PAPA JOHNS INTERNATIONAL INC
Form 10-Q
May 08, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 1, 2018

OR

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

Commission File Number: 0-21660

PAPA JOHN'S INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 61-1203323 |

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

2002 Papa John's Boulevard

Louisville, Kentucky 40299-2367

(Address of principal executive offices)

(502) 261-7272

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| | Emerging growth company |

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

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

At May 1, 2018, there were outstanding 32,193,319 shares of the registrant's common stock, par value $0.01 per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

| (In thousands, except per share amounts) | April 1, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 31,935 | $ 22,345 |
| Accounts receivable, net | 62,949 | 64,644 |
| Notes receivable, net | 4,662 | 4,333 |
| Income tax receivable | — | 3,903 |
| Inventories | 28,285 | 30,620 |
| Prepaid expenses | 27,990 | 28,522 |
| Other current assets | 17,529 | 9,494 |
| Assets held for sale | 5,900 | 6,133 |
| Total current assets | 179,250 | 169,994 |
| Property and equipment, net | 229,576 | 234,331 |
| Notes receivable, less current portion, net | 16,084 | 15,568 |
| Goodwill | 86,746 | 86,892 |
| Deferred income taxes, net | 614 | 585 |
| Other assets | 67,547 | 48,183 |
| Total assets | $ 579,817 | $ 555,553 |
| | | |
| Liabilities and stockholders' equity (deficit) | | |
| Current liabilities: | | |
| Accounts payable | $ 31,072 | $ 32,006 |
| Income and other taxes payable | 10,094 | 10,561 |
| Accrued expenses and other current liabilities | 92,890 | 70,293 |
| Deferred revenue current | 2,400 | — |
| Current portion of long-term debt | 20,000 | 20,000 |
| Total current liabilities | 156,456 | 132,860 |
| Deferred revenue | 13,671 | 2,652 |
| Long-term debt, less current portion, net | 568,770 | 446,565 |
| Deferred income taxes, net | 6,125 | 12,546 |
| Other long-term liabilities | 76,993 | 60,146 |
| Total liabilities | 822,015 | 654,769 |

| | | |
|---|---|---|
| Redeemable noncontrolling interests | 7,037 | 6,738 |
| Stockholders' equity (deficit): | | |
| Preferred stock ($0.01 par value per share; no shares issued) | — | — |
| Common stock ($0.01 par value per share; issued 44,268 at April 1, 2018 and 44,221 at December 31, 2017) | 443 | 442 |
| Additional paid-in capital | 163,198 | 184,785 |
| Accumulated other comprehensive income (loss) | 4,110 | (2,117) |
| Retained earnings | 280,853 | 292,251 |
| Treasury stock (12,245 shares at April 1, 2018 and 10,290 shares at December 31, 2017, at cost) | (714,097) | (597,072) |
| Total stockholders' equity (deficit), net of noncontrolling interests | (265,493) | (121,711) |
| Noncontrolling interests in subsidiaries | 16,258 | 15,757 |
| Total stockholders' equity (deficit) | (249,235) | (105,954) |
| Total liabilities, redeemable noncontrolling interests and stockholders' equity (deficit) | $ 579,817 | $ 555,553 |

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

| | Three Months Ended | |
|---|---|---|
| (In thousands, except per share amounts) | April 1, 2018 | March 26, 2017 |
| Revenues: | | |
| Domestic Company-owned restaurant sales | $ 190,242 | $ 206,896 |
| North America franchise royalties and fees | 24,806 | 27,607 |
| North America commissary | 161,713 | 171,340 |
| International | 30,114 | 25,622 |
| Other revenues | 20,494 | 17,801 |
| Total revenues | 427,369 | 449,266 |
| Costs and expenses: | | |
| Operating costs (excluding depreciation and amortization shown separately below): | | |
| Domestic Company-owned restaurant expenses | 157,319 | 165,419 |
| North America commissary | 151,681 | 159,957 |
| International expenses | 19,030 | 15,791 |
| Other expenses | 20,958 | 17,547 |
| General and administrative expenses | 39,729 | 36,414 |
| Depreciation and amortization | 11,539 | 10,457 |
| Total costs and expenses | 400,256 | 405,585 |
| Refranchising gain, net | 204 | — |
| Operating income | 27,317 | 43,681 |
| Net Interest expense | (4,955) | (1,810) |
| Income before income taxes | 22,362 | 41,871 |
| Income tax expense | 4,982 | 11,972 |
| Net income before attribution to noncontrolling interests | 17,380 | 29,899 |
| Income attributable to noncontrolling interests | (643) | (1,471) |
| Net income attributable to the Company | $ 16,737 | $ 28,428 |
| | | |
| Calculation of income for earnings per share: | | |
| Net income attributable to the Company | $ 16,737 | $ 28,428 |
| Change in noncontrolling interest redemption value | — | 520 |
| Net income attributable to participating securities | (75) | (117) |
| Net income attributable to common shareholders | $ 16,662 | $ 28,831 |
| | | |
| Basic earnings per common share | $ 0.50 | $ 0.78 |
| Diluted earnings per common share | $ 0.50 | $ 0.77 |
| | | |
| Basic weighted average common shares outstanding | 33,279 | 36,810 |
| Diluted weighted average common shares outstanding | 33,552 | 37,350 |

| | | |
|---|---|---|
| Dividends declared per common share | $ 0.225 | $ 0.200 |

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

| (In thousands) | Three Months Ended April 1, 2018 | March 26, 2017 |
|---|---|---|
| Net income before attribution to noncontrolling interests | $ 17,380 | $ 29,899 |
| Other comprehensive income (loss), before tax: | | |
| Foreign currency translation adjustments | 1,983 | 613 |
| Interest rate swaps (1) | 6,718 | (468) |
| Other comprehensive income (loss), before tax | 8,701 | 145 |
| Income tax effect: | | |
| Foreign currency translation adjustments | (473) | (227) |
| Interest rate swaps (2) | (1,545) | 173 |
| Income tax effect (3) | (2,018) | (54) |
| Other comprehensive income (loss), net of tax | 6,683 | 91 |
| Comprehensive income before attribution to noncontrolling interests | 24,063 | 29,990 |
| Less: comprehensive income, redeemable noncontrolling interests | 344 | (794) |
| Less: comprehensive income, nonredeemable noncontrolling interests | 299 | (677) |
| Comprehensive income attributable to the Company | $ 24,706 | $ 28,519 |

(1) Amounts reclassified out of accumulated other comprehensive income (loss) into net interest expense included $108 and $198 for the three months ended April 1, 2018 and March 26, 2017, respectively.

(2) The income tax effects of amounts reclassified out of accumulated other comprehensive income (loss) into net interest expense were $25 and $73 for the three months ended April 1, 2018 and March 26, 2017, respectively.

(3) As of January 1, 2018, we adopted ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," and reclassified stranded tax effects of approximately $450 to retained earnings. See "Note 2" of "Notes to Condensed Consolidated Financial Statements" for additional information.

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

| | Three Months Ended | |
|---|---|---|
| (In thousands) | April 1, 2018 | March 26, 2017 |
| Operating activities | | |
| Net income before attribution to noncontrolling interests | $ 17,380 | $ 29,899 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for uncollectible accounts and notes receivable | 1,539 | (417) |
| Depreciation and amortization | 11,539 | 10,457 |
| Deferred income taxes | (2,004) | 1,015 |
| Stock-based compensation expense | 2,475 | 2,736 |
| Gain on refranchising | (204) | — |
| Other | 1,903 | 769 |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | 86 | (1,048) |
| Income tax receivable | 3,903 | 2,372 |
| Inventories | 2,193 | 2,425 |
| Prepaid expenses | (217) | 3,574 |
| Other current assets | 5,097 | (134) |
| Other assets and liabilities | (514) | (1,577) |
| Accounts payable | 1,209 | (5,239) |
| Income and other taxes payable | (466) | 7,817 |
| Accrued expenses and other current liabilities | (3,103) | (5,164) |
| Deferred revenue | 220 | (156) |
| Net cash provided by operating activities | 41,036 | 47,329 |
| Investing activities | | |
| Purchases of property and equipment | (9,320) | (15,064) |
| Loans issued | (563) | (715) |
| Repayments of loans issued | 1,636 | 863 |
| Acquisitions, net of cash acquired | — | (21) |
| Proceeds from divestitures of restaurants | 3,690 | — |
| Other | 114 | 7 |
| Net cash used in investing activities | (4,443) | (14,930) |
| Financing activities | | |
| Repayments of term loan | (5,000) | — |
| Net proceeds (repayments) of revolving credit facility | 127,000 | (5,575) |
| Cash dividends paid | (7,565) | (7,354) |
| Tax payments for equity award issuances | (1,342) | (2,259) |
| Proceeds from exercise of stock options | 1,770 | 3,248 |
| Acquisition of Company common stock | (141,736) | (13,075) |
| Distributions to noncontrolling interest holders | (432) | (702) |
| Other | 183 | 396 |

| | | |
|---|---|---|
| Net cash used in financing activities | (27,122) | (25,321) |
| Effect of exchange rate changes on cash and cash equivalents | 119 | 74 |
| Change in cash and cash equivalents | 9,590 | 7,152 |
| Cash and cash equivalents at beginning of period | 22,345 | 15,563 |
| Cash and cash equivalents at end of period | $ 31,935 | $ 22,715 |

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

April 1, 2018

## 1.Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete annual financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three months ended April 1, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 30, 2018. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for Papa John's International, Inc. (referred to as the "Company", "Papa John's" or in the first-person notations of "we", "us" and "our") for the year ended December 31, 2017.

## 2.Significant Accounting Policies

### Noncontrolling Interests

Papa John's has four joint venture arrangements in which there are noncontrolling interests held by third parties after the divestiture of one joint venture in the first quarter of 2018. See Note 7 for more information on this divestiture. These joint ventures include 216 restaurants at April 1, 2018. We are required to report the consolidated net income at amounts attributable to the Company and the noncontrolling interests. Additionally, disclosures are required to clearly identify and distinguish between the interests of the Company and the interests of the noncontrolling owners, including a disclosure on the face of the Condensed Consolidated Statements of Income attributable to the noncontrolling interest holders.

The income before income taxes attributable to these joint ventures for the three months ended April 1, 2018 and March 26, 2017 was as follows (in thousands):

| | Three Months Ended | |
|---|---|---|
| | April 1, 2018 | March 26, 2017 |
| Papa John's International, Inc. | $ 1,295 | $ 2,362 |
| Noncontrolling interests | 643 | 1,471 |
| Total income before income taxes | $ 1,938 | $ 3,833 |

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

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

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Revenue Recognition

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

As further described in Accounting Standards Adopted and Note 3, Adoption of ASU 2014-09, "Revenue from Contracts with Customers," revenue recognition in 2018 follows ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)" and ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing." Prior year revenue recognition follows ASU Topic 605, Revenue Recognition.

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

Company-owned Restaurant Sales

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

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

Commissary Sales

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

Franchise Royalties and Fees

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

The majority of initial franchise license fees and area development fees are from international locations.  The franchise license fees are billed at the store opening date.  Area development exclusivity fees are billed upon execution of the development agreements which grant the right to develop franchised restaurants in future periods in specific geographic areas.  Area development exclusivity fees are included in deferred revenue in the Condensed Consolidated Balance Sheets and allocated on a pro rata basis to all stores opened under that specific development agreement.  Franchise license renewal fees for both domestic and international locations, which generally occur every 10 years, are billed before the renewal date.  The pre-opening services provided to franchisees do not contain separate and distinct performance obligations from the franchise right; thus, the fees collected will be amortized on a straight-line basis

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beginning at the store opening date through the term of the franchise agreement, which is typically 10 years. Fees received for future renewal periods are amortized over the life of the renewal period. For periods prior to adoption of Topic 606, revenue was recognized when we performed our obligations related to such fees, primarily the store opening date for initial franchise fees and area development fees, or the date the renewal option was effective for renewal fees.

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

Other Revenues

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

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

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

Franchise Marketing Fund revenues represent contributions collected by various international and domestic marketing funds where we have determined that we have control over the activities of the fund. Contributions are based on a percentage of monthly restaurant sales. The adoption of Topic 606 revises the determination of whether these arrangements are considered principal versus agent. When we are determined to be the principal in these arrangements, advertising fund contributions and expenditures are reported on a gross basis in the Condensed Consolidated Statements of Income. We expect such advertising fund contributions and expenditures will be largely offsetting and therefore do not expect a significant impact on our reported income before income taxes. Our obligation related to these funds is to develop and conduct advertising activities in a specific country, region, or market, including the placement of electronic and print materials. Marketing fund contributions are billed monthly.

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

Deferred Income Tax Accounts and Tax Reserves

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

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax attribute carryforwards (e.g., net operating losses, capital losses, and foreign tax credits). The effect on deferred taxes of changes in tax rates is recognized

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in the period in which the new tax rate is enacted. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted, significantly decreasing the U.S. federal income tax rate for corporations effective January 1, 2018. As a result, we remeasured our deferred tax assets, liabilities and related valuation allowances. This remeasurement yielded a one-time benefit of approximately $7.0 million due to the lower income tax rate in 2017. Given the substantial changes associated with the Tax Act, the estimated financial impacts for 2017 are provisional and subject to further interpretation and clarification of the Tax Act during 2018. As of April 1, 2018, we had a net deferred income tax liability of approximately $5.5 million.

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

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

Fair Value Measurements and Disclosures

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

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

· Level 1: Quoted market prices in active markets for identical assets or liabilities.

·

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

· Level 3: Unobservable inputs that are not corroborated by market data.

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

| | Carrying | Fair Value Measurements | | |
|---|---|---|---|---|
| | Value | Level 1 | Level 2 | Level 3 |
| April 1, 2018 | | | | |
| Financial assets: | | | | |
| Cash surrender value of life insurance policies (a) | $ 28,469 | $ 28,469 | $ — | $ — |
| Interest rate swaps (b) | 7,369 | — | 7,369 | — |
| December 31, 2017 | | | | |
| Financial assets: | | | | |
| Cash surrender value of life insurance policies (a) | $ 28,645 | $ 28,645 | $ — | $ — |
| Interest rate swaps (b) | 651 | — | 651 | — |

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

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

Our assets and liabilities that were measured at fair value on a non-recurring basis as of April 1, 2018 and December 31, 2017 include assets and liabilities held for sale. The fair value was determined using a market-based approach with unobservable inputs (Level 3) less any estimated selling costs.

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

Variable Interest Entity

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

Accounting Standards Adopted

Revenue from Contracts with Customers

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

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

Certain Tax effects from Accumulated Other Comprehensive Income

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

Accounting Standards to be Adopted in Future Periods

Leases

In February 2016, the FASB issued ASU 2016-02, "Leases," ("ASU 2016-02"), which amends leasing guidance by requiring companies to recognize a right-of-use asset and a lease liability for all operating and capital leases (financing) with lease terms greater than twelve months. The lease liability will be equal to the present value of lease payments. The lease asset will be based on the lease liability, subject to adjustment, such as for initial direct costs. For income statement purposes, leases will continue to be classified as operating or capital (financing) with lease expense in both

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cases calculated substantially the same as under the prior leasing guidance. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018 (fiscal 2019 for the Company), and early adoption is permitted. The Company has not yet determined the full impact of the adoption on its consolidated financial statements but expects the adoption will result in a significant increase in the non-current assets and liabilities reported on our Consolidated Balance Sheet.

Reclassification

Certain prior year amounts have been reclassified in the Condensed Consolidated Statement of Income. See Note 10 for additional information.

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

The Company adopted ASU 2014-09 and Topic 606 using the modified retrospective transition method effective January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented in accordance with Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605, Revenue Recognition.

The cumulative effect adjustment of $21.5 million was recorded as a reduction to retained earnings as of January 1, 2018 to reflect the impact of adopting Topic 606. The impact of applying Topic 606 for the quarter ended April 1, 2018, was an increase in revenues of $2.4 million and a decrease of $0.5 million in pre-tax income.

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

Cumulative adjustment from adoption

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

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

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

| | | | |
|---|---|---|---|
| Additional paid-in capital | 184,785 | — | 184,785 |
| Accumulated other comprehensive loss | (2,117) | — | (2,117) |
| Retained earnings | 292,251 | (21,527) | 270,724 |
| Treasury stock (10,290 shares at December 31, 2017, at cost) | (597,072) | — | (597,072) |
| Total stockholders' equity (deficit), net of noncontrolling interests | (121,711) | (21,527) | (143,238) |
| Noncontrolling interests in subsidiaries | 15,757 | — | 15,757 |
| Total stockholders' equity (deficit) | (105,954) | (21,527) | (127,481) |
| Total liabilities, redeemable noncontrolling interests and stockholders' equity (deficit) | $ 555,553 | $ (1,094) | $ 554,459 |

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

| (In thousands, except per share amounts) | As Reported April 1, 2018 | Total Adjustments | Balance Sheet Without Adoption of Topic 606 |
|---|---|---|---|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 31,935 | $ (3,422) | $ 28,513 |
| Accounts receivable, net | 62,949 | (376) | 62,573 |
| Notes receivable, net | 4,662 | — | 4,662 |
| Income tax receivable | — | — | — |
| Inventories | 28,285 | — | 28,285 |
| Prepaid expenses | 27,990 | 4,398 | 32,388 |
| Other current assets | 17,529 | — | 17,529 |
| Assets held for sale | 5,900 | — | 5,900 |
| Total current assets | 179,250 | 600 | 179,850 |
| Property and equipment, net | 229,576 | — | 229,576 |
| Notes receivable, less current portion, net | 16,084 | — | 16,084 |
| Goodwill | 86,746 | — | 86,746 |
| Deferred income taxes, net | 614 | — | 614 |
| Other assets | 67,547 | 907 | 68,454 |
| Total assets | $ 579,817 | $ 1,507 | $ 581,324 |
| Liabilities and stockholders' equity (deficit) | | | |
| Current liabilities: | | | |
| Accounts payable | $ 31,072 | $ 1,237 | $ 32,309 |
| Income and other taxes payable | 10,094 | — | 10,094 |
| Accrued expenses and other current liabilities | 92,890 | (14,854) | 78,036 |
| Deferred revenue current | 2,400 | (2,400) | — |
| Current portion of long-term debt | 20,000 | — | 20,000 |
| Total current liabilities | 156,456 | (16,017) | 140,439 |
| Deferred revenue | 13,671 | (11,027) | 2,644 |
| Long-term debt, less current portion, net | 568,770 | — | 568,770 |
| Deferred income taxes, net | 6,125 | 6,593 | 12,718 |
| Other long-term liabilities | 76,993 | — | 76,993 |
| Total liabilities | 822,015 | (20,451) | 801,564 |
| Redeemable noncontrolling interests | 7,037 | — | 7,037 |
| Stockholders' equity (deficit): | | | |
| Preferred stock ($0.01 par value per share; no shares issued) | — | — | — |
| Common stock ($0.01 par value per share; issued 44,268 at April 1, 2018) | 443 | — | 443 |

| | | | |
|---|---|---|---|
| Additional paid-in capital | 163,198 | — | 163,198 |
| Accumulated other comprehensive income (loss) | 4,110 | — | 4,110 |
| Retained earnings | 280,853 | 21,958 | 302,811 |
| Treasury stock (12,245 shares at April 1, 2018, at cost) | (714,097) | — | (714,097) |
| Total stockholders' equity (deficit), net of noncontrolling interests | (265,493) | 21,958 | (243,535) |
| Noncontrolling interests in subsidiaries | 16,258 | — | 16,258 |
| Total stockholders' equity (deficit) | (249,235) | 21,958 | (227,277) |
| Total liabilities, redeemable noncontrolling interests and stockholders' equity (deficit) | $ 579,817 | $ 1,507 | $ 581,324 |

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| (In thousands, except per share amounts) | As Reported Three Months Ended April 1, 2018 | Total Adjustments | Income Statement Without Adoption of Topic 606 |
|---|---|---|---|
| Revenues: | | | |
| Domestic Company-owned restaurant sales | $ 190,242 | $ 264 | $ 190,506 |
| North America franchise royalties and fees | 24,806 | 38 | 24,844 |
| North America commissary | 161,713 | — | 161,713 |
| International | 30,114 | 149 | 30,263 |
| Other revenues | 20,494 | (2,887) | 17,607 |
| Total revenues | 427,369 | (2,436) | 424,933 |
| Costs and expenses: | | | |
| Operating costs (excluding depreciation and amortization shown separately below): | | | |
| Domestic Company-owned restaurant expenses | 157,319 | (66) | 157,253 |
| North America commissary | 151,681 | — | 151,681 |
| International expenses | 19,030 | — | 19,030 |
| Other expenses | 20,958 | (3,359) | 17,599 |
| General and administrative expenses | 39,729 | 504 | 40,233 |
| Depreciation and amortization | 11,539 | — | 11,539 |
| Total costs and expenses | 400,256 | (2,921) | 397,335 |
| Refranchising and impairment gains/(losses), net | 204 | — | 204 |
| Operating income | 27,317 | 485 | 27,802 |
| Net Interest expense | (4,955) | — | (4,955) |
| Income before income taxes | 22,362 | 485 | 22,847 |
| Income tax expense | 4,982 | 112 | 5,094 |
| Net income before attribution to noncontrolling interests | 17,380 | 373 | 17,753 |
| Income attributable to noncontrolling interests | (643) | — | (643) |
| Net income attributable to the Company | $ 16,737 | $ 373 | $ 17,110 |
| | | | |
| Calculation of income for earnings per share: | | | |
| Net income attributable to the Company | $ 16,737 | $ 373 | $ 17,110 |
| Change in noncontrolling interest redemption value | — | — | — |
| Net income attributable to participating securities | (75) | — | (75) |
| Net income attributable to common shareholders | $ 16,662 | $ 373 | $ 17,035 |
| | | | |
| Basic earnings per common share | $ 0.50 | $ 0.01 | $ 0.51 |
| Diluted earnings per common share | $ 0.50 | $ 0.01 | $ 0.51 |
| | | | |
| Basic weighted average common shares outstanding | 33,279 | 33,279 | 33,279 |
| Diluted weighted average common shares outstanding | 33,552 | 33,552 | 33,552 |

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Transaction Price Allocated to the Remaining Performance Obligations

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

| | Performance Obligations by Period | | | | | | |
|---|---|---|---|---|---|---|---|
| | Less than 1 Year | 1-2 Years | 2-3 Years | 3-4 Years | 4-5 Years | Thereafter | Total |
| Franchise Fees | $ 2,400 | $ 2,141 | $ 1,909 | $ 1,681 | $ 1,461 | $ 3,835 | $ 13,427 |

An additional $2.6 million of area development fees related to unopened stores is included in deferred revenue. Timing of revenue recognition is dependent upon the timing of store openings.

As of April 1, 2018, the amount allocated to the Papa Rewards loyalty program is $15.0 million and is reflected in the Condensed Consolidated Balance Sheet as part of the contract liability. This will be recognized as revenue as the points are redeemed, which is expected to occur within the next year. If participants earn and redeem points at a consistent rate, there would be minimal change to the liability.

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

4. Revenue Recognition

Disaggregation of Revenue

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

Reportable Segments
Quarter Ended April 1, 2018

| Major Products/Services Lines | Domestic Company-owned restaurants | North America commissaries | North America franchising | International | All others | Total |
|---|---|---|---|---|---|---|
| Company-owned restaurant sales | $ 190,242 | $ - | $ - | $ 3,453 | $ - | $ 193,695 |
| Commissary sales | - | 217,587 | - | 17,679 | - | 235,266 |
| Franchise royalties and fees | - | - | 25,825 | 8,982 | - | 34,807 |
| Other revenues | - | - | - | 5,488 | 23,150 | 28,638 |
| Eliminations | - | (55,874) | (1,019) | (70) | (8,074) | (65,037) |
| Total | $ 190,242 | $ 161,713 | $ 24,806 | $ 35,532 | $ 15,076 | $ 427,369 |

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

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Contract Balances

The following table (in thousands) provides information about contract liabilities.

| | April 1, 2018 | January 1, 2018 | Change |
|---|---|---|---|
| Deferred revenue | $ 16,071 | $ 15,850 | $ 220 |
| Customer loyalty program | 15,022 | 14,724 | 298 |
| Total contract liabilities | $ 31,093 | $ 30,574 | $ 518 |

The contract liabilities primarily relate to franchise fees which we classify as “Deferred revenue” and customer loyalty program obligations which are classified with “Accrued expenses and other current liabilities.” During the first quarter of 2018, the Company recognized $3.9 million in revenue related to deferred revenue and customer loyalty program.

5. Stockholders’ Equity (Deficit)

Shares Authorized and Outstanding

The Company has authorized 5.0 million shares of preferred stock and 100.0 million shares of common stock. The Company’s outstanding shares of common stock, net of repurchased common stock, were 32.0 million shares at April 1, 2018 and 33.9 million shares at December 31, 2017. There were no shares of preferred stock issued or outstanding at April 1, 2018 and December 31, 2017.

Share Repurchase Program

Our Board of Directors has authorized the repurchase of up to $2.075 billion of common stock under a share repurchase program that began on December 9, 1999 and expires on February 27, 2019. Funding for the share repurchase program has been provided through a credit facility, operating cash flow, stock option exercises and cash and cash equivalents.

On March 1, 2018, the Company announced a $100 million accelerated share repurchase agreement (“ASR Agreement”) with Bank of America, N.A. (“BofAML”). Pursuant to the terms of the ASR Agreement, we paid BofAML $100.0 million in cash, and on March 6, 2018, we received an initial delivery of approximately 1.3 million shares of common stock for approximately $78.0 million. The accelerated share repurchase transaction qualifies for equity accounting treatment. Shares that have been paid for but not yet delivered are reflected as a reduction of additional paid-in-capital while other repurchased common stock is reflected as an increase in treasury stock within stockholders’ equity (deficit). Additional shares may be received prior to and/or at final settlement, based generally on the average of the daily volume-weighted average prices of our Company’s common stock during the term of the ASR Agreement, less a discount. Subsequent to the end of the quarter through May 1, 2018, the Company acquired an additional 28,739 shares at an aggregate cost of $1.7 million through the ASR Agreement.

Cash Dividend

The Company paid a cash dividend of approximately $7.6 million ($0.225 per common share) during the first quarter of 2018. Subsequent to the first quarter, on May 2, 2018, our Board of Directors declared a first quarter dividend of $0.225 per common share (approximately $7.3 million based on the number of shares outstanding as of May 1, 2018). The dividend will be paid on May 25, 2018 to shareholders of record as of the close of business on May 14, 2018.

6.Earnings Per Share

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

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method, undistributed earnings allocated to participating securities are subtracted from net income attributable to the Company in determining net income attributable to common shareholders.

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

| | Three Months Ended April 1, 2018 | Three Months Ended March 26, 2017 |
|---|---|---|
| Basic earnings per common share: | | |
| Net income attributable to the Company | $ 16,737 | $ 28,428 |
| Change in noncontrolling interest redemption value | — | 520 |
| Net income attributable to participating securities | (75) | (117) |
| Net income attributable to common shareholders | $ 16,662 | $ 28,831 |
| Weighted average common shares outstanding | 33,279 | 36,810 |
| Basic earnings per common share | $ 0.50 | $ 0.78 |
| Diluted earnings per common share: | | |
| Net income attributable to common shareholders | $ 16,662 | $ 28,831 |
| Weighted average common shares outstanding | 33,279 | 36,810 |
| Dilutive effect of outstanding equity awards (a) | 273 | 540 |
| Diluted weighted average common shares outstanding | 33,552 | 37,350 |
| Diluted earnings per common share | $ 0.50 | $ 0.77 |

(a) Excludes 790 and 117 awards for the three months ended April 1, 2018 and March 26, 2017, respectively, as the effect of including such awards would have been antidilutive.

## 7.Divestiture

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

In connection with the divestiture, we wrote off $745,000 of goodwill. This goodwill was allocated based on the relative fair value of the sales proceeds versus the total fair value of the company-owned restaurants' reporting unit. There was a refranchising gain of $204,000 on the sale.

As a result of assigning our interest in obligations under property leases as a condition of the refranchising of the Denver market, we are contingently liable for payment of the 31 leases. These leases have varying terms, the latest of which expires in 2024. As of April 1, 2018, the estimated maximum amount of undiscounted payments the Company could be required to make in the event of nonpayment by the primary lessees was $3.9 million. The fair value of the guarantee is not material.

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8.Debt

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

| | April 1, 2018 | December 31, 2017 |
|---|---|---|
| Outstanding debt | $ 592,000 | $ 470,000 |
| Unamortized debt issuance costs | (3,230) | (3,435) |
| Current portion of long-term debt | (20,000) | (20,000) |
| Total long-term debt, less current portion, net | $ 568,770 | $ 446,565 |

Our outstanding debt of $592.0 million at April 1, 2018 represented amounts outstanding under a new credit agreement. On August 30, 2017, we entered into a new credit agreement (the “Credit Agreement”) replacing the previous $500.0 million credit facility (“Previous Credit Facility”). The Credit Agreement provides for an unsecured revolving credit facility in an aggregate principal amount of $600.0 million (the “Revolving Facility”) and an unsecured term loan facility in an aggregate principal amount of $400.0 million (the “Term Loan Facility” and together with the Revolving Facility, the “Facilities”). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to $300.0 million, subject to certain conditions. Our outstanding debt as of April 1, 2018 under the Facilities of $592.0 million was composed of $390.0 million outstanding under the Term Loan and $202.0 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately $364.8 million as of April 1, 2018. In connection with the Credit Agreement, the Company capitalized $3.2 million of debt issuance costs, which are being amortized into interest expense, over the term of the Facilities. Total unamortized debt issuance costs of approximately $3.2 million were netted against debt as of April 1, 2018.

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

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

The Credit Agreement contains customary affirmative and negative covenants, including financial covenants requiring the maintenance of specified fixed charges and leverage ratios. At April 1, 2018, we were in compliance with these financial covenants.

We attempt to minimize interest risk exposure by fixing our rate through the utilization of interest rate swaps, which are derivative financial instruments. Our swaps are entered into with financial institutions that participate in our Credit Agreement. By using a derivative instrument to hedge exposures to changes in interest rates, we expose ourselves to credit risk. Credit risk is due to the possible failure of the counterparty to perform under the terms of the derivative contract.

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

| Effective Dates | Floating Rate Debt | Fixed Rates |
|---|---|---|
| July 30, 2013 through April 30, 2018 | $ 75 million | 1.42 % |
| December 30, 2014 through April 30, 2018 | $ 50 million | 1.36 % |
| April 30, 2018 through April 30, 2023 | $ 55 million | 2.33 % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.36 % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.34 % |
| January 30, 2018 through August 30, 2022 | $ 100 million | 1.99 % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 1.99 % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 2.00 % |
| January 30, 2018 through August 30, 2022 | $ 25 million | 1.99 % |

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

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

| | Interest Rate Swap Derivatives | |
|---|---|---|
| Balance Sheet Location | Fair Value April 1, 2018 | Fair Value December 31, 2017 |
| Other current and long-term assets | $ 7,369 | $ 651 |

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

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

| Derivatives - Cash Flow Hedging Relationships | Amount of Gain or (Loss) Recognized in AOCI/AOCL on Derivative | Location of Gain or (Loss) Reclassified from AOCI/AOCL into Income | Amount of Gain or (Loss) Reclassified from AOCI/AOCL into Income | Total Interest Expense on Consolidated Statements of Income |
|---|---|---|---|---|
| Interest rate swaps for the three months ended: | | | | |
| April 1, 2018 | $ 5,173 | Interest expense | $ (108) | $ (5,220) |
| March 26, 2017 | $ (295) | Interest expense | $ (198) | $ (1,946) |

The weighted average interest rates on our debt, including the impact of the interest rate swap agreements, were 3.5% and 2.2% for the three months ended April 1, 2018 and March 26, 2017, respectively. Interest paid, including payments made or received under the swaps, was $4.9 million and $1.9 million for the three months ended April 1, 2018 and March 26, 2017, respectively. As of April 1, 2018, the portion of the aggregate $7.4 million interest rate swap asset that would be reclassified into earnings during the next twelve months as interest income approximates $1.7 million.

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9.Segment Information

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

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

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

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Our segment information is as follows:

| | Three Months Ended | |
|---|---|---|
| (In thousands) | April 1, 2018 | March 26, 2017 |
| Revenues | | |
| Domestic Company-owned restaurants | $ 190,242 | $ 206,896 |
| North America commissaries | 161,713 | 171,340 |
| North America franchising | 24,806 | 27,607 |
| International | 35,532 | 28,518 |
| All others | 15,076 | 14,905 |
| Total revenues | $ 427,369 | $ 449,266 |
| | | |
| Intersegment revenues: | | |
| North America commissaries | $ 55,874 | $ 61,736 |
| North America franchising | 1,019 | 764 |
| International | 70 | 63 |
| All others | 8,074 | 5,026 |
| Total intersegment revenues | $ 65,037 | $ 67,589 |
| | | |
| Income (loss) before income taxes: | | |
| Domestic Company-owned restaurants | $ 7,229 | $ 15,487 |
| North America commissaries (1) | 8,610 | 12,244 |
| North America franchising | 22,359 | 24,875 |
| International | 3,537 | 4,344 |
| All others (1) (2) | (909) | 460 |
| Unallocated corporate expenses (1) (2) | (18,131) | (16,381) |
| Elimination of intersegment (profits) losses | (333) | 842 |
| Total income before income taxes | $ 22,362 | $ 41,871 |
| | | |
| Property and equipment: | | |
| Domestic Company-owned restaurants | $ 232,662 | |
| North America commissaries | 137,002 | |
| International | 17,784 | |
| All others | 60,993 | |
| Unallocated corporate assets | 193,593 | |
| Accumulated depreciation and amortization | (412,458) | |
| Net property and equipment | $ 229,576 | |

(1) The Company refined its overhead allocation process in 2018 resulting in transfers of expenses from Unallocated corporate expenses of $3.8 million to other segments, primarily North America commissaries of $2.3 million and All others of $900,000. These allocations were eliminated in consolidation.

(2) Certain prior year amounts have been reclassified to conform to current year presentation.

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Note 10. Reclassifications of Prior Year Balances

As shown in the table below we have reclassified certain prior year amounts within the Condensed Consolidated Statements of Income, for the three months ended March 26, 2017, in order to conform with current year presentation. These reclassifications had no effect on previously reported total consolidated revenues, total costs and expenses and net income.

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

| | Three Months Ended March 26, 2017 | | |
|---|---|---|---|
| (In thousands, except per share amounts) | As reported | Reclassifications | Adjusted |
| Revenues: | | | |
| North America commissary and other sales (1) | 186,245 | (14,905) | 171,340 |
| International (2) | 28,518 | (2,896) | 25,622 |
| Other revenues (1) (2) | - | 17,801 | 17,801 |
| Costs and expenses: | | | |
| North America commissary and other expenses (1) | 173,712 | (13,755) | 159,957 |
| International expenses (2) | 17,990 | (2,199) | 15,791 |
| Other expenses (1) (2) (3) | - | 17,547 | 17,547 |
| General and administrative expenses (3) | 38,007 | (1,593) | 36,414 |

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

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

Overview

Papa John’s International, Inc. (referred to as the “Company,” “Papa John’s” or in the first-person notations of “we,” “us” and “our”) began operations in 1984. As of April 1, 2018, there were 5,212 Papa John’s restaurants (713 Company-owned and 4,499 franchised) operating in all 50 states and 45 international countries and territories. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, and information systems and related services used in their operations.

The results of operations are based on the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”). The preparation of consolidated financial statements requires management to select accounting policies for critical accounting areas and make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions in our critical accounting policies could materially impact our operating results. See “Notes 1, 2 and 3” of “Notes to Condensed Consolidated Financial Statements” for a discussion of the basis of presentation and the significant accounting policies.

Restaurant Progression

| | Three Months Ended | |
|---|---|---|
| | April 1, 2018 | March 26, 2017 |
| North America Company-owned: | | |
| Beginning of period | 708 | 702 |
| Opened | 4 | 2 |
| Closed | (2) | — |
| Acquired from franchisees | — | 1 |
| Sold to franchisees | (31) | — |
| End of period | 679 | 705 |
| International Company-owned: | | |
| Beginning of period | 35 | 42 |
| Closed | (1) | (1) |
| End of period | 34 | 41 |
| North America franchised: | | |
| Beginning of period | 2,733 | 2,739 |
| Opened | 18 | 15 |
| Closed | (37) | (30) |

| | | |
|---|---|---|
| Acquired form Company | 31 | — |
| Sold to Company | — | (1) |
| End of period | 2,745 | 2,723 |
| International franchised: | | |
| Beginning of period | 1,723 | 1,614 |
| Opened | 53 | 38 |
| Closed | (22) | (39) |
| End of period | 1,754 | 1,613 |
| Total restaurants - end of period | 5,212 | 5,082 |

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Results of Operations

Revenue Recognition and Income Statement Presentation

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP, including industry-specific requirements, and provides companies with a single revenue recognition framework for recognizing revenue from contracts with customers. In March and April 2016, the FASB issued the following amendments to clarify the implementation guidance: ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” and ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing”. This update and subsequently issued amendments (collectively “Topic 606”) requires companies to recognize revenue at amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services at the time of transfer. The standard requires that we assess contracts to determine each separate and distinct performance obligation.  If a contract has multiple performance obligations, we allocate the transaction price using our best estimate of the standalone selling price to each distinct good or service in the contract.

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

The cumulative effect adjustment of $21.5 million was recorded as a reduction to retained earnings as of January 1, 2018 to reflect the impact of adopting Topic 606. The impact of applying Topic 606 for the quarter ended April 1, 2018 was an increase of $2.4 million to revenues and a decrease of approximately $0.5 million to pre-tax income, or $0.01 diluted earnings per share.

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

Review of Consolidated Operating Results

Revenues. Domestic Company-owned restaurant sales were $190.2 million in the first quarter of 2018, a decrease of $16.7 million, or 8.0%, compared to the first quarter of 2017. This decrease was primarily due to a 6.1% decrease in comparable sales and a 1.1% decrease in equivalent units, driven by the refranchising of the Denver market. “Comparable sales” represents the change in year-over-year sales for the same base of restaurants for the same fiscal periods. “Equivalent units” represents the number of restaurants open at the beginning of a given period, adjusted for restaurants opened, closed, acquired or sold during the period on a weighted average basis.

North America franchise royalties and fees were $24.8 million in the first quarter of 2018, a decrease of $2.8 million, or 10.1%, compared to the first quarter of 2017. The decrease was primarily due to a 5.0% decrease in comparable sales and higher royalty waivers. North America franchise restaurant sales decreased 4.9% to $558.4 million for the three months ended April 1, 2018. The decrease was primarily due to the decrease in comparable sales noted above. North America franchise restaurant sales are not included in Company revenues; however, our North America franchise royalties are derived from these sales.

North America commissary sales were $161.7 million in the first quarter of 2018, a decrease of $9.6 million, or 5.6%, compared to the first quarter of 2017. This decrease was primarily due to lower sales volumes attributable to lower restaurant sales.

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International revenues were $30.1 million in the first quarter of 2018, an increase of $4.5 million, or 17.5%, compared to the first quarter of 2017. This increase was primarily due to a higher number of equivalent units for the first quarter of 2018. The favorable impact of foreign currency exchange rates was approximately $2.8 million for the first quarter of 2018 which was primarily attributable to foreign exchange rates in the United Kingdom ("UK"). International franchise restaurant sales increased 21.1% to $213.1 million, excluding the impact of foreign currency, in the three months ended April 1, 2018 primarily due to an increase in equivalent units. International franchise restaurant sales are not included in Company revenues; however, our international royalty revenue is derived from these sales.

Other revenues were $20.5 million in the first quarter of 2018, an increase of $2.7 million, or 15.1%. The increase is primarily due to the required 2018 reporting of franchise marketing fund revenues and expenses on a gross basis for the various funds we control in accordance with ASU 2014-09 guidelines. These amounts were previously reported on a net basis. As we did not restate the 2017 amounts in accordance with our adoption of ASU 2014-09 guidelines using the modified retrospective approach, comparability between 2018 and 2017 amounts is reduced. See "Note 3" of "Notes to Condensed Consolidated Financial Statements" for more details. This increase was partially offset by lower revenues for Preferred Marketing Solutions, our print and promotions subsidiary.

Costs and expenses. The operating margin for domestic Company-owned restaurants was 17.3% for the first quarter of 2018 compared to 20.0% in the first quarter of 2017, and consisted of the following (dollars in thousands):

| | Three months ended April 1, 2018 | | March 26, 2017 | |
|---|---|---|---|---|
| Restaurant sales | $ 190,242 | | $ 206,896 | |
| Cost of sales | 43,145 | 22.7% | 46,912 | 22.7% |
| Other operating expenses | 114,174 | 60.0% | 118,507 | 57.3% |
| Total expenses | $ 157,319 | 82.7% | $ 165,419 | 80.0% |
| Margin | $ 32,923 | 17.3% | $ 41,477 | 20.0% |

Domestic Company-owned restaurants margin, decreased $8.6 million and 2.7%, as a percentage of restaurant sales, in the first quarter of 2018. The margin decrease for the quarter was primarily attributable to lower comparable sales and unfavorable labor costs including higher minimum wages and increased non-owned automobile costs. As a percentage of restaurant sales, the margin also decreased due to lower sales as a result of the impact of various fixed costs.

North America commissary margin was 6.2% in the first quarter of 2018 compared to 6.6% for the corresponding 2017 periods and consisted of the following (dollars in thousands):

| | Three months ended | | | |
|---|---|---|---|---|
| | April 1, 2018 | | March 26, 2017 | |
| North America commissary sales | $ 161,713 | | $ 171,340 | |
| North America commissary expenses | 151,681 | | 159,957 | |
| Margin | $ 10,032 | 6.2% | $ 11,383 | 6.6% |

North America commissary operating margins decreased $1.4 million, or 0.4%, primarily due to lower sales volumes.

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The international operating margin was 36.8% in the first quarter of 2018 compared to 38.4% in the first quarter of 2017 and consisted of the following (dollars in thousands):

| | Three months ended April 1, 2018 | | | | March 26, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Revenues | Expenses | Margin $ | Margin % | Revenues | Expenses | Margin $ | Margin % |
| Franchise royalties and fees | $ 8,982 | $ - | $ 8,982 | | $ 7,936 | $ - | $ 7,936 | |
| Restaurant, commissary and other | 21,132 | 19,030 | 2,102 | 9.9% | 17,686 | 15,791 | 1,895 | 10.7% |
| Total international | $ 30,114 | $ 19,030 | $ 11,084 | 36.8% | $ 25,622 | $ 15,791 | $ 9,831 | 38.4% |

The higher margin of $1.3 million was primarily attributable to higher royalties on increased franchise restaurant sales, primarily due to an increase in equivalent units and the favorable impact of foreign exchange rates in 2018. The margin decreased 1.6%, as a percentage of sales, primarily due to the higher mix of United Kingdom commissary sales, which have a lower margin than franchise royalties.

As previously discussed, other revenues and other expenses are new financial statement line items. The margin on other revenues and other expenses decreased 3.7% in the first quarter of 2018 compared to the first quarter of 2017 and consisted of the following (dollars in thousands):

| | Three months ended | | | |
|---|---|---|---|---|
| | April 1, 2018 | | March 26, 2017 | |
| Other revenues | $ 20,494 | | $ 17,801 | |
| Other expenses | 20,958 | | 17,547 | |
| Margin (loss) | $ (464) | -2.3% | $ 254 | 1.4% |

Other margin decreased $718,000 in the first quarter of 2018 primarily due to higher advertising spend in the United Kingdom.

General and administrative ("G&A") expenses were $39.7 million, or 9.3% of revenues in the first quarter of 2018 compared to $36.4 million, or 8.1% of revenues in the first quarter of 2017. The increase of $3.3 million was primarily due to an increase in bad debt expense, higher legal costs and an increase in various technology initiative costs.

Depreciation and amortization. Depreciation and amortization was $11.5 million, or 2.7% of revenues in the first quarter of 2018, compared to $10.5 million, or 2.3% of revenues for the first quarter of 2017. This increase is primarily due to additional depreciation on technology related investments and higher depreciation associated with our new Georgia QCC.

Interest expense. Interest expense increased approximately $3.1 million primarily due to both an increase in average outstanding debt balance, which is primarily due to share repurchases, including through our accelerated share repurchase program, as well as higher interest rates.

Income before income taxes. Income before income taxes was $22.4 million, or a decrease of $19.5 million from the same period in 2017. The decrease is attributable to the items described above.

Income tax expense. The effective income tax rate was 22.3% in the first quarter of 2018 representing a decrease of 6.3% from the prior year comparable period. The decrease in the effective income tax rates for 2018 was primarily attributable to the impact of the "Tax Cuts and Jobs Act" (the "Tax Act") which reduced the U.S. corporate tax rate from 35% to 21% in 2018. This decrease was offset by an approximate 3.8% increase in the income tax rate for share-based compensation tax deductions, which were unfavorable in 2018 due to the lower stock price of the Company as restrictions lapsed on equity awards. See "Note 2" of "Notes to Condensed Consolidated Financial Statements" for additional information.

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Diluted earnings per share. Diluted earnings per share decreased 35.1% to $0.50 in the first quarter of 2018 compared to $0.77 in the first quarter of 2017 primarily due to a decrease in net income attributable to common shareholders.

## Liquidity and Capital Resources

### Debt

Our outstanding debt of $592.0 million at April 1, 2018 represented amounts outstanding under a new credit agreement. On August 30, 2017, we entered into a new credit agreement (the "Credit Agreement") replacing the previous $500.0 million credit facility ("Previous Credit Facility"). The Credit Agreement provides for an unsecured revolving credit facility in an aggregate principal amount of $600.0 million (the "Revolving Facility") and an unsecured term loan facility in an aggregate principal amount of $400.0 million (the "Term Loan Facility" and together with the Revolving Facility, the "Facilities"). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to $300.0 million, subject to certain conditions. Our outstanding debt of $592.0 million as of April 1, 2018 under the Facilities was composed of $390.0 million outstanding under the Term Loan and $202.0 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately $364.8 million as of April 1, 2018. In connection with the Credit Agreement, the Company capitalized $3.2 million of debt issuance costs, which are being amortized into interest expense, over the term of the Facilities. Total unamortized debt issuance costs of approximately $3.2 million were netted against debt as of April 1, 2018.

Loans under the Facilities accrue interest at a per annum rate equal to, at the Company's election, either a LIBOR rate plus a margin ranging from 75 to 200 basis points or a base rate (generally determined by a prime rate, federal funds rate or a LIBOR rate plus 1.00%) plus a margin ranging from 0 to 100 basis points. In each case, the actual margin is determined according to a ratio of the Company's total indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA") for the then most recently ended four quarter period (the "Leverage Ratio"). The Previous Credit Facility accrued interest based on the LIBOR rate plus a margin ranging from 75 to 175 basis points. An unused commitment fee at a rate ranging from 15 to 30 basis points per annum, determined according to the Leverage Ratio, applies to the unutilized commitments under the Revolving Facility; the unused commitment fee under the Previous Credit Facility was 15 to 25 basis points. Loans outstanding under the Credit Agreement may be prepaid at any time without premium or penalty, subject to customary breakage costs in the case of borrowings for which a LIBOR rate election is in effect. Up to $35.0 million of the Revolving Facility may be advanced in certain agreed foreign currencies, including Euros, Pounds Sterling, Canadian Dollars, Japanese Yen, and Mexican Pesos.

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

| Effective Dates | Floating Rate Debt | Fixed Rates | |
|---|---|---|---|
| July 30, 2013 through April 30, 2018 | $ 75 million | 1.42 | % |
| December 30, 2014 through April 30, 2018 | $ 50 million | 1.36 | % |
| April 30, 2018 through April 30, 2023 | $ 55 million | 2.33 | % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.36 | % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.34 | % |
| January 30, 2018 through August 30, 2022 | $ 100 million | 1.99 | % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 1.99 | % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 2.00 | % |
| January 30, 2018 through August 30, 2022 | $ 25 million | 1.99 | % |

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

| | Permitted Ratio | Actual Ratio for the Quarter Ended April 1, 2018 |
|---|---|---|
| Leverage Ratio | Not to exceed 4.5 to 1.0 | 3.3 to 1.0 |
| Interest Coverage Ratio | Not less than 2.75 to 1.0 | 3.8 to 1.0 |

As stated above, our leverage ratio is defined as outstanding debt divided by consolidated EBITDA for the most recent four fiscal quarters. The Leverage Ratio permitted by the Credit Agreement will decrease over time to 3.75 to 1.00. Our interest coverage ratio is defined as the sum of consolidated EBITDA and consolidated rental expense for the most recent four fiscal quarters divided by the sum of consolidated interest expense and consolidated rental expense for the most recent four fiscal quarters. We were in compliance with all financial covenants as of April 1, 2018.

Cash Flows

Cash flow provided by operating activities was $41.0 million in the first quarter of 2018 compared to $47.3 million in the first quarter of 2017. The decrease of approximately $6.3 million was primarily due to lower net income.

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

| | Three Months Ended | |
|---|---|---|
| | April 1, 2018 | March 26, 2017 |
| Net cash provided by operating activities | $ 41,036 | $ 47,329 |
| Purchases of property and equipment | (9,320) | (15,064) |
| Free cash flow (a) | $ 31,716 | $ 32,265 |

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

Cash flow used in investing activities was $4.4 million in the first quarter of 2018 compared to $14.9 million for the same period in 2017, or a decrease of $10.5 million. The decrease in cash flow used in investing activities was primarily due to proceeds from the refranchising of our joint venture in Denver, Colorado and lower capital spend as 2017 included construction costs for our commissary in Georgia, which opened in July of 2017.

We also require capital for share repurchases and the payment of cash dividends, which are funded by cash flow from operations and borrowings from our Credit Agreement. In the first quarter of 2018, we had net proceeds of $122.0 million from the issuance of long-term debt and spent $141.7 million on share repurchases. In the first quarter of 2017, we had net repayments of $5.6 million from the issuance of long-term debt and spent $13.1 million of share repurchases.

On March 1, 2018 the Company announced a $100 million accelerated share repurchase agreement (“ASR Agreement”) with Bank of America, N.A. (“BofAML”). Pursuant to the terms of the ASR Agreement, we paid BofAML $100 million in cash, and on March 6, 2018, we received an initial delivery of approximately 1.3 million shares of common stock for approximately $78.0 million. Additional shares may be received prior to and/or at final settlement, based generally on the average of the daily volume-weighted average prices of the Company’s common stock during the term of the ASR Agreement, less a discount.

The timing and volume of share repurchases may be executed at the discretion of management on an opportunistic basis, or pursuant to trading plans or other arrangements. Any share repurchase under this program may be made in the open

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market, in privately negotiated transactions, or otherwise, and may depend upon prevailing market conditions and other factors. Repurchases under the Company's share repurchase program may be commenced or suspended from time to time at the Company's discretion without prior notice.

We paid cash dividends of $7.6 million ($0.225 per common share) and $7.4 million ($0.20 per common share) for the three months ended April 1, 2018 and March 26, 2017, respectively. Subsequent to the first quarter on May 2, 2018, our Board of Directors declared a second quarter dividend of $0.225 per common share (approximately $7.3 million based on the number of shares outstanding as of May 1, 2018). The dividend will be paid on May 25, 2018 to shareholders of record as of the close of business on May 14, 2018. The declaration and payment of any future dividends will be at the discretion of our Board of Directors, subject to the Company's financial results, cash requirements, and other factors deemed relevant by our Board of Directors.

Forward-Looking Statements

Certain matters discussed in this report, including information within Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the federal securities laws. Generally, the use of words such as "expect," "intend," "estimate," "believe," "anticipate," "will," "for "plan," "project," or similar words identify forward-looking statements that we intend to be included within the safe harbor protections provided by the federal securities laws. Such forward-looking statements may relate to projections or guidance concerning business performance, revenue, earnings, cash flow, contingent liabilities, resolution of litigation, commodity costs, profit margins, unit growth, unit level performance, capital expenditures, share repurchases, dividends, effective tax rates, the impact of the Tax Cuts and Job Act and the adoption of new accounting standards, and other financial and operational measures. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are beyond our control. Therefore, actual outcomes and results may differ materially from those matters expressed or implied in such forward-looking statements. The risks, uncertainties and assumptions that are involved in our forward-looking statements include, but are not limited to:

- aggressive changes in pricing or other marketing or promotional strategies by competitors, which may adversely affect sales and profitability; and new product and concept developments by food industry competitors;
- changes in consumer preferences or consumer buying habits, including the growing popularity of delivery aggregators, as well as changes in general economic conditions or other factors that may affect consumer confidence and discretionary spending;
- the adverse impact on the Company or our results caused by product recalls, food quality or safety issues, incidences of foodborne illness, food contamination and other general public health concerns about our company-owned or franchised restaurants or others in the restaurant industry;
- the effectiveness of our initiatives to improve our brand proposition and operating results, including marketing, advertising and public relations initiatives, technology investments and changes in unit-level operations;
- the ability of the Company and its franchisees to meet planned growth targets and operate new and existing restaurants profitably, including difficulties finding qualified franchisees, store level employees or suitable sites;
-

increases in food costs or sustained higher other operating costs. This could include increased employee compensation, benefits, insurance, tax rates, new regulatory requirements or increasing compliance costs;

- increases in insurance claims and related costs for programs funded by the Company up to certain retention limits, including medical, owned and non-owned automobiles, workers’ compensation, general liability and property;
- disruption of our supply chain or commissary operations which could be caused by our sole source of supply of cheese or limited source of suppliers for other key ingredients or more generally due to weather, natural disasters including drought, disease, or geopolitical or other disruptions beyond our control;
- increased risks associated with our international operations, including economic and political conditions, instability or uncertainty in our international markets, especially emerging markets, fluctuations in currency exchange rates, difficulty in meeting planned sales targets and new store growth;
- the impact of current or future claims and litigation and our ability to comply with current, proposed or future legislation that could impact our business including compliance with the European Union General Data Protection Regulation;
- failure to effectively execute succession planning;

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- disruption of critical business or information technology systems, or those of our suppliers, and risks associated with systems failures and data privacy and security breaches, including theft of confidential company, employee and customer information, including payment cards;
- changes in Federal or state income, general and other tax laws, rules and regulations, including changes from the Tax Cuts and Jobs Act and any related Treasury regulations, rules or interpretations if and when issued; and
- changes in generally accepted accounting principles including new standards for revenue recognition and leasing.

For a discussion of these and other risks that may cause actual results to differ from expectations, refer to "Part I. Item 1A. – Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as subsequent filings. We undertake no obligation to update publicly any forward-looking statements, whether as a result of future events, new information or otherwise, except as required by law.

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

### Interest Rate Risk

Our outstanding debt of $592.0 million at April 1, 2018 represented amounts outstanding under a new credit agreement. On August 30, 2017, we entered into a new credit agreement (the "Credit Agreement") replacing the previous $500.0 million credit facility ("Previous Credit Facility"). The Credit Agreement provides for an unsecured revolving credit facility in an aggregate principal amount of $600.0 million (the "Revolving Facility") and an unsecured term loan facility in an aggregate principal amount of $400.0 million (the "Term Loan Facility" and together with the Revolving Facility, the "Facilities"). Additionally, we have the option to increase the Revolving Facility or the Term Loan Facility in an aggregate amount of up to $300.0 million, subject to certain conditions. Our outstanding debt of $592.0 million as of April 1, 2018 under the Facilities was composed of $390.0 million outstanding under the Term Loan and $202.0 million outstanding under the Revolving Facility. Including outstanding letters of credit, the remaining availability under the Facilities was approximately $364.8 million as of April 1, 2018. In connection with the Credit Agreement, the Company capitalized $3.2 million of debt issuance costs, which are being amortized into interest expense, over the term of the Facilities. Total unamortized debt issuance costs of approximately $3.2 million were netted against debt as of April 1, 2018.

Loans under the Facilities accrue interest at a per annum rate equal to, at the Company's election, either a LIBOR rate plus a margin ranging from 75 to 200 basis points or a base rate (generally determined by a prime rate, federal funds rate or a LIBOR rate plus 1.00%) plus a margin ranging from 0 to 100 basis points. In each case, the actual margin is determined according to a ratio of the Company's total indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA") for the then most recently ended four quarter period (the "Leverage Ratio"). The Previous Credit Facility accrued interest based on the LIBOR rate plus a margin ranging from 75 to 175 basis points. An unused commitment fee at a rate ranging from 15 to 30 basis points per annum, determined according to the Leverage Ratio, applies to the unutilized commitments under the Revolving Facility; the unused commitment fee under the Previous Credit Facility was 15 to 25 basis points. Loans outstanding under the Credit Agreement may be prepaid at any time without premium or penalty, subject to customary breakage costs in the case of borrowings for which a

LIBOR rate election is in effect.  Up to $35.0 million of the Revolving Facility may be advanced in certain agreed foreign currencies, including Euros, Pounds Sterling, Canadian Dollars, Japanese Yen, and Mexican Pesos.

We attempt to minimize interest risk exposure by fixing our rate through the utilization of interest rate swaps, which are derivative financial instruments. Our swaps are entered into with financial institutions that participate in our Credit Agreement. By using a derivative instrument to hedge exposures to changes in interest rates, we expose ourselves to credit risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract.

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

| Effective Dates | Floating Rate Debt | Fixed Rates |
|---|---|---|
| July 30, 2013 through April 30, 2018 | $ 75 million | 1.42 % |
| December 30, 2014 through April 30, 2018 | $ 50 million | 1.36 % |
| April 30, 2018 through April 30, 2023 | $ 55 million | 2.33 % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.36 % |
| April 30, 2018 through April 30, 2023 | $ 35 million | 2.34 % |
| January 30, 2018 through August 30, 2022 | $ 100 million | 1.99 % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 1.99 % |
| January 30, 2018 through August 30, 2022 | $ 75 million | 2.00 % |
| January 30, 2018 through August 30, 2022 | $ 25 million | 1.99 % |

The weighted average interest rate on the borrowings under the Credit Agreement, including the impact of the interest rate swap agreements, was 3.5% for the first quarter of 2018. An increase in the present interest rate of 100 basis points on the line of credit balance outstanding as of April 1, 2018 would increase annual interest expense by $1.9 million.

Foreign Currency Exchange Rate Risk

We are exposed to foreign currency exchange rate fluctuations from our operations outside of the United States, which can adversely impact our revenues, net income and cash flows. Our international operations principally consist of Company-owned restaurants in China, distribution sales to franchised Papa John’s restaurants located in the United Kingdom, Mexico and China and our franchise sales and support activities, which derive revenues from sales of franchise and development rights and the collection of royalties from our international franchisees. For each of the periods presented, between 6% and 7% of our revenues were derived from these operations.

We have not historically hedged our exposure to foreign currency fluctuations. Foreign currency exchange rate fluctuations had a favorable impact on our International revenues of approximately $2.8 million for the three months ended April 1, 2018 and a $3.1 million unfavorable impact for the three months ended March 26, 2017. Foreign currency exchange rate fluctuations had no significant impact on income before income taxes for the three months ended April 1, 2018 and March 26, 2017.

The outcome of the June 2016 referendum in the United Kingdom was a vote for the United Kingdom to cease to be a member of the European Union (known as “Brexit”). This resulted in a lower valuation, on a historical basis, of the British Pound in comparison to the US Dollar. The future impact of Brexit on our franchise operations included in the European Union could also include but may not be limited to additional currency volatility and future trade, tariff, and regulatory changes. As of April 1, 2018, 29.7% of our total international restaurants are in countries within the European Union.

Commodity Price Risk

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

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The following table presents the actual average block price for cheese by quarter through the first quarter of 2018 and the projected average block price for cheese by quarter through 2017 (based on the May 1, 2018 Chicago Mercantile Exchange cheese futures market prices):

| | 2018 Projected Block Price | | 2017 Actual Block Price |
|---|---|---|---|
| Quarter 1 | $ 1.522 | | $ 1.613 |
| Quarter 2 | 1.642 | | 1.566 |
| Quarter 3 | 1.711 | | 1.642 |
| Quarter 4 | 1.707 | | 1.639 |
| Full Year | $ 1.646 | * | $ 1.615 |

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

## Item 4.Controls and Procedures

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

During the most recently completed fiscal quarter, there was no change made in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition on our financial statements to facilitate their adoption on January 1, 2018. There were no changes to our internal control over financial reporting that materially affected the Company’s internal control over financial reporting due to the adoption of the new standards.

# PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

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

## Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

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

Our Board of Directors has authorized the repurchase of up to $2.075 billion of common stock under a share repurchase program that began on December 9, 1999 and expires on February 27, 2019. This includes an additional $500 million authorized on July 27, 2017. Through April 1, 2018, a total of 114.5 million shares with an aggregate cost of $1.8 billion and an average price of $15.43 per share have been repurchased under this program. Subsequent to April 1, 2018, through May 1, 2018, we acquired an additional 28,739 shares at an aggregate cost of $1.7 million. As of May 1, 2018, approximately $306.3 million remained available for repurchase of common stock under this authorization.

The following table summarizes our repurchases by fiscal period during the first quarter of 2018 (in thousands, except per-share amounts):

| Fiscal Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| 1/1/2018 - 1/28/2018 | 309 | $ 59.82 | 112,871 | $ 409,207 |
| 1/29/2018 - 2/25/2018 | 297 | $ 59.58 | 113,168 | $ 391,512 |
| 2/26/2018 - 4/1/2018 | 1,395 | $ 59.90 | 114,562 | $ 307,978 |

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

During the fiscal quarter of 2018, the Company acquired approximately 21,000 shares of its common stock from employees to satisfy minimum tax withholding obligations that arose upon (i) vesting of restricted stock granted pursuant to approved plans and (ii) distribution of shares of common stock issued pursuant to deferred compensation obligations.

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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 April 1, 2018, filed on May 8, 2018, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Comprehensive Income, (iv) the Condensed Consolidated Statements of Cash Flows and (v) the Notes to Condensed Consolidated Financial Statements. |

SIGNATURE

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

PAPA JOHN'S INTERNATIONAL, INC.
(Registrant)

Date: May 8, 2018 /s/ Joseph H. Smith
Joseph H. Smith
Senior Vice President, Chief Financial Officer