
| Balance at December 26, 2010  | 25,439             | \$ 361       | \$ 245,380                                     | \$ 849                            | \$ 243,152        | \$ (291,048)   | \$ 8,506                                    | \$ 207,200                 |



Comprehensive  
income:

|   |          |        |            |          |            |              |          |            |
|---|----------|--------|------------|----------|------------|--------------|----------|------------|
| Net income  | -        | -      | -          | -        | 39,674     | -            | 2,868    | 42,542     |
| Change in<br>valuation of interest<br>rate                            |          |        |            |          |            |              |          |            |
| swap agreements,<br>net of tax of \$35                                | -        | -      | -          | 66       | -          | -            | -        | 66         |
| Foreign currency<br>translation                                       | -        | -      | -          | 440      | -          | -            | -        | 440        |
| Comprehensive<br>income   |          |        |            |          |            |              |          | 43,048     |
| Exercise of stock<br>options  | 459      | 5      | 10,976     | -        | -          | -            | -        | 10,981     |
| Tax effect of equity<br>awards  | -        | -      | (1,449 )   | -        | -          | -            | -        | (1,449 )   |
| Acquisition of<br>Company common<br>stock                             | (1,615 ) | -      | -          | -        | -          | (49,579 )    | -        | (49,579 )  |
| Net contributions<br>(distributions) -<br>noncontrolling<br>interests | -        | -      | -          | -        | -          | -            | (3,129 ) | (3,129 )   |
| Stock-based<br>compensation<br>expense                                | -        | -      | 5,266      | -        | -          | -            | -        | 5,266      |
| Issuance of<br>restricted stock                                       | 92       | -      | (2,253 )   | -        | -          | 2,253        | -        | -          |
| Other   | -        | -      | (66 )      | -        | -          | 282          | -        | 216        |
| Balance at<br>September 25, 2011                                      | 24,375   | \$ 366 | \$ 257,854 | \$ 1,355 | \$ 282,826 | \$ (338,092) | \$ 8,245 | \$ 212,554 |

At September 26, 2010, accumulated other comprehensive income of \$680 was comprised of unrealized foreign currency translation gains of \$1,565, partially offset by a net unrealized loss on the interest rate swap agreements of \$833 and a \$52 pension plan liability for PJUK.

At September 25, 2011, accumulated other comprehensive income of \$1,355 was comprised of unrealized foreign currency translation gains of \$1,448, partially offset by a net unrealized loss on the interest rate swap agreement of \$93.

See accompanying notes.

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

| (In thousands)  | Nine Months Ended |                |
|---|-------------------|----------------|
|   | Sept. 25, 2011    | Sept. 26, 2010 |
| Operating activities  |                   |                |
| Net income, net of noncontrolling interests                                       | \$ 39,674         | \$ 37,915      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |                |
| Provision for uncollectible accounts and notes receivable                         | 882               | 1,257          |
| Depreciation and amortization   | 24,711            | 24,122         |
| Deferred income taxes   | 5,219             | (850)          |
| Stock-based compensation expense  | 5,266             | 4,491          |
| Excess tax benefit on equity awards   | (576)             | (242)          |
| Other   | 1,272             | 303            |
| Changes in operating assets and liabilities, net of acquisitions:                 |                   |                |
| Accounts receivable   | (3,071)           | (4,094)        |
| Inventories   | 201               | (525)          |
| Prepaid expenses  | 3,506             | 1,309          |
| Other current assets  | (107)             | 381            |
| Other assets and liabilities  | 491               | (397)          |
| Accounts payable  | 3,896             | (2,119)        |
| Income and other taxes payable  | 3,078             | 5,499          |
| Accrued expenses  | -                 | (5,701)        |
| Unearned franchise and development fees   | (94)              | 810            |
| Net cash provided by operating activities   | 84,348            | 62,159         |
| Investing activities  |                   |                |
| Purchase of property and equipment  | (20,647)          | (23,608)       |
| Purchase of investments   | (205)             | (548)          |
| Proceeds from sale or maturity of investments                                     | 128               | 301            |
| Loans issued  | (2,598)           | (1,736)        |
| Loan repayments   | 4,542             | 2,444          |
| Proceeds from divestitures of restaurants   | -                 | 1,423          |
| Other   | 62                | 10             |
| Net cash used in investing activities   | (18,718)          | (21,714)       |
| Financing activities  |                   |                |
| Net repayments on line of credit facility   | (49,000)          | -              |
| Excess tax benefit on equity awards   | 576               | 242            |
| Tax payments for restricted stock   | (1,041)           | -              |
| Proceeds from exercise of stock options   | 10,981            | 5,304          |
| Acquisition of Company common stock   | (49,579)          | (43,215)       |
| Noncontrolling interests, net of contributions and distributions                  | (261)             | (235)          |
| Other   | 97                | 104            |
| Net cash used in financing activities   | (88,227)          | (37,800)       |

|  |           |           |
|--|-----------|-----------|
| Effect of exchange rate changes on cash and cash equivalents | 67        | 78        |
| Change in cash and cash equivalents                          | (22,530 ) | 2,723     |
| Cash and cash equivalents at beginning of period             | 46,225    | 25,457    |
| Cash and cash equivalents at end of period                   | \$ 23,695 | \$ 28,180 |

See accompanying notes.

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

Notes to Condensed Consolidated Financial Statements  
(Unaudited)

September 25, 2011

## 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 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 accounting principles generally accepted in the United States for complete 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 nine months ended September 25, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ended December 25, 2011. 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 26, 2010.

## 2. Significant Accounting Policies

## Noncontrolling Interests

The Consolidation topic of the Accounting Standards Codification ("ASC") requires all entities to report noncontrolling interests in subsidiaries as equity in the consolidated financial statements, but separate from the equity of the parent company. The Consolidation topic further requires that consolidated net income be reported at amounts attributable to the parent and the noncontrolling interest, rather than expensing the income attributable to the noncontrolling interest holder. Additionally, disclosures are required to clearly identify and distinguish between the interests of the parent company and the interests of the noncontrolling owners, including a disclosure on the face of the consolidated statements for income attributable to the noncontrolling interest holder.

Papa John's had two joint venture arrangements as of September 25, 2011 and September 26, 2010, which were as follows:

|                        | Restaurants | Restaurants | Restaurant            | Papa      | Noncontrolling |    |   |
|------------------------|-------------|-------------|-----------------------|-----------|----------------|----|---|
|                        | as of       | as of       | Locations             | John's    | Interest       |    |   |
|                        | Sept. 25,   | Sept. 26,   |                       | Ownership | Ownership *    |    |   |
|                        | 2011        | 2010        |                       | *         |                |    |   |
| Star Papa, LP          | 75          | 75          | Texas                 | 51        | %              | 49 | % |
| Colonel's Limited, LLC | 52          | 52          | Maryland and Virginia | 70        | %              | 30 | % |

\*The ownership percentages were the same for both the 2011 and 2010 periods presented in the accompanying consolidated financial statements.



The pre-tax income attributable to the joint ventures for the three and nine months ended September 25, 2011 and September 26, 2010 was as follows:

| (In thousands)                     | Three Months Ended |                   | Nine Months Ended |                   |
|------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                    | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| Papa John's<br>International, Inc. | \$ 1,377           | \$ 1,146          | \$ 4,693          | \$ 4,240          |
| Noncontrolling interests           | 817                | 672               | 2,868             | 2,672             |
| Total pre-tax income               | \$ 2,194           | \$ 1,818          | \$ 7,561          | \$ 6,912          |

The noncontrolling interest holders' equity in the joint venture arrangements totaled \$8.2 million as of September 25, 2011 and \$8.5 million as of December 26, 2010.

#### Deferred Income Tax Assets and Tax Reserves

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

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax loss carryforwards. The effect on deferred taxes of changes in tax rates is recognized in the period in which the enactment date changes. As a result, our effective tax rate may fluctuate. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize. As of September 25, 2011, we had a net deferred tax asset balance of \$3.2 million. We have not provided a valuation allowance for the deferred tax assets since we believe it is more likely than not that future earnings will be sufficient to ensure the realization of the net deferred tax assets for federal and state purposes.

Certain tax authorities periodically audit the Company. We provide reserves for potential exposures. We evaluate these issues on a quarterly basis to adjust for events, such as court rulings or audit settlements, which may impact our ultimate payment for such exposures.

#### New Accounting Pronouncements

##### Comprehensive Income

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income: Presentation of Comprehensive Income. In accordance with the new guidance, an entity will no longer be permitted to record comprehensive income in its Consolidated Statements of Stockholders' Equity. Instead, entities will be required to present components of comprehensive income in either one continuous financial statement with two sections, net income and other comprehensive income, or in two separate but consecutive statements. This guidance will be required beginning with our first quarter of fiscal 2012. We do not expect the adoption of this ASU to have any impact on our operating results.

Intangibles – Goodwill and Other

In September 2011, the FASB issued ASU No. 2011-08, Intangibles – Goodwill and Other. The amendments in this update will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. This guidance will be required beginning with our first quarter of fiscal 2012. We do not expect the adoption of this ASU to have a material impact on our operating results.

#### Reclassification of Hawaii, Alaska and Canada

In 2011, we realigned management responsibility and financial reporting for Hawaii, Alaska and Canada from our International business segment to our Domestic franchising segment in order to better leverage existing infrastructure and systems. As a result, we renamed the Domestic franchising segment “North America franchising” in the first quarter of 2011. Certain prior year amounts have been reclassified in our Consolidated Statements of Income and in our segment information to conform to the current year presentation.

#### Subsequent Events

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission in this Form 10-Q. There were no subsequent events that required recognition or disclosure.

### 3. Accounting for Variable Interest Entities

The Consolidation topic of the ASC provides a framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, noncontrolling interests and results of activities of a VIE in its consolidated financial statements.

In general, a VIE is a corporation, partnership, limited liability company, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

Consolidation of a VIE is required if a party with an ownership, contractual or other financial interest in the VIE (“a variable interest holder”) is obligated to absorb a majority of the risk of loss from the VIE’s activities, is entitled to receive a majority of the VIE’s residual returns (if no party absorbs a majority of the VIE’s losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary. Upon consolidation, the primary beneficiary generally must initially record all of the VIE’s assets, liabilities and noncontrolling interests at fair value and subsequently account for the VIE as if it were consolidated based on majority voting interest. The variable interest holder is also required to make disclosures about VIEs in which it has a significant variable interest even when it is not required to consolidate.

Through February 2011, we had a cheese purchasing arrangement with BIBP Commodities, Inc. (BIBP), a special-purpose entity formed at the direction of our Franchise Advisory Council, for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants. BIBP was an independent, franchisee-owned corporation. BIBP purchased cheese at the market price and sold it to our distribution subsidiary, PJ Food Service, Inc. (“PJFS”), at a fixed price. PJFS in turn sold cheese to Papa John’s restaurants (both domestic Company-owned and franchised) at a fixed monthly price. PJFS purchased \$25.1 million of cheese from BIBP for the three months ended March 27, 2011 and purchased \$37.1 million and \$113.6 million of cheese for the three and nine months ended September 26, 2010, respectively. PJFS terminated its purchasing agreement with BIBP in February 2011 as described below.

Prior to the termination of the purchasing agreement with BIBP, we recognized the operating losses generated by BIBP when BIBP’s shareholders’ equity was in a net deficit position. Further, we recognized the subsequent operating income generated by BIBP up to the amount of any losses previously recognized. Prior to ceasing operating activities, BIBP operated at breakeven for the three months ended March 27, 2011. We recognized a pre-tax loss of \$658,000 (\$417,000 net of tax, or \$0.02 per diluted share) and pre-tax income of \$5.5 million (\$3.5 million net of tax, or \$0.13



per diluted share) for the three and nine months ended September 26, 2010, respectively, from the consolidation of BIBP.

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In February 2011, we terminated the purchasing agreement with BIBP and BIBP no longer has operating activities. Over 99% of our domestic franchisees have entered into a cheese purchasing agreement with PJFS. The cheese purchasing agreement requires participating domestic franchisees to purchase cheese through PJFS, or to pay the franchisee's portion of any accumulated cheese liability upon ceasing to purchase cheese from PJFS when a liability exists. The cheese purchasing agreement specifies that PJFS will charge the franchisees a predetermined price for cheese on a monthly basis. Any difference between the amount charged to franchisees and the actual price paid by PJFS for cheese is recorded as a receivable from or a payable to the franchisees, to be repaid based upon a predetermined formula outlined in the agreement.

#### 4. Debt

Our debt is comprised of the following (in thousands):

|                          | Sept. 25,<br>2011 | Dec. 26,<br>2010 |
|--------------------------|-------------------|------------------|
| Revolving line of credit | \$ 50,000         | \$ 99,000        |
| Other                    | -                 | 17               |
| Total long-term debt     | \$ 50,000         | \$ 99,017        |

In September 2010, we entered into a five-year, unsecured Revolving Credit Facility ("New Credit Facility") totaling \$175.0 million that replaced a \$175.0 million unsecured Revolving Credit Facility ("Old Credit Facility"). Under the New Credit Facility, outstanding balances accrue interest at 100.0 to 175.0 basis points over the London Interbank Offered Rate (LIBOR) or other bank-developed rates, at our option. The commitment fee on the unused balance ranges from 17.5 to 25.0 basis points. The increment over LIBOR and the commitment fee are determined quarterly based upon the ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (EBITDA), as defined in the New Credit Facility. Outstanding balances under the Old Credit Facility accrued interest at 50.0 to 100.0 basis points over LIBOR or other bank developed rates, at our option. The commitment fee on the unused balance ranged from 12.5 to 20.0 basis points. The remaining availability under our New Credit Facility, reduced for certain outstanding letters of credit, was \$111.6 million as of September 25, 2011 and \$59.1 million as of December 26, 2010. The fair value of our outstanding debt approximates the carrying value since our debt agreements are variable-rate instruments.

The New Credit Facility contains customary affirmative and negative covenants, including financial covenants requiring the maintenance of specified fixed charges and leverage ratios. We were in compliance with all covenants at September 25, 2011 and December 26, 2010.

In August 2011, we entered into a new interest rate swap agreement that provides for a fixed rate of 0.53%, as compared to LIBOR, with a notional amount of \$50.0 million. The new interest rate swap agreement expires in August 2013. We had two interest rate swap agreements that expired in January 2011. The previous swap agreements provided for fixed rates of 4.98% and 3.74%, as compared to LIBOR, with each having a notional amount of \$50.0 million.

Our swaps are derivative instruments that are designated as cash flow hedges because the swaps provide a hedge against the effects of rising interest rates on present and/or forecasted future borrowings. The effective portion of the gain or loss on the swap is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedge affects earnings. Gains or losses on a swap representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. Amounts payable or receivable under the swap are accounted for as adjustments to

interest expense. As of September 25, 2011, the swap is an effective cash flow hedge.

The swaps are recorded in other long-term liabilities with fair values of \$147,000 and \$313,000 as of September 25, 2011 and December 26, 2010, respectively. As of September 25, 2011, the portion of the \$147,000 interest rate swap liability that would be reclassified into earnings during the next twelve months as interest expense approximates \$76,000.

There were no derivatives that were not designated as hedging instruments under the provisions of the ASC topic, Derivatives and Hedging.

Interest expense for the swaps was \$12,000 and \$1.0 million for the three months ended September 25, 2011 and September 26, 2010, respectively, and \$305,000 and \$3.1 million for the nine months ended September 25, 2011 and September 26, 2010, respectively.

The weighted average interest rates for our Revolving Credit Facilities, including the impact of the previously mentioned swap agreements were 1.29% and 5.20% for the three months ended September 25, 2011 and September 26, 2010, respectively, and 2.04% and 5.09% for the nine months ended September 25, 2011 and September 26, 2010, respectively. Interest paid, including payments made or received under the swaps, was \$230,000 and \$1.4 million for the three months ended September 25, 2011 and September 26, 2010, respectively, and \$1.4 million and \$4.0 million for the nine months ended September 25, 2011 and September 26, 2010, respectively.

#### 5. Calculation of Earnings Per Share

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

|  | Three Months Ended |                   | Nine Months Ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| Basic earnings per common share:                   |                    |                   |                   |                   |
| Net income   | \$ 11,123          | \$ 7,848          | \$ 39,674         | \$ 37,915         |
| Weighted average shares outstanding                | 24,964             | 25,951            | 25,302            | 26,586            |
| Basic earnings per common share                    | \$ 0.45            | \$ 0.30           | \$ 1.57           | \$ 1.43           |
| Earnings per common share - assuming dilution:     |                    |                   |                   |                   |
| Net income   | \$ 11,123          | \$ 7,848          | \$ 39,674         | \$ 37,915         |
| Weighted average shares outstanding                | 24,964             | 25,951            | 25,302            | 26,586            |
| Dilutive effect of outstanding compensation awards | 182                | 130               | 226               | 157               |
| Diluted weighted average shares outstanding        | 25,146             | 26,081            | 25,528            | 26,743            |
| Earnings per common share - assuming dilution      | \$ 0.44            | \$ 0.30           | \$ 1.55           | \$ 1.42           |

Shares subject to options to purchase common stock with an exercise price greater than the average market price for the quarter were not included in the computation of earnings per common share – assuming dilution because the effect would have been antidilutive. The weighted average number of shares subject to the antidilutive options was 207,000 and 1.7 million for the three-month periods ended September 25, 2011 and September 26, 2010, respectively. The weighted average number of shares subject to the antidilutive options for the nine-month periods ended September 25, 2011 and September 26, 2010 was 306,000 and 1.5 million, respectively.

## 6. Comprehensive Income

Comprehensive income is comprised of the following:

| (In thousands)   | Three Months Ended |                   | Nine Months Ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| Net income, including noncontrolling interests                   | \$ 11,940          | \$ 8,520          | \$ 42,542         | \$ 40,587         |
| Change in valuation of interest rate swap agreements, net of tax | (93 )              | 581               | 66                | 1,730             |
| Foreign currency translation gain (loss)                         | (160 )             | 1,471             | 440               | 34                |
| Comprehensive income   | \$ 11,687          | \$ 10,572         | \$ 43,048         | \$ 42,351         |

## 7. Commitments and Contingencies

## Lease Agreements

As a condition of the sale of our former Perfect Pizza operations in the United Kingdom (UK) in March 2006, we remain contingently liable for payment under approximately 40 lease agreements for Perfect Pizza's restaurant sites, for which the Perfect Pizza franchisees and franchisor are primarily liable. As the initial party to the lease agreements, we are liable to the extent that the primary obligor does not satisfy its payment obligations. The leases have varying terms, the latest of which expires in 2017, with most expiring by the end of 2014. As of September 25, 2011 the estimated maximum amount of undiscounted rental payments we would be required to make in the event of non-payment under all such leases was approximately \$2.5 million, excluding the \$782,000 charge discussed below.

On August 1, 2011 the High Court of Justice Chancery Division, Birmingham District Registry entered an order placing Perfect Pizza in administration, thereby providing Perfect Pizza with protection from its creditors in accordance with UK insolvency law. On the same date, the administrators entered into an agreement to sell substantially all of the business and assets of Perfect Pizza. In accordance with the terms of the agreement, the buyer has an option period of up to nine months to determine which Perfect Pizza leases they will assume.

The buyer is continuing to assess most restaurant leases but has identified certain leases that will likely not be assumed. Accordingly, for the three and nine months ended September 25, 2011, we recorded an expense of \$782,000 in other general expenses in the accompanying Consolidated Statements of Income, representing the remaining rentals, taxes and insurance related to these specific leases. Given the uncertainty of the remaining restaurant locations, we are unable to reasonably estimate any potential additional liability for those locations and therefore no amount has been recorded in the consolidated financial statements as of September 25, 2011 with respect to the remaining restaurant locations.

## Contingencies

We are subject to claims and legal actions in the ordinary course of business. We believe that all such claims and actions currently pending against us are either adequately covered by insurance or would not have a material adverse effect on us if decided in a manner unfavorable to us.

## 8. Segment Information

We have defined six reportable segments: domestic Company-owned restaurants, domestic commissaries, North America franchising, international operations, variable interest entities (“VIEs”) and all other units.

The domestic Company-owned restaurant segment consists of the operations of all domestic (“domestic” is defined as restaurants operating in the United States) Company-owned restaurants and derives its revenues principally from retail sales of pizza and other food and beverage products to the general public. The domestic commissary segment consists of the operations of our regional dough production and product distribution centers and derives its revenues principally from the sale and distribution of food and paper products to Company-owned and franchised restaurants. The North America franchising segment consists of our franchise sales and support activities and derives its revenues from the sale of franchise and development rights and the collection of royalties from our franchisees located in the United States and Canada. The international operations segment principally consists of our Company-owned restaurants and distribution sales to franchised Papa John’s restaurants located in the United Kingdom, China 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. BIBP was a variable interest entity in which we were deemed the primary beneficiary, as defined in Note 3, and is the only activity reflected in the VIE segment. All other business units that do not meet the quantitative thresholds for determining reportable segments, which we refer to as our “all others” segment, consist of operations that derive revenues from the sale, principally to Company-owned and franchised restaurants, of printing and promotional items, risk management services, and information systems and related services used in restaurant operations, including our 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 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 related profit 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.

As previously noted, beginning in 2011, we realigned management responsibility for Hawaii, Alaska and Canada from the International segment to the Domestic franchising segment in order to better leverage existing infrastructure and systems. As a result, we renamed the Domestic franchising segment “North America franchising” in the first quarter of 2011. The prior year data in the following table has been reclassified from the International segment to the North America franchising segment to conform to the current year presentation.

Our segment information is as follows:

| (In thousands)   | Three Months Ended |                   | Nine Months Ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| Revenues from external customers:                                    |                    |                   |                   |                   |
| Domestic Company-owned restaurants                                   | \$128,787          | \$120,414         | \$395,099         | \$374,652         |
| Domestic commissaries  | 130,870            | 111,884           | 379,569           | 338,460           |
| North America franchising *  | 18,122             | 16,802            | 56,265            | 52,598            |
| International *  | 15,521             | 11,888            | 42,551            | 34,175            |
| All others   | 12,368             | 12,138            | 38,185            | 39,674            |
| Total revenues from external customers                               | \$305,668          | \$273,126         | \$911,669         | \$839,559         |
| Intersegment revenues:   |                    |                   |                   |                   |
| Domestic commissaries  | \$38,702           | \$32,376          | \$112,674         | \$99,254          |
| North America franchising  | 542                | 494               | 1,625             | 1,509             |
| International  | 58                 | 163               | 163               | 852               |
| Variable interest entities   | -                  | 37,052            | 25,117            | 113,556           |
| All others   | 2,793              | 2,854             | 7,919             | 8,713             |
| Total intersegment revenues  | \$42,095           | \$72,939          | \$147,498         | \$223,884         |
| Income (loss) before income taxes:                                   |                    |                   |                   |                   |
| Domestic Company-owned restaurants                                   | \$4,273            | \$5,503           | \$22,577          | \$25,604          |
| Domestic commissaries  | 7,237              | 5,393             | 21,112            | 20,577            |
| North America franchising *  | 15,941             | 14,663            | 50,190            | 46,713            |
| International *  | 249                | (1,309 )          | (817 )            | (4,162 )          |
| Variable interest entities   | -                  | (658 )            | -                 | 5,505             |
| All others   | (66 )              | 60                | (742 )            | 1,187             |
| Unallocated corporate expenses                                       | (11,085 )          | (11,004 )         | (29,371 )         | (33,963 )         |
| Elimination of intersegment profits                                  | 297                | (108 )            | (256 )            | (329 )            |
| Total income before income taxes                                     | \$16,846           | \$12,540          | \$62,693          | \$61,132          |
| Income attributable to noncontrolling interests                      | (817 )             | (672 )            | (2,868 )          | (2,672 )          |
| Total income before income taxes, net<br>of noncontrolling interests | \$16,029           | \$11,868          | \$59,825          | \$58,460          |
| Property and equipment:  |                    |                   |                   |                   |
| Domestic Company-owned restaurants                                   | \$173,814          |                   |                   |                   |
| Domestic commissaries  | 85,264             |                   |                   |                   |
| International  | 18,279             |                   |                   |                   |
| All others   | 36,157             |                   |                   |                   |
| Unallocated corporate assets   | 130,287            |                   |                   |                   |
| Accumulated depreciation and amortization                            | (260,617 )         |                   |                   |                   |
| Net property and equipment   | \$183,184          |                   |                   |                   |

\*The results for the three and nine months ended September 26, 2010 for franchised restaurants operating in Hawaii, Alaska and Canada have been reclassified from the International segment to the North America franchising segment to conform to the current year presentation. The impact of the reclassification was to increase North America franchising revenues and income before income taxes by \$362,000 and \$302,000, respectively, for the three months ended September 26, 2010, and \$1.1 million and \$982,000, respectively, for the nine months ended September 26, 2010,



with corresponding decreases in the International segment.

## 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 1985. At September 25, 2011, there were 3,780 Papa John's restaurants (623 Company-owned and 3,157 franchised) operating in all 50 states and 32 countries. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, risk management services, and information systems and related services used in their operations.

### Results of Operations and Critical Accounting Policies and Estimates

The results of operations are based on the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States. 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 the operating results. We have identified the following accounting policies and related judgments as critical to understanding the results of our operations:

#### Allowance for Doubtful Accounts and Notes Receivable

We establish reserves for uncollectible accounts and notes receivable based on overall receivable aging levels and a specific evaluation of accounts and notes for franchisees and other customers with known financial difficulties. These reserves and corresponding write-offs could significantly increase if the identified franchisees and other customers begin to or continue to experience deteriorating financial results.

#### Long-Lived and Intangible Assets

The recoverability of long-lived assets is evaluated if impairment indicators exist. Indicators of impairment include historical financial performance, current operating trends and our future operating plans. If impairment indicators exist, we evaluate the recoverability of long-lived assets on an operating unit basis (e.g., an individual restaurant) based on undiscounted expected future cash flows before interest for the expected remaining useful life of the operating unit. Recorded values for long-lived assets that are not expected to be recovered through undiscounted future cash flows are written down to current fair value, which is generally determined from estimated discounted future net cash flows for assets held for use or estimated net realizable value for assets held for sale.

The recoverability of indefinite-lived intangible assets (i.e., goodwill) is evaluated annually, or more frequently if impairment indicators exist, on a reporting unit basis by comparing the estimated fair value to its carrying value. Our estimated fair value for Company-owned restaurants is comprised of two components. The first component is the estimated cash sales price that would be received at the time of the sale and the second component is an investment in the continuing franchise agreement, representing the discounted value of future royalties less any incremental direct operating costs that would be collected under the ten-year franchise agreement.

At September 25, 2011, we had a net investment of \$21.1 million associated with our United Kingdom subsidiary (PJUK). The goodwill allocated to this entity was \$14.7 million at September 25, 2011. We have previously recorded goodwill impairment charges for this entity. We believe PJUK will continue to improve its operating results through ongoing growth initiatives, by increasing Papa John's brand awareness in the United Kingdom, improving sales and profitability for individual franchised restaurants and increasing net PJUK franchised unit openings over the next

several years. If our continued growth initiatives with PJUK are not successful, future impairment charges could be recorded.

### Insurance Reserves

Our insurance programs for workers' compensation, general liability, owned and non-owned automobiles and health insurance coverage provided to our employees are self-insured up to certain individual and aggregate reinsurance levels. Losses are accrued based upon undiscounted estimates of the aggregate retained liability for claims incurred using certain third-party actuarial projections and our claims loss experience. The estimated insurance claims losses could be significantly affected should the frequency or ultimate cost of claims significantly differ from historical trends used to estimate the insurance reserves recorded by the Company.

### Deferred Income Tax Accounts and Tax Reserves

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

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax loss carryforwards. The effect on deferred taxes of changes in tax rates is recognized in the period in which the enactment date changes. As a result, our effective tax rate may fluctuate. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize. As of September 25, 2011, we had a net deferred tax asset balance of \$3.2 million. We have not provided a valuation allowance for the deferred tax assets since we believe it is more likely than not that future earnings will be sufficient to ensure the realization of the net deferred tax assets for federal and state purposes.

Certain tax authorities periodically audit the Company. We provide reserves for potential exposures. We evaluate these issues on a quarterly basis to adjust for events, such as court rulings or audit settlements, which may impact our ultimate payment for such exposures.

### Consolidation of BIBP Commodities, Inc. as a Variable Interest Entity

BIBP was a franchisee-owned corporation that conducted a cheese-purchasing program on behalf of Company-owned and franchised restaurants operating in the United States through February 2011. As the primary beneficiary, we consolidated the operating results of BIBP. BIBP operated at breakeven for the first two months of 2011 and recognized a pre-tax loss of \$700,000 and pre-tax income of \$5.5 million for the three and nine months ended September 26, 2010, respectively.

Consolidation accounting required the net impact from the consolidation of BIBP to be reflected primarily in three separate components of our statement of income. The first component was the portion of BIBP operating income or loss attributable to the amount of cheese purchased by Company-owned restaurants during the period. This portion of BIBP operating income was reflected as a reduction in the "Domestic Company-owned restaurant expenses - cost of sales" line item. This approach effectively reported cost of sales for Company-owned restaurants as if the purchasing arrangement with BIBP did not exist and such restaurants were purchasing cheese at the spot market prices (i.e., the impact of BIBP was eliminated in consolidation).

The second component of the net impact from the consolidation of BIBP was reflected in the caption "Loss (income) from the franchise cheese-purchasing program, net of noncontrolling interest." This line item represented BIBP's

income or loss from purchasing cheese at the spot market price and selling to franchised restaurants at a fixed monthly price, net of any income or loss attributable to the noncontrolling interest BIBP shareholders. The amount of income or loss attributable to the BIBP shareholders depended on its cumulative shareholders' equity balance and the change in such balance during the reporting period. The third component was reflected as interest expense, when BIBP was in a net borrowing position during the reporting period.

The following table summarizes the impact of BIBP, prior to the required consolidating eliminations, on our consolidated statements of income for the three and nine months ended September 25, 2011 and September 26, 2010 (in thousands):

|                                     | Three Months Ended |                   | Nine Months Ended |                   |
|-------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                     | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| BIBP sales                          | \$-                | \$37,052          | \$25,117          | \$113,556         |
| Cost of sales                       | -                  | 37,580            | 25,100            | 107,629           |
| General and administrative expenses | -                  | 25                | 17                | 66                |
| Total costs and expenses            | -                  | 37,605            | 25,117            | 107,695           |
| Operating (loss) income             | -                  | (553 )            | -                 | 5,861             |
| Interest expense                    | -                  | (105 )            | -                 | (356 )            |
| (Loss) income before income taxes   | \$-                | \$(658 )          | \$-               | \$5,505           |

In February 2011, we terminated the purchasing arrangement with BIBP and BIBP no longer has operating activities. Over 99% of our domestic franchisees have entered into a cheese purchasing agreement with PJFS. The cheese purchasing agreement requires participating domestic franchisees to purchase cheese through PJFS, or to pay the franchisee's portion of any accumulated cheese liability upon ceasing to purchase cheese from PJFS when a liability exists. The cheese purchasing agreement specifies that PJFS will charge the franchisees a predetermined price for cheese on a monthly basis. Any difference between the amount charged to franchisees and the actual price paid by PJFS for cheese will be recorded as a receivable from or a payable to the franchisees, to be repaid based upon a predetermined formula outlined in the agreement.

#### Non-GAAP Measures

The financial measures we present in this report that exclude the impact of the consolidation of BIBP are not measures defined within accounting principles generally accepted in the United States ("GAAP"). These non-GAAP measures should not be construed as a substitute for or a better indicator of the Company's performance than the Company's GAAP measures. We believe the financial information excluding the impact of the consolidation of BIBP is important for purposes of comparison to prior period results. We analyze our business performance and trends excluding the impact of the consolidation of BIBP because the results of BIBP are not indicative of the principal operating activities of the Company. In addition, annual cash bonuses, and certain long-term incentive programs for various levels of management, were based on financial measures that excluded BIBP. The presentation of the non-GAAP measures in this report is made alongside the most directly comparable GAAP measures.

In addition, we present free cash flow in this report, which is not a term defined by GAAP. Free cash flow is defined as net cash provided by operating activities (from the consolidated statements of cash flows) excluding the impact of BIBP, less the purchases of property and equipment. We view free cash flow as an important measure because it is one factor that management uses in determining the amount of cash available for discretionary investment. Free cash flow is not a term defined by GAAP and as a result our measure of free cash flow might not be comparable to similarly titled measures used by other companies. Free cash flow should not be construed as a substitute for or a better indicator of our performance than the Company's GAAP measures.

## Restaurant Progression:

|                                   | Three Months Ended |                   | Nine Months Ended |                   |
|-----------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                   | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| North America Company-owned:      |                    |                   |                   |                   |
| Beginning of period               | 595                | 590               | 591               | 588               |
| Opened                            | 2                  | -                 | 6                 | 4                 |
| Closed                            | -                  | -                 | -                 | (2 )              |
| End of period                     | 597                | 590               | 597               | 590               |
| International Company-owned:      |                    |                   |                   |                   |
| Beginning of period               | 23                 | 29                | 21                | 26                |
| Opened                            | 3                  | 2                 | 5                 | 6                 |
| Closed                            | -                  | (1 )              | -                 | (1 )              |
| Acquired from franchisees         | -                  | -                 | -                 | 1                 |
| Sold to franchisees               | -                  | (10 )             | -                 | (12 )             |
| End of period                     | 26                 | 20                | 26                | 20                |
| North America franchised (a):     |                    |                   |                   |                   |
| Beginning of period               | 2,393              | 2,283             | 2,346             | 2,246             |
| Opened                            | 36                 | 48                | 103               | 130               |
| Closed                            | (16 )              | (10 )             | (36 )             | (55 )             |
| End of period                     | 2,413              | 2,321             | 2,413             | 2,321             |
| International franchised (a):     |                    |                   |                   |                   |
| Beginning of period               | 722                | 614               | 688               | 609               |
| Opened                            | 33                 | 33                | 82                | 80                |
| Closed                            | (11 )              | (5 )              | (26 )             | (48 )             |
| Acquired from Company             | -                  | 10                | -                 | 12                |
| Sold to Company                   | -                  | -                 | -                 | (1 )              |
| End of period                     | 744                | 652               | 744               | 652               |
| Total restaurants - end of period | 3,780              | 3,583             | 3,780             | 3,583             |

(a) The restaurant unit data for the three and nine months ended September 26, 2010 has been adjusted to reflect the reclassification of restaurants operating in Hawaii, Alaska and Canada from International franchised to North America franchised. There were 63 restaurants reclassified from International to North America franchised as of September 26, 2010.

## Franchise Support Incentives

In December 2010, our domestic franchisees voted in favor of a proposal to increase the national marketing fund contribution rate for 2011 to 2013 (“National Marketing Fund Agreement”). The primary terms of the National Marketing Fund Agreement are as follows:

- National Marketing Fund Contribution Rate – Domestic Company-owned and franchised restaurants will contribute 4.0% of sales to the marketing fund in 2011 and have agreed to a minimum contribution rate in 2012 and 2013. The Company expects this agreement to primarily represent a shift, or a slight increase, in total marketing expenditures, and believes an increase in marketing expenditures on a national basis will improve the consistency of the overall marketing message and favorably impact brand awareness.
- BIBP Accumulated Deficit – BIBP had an accumulated deficit (representing prior purchases of cheese by PJFS from BIBP at below market prices) of \$14.2 million at December 26, 2010. PJFS agreed to pay to BIBP the amount equal to the accumulated deficit at December 26, 2010. Accordingly, BIBP recorded a decrease of \$14.2 million in cost of sales and PJFS recorded a corresponding increase in cost of sales in the 2010 financial statements. This transaction did not have any impact on the Company's 2010 consolidated income statement results since both PJFS and BIBP were fully consolidated with the Company's financial results.
- Cheese Purchasing Agreement – As previously discussed, in order to facilitate franchisees' planning of food costs and promotions going forward, PJFS agreed to charge a fixed monthly price for cheese to franchisees who signed a cheese purchasing agreement with PJFS.
- Online Ordering System Fees – The Company agreed to reduce the online ordering fee paid by domestic franchisees by 0.5% for 2011, and agreed to limit the fee for 2012 and 2013.
- Royalty Rebate Program – The standard royalty rate in 2011 is 5.0% of sales. Franchisees can earn up to a 0.25% quarterly royalty rebate for 2011 to 2013 by meeting certain sales growth targets; they can earn an additional 0.20% royalty rebate in 2011 by making specified re-imaging restaurant lobby investments. The Company agreed to consider a similar capital investment-based royalty rebate opportunity for franchisees in 2012 and 2013 as well.

From time to time, we offer additional discretionary support initiatives to our franchisees, including:

- Food cost relief by lowering the commissary margin on certain commodities sold by PJFS to the franchise system and by providing incentive rebate opportunities;
- Targeted royalty relief and local marketing support to assist certain identified franchisees or markets;
- Restaurant opening incentives; and
- Financing on a selected basis, primarily to assist new or existing franchisees with the acquisition of troubled franchise restaurants or to build new restaurants.

In 2010, we provided additional system-wide national marketing contributions, additional system-wide local print marketing contributions and certain other system-wide incentives.



## Summary of Operating Results – Segment Review

### Discussion of Revenues

Total revenues were \$305.7 million for the third quarter of 2011, representing an increase of 11.9% from revenues of \$273.1 million for the same quarter in 2010. For the nine months ended September 25, 2011, total revenues were \$911.7 million, representing an increase of 8.6% from revenues of \$839.6 million for the comparable period in 2010. The increases were primarily due to the following:

- Domestic Company-owned restaurant sales increased \$8.4 million, or 7.0%, and \$20.4 million, or 5.5%, for the three and nine months ended September 25, 2011, respectively, primarily due to increases in comparable sales of 6.3% and 5.0%, respectively. “Comparable sales” represents sales generated by restaurants open for the entire twelve-month period reported.
- North America franchise royalty revenues increased approximately \$1.3 million, or 7.9%, and \$3.7 million, or 7.0%, for the three and nine months ended September 25, 2011, respectively, due to increases in comparable sales of 4.9% and 3.6%, respectively, and increases in the number of franchise restaurants.
- Domestic commissary sales increased \$19.0 million, or 17.0%, and \$41.1 million, or 12.1%, for the three and nine months ended September 25, 2011, respectively. The increases were primarily due to increases in the selling prices of certain commodities, most notably cheese, and increases in sales volumes.
- International revenues increased \$3.6 million, or 30.6%, and \$8.4 million, or 24.5%, for the three and nine months ended September 25, 2011, respectively, primarily due to increases in the number of restaurants and increases in comparable sales of 4.7% and 5.0%, respectively, calculated on a constant dollar basis. Through the first three quarters of 2010, the International segment included revenues from Company-owned restaurants located in the United Kingdom, which were sold in the third quarter of 2010.

Revenues for the nine-month period ended September 25, 2011 were also impacted by a \$1.5 million decrease in other sales primarily resulting from a decline in sales at our print and promotions subsidiary, Preferred Marketing Solutions, and reduced online fees charged to our domestic franchisees pursuant to the National Marketing Fund Agreement.

### Discussion of Operating Results

Our income before income taxes, net of noncontrolling interests, totaled \$16.0 million for the three months ended September 25, 2011, compared to \$11.9 million for the same period in 2010 (\$12.5 million in the corresponding period in 2010, excluding the impact of BIBP, an increase of \$3.5 million or 28.0%), and \$59.8 million for the nine months ended September 25, 2011, compared to \$58.5 million for the same period in 2010 (\$53.0 million in the corresponding period in 2010, excluding the impact of BIBP, an increase of \$6.9 million or 13.0%).

Income before income taxes, net of noncontrolling interests is summarized in the following table on an operating segment basis (in thousands):

|   | Three Months Ended |                   |                        | Nine Months Ended |                   |                        |
|---|--------------------|-------------------|------------------------|-------------------|-------------------|------------------------|
|   | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Increase<br>(Decrease) | Sept. 25,<br>2011 | Sept. 26,<br>2010 | Increase<br>(Decrease) |
| Domestic Company-owned restaurants                                | \$4,273            | \$5,503           | \$(1,230 )             | \$22,577          | \$25,604          | \$(3,027 )             |
| Domestic commissaries   | 7,237              | 5,393             | 1,844                  | 21,112            | 20,577            | 535                    |
| North America franchising *                                       | 15,941             | 14,663            | 1,278                  | 50,190            | 46,713            | 3,477                  |
| International *   | 249                | (1,309 )          | 1,558                  | (817 )            | (4,162 )          | 3,345                  |
| All others  | (66 )              | 60                | (126 )                 | (742 )            | 1,187             | (1,929 )               |
| Unallocated corporate expenses                                    | (11,085 )          | (11,004 )         | (81 )                  | (29,371 )         | (33,963 )         | 4,592                  |
| Elimination of intersegment losses (profits)                      | 297                | (108 )            | 405                    | (256 )            | (329 )            | 73                     |
| Income before income taxes, excluding                             |                    |                   |                        |                   |                   |                        |
| variable interest entities  | 16,846             | 13,198            | 3,648                  | 62,693            | 55,627            | 7,066                  |
| BIBP, a variable interest entity                                  | -                  | (658 )            | 658                    | -                 | 5,505             | (5,505 )               |
| Total income before income taxes                                  | 16,846             | 12,540            | 4,306                  | 62,693            | 61,132            | 1,561                  |
| Income attributable to noncontrolling interests                   | (817 )             | (672 )            | (145 )                 | (2,868 )          | (2,672 )          | (196 )                 |
| Total income before income taxes, net of noncontrolling interests | \$16,029           | \$11,868          | \$4,161                | \$59,825          | \$58,460          | \$1,365                |

\*In 2011, we realigned management responsibility for Hawaii, Alaska and Canada from the International segment to the Domestic franchising segment in order to better leverage existing infrastructure and systems. As a result, we renamed the Domestic franchising segment "North America franchising". The prior year income before income taxes for these restaurants has been reclassified from the International segment to the North America franchising segment to conform to the current year presentation. The impact of the reclassification was to increase income before income taxes for the North America franchising segment by \$302,000 and \$982,000 for the three and nine months ended September 26, 2010, respectively, with corresponding decreases in income before income taxes for the International segment.

Changes in income before income taxes, net of noncontrolling interests, for the three and nine months ended September 25, 2011, respectively, excluding the impact of BIBP, are summarized on a segment basis as follows:

- Domestic Company-owned Restaurant Segment. Domestic Company-owned restaurants' operating income was \$4.3 million for the three months ended September 25, 2011, compared to \$5.5 million for the comparable 2010 period, and \$22.6 million for the nine months ended September 25, 2011, compared to \$25.6 million for the comparable 2010 period. The decreases of \$1.2 million and \$3.0 million for the three- and nine- month periods were due to increased commodity costs, primarily cheese, partially offset by incremental profits from higher comparable sales. The nine-month period in 2011 was also impacted by increased advertising costs.

Domestic Commissary Segment. Domestic commissaries' operating income increased \$1.8 million and approximately \$500,000 for the three and nine months ended September 25, 2011, over the comparable 2010 periods. The increases were due to higher operating income dollar margin attributable to higher sales volumes, partially offset by increased costs attributable to higher fuel prices.

- North America Franchising Segment. North America franchising operating income increased approximately \$1.3 million and \$3.5 million for the three- and nine-month periods of 2011, respectively, as compared to the comparable 2010 periods. The increases were due to the previously mentioned royalty revenue increases.

- **International Segment.** The operating income in the International segment for the third quarter of 2011 was approximately \$250,000, compared to an operating loss of \$1.3 million for the prior year comparable quarter and was a loss of approximately \$800,000 compared to a loss of \$4.2 million for the nine months ended September 25, 2011 and September 26, 2010, respectively. The improvements in operating results of \$1.6 million and \$3.3 million, respectively, were primarily due to increased royalties due to growth in the number of units and comparable sales increases of 4.7% and 5.0% for the three- and nine-month periods, respectively. Additionally, the prior year results included start-up costs associated with our Company-owned commissary in the United Kingdom that opened in 2010.
- **All Others Segment.** The “All others” segment reported losses of approximately \$70,000 and \$700,000 for the three and nine months ended September 25, 2011, respectively. The “All others” reporting segment operating results declined approximately \$100,000 and \$1.9 million for the three- and nine-month periods, respectively, as compared to the corresponding 2010 periods. The decreases were primarily due to a decline in the operating results of our online ordering (“eCommerce”) business, partially offset by improvements in operating income at our print and promotions subsidiary, Preferred Marketing Solutions. The decline in the operating results of our eCommerce business was due to an increase in infrastructure and support costs attributable to the new online ordering system. Additionally, online revenues decreased for the nine months ended September 25, 2011.
- **Unallocated Corporate Segment.** Unallocated corporate expenses increased \$81,000 and decreased \$4.6 million for the three and nine months ended September 25, 2011, respectively, as compared to the corresponding periods in the prior year. The components of unallocated corporate expenses were as follows (in thousands):

|   | Three Months Ended |                   |                        | Nine Months Ended |                   |                        |
|---|--------------------|-------------------|------------------------|-------------------|-------------------|------------------------|
|   | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Increase<br>(decrease) | Sept. 25,<br>2011 | Sept. 26,<br>2010 | Increase<br>(decrease) |
| General and administrative (a)              | \$5,629            | \$5,962           | \$(333 )               | \$18,987          | \$20,735          | \$(1,748 )             |
| Net interest (b)                            | 116                | 1,140             | (1,024 )               | 675               | 3,086             | (2,411 )               |
| Depreciation                                | 1,818              | 2,293             | (475 )                 | 6,236             | 6,694             | (458 )                 |
| Franchise incentives and initiatives (c)    | 2,754              | 1,750             | 1,004                  | 2,754             | 4,250             | (1,496 )               |
| Perfect Pizza lease obligation (d)          | 782                | -                 | 782                    | 782               | -                 | 782                    |
| Other income                                | (14 )              | (141 )            | 127                    | (63 )             | (802 )            | 739                    |
| <b>Total unallocated corporate expenses</b> | <b>\$11,085</b>    | <b>\$11,004</b>   | <b>\$81</b>            | <b>\$29,371</b>   | <b>\$33,963</b>   | <b>\$(4,592 )</b>      |

- (a) The decrease in unallocated corporate general and administrative costs for the nine months ended September 25, 2011 was due to lower short- and long-term incentive compensation costs, and lower sponsorship fees, partially offset by increased travel costs.
- (b) The decreases in net interest expense reflect the decrease in our average outstanding debt balance and lower interest rates.
- (c) In 2010, we provided discretionary contributions to the national marketing fund and other local advertising cooperatives. In 2011, we offered incentives to domestic franchisees for meeting certain sales targets, including driving comparable sales, transactions and online sales.
- (d)

The Perfect Pizza lease obligation relates to rents, taxes and insurance associated with the former Perfect Pizza operations in the United Kingdom. See the notes to condensed consolidated financial statements for additional information.

Diluted earnings per share were \$0.44 in the third quarter of 2011, compared to \$0.30 (\$0.32 per share, excluding the impact of BIBP, an increase of \$0.12 or 37.5%) in the third quarter of 2010. For the nine months ended September 25, 2011 and September 26, 2010, diluted earnings per share were \$1.55 and \$1.42, respectively (\$1.29 per share for the nine months ended September 26, 2010, excluding the impact of BIBP, an increase of \$0.26 or 20.2%). Diluted weighted average shares outstanding decreased 3.6% and 4.5% for the three and nine months ended September 25, 2011, respectively, from the prior comparable periods. Diluted earnings per share increased \$0.01 and \$0.07 for the three- and nine-month periods, respectively, due to the reductions in shares outstanding.

#### Review of Consolidated Operating Results

**Revenues.** Domestic Company-owned restaurant sales were \$128.8 million for the three months ended September 25, 2011, compared to \$120.4 million for the same period in 2010, and \$395.1 million for the nine months ended September 25, 2011, compared to \$374.7 million for the same period in 2010. The increases of \$8.4 million and \$20.4 million, respectively, were primarily due to the previously mentioned increases of 6.3% and 5.0% in comparable sales for the three and nine months ended September 25, 2011, respectively.

North America franchise sales were \$419.7 million for the three months ended September 25, 2011, compared to \$395.2 million for the same period in 2010, and \$1.287 billion for the nine months ended September 25, 2011, compared to \$1.208 billion for the same period in 2010. Domestic franchise comparable sales increased 4.9% for the third quarter and increased 3.6% for the nine months ended September 25, 2011, and equivalent units increased 3.6% and 4.5%, respectively, for the comparable 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 sales are not included in our Consolidated Statements of Income; however, our North America franchise royalty revenue is derived from these sales. North America franchise royalties were \$18.0 million and \$55.8 million for the three and nine months ended September 25, 2011, respectively, representing increases of 7.9% and 7.0% from the comparable periods in the prior year. The increases in royalties were primarily due to the previously noted increases in franchise sales.

Average weekly sales for comparable units include restaurants that were open throughout the periods presented below. The comparable sales base for Company-owned and North America franchised restaurants, respectively, includes restaurants acquired by the Company or divested to franchisees during the previous twelve months. Average weekly sales for non-comparable units include restaurants that were not open throughout the periods presented below and include non-traditional sites. Average weekly sales for non-traditional units that do not have continuous operations are calculated based upon actual days open.

The comparable sales base and average weekly sales for 2011 and 2010 for domestic Company-owned and North America franchised restaurants consisted of the following:

|   | Three Months Ended |            |                |            |
|---|--------------------|------------|----------------|------------|
|   | Sept. 25, 2011     |            | Sept. 26, 2010 |            |
|   | Company            | Franchised | Company        | Franchised |
| Total domestic units (end of period)              | 597                | 2,413      | 590            | 2,321      |
| Equivalent units                                  | 591                | 2,328      | 586            | 2,247      |
| Comparable sales base units                       | 582                | 2,150      | 577            | 2,071      |
| Comparable sales base percentage                  | 98.5 %             | 92.4 %     | 98.5 %         | 92.2 %     |
| Average weekly sales - comparable units           | \$ 16,850          | \$ 14,154  | \$ 15,881      | \$ 13,542  |
| Average weekly sales - total non-comparable units | \$ 11,144          | \$ 10,422  | \$ 11,347      | \$ 13,348  |

|                                  |           |           |           |           |
|----------------------------------|-----------|-----------|-----------|-----------|
| Average weekly sales - all units | \$ 16,763 | \$ 13,869 | \$ 15,813 | \$ 13,527 |
|----------------------------------|-----------|-----------|-----------|-----------|

|   | Nine Months Ended |            |                |            |
|---|-------------------|------------|----------------|------------|
|   | Sept. 25, 2011    |            | Sept. 26, 2010 |            |
|   | Company           | Franchised | Company        | Franchised |
| Total domestic units (end of period)              | 597               | 2,413      | 590            | 2,321      |
| Equivalent units                                  | 588               | 2,318      | 585            | 2,217      |
| Comparable sales base units                       | 581               | 2,126      | 576            | 2,071      |
| Comparable sales base percentage                  | 98.8              | % 91.7     | % 98.4         | % 93.4     |
| Average weekly sales - comparable units           | \$17,303          | \$14,559   | \$16,496       | \$14,074   |
| Average weekly sales - total non-comparable units | \$11,155          | \$10,612   | \$10,939       | \$12,468   |
| Average weekly sales - all units                  | \$17,224          | \$14,231   | \$16,410       | \$13,967   |

Note: Franchised data for the three and nine months ended September 26, 2010 has been reclassified to include units operating in Hawaii, Alaska and Canada. These units were previously reported in our International segment.

Domestic commissary sales increased 17.0% to \$130.9 million for the three months ended September 25, 2011 from \$111.9 million in the comparable 2010 period and increased 12.1% to \$379.6 million for the nine months ended September 25, 2011 from \$338.5 million in the comparable 2010 period. The increases were due to increases in the selling prices of certain commodities, most notably cheese, and increases in sales volumes.

Other sales increased approximately \$200,000 and decreased \$1.5 million for the three and nine months ended September 25, 2011, respectively. The decrease for the nine-month period primarily resulted from a decline in sales at our print and promotions subsidiary, Preferred Marketing Solutions, and a reduction in the online fee charged to our domestic franchisees in connection with the National Marketing Fund Agreement.

International franchise sales were \$81.9 million for the three months ended September 25, 2011, compared to \$67.0 million for the same period in 2010, and \$236.7 million for the nine months ended September 25, 2011, compared to \$188.4 million for the same period in 2010. International franchise sales are not included in our Consolidated Statements of Income; however, our international royalty revenue is derived from these sales. Total international revenues were \$15.5 million for the three months ended September 25, 2011, compared to \$11.9 million for the same period in 2010, and \$42.6 million for the nine months ended September 25, 2011, compared to \$34.2 million for the same period in 2010, reflecting an increase in the number of restaurants in addition to the 4.7% and 5.0% increases in comparable sales, calculated on a constant dollar basis. These increases were partially offset by the prior year's inclusion of revenues from Company-owned restaurants located in the United Kingdom, which were sold in the third quarter of 2010. Our PJUK operations represented 52% of international revenues during the nine-month period in 2011.

**Costs and Expenses.** The restaurant operating margin for domestic Company-owned units was 17.4% for the three months ended September 25, 2011, compared to 18.2% (18.3% excluding BIBP) for the same period in 2010, and 19.1% for the nine months ended September 25, 2011, compared to 20.8% (20.4% excluding BIBP) for the same period in 2010. Excluding the impact of consolidating BIBP in 2010, the restaurant operating margin decreased 0.9% and 1.3% for the three and nine months ended September 25, 2011, respectively, consisting of the following differences:

- Cost of sales was 2.5% and 1.8% higher as a percentage of sales for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010, due to the impact of higher commodities costs, principally cheese, wheat and meats.
- Salaries and benefits were 0.5% and 0.4% lower as a percentage of sales for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010, reflecting the benefit of increased



sales.

- Advertising and related costs as a percentage of sales were 0.2% lower and 0.2% higher for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010. National marketing as a percentage of sales increased for both the three- and nine-month periods. Local advertising can vary somewhat from quarter to quarter.
- Occupancy costs and other operating costs, on a combined basis, as a percentage of sales, were 0.9% and 0.3% lower for the three and nine months ended September 25, 2011, respectively, as compared to the corresponding 2010 periods, reflecting the benefit of increased sales.

Domestic commissary and other margin was 7.4% for the three months ended September 25, 2011, compared to 7.3% for the corresponding period in 2010, and 7.4% for the nine months ended September 25, 2011, compared to 8.4% for the corresponding period in 2010. Domestic commissary and other margin increased 0.1% and decreased 1.0% for the three and nine months ended September 25, 2011, respectively, consisting of the following differences:

- Cost of sales was 0.9% and 1.3% higher as a percentage of revenues for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010. Cost of sales increased primarily due to the impact of higher commodities costs, primarily cheese, wheat and meats. In addition, a reduction in online fee revenue from franchisees pursuant to the National Marketing Fund Agreement and an increase in eCommerce support costs contributed to the increases in cost of sales.
- Salaries and benefits were 0.7% and 0.5% lower as a percentage of revenues for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010, reflecting the benefit of increased sales.
- Other operating expenses were 0.3% lower and 0.2% higher as a percentage of revenues for the three and nine months ended September 25, 2011, respectively, as compared to the same periods of 2010. Fuel prices were higher in 2011; however, the decrease on a percentage of sales-basis for the three-month period was due to increased sales.

We recorded a pre-tax loss of \$400,000 and pre-tax income of \$4.6 million from the franchise cheese-purchasing program, net of noncontrolling interest, for the three and nine months ended September 26, 2010. These results represent only the portion of BIBP's operating income related to the proportion of BIBP cheese sales to franchisees. The total impact of the consolidation of BIBP on Papa John's pre-tax income was a pre-tax loss of approximately \$700,000 and pre-tax income of \$5.5 million for the three and nine months ended September 26, 2010 (no impact in 2011 through February, at which time the purchasing agreement with BIBP was terminated).

International operating expenses were 84.0% of international restaurant and commissary sales for the three months ended September 25, 2011, compared to 89.0% for the same period in 2010, and 85.1% of international restaurant and commissary sales for the nine months ended September 25, 2011, compared to 89.0% for the same period in 2010. The improvements in operating expenses as a percentage of sales were due to both improvements in operating results in our Beijing, China restaurants and our PJUK commissary. The nine-month period in 2010 included start-up costs associated with our PJUK commissary, which was opened in 2010.

General and administrative expenses were \$27.3 million, or 8.9%, of revenues for the three months ended September 25, 2011, compared to \$27.1 million, or 9.9%, of revenues for the same period in 2010, and \$84.0 million, or 9.2%, of revenues, for the nine months ended September 25, 2011, compared to \$84.0 million, or 10.0%, of revenues for the same period in 2010. The dollar amounts were relatively flat for both years and declined as a percentage of sales.

Other general expenses reflected net expense of \$4.8 million for the three months ended September 25, 2011, compared to \$2.6 million for the comparable period in 2010, and \$7.0 million for the nine months ended September 25, 2011, compared to \$6.6 million for the comparable period in 2010, as detailed below (in thousands):

|   | Three Months Ended |                   |                        | Nine Months Ended |                   |                        |
|---|--------------------|-------------------|------------------------|-------------------|-------------------|------------------------|
|   | Sept. 25,<br>2011  | Sept. 26,<br>2010 | Increase<br>(Decrease) | Sept. 25,<br>2011 | Sept. 26,<br>2010 | Increase<br>(Decrease) |
| Disposition and valuation-related costs                   | \$120              | \$203             | \$(83 )                | \$506             | \$554             | \$(48 )                |
| Provision for uncollectible accounts and notes receivable | 583                | 308               | 275                    | 455               | 642               | (187 )                 |
| Pre-opening costs   | 27                 | 22                | 5                      | 183               | 142               | 41                     |
| Franchise and development incentives and initiatives (a)  | 3,307              | 2,083             | 1,224                  | 3,927             | 4,854             | (927 )                 |
| Perfect Pizza lease obligation (b)                        | 782                | -                 | 782                    | 782               | -                 | 782                    |
| Other (income) expense                                    | (42 )              | 27                | (69 )                  | 1,164             | 428               | 736                    |
| Total other general expenses                              | \$4,777            | \$2,643           | \$2,134                | \$7,017           | \$6,620           | \$397                  |

(a) In 2010, we provided discretionary contributions to the national marketing fund and other local advertising cooperatives. The 2011 amounts include approximately \$2.8 million of incentives offered to domestic franchisees for meeting certain sales targets, including driving comparable sales, transactions and online sales for the three and nine months ended September 25, 2011.

(b) The Perfect Pizza lease obligation relates to rents, taxes and insurance associated with the former Perfect Pizza operations in the United Kingdom. See the notes to condensed consolidated financial statements for additional information.

Depreciation and amortization was \$8.0 million (2.6% of revenues) for the three months ended September 25, 2011, compared to \$8.1 million (3.0% of revenues) for the comparable 2010 period, and \$24.7 million (2.7% of revenues) for the nine months ended September 25, 2011, compared to \$24.1 million (2.9% of revenues) for the comparable 2010 period. The increase for the nine-month period was primarily due to the enhancements made to our online ordering system in late 2010.

Net interest. Net interest expense was approximately \$100,000 for the three months ended September 25, 2011, compared to \$1.2 million for the same period in 2010, and approximately \$600,000 for the nine months ended September 25, 2011, compared to \$3.4 million for the same period in 2010. The decreases in net interest costs reflect a lower average outstanding debt balance and lower effective interest rates.

Income Tax Expense. Our effective income tax rates were 29.1% and 32.1% for the three and nine months ended September 25, 2011, respectively, representing decreases of 3.2% and 1.2%, from the prior year rates, excluding BIBP. Our tax rates, net of noncontrolling interests, were 30.6% and 33.7% for the three and nine months ended September 25, 2011, representing decreases of 3.4% and 1.3% from the prior year rates, excluding BIBP. The lower effective rates were primarily due to the finalization of certain income tax issues which resulted in income tax benefits of \$1.0 million and \$1.6 million for the three- and nine-month periods, respectively. Our effective income tax rate may fluctuate from quarter to quarter for various reasons, including the settlement or resolution of specific federal and

state issues.

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## Liquidity and Capital Resources

Our debt is comprised of the following (in thousands):

|                          | Sept. 25,<br>2011 | Dec. 26,<br>2010 |
|--------------------------|-------------------|------------------|
| Revolving line of credit | \$ 50,000         | \$ 99,000        |
| Other                    | -                 | 17               |
| Total long-term debt     | \$ 50,000         | \$ 99,017        |

In September 2010, we entered into a five-year, unsecured Revolving Credit Facility (“New Credit Facility”) totaling \$175.0 million that replaced a \$175.0 million unsecured Revolving Credit Facility (“Old Credit Facility”). Under the New Credit Facility, outstanding balances accrue interest at 100.0 to 175.0 basis points over the London Interbank Offered Rate (LIBOR) or other bank-developed rates, at our option. The commitment fee on the unused balance ranges from 17.5 to 25.0 basis points. The increment over LIBOR and the commitment fee are determined quarterly based upon the ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (EBITDA), as defined by the New Credit Facility. Outstanding balances under the Old Credit Facility accrued interest at 50.0 to 100.0 basis points over LIBOR or other bank developed rates, at our option. The commitment fee on the unused balance ranged from 12.5 to 20.0 basis points. We have used interest rate swaps to hedge against the effects of potential interest rate increases on borrowings under our revolving credit facility. We currently have a swap with a fixed rate of 0.53%, as compared to LIBOR, with a notional amount of \$50.0 million. See the notes to condensed consolidated financial statements for additional information.

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

|                         | Permitted Ratio          | Actual Ratio for the<br>Quarter Ended<br>September 25, 2011 |
|-------------------------|--------------------------|---|
| Leverage Ratio          | Not to exceed 2.5 to 1.0 | 0.5 to 1.0  |
| Interest Coverage Ratio | Not less than 3.5 to 1.0 | 5.1 to 1.0  |

Our leverage ratio is defined as outstanding debt divided by consolidated EBITDA for the most recent four fiscal quarters. Our interest coverage ratio is defined as the sum of consolidated EBITDA and consolidated rental expense for the most recent four fiscal quarters divided by the sum of consolidated interest expense and consolidated rental expense for the most recent four fiscal quarters. We were in compliance with all covenants at September 25, 2011 and December 26, 2010.

Cash flow from operating activities was \$84.3 million for the nine months ended September 25, 2011, compared to \$62.2 million for the same period in 2010. The consolidation of BIBP increased cash flow from operations by \$5.5 million in the first nine months of 2010. Excluding the impact of BIBP, cash flow from operations was \$84.3 million in the first nine months of 2011 and \$56.7 million in the first nine months of 2010. The increase of \$27.7 million was due to higher net income and favorable working capital changes, primarily due to timing of payments.



The Company's free cash flow for the nine months ended September 25, 2011 and September 26, 2010 was as follows (in thousands):

|   | Nine Months Ended |                   |
|---|-------------------|-------------------|
|   | Sept. 25,<br>2011 | Sept. 26,<br>2010 |
| Net cash provided by operating activities         | \$ 84,348         | \$ 62,159         |
| Pre-tax income from BIBP cheese purchasing entity | -                 | (5,505 )          |
| Purchase of property and equipment                | (20,647 )         | (23,608 )         |
| Free cash flow (a)                                | \$ 63,701         | \$ 33,046         |

(a) Free cash flow is defined as net cash provided by operating activities (from the consolidated statements of cash flows) excluding the impact of BIBP, less the purchases of property and equipment. See "Non-GAAP Measures" above for more information about this non-GAAP measure, its limitations and why we present free cash flow alongside the most directly comparable GAAP measure.

We require capital primarily for the development, acquisition, renovation and maintenance of restaurants, including re-image costs for Company-owned restaurants in connection with a domestic system-wide re-image program, the development, renovation and maintenance of commissary and print and promotions facilities and equipment and the enhancement of corporate systems and facilities. During the nine months ended September 25, 2011, capital expenditures of \$20.6 million and common stock repurchases of \$49.6 million (1.6 million shares at an average price of \$30.70 per share) were funded primarily by cash flow from operations and from available cash and cash equivalents. Subsequent to September 25, 2011, through October 26, 2011, we repurchased an additional 252,000 shares with an aggregate cost of \$7.7 million and an average cost of \$30.74 per share. As of October 26, 2011, \$29.5 million remained available for repurchase of common stock under this authorization.

Our outstanding principal balance under our revolving line of credit decreased from \$99.0 million at December 26, 2010 to \$50.0 million at September 25, 2011, as we used available cash to reduce our outstanding debt.

#### Forward-Looking Statements

Certain matters discussed in this report, including information within Management's Discussion and Analysis of Financial Condition and Results of Operations, and other Company communications constitute forward-looking statements within the meaning of the federal securities laws. Generally, the use of words such as "expect," "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 statements may relate to projections concerning business performance, revenue, earnings, contingent liabilities, commodity costs, margins, unit growth 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: changes in pricing or other marketing or promotional strategies by competitors which may adversely affect sales, including an increase in or continuation of the aggressive pricing and promotional environment; new product and concept developments by food industry competitors; the ability of the Company and its franchisees to meet planned growth targets and operate new and existing restaurants profitably; general economic and political conditions

and resulting impact on consumer buying habits; changes in consumer preferences; increases in or sustained high costs of food ingredients and other commodities, paper, utilities, fuel, employee compensation and benefits, insurance and similar costs (including the impact of federal health care legislation); the ability of the Company to pass along such increases in or sustained high costs to franchisees or consumers; the impact of current or future legal claims and current proposed legislation impacting our business; the impact that product recalls, food quality or safety issues, and general public health concerns could have on our restaurants; currency exchange and interest rates; credit risk associated with parties to leases of restaurants and commissaries, including those Perfect Pizza locations formerly operated by us, for which we remain contractually liable; and increased risks associated with our international operations, including economic and political conditions in our international markets and difficulty in meeting planned sales targets for our international operations. These and other risk factors as discussed in detail in “Part I. Item 1A. – Risk Factors” in our Annual Report on Form 10-K for our 2010 fiscal year and “Part II. Item 1A. – Risk Factors” of the Quarterly Report on Form 10-Q for the fiscal quarter ended June 26, 2011, could materially affect the Company’s business, financial condition or operating results. 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

Our debt at September 25, 2011 was comprised of a \$50.0 million outstanding principal balance on our \$175.0 million unsecured revolving line of credit. The interest rate on the revolving line of credit is variable and is based on the London Interbank Offered Rate (LIBOR) plus a 100.0 to 175.0 basis point spread, tiered based upon debt and cash flow levels, or other bank developed rates at our option.

In August 2011, we entered into a new interest rate swap agreement that provides for a fixed rate of 0.53%, as compared to LIBOR, with a notional amount of \$50.0 million. The new interest rate swap agreement expires in August 2013. We had two interest rate swap agreements that expired in January 2011. The previous swap agreements provided for fixed rates of 4.98% and 3.74%, as compared to LIBOR, with each having a notional amount of \$50.0 million.

The effective interest rate on the revolving line of credit, including the impact of the interest rate swap agreement, was 1.53% as of September 25, 2011. An increase in the present interest rate of 100 basis points on the line of credit balance outstanding as of September 25, 2011, net of the swap, would have no impact on interest expense.

We do not enter into financial instruments to manage foreign currency exchange rates since less than 5% of our total revenues are derived from sales to customers and royalties outside the contiguous United States.

Cheese costs, historically representing 35% to 40% of our total food cost, are subject to seasonal fluctuations, weather, availability, demand and other factors that are beyond our control. As previously discussed in “Results of Operations and Critical Accounting Policies and Estimates”, we had a purchasing arrangement with a third-party entity, BIBP, formed at the direction of our Franchise Advisory Council, for the sole purpose of reducing cheese price volatility to restaurants operating in the United States. In February 2011, we terminated this purchasing arrangement with BIBP and BIBP ceased operations. Over 99% of our franchisees have entered into a cheese purchasing agreement with PJFS. The cheese purchasing agreement specifies that PJFS will charge the franchisees a predetermined price for cheese on a monthly basis. Any difference between the amount charged to franchisees and the actual price paid by PJFS for cheese will be recorded as a receivable from or a payable to the franchisees, to be repaid based upon a predetermined formula outlined in the agreement.

Consolidation accounting requires the portion of BIBP operating income (loss) related to domestic Company-owned restaurants to be reflected as a reduction (increase) in the “Domestic Company-owned restaurant expenses – cost of sales” line item, thus reflecting the actual market price of cheese had the purchasing arrangement not existed. The consolidation of BIBP had a significant impact on our 2010 operating results, and no impact in 2011 as BIBP had breakeven results while operating through February 2011.

The following table presents the actual average block price for cheese by quarter through the third quarter of 2011 and the projected fourth quarter and full-year 2011 average block price (based on the October 26, 2011 Chicago Mercantile Exchange milk futures market prices), and the average BIBP block price by quarter for 2010:

|           | 2011<br>Projected<br>Block Price | 2010<br>BIBP<br>Block Price | Actual<br>Block<br>Price |
|-----------|----------------------------------|-----------------------------|--------------------------|
| Quarter 1 | \$ 1.695                         | \$ 1.595                    | \$ 1.431                 |
| Quarter 2 | 1.736                            | 1.529                       | 1.407                    |
| Quarter 3 | 2.006                            | 1.572                       | 1.597                    |
| Quarter 4 | 1.704 *                          | 1.645                       | 1.578                    |
| Full Year | \$ 1.785 *                       | \$ 1.585                    | \$ 1.503                 |

\*amounts are estimates based on futures prices

BIBP operated at breakeven in 2011 and ceased operations in February 2011. The following table presents the 2010 impact by quarter on our pre-tax income due to consolidating BIBP (in thousands):

|               | Actual<br>2010 |
|---------------|----------------|
| Quarter 1     | \$ 3,485       |
| Quarter 2     | 2,678          |
| Quarter 3     | (658 )         |
| Quarter 4 (a) | 15,449         |
| Full Year     | \$ 20,954      |

(a) Includes a reduction in BIBP's cost of sales of \$14.2 million at 2010 fiscal year-end associated with PJFS's agreement to pay BIBP for past cheese purchases an amount equal to its accumulated deficit.

#### Item 4. Controls and Procedures

Our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended ("1934 Act")). Based upon their evaluation, the CEO and CFO concluded that the disclosure controls and procedures are effective as of the end of the period covered by this report.

We also maintain a system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the 1934 Act) designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. During our most recent fiscal quarter, there have been no changes in our internal control over financial reporting that occurred that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.



## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

We are subject to claims and legal actions in the ordinary course of business. We believe that all such claims and actions currently pending against us are either adequately covered by insurance or would not have a material adverse effect on us if decided in a manner unfavorable to us.

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

Our Board of Directors has authorized the repurchase of up to \$875.0 million of common stock under a share repurchase program that began on December 9, 1999 and expires on December 31, 2011. Through September 25, 2011, a total of 47.0 million shares with an aggregate cost of \$837.7 million and an average price of \$17.82 per share have been repurchased under this program. Subsequent to September 25, 2011, through October 26, 2011, we acquired an additional 252,000 shares with an aggregate cost of \$7.7 million and an average cost of \$30.74 per share. As of October 26, 2011, \$29.5 million remained available for the repurchase of common stock under this authorization.

The following table summarizes our repurchases by fiscal period during the first nine months of 2011 (in thousands, except per-share amounts):

| Fiscal Period              | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total Number<br>of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | Maximum<br>Dollar<br>Value of<br>Shares<br>that May Yet<br>Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|----------------------------|---|---------------------------------------|--|---|
| 12/27/2010 -<br>01/23/2011 | 66  | \$27.93                               | 45,455   | \$85,030  |
| 01/24/2011 -<br>02/20/2011 | -   | -*                                    | 45,455   | \$85,030  |
| 02/21/2011 -<br>03/27/2011 | 77  | \$29.57                               | 45,532   | \$82,742  |
| 03/28/2011 -<br>04/24/2011 | 15  | \$30.01                               | 45,547   | \$82,288  |
| 04/25/2011 -<br>05/22/2011 | 140                                       | \$31.39                               | 45,687   | \$77,892  |
| 05/23/2011 -<br>06/26/2011 | 519                                       | \$33.11                               | 46,206   | \$60,699  |
| 06/27/2011 -<br>07/24/2011 | 96  | \$32.04                               | 46,302   | \$57,636  |
| 07/25/2011 -<br>08/21/2011 | 223                                       | \$29.48                               | 46,525   | \$51,052  |
|                            | 479                                       | \$28.77                               | 47,004   | \$37,282  |

08/22/2011 -  
09/25/2011

\*There were no share repurchases during this period.

In May 2011, our authorization to repurchase common stock increased by \$50.0 million. For presentation purposes, the maximum dollar value of shares that may be purchased was adjusted retroactively to December 26, 2010.

The Company utilizes a written trading plan under Rule 10b5-1 under the Securities Exchange Act of 1934, as amended from time to time, to facilitate the repurchase of shares of our common stock under this share repurchase program. There can be no assurance that we will repurchase shares of our common stock either through a Rule 10b5-1 trading plan or otherwise.

In May 2011, 34,000 shares of the Company's common stock were acquired from employees to satisfy 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.

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Item 6. Exhibits

| Exhibit Number | Description   |
|----------------|---|
| 31.1           | Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2           | Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1           | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2           | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101            | Financial statements from the quarterly report on Form 10-Q of Papa John's International, Inc. for the quarter ended September 25, 2011, filed on November 1, 2011, formatted in XBRL: (i) the Consolidated Statements of Income, (ii) the Condensed Consolidated Balance Sheets, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) Notes to Condensed Consolidated Financial Statements. |

SIGNATURE

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

PAPA JOHN'S INTERNATIONAL, INC.  
(Registrant)

Date: November 1, 2011

/s/ Lance F. Tucker  
Lance F. Tucker  
Senior Vice President and  
Chief Financial Officer