

PAPA JOHNS INTERNATIONAL INC

Form 10-K

February 23, 2010

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 27, 2009

or

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

For the transition period from _____ to _____

Commission File Number: 0-21660

PAPA JOHN S INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

61-1203323
(I.R.S. Employer
Identification No.)

2002 Papa Johns Boulevard
Louisville, Kentucky 40299-2367

(Address of principal executive offices)

(502) 261-7272

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

(Title of Each Class)	(Name of each exchange on which registered)
Common Stock, \$.01 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates of the Registrant, computed by reference to the closing sale price on The NASDAQ Stock Market as of the last business day of the Registrant's most recently completed second fiscal quarter, June 28, 2009, was approximately \$540,875,044.

As of February 16, 2010, there were 27,174,710 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Part III are incorporated by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 28, 2010.

Table of Contents

TABLE OF CONTENTS

PART I

<u>Item 1.</u>	<u>Business</u>
<u>Item 1A.</u>	<u>Risk Factors</u>
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>
<u>Item 2.</u>	<u>Properties</u>
<u>Item 3.</u>	<u>Legal Proceedings</u>
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>

PART II

<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>
<u>Item 6.</u>	<u>Selected Financial Data</u>
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>
<u>Item 9A.</u>	<u>Controls and Procedures</u>
<u>Item 9B.</u>	<u>Other Information</u>

PART III

<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>
<u>Item 11.</u>	<u>Executive Compensation</u>
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>

PART IV

<u>Item 15.</u>	<u>Exhibits, Financial Statement Schedules</u>
-----------------	--

Table of Contents

PART I

Item 1. Business

General

Papa John's International, Inc. (referred to as the Company, Papa John's or in the first person notations of we, us and our) operates and franchises pizza delivery and carryout restaurants and, in certain international markets, dine-in and restaurant-based delivery restaurants under the trademark Papa John's. The first Company-owned Papa John's restaurant opened in 1985 and the first franchised restaurant opened in 1986. At December 27, 2009, there were 3,469 Papa John's restaurants in operation, consisting of 614 Company-owned and 2,855 franchised restaurants operating domestically in all 50 states, the District of Columbia and Puerto Rico and in 29 countries.

Papa John's has defined six reportable segments: domestic restaurants, domestic commissaries (Quality Control Centers), domestic franchising, international operations, variable interest entities and all other business units. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 20 of Notes to Consolidated Financial Statements for financial information about these segments for the fiscal years ended December 27, 2009, December 28, 2008 and December 30, 2007.

All of our periodic and current reports filed with the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, as amended, are available, free of charge, through our web site located at www.papajohns.com, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports. Those documents are available through our website as soon as reasonably practicable after we electronically file them with the SEC. We also make available free of charge on our website our Corporate Governance Guidelines; Board Committee Charters; and our Code of Ethics, which applies to Papa John's directors, officers and employees. Printed copies of such documents are also available free of charge upon written request to Investor Relations, Papa John's International, Inc., P.O. Box 99900, Louisville, KY 40269-0900. You may read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. This information is also available at www.sec.gov. The references to these website addresses do not constitute incorporation by reference of the information contained on the websites, which should not be considered part of this document.

Strategy

Our goal is to build the strongest brand loyalty of all pizza restaurants. The key elements of our strategy include:

Menu. Domestic Papa John's restaurants offer a menu of high-quality pizza along with side items, including breadsticks, cheesesticks, chicken strips and wings, dessert items and canned or bottled beverages. Papa John's traditional crust pizza is prepared using fresh dough (never frozen). Papa John's pizzas are made from a proprietary blend of wheat flour, cheese made from 100% real mozzarella, fresh-packed pizza sauce made from vine-ripened tomatoes (not from concentrate) and a proprietary mix of savory spices, and a choice of high-quality meat (100% beef, pork

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

and chicken with no fillers) and vegetable toppings. Domestically, all ingredients and toppings can be purchased from our Quality Control Center (QC Center) system, which delivers to individual restaurants twice weekly.

Table of Contents

Internationally, the menu may be more diverse than in our domestic operations to meet local tastes and customs.

In addition to our fresh dough traditional crust pizza, we offer a thin crust pizza, which is a par-baked product produced by a third-party vendor. Our traditional crust pizza offers a container of our special garlic sauce and a pepperoncini pepper. Each thin crust pizza is served with a packet of special seasonings and a pepperoncini pepper.

We continue to test new product offerings both domestically and internationally. The new products can become a part of the permanent menu if they meet certain established guidelines.

Efficient Operating System. We believe our operating and distribution systems, restaurant layout and designated delivery areas result in lower restaurant operating costs and improved food quality, and promote superior customer service. Our domestic QC Center system takes advantage of volume purchasing of food and supplies, and provides consistency and efficiencies of scale in fresh dough production. This eliminates the need for each restaurant to order food from multiple vendors and commit substantial labor and other resources to dough preparation.

Commitment to Team Member Training and Development. We are committed to the development and motivation of our team members through training programs, incentive compensation and opportunities for advancement. Team member training programs are conducted for corporate team members, and offered to our franchisees at training locations across the United States and internationally. We offer performance-based financial incentives to corporate and restaurant team members at various levels.

Marketing. Our marketing strategy consists of both national and local components. Our domestic national strategy includes national advertising on television, through print, direct mail and online. Ten national television campaigns aired in 2009.

Our local restaurant-level marketing programs target consumers within the delivery area of each restaurant, making extensive use of print materials including targeted direct mail and store-to-door couponing. Local marketing efforts also include a variety of community-oriented activities within schools, sports venues and other organizations. Local marketing efforts are supplemented with radio and television advertising, produced both locally and on a national basis.

In international markets, we target customers who live or work within a small radius of a Papa John's restaurant. Certain markets can effectively use television and radio as part of their marketing strategies. The majority of the marketing efforts use print materials such as flyers, newspaper inserts and in-store marketing materials. Local marketing efforts, such as sponsoring or participating in community events, sporting events and school programs, are also used to build customer awareness.

Franchise System. We are committed to maintaining and developing a strong franchise system by attracting experienced operators, supporting them to expand and grow their business and monitoring their compliance with our high standards. We seek to attract franchisees with experience in restaurant or retail operations and with the financial resources and management capability to open single or multiple locations. To ensure consistent food quality, each domestic franchisee is required to purchase dough and tomato sauce from our QC Centers and to purchase all other supplies from our QC Centers or approved suppliers. QC Centers outside the U.S. or in remote areas may be operated by franchisees pursuant to

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

license agreements or by other third parties. We devote significant resources to provide Papa John's franchisees with assistance in restaurant operations, management training, team member training, marketing, site selection and restaurant design. We also provide significant assistance to licensed

Table of Contents

international QC Centers in sourcing approved high-quality suppliers located in-country or approved regional suppliers to the extent possible.

International Operations. As of December 27, 2009, we had 688 Papa John's restaurants operating in 29 countries, Puerto Rico, Hawaii, and Alaska (Hawaii and Alaska units are included in our international operations for reporting purposes). Substantially all of the Papa John's international units are franchised operations (we own and operate eight restaurants in the United Kingdom and 18 in Beijing, China). During 2009 and 2008 we opened 100 and 140 international net new units (new unit openings less unit closings), respectively. We plan to continue to grow our international franchise units during the next several years. Our total international development pipeline as of December 27, 2009 included approximately 1,200 restaurants with a substantial majority of the restaurants scheduled to open over the next eight years.

Unit Sales and Investment Costs

In 2009, the 559 domestic Company-owned restaurants included in the full year's comparable restaurant base generated average sales of \$869,000. Domestic franchise sales on average are lower than Company-owned restaurants as a higher percentage of our Company-owned restaurants are located in more heavily penetrated markets.

The average cash investment for the five domestic Company-owned restaurants opened during the 2009 fiscal year, exclusive of land, was approximately \$240,000 per unit, excluding tenant allowances that we received. We expect the average cash investment for the five domestic Company-owned restaurants expected to open in 2010 to approximate \$240,000 per unit. Substantially all domestic restaurants do not offer dine-in areas, which reduces our restaurant capital investment.

Development

A total of 216 Papa John's restaurants were opened during 2009, consisting of nine Company-owned (five domestic and four international) and 207 franchised restaurants (79 domestic and 128 international), while 127 Papa John's restaurants closed during 2009, consisting of 9 Company-owned restaurants (eight domestic and one international) and 118 franchised restaurants (87 domestic and 31 international). The 87 domestic franchise closings included the closure of 26 non-traditional event-based units, which had a minimal net financial impact to the Company, in connection with the termination of a sponsorship agreement.

During 2010, we plan to open approximately 140 to 180 worldwide net new units. We expect to open 15 to 20 Company-owned restaurants (five domestic and 10 to 15 international) and 225 to 260 franchised restaurants (95 to 110 domestic and 130 to 150 international). We also expect approximately 100 Papa John's restaurants to close during 2010, the majority of which are expected to be domestic franchised units. Domestic and international franchised unit expansion is expected to continue with an emphasis on markets in the Americas, the United Kingdom, the Middle East and Asia. We expect our expansion in Asia to include a significant focus in China.

Our Company-owned expansion strategy is to continue to open domestic restaurants in existing markets as appropriate, although most of our Company-owned markets are well penetrated, thereby increasing consumer awareness and enabling us to take advantage of operational and marketing efficiencies. Our experience in developing markets indicates that market penetration through the opening of multiple restaurants in a

particular market results in increased average restaurant sales in that market over time. We have co-developed markets with some franchisees or divided markets among franchisees, and will continue to utilize market co-development in the future, where appropriate.

Table of Contents

Of the total 2,781 domestic units open as of December 27, 2009, 588 or 21% were Company-owned (including 127 units owned in joint venture arrangements with franchisees in which the Company has a majority ownership position). The Company expects the percentage of domestic Company-owned units to decrease below 20% over the next few years, because future net openings will be more heavily weighted toward franchise units.

Restaurant Design and Site Selection

Backlit awnings, neon window designs and other visible signage characterize the exterior of most Papa John's restaurants. A typical inline or endcap domestic Papa John's restaurant averages 1,100 to 1,500 square feet. Papa John's restaurants are designed to facilitate a smooth flow of food orders through the restaurant. The layout includes specific areas for order taking, pizza preparation and routing, resulting in simplified operations, lower training and labor costs, increased efficiency and improved consistency and quality of food products. The typical interior of a Papa John's restaurant has a vibrant color scheme, and includes a bright menu board, custom counters and a carryout customer area. The counters are designed to allow customers to watch the team members slap out the dough and put sauce and toppings on pizzas.

Most of our international Papa John's restaurants are between 900 and 1,400 square feet; however, in order to meet certain local customer preferences, many international restaurants have been opened in larger spaces to accommodate both dine-in and restaurant-based delivery service, typically with 35 to 100 seats. We will utilize dine-in service as part of our international growth strategy based on a country-by-country evaluation of consumer preferences and trends.

We define a traditional domestic Papa John's restaurant as a delivery and carryout unit that services a defined trade area. We consider the location of a traditional restaurant to be important and therefore devote significant resources to the investigation and evaluation of potential sites. The site selection process includes a review of trade area demographics, target population density and competitive factors. A member of our development team inspects each potential domestic Company-owned restaurant location and substantially all franchised restaurant locations and the surrounding market before a site is approved. Our restaurants are typically located in strip shopping centers or freestanding buildings that provide visibility, curb appeal and accessibility. Our restaurant design can be configured to fit a wide variety of building shapes and sizes, which increases the number of suitable locations for our restaurants.

Non-traditional Papa John's restaurants do not generally provide delivery to a defined trade area but rather serve a captive customer group on a continuous operation or an event-driven service (e.g., airports, stadiums, entertainment venues, military bases, university food service, etc.). Non-traditional units are designed to fit the unique requirements of the venue.

We provide layout and design services and recommendations for subcontractors, signage installers and telephone systems to Papa John's franchisees. Our franchisees can purchase complete new store equipment packages through an approved third-party supplier. We sell replacement smallwares and related items to our franchisees through our support services subsidiary, Preferred Marketing Solutions, Inc.

Table of Contents

Quality Control (QC) Centers; Strategic Supply Chain Management

Our domestic QC Centers, comprised of nine full-service regional production and distribution centers and one distribution-only center, supply pizza dough, food products, paper products, smallwares and cleaning supplies twice weekly to each restaurant. This system enables us to monitor and control product quality and consistency, while lowering food and other costs. Our full-service QC Centers are located in Louisville, Kentucky; Dallas, Texas; Pittsburgh, Pennsylvania; Orlando, Florida; Raleigh, North Carolina; Denver, Colorado; Portland, Oregon; Des Moines, Iowa; and Phoenix, Arizona. We also operate a distribution-only center in Cranbury, NJ. The primary difference between a full-service QC Center and a distribution-only center is that full-service QC Centers produce fresh pizza dough in addition to providing other food and paper products used in our restaurants. The QC Center system capacity is continually evaluated in relation to planned restaurant growth, and facilities are developed or upgraded as operational or economic conditions warrant. We consider the current domestic QC Center system capacity sufficient to accommodate domestic restaurant development for the next several years without significant additional capital requirements.

Our subsidiary, Papa John's UK (PJUK) purchases its products from a third-party distribution center. We expect to open and operate a full-service QC Center in the United Kingdom in the first six months of 2010. We own full-service QC Centers in Mexico City, Mexico; Cancun, Mexico and Beijing, China. Other international full-service QC Centers are licensed to franchisees and non-franchisee third parties, and are generally located in the markets where our franchisees have restaurants. We expect future international QC Centers to be licensed to franchisees or non-franchisee third parties; however, we may open Company-owned QC Centers at our discretion. We also have the right to acquire licensed QC Centers from our international licensees in certain circumstances.

We set quality standards for all products used in our restaurants and designate approved outside suppliers of food and paper products that meet our quality standards. In order to ensure product quality and consistency, all domestic Papa John's restaurants are required to purchase tomato sauce and dough from our QC Centers. Franchisees may purchase other goods directly from our QC Centers or approved suppliers. National purchasing agreements with most of our suppliers generally result in volume discounts to us, allowing us to sell products to our restaurants at prices we believe are below those generally available in the marketplace. Within our domestic QC Center system, products are distributed to restaurants by refrigerated trucks leased and operated by us or transported by a dedicated logistics company.

PJ Food Service, Inc. (PJFS), our wholly owned subsidiary that operates our domestic Company-owned QC Centers, has a purchasing arrangement with BIBP Commodities, Inc. (BIBP), a third-party entity formed by franchisees for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants. Historically, under this arrangement, PJFS purchased cheese from BIBP at a fixed quarterly price based in part on historical average cheese prices. Effective in March 2009, we modified the BIBP formula to establish the price of cheese on a monthly basis at the projected spot market price plus a certain adjustment based on BIBP's cumulative financial position. Gains and losses incurred by BIBP are passed on to the QC Centers and therefore to Company-owned and franchised restaurants through adjustments to the selling price. Over time, PJFS purchases cheese at a price approximating the actual average market price, but with more short-term predictability. See Management's Discussion and Analysis of Financial Condition and Results of Operations Consolidation of BIBP Commodities, Inc. (BIBP) as a Variable Interest Entity, and Note 3 of Notes to Consolidated Financial Statements for additional information concerning BIBP and the purchasing arrangement, and the related financial statement treatment of BIBP's results.

Table of Contents

Marketing Programs

All domestic Company-owned and franchised Papa John's restaurants within a defined market are required to join an area advertising cooperative (Co-op). Each member restaurant contributes a percentage of sales to the Co-op for market-wide programs, such as radio, television and print advertising. The rate of contribution and uses of the monies collected are determined by a majority vote of the Co-op's members (in most cases the contribution rate cannot be below 2.0% without approval from Papa John's). The restaurant-level and Co-op marketing efforts are supported by print and electronic advertising materials that are produced by the Papa John's Marketing Fund, Inc., a non-profit corporation (the Marketing Fund). The Marketing Fund produces and buys air time for Papa John's national television commercials, in addition to other brand-building activities, such as consumer research and public relations activities. All domestic Company-owned and franchised Papa John's restaurants are required to contribute a certain minimum percentage of sales to the Marketing Fund. The contribution rate to the Marketing Fund can be increased above the required minimum contribution rate if approved by the governing board of the Marketing Fund up to certain levels and beyond those levels if approved by a supermajority of domestic restaurants. The contribution percentage increased to 2.82% for the last nine months of 2009, from 2.7% effective for the first quarter of 2009 and for years 2008 and 2007. The contribution percentage to the Marketing Fund is currently set to average 2.92% for 2010.

Restaurant-level marketing programs target the delivery area of each restaurant, making extensive use of targeted print materials including direct mail and store-to-door coupons. The local marketing efforts also include a variety of community-oriented activities with schools, sports teams and other organizations. In markets in which Papa John's has a significant presence, local marketing efforts are supplemented with local radio and television advertising.

We provide both Company-owned and franchised restaurants with pre-approved print marketing materials and with catalogs for the purchase of uniforms and promotional items. We also provide direct marketing services to Company-owned and franchised restaurants using customer information gathered by our proprietary point-of-sale technology (see Company Operations *Point of Sale Technology*).

We have developed a system by which domestic Papa John's restaurant customers in areas we service are able to place orders online at papajohns.com, including the plan ahead ordering advance ordering feature and Spanish-language ordering capability. In addition, our customers can order via text messaging and mobile web capabilities. We receive a percentage-based fee from domestic franchisees for online sales, in addition to royalties, designed to cover the cost of this service.

We offer our customers the opportunity to purchase a reloadable gift card marketed as the Papa Card, in any denomination from \$10 to \$100. We also offer Papa Cards for sale to consumers through third-party outlets and continue to explore other Papa Card distribution opportunities. The Papa Card may be redeemed for delivery, carryout and online orders and is accepted at substantially all Papa John's traditional domestic restaurants.

Company Operations

Restaurant Personnel. A typical Papa John's Company-owned domestic restaurant employs a restaurant manager and approximately 20 to 25 hourly team members, most of whom work part-time. The manager is responsible for the day-to-day operation of the restaurant and maintaining Company-established operating standards. The operating standards and other resources are contained in a comprehensive operations manual

supplied to each restaurant. We seek to hire experienced restaurant managers and staff, provide comprehensive training on operations and managerial skills, and motivate and retain personnel by providing opportunities for advancement and performance-based financial incentives.

Table of Contents

We also employ directors of operations who are responsible for overseeing an average of seven Company-owned restaurants. The directors of operations report to operations vice presidents, who are each responsible for the management of approximately 100 Company-owned restaurants in specific geographic regions. The operations vice presidents report to four division vice presidents, who also have responsibility for franchise restaurant operations in their respective regions. These team members are eligible to earn performance-based financial incentives.

Training and Education. The Operations Support and Training (OST) department is responsible for creating the tools and materials for the training and development of team members. With these tools and materials, our field-based trainers train and certify training general managers in all markets. Operations personnel, both corporate and franchise, complete our management training program and ongoing development programs in which instruction is given on all aspects of our systems and operations. The program includes hands-on training at an operating Papa John s restaurant by a Company-certified training general manager. Our training includes new team member orientation, in-store and delivery training, core management skills training and new product or program implementation. Our ongoing developmental workshops include operating partner training, advanced operator training and senior operator training. We provide on-site training and operating support before, during and after the opening of all Company-owned restaurants and for the first two restaurants per franchise group, with additional support available upon request.

Point of Sale Technology. Point of sale technology (our proprietary PROFIT System™) is in place in all domestic traditional Papa John s restaurants. We believe this technology facilitates faster and more accurate order-taking and pricing, reduces paperwork and allows the restaurant manager to better monitor and control food and labor costs. We believe the PROFIT System enhances restaurant-level marketing capabilities through the development of a database containing information on customers and their buying habits with respect to our products. Polling capabilities allow us to obtain restaurant operating information, thereby improving the speed, accuracy and efficiency of restaurant-level reporting. The PROFIT System is also closely integrated with our online ordering system in all domestic traditional Papa John s restaurants, enabling Papa John s to offer nationwide online ordering to our customers. We have begun the process of evaluating next-generation point of sale technology and expect to begin pilot tests with a selected third party system in a limited number of restaurants in 2010.

Joint Ventures. We operate 127 Company-owned restaurants under two joint venture arrangements. Under the first arrangement, we own 70% of an entity operating 52 Papa John s restaurants located in Virginia and Maryland. Under the second arrangement, we own 51% of an entity operating 75 Papa John s restaurants located in Texas. We will continue to evaluate further joint venture arrangements on an individual basis as opportunities arise.

Hours of Operation. Our domestic restaurants are open seven days a week, typically from 11:00 a.m. to 12:30 a.m. Monday through Thursday, 11:00 a.m. to 1:30 a.m. on Friday and Saturday and 12:00 noon to 11:30 p.m. on Sunday. Carryout hours are generally more limited for late night security purposes.

Franchise Program

General. We continue to attract franchisees with significant restaurant and retail experience. We consider our franchisees to be a vital part of our system s continued growth and believe our relationship with our franchisees is good. As of December 27, 2009, there were 2,855 franchised Papa John s restaurants operating in all 50 states, the District of Columbia, Puerto Rico and 29 countries. As of December 27, 2009, we have development agreements with our franchisees for more than 200 additional domestic franchised restaurants, the majority of which are committed to open over the next four years, and

Table of Contents

agreements for approximately 1,200 additional international franchised restaurants, the substantial majority of which are scheduled to open over the next eight years. There can be no assurance that all of these restaurants will be opened or that the development schedule set forth in the development agreements will be achieved. During 2009, 207 (79 domestic and 128 international) franchised Papa John's restaurants were opened.

Approval. Franchisees are approved on the basis of the applicant's business background, restaurant operating experience and financial resources. We seek franchisees to enter into development agreements for single or multiple restaurants. We require each franchisee to complete our training program or to hire a full-time operator who completes the training and has either an equity interest or the right to acquire an equity interest in the franchise operation.

Domestic Development and Franchise Agreements. We enter into development agreements with our domestic franchisees for the opening of a specified number of restaurants within a defined period of time and specified geographic area. Substantially all existing franchise agreements have an initial 10-year term with a 10-year renewal option. We have the right to terminate a franchise agreement for a variety of reasons, including a franchisee's failure to make payments when due or failure to adhere to our policies and standards. Many state franchise laws limit the ability of a franchisor to terminate or refuse to renew a franchise.

Under our current standard domestic development agreement, the franchisee is required to pay, at the time of signing the agreement, a non-refundable fee of \$25,000 for the first restaurant and \$5,000 for any additional restaurants. The non-refundable fee is credited against the standard \$25,000 franchise fee payable to us upon signing the franchise agreement for a specific location. Generally, a franchise agreement is executed when a franchisee secures a location. Our current standard development agreement requires the franchisee to pay a royalty fee of 5% of sales; however, the majority of our franchised restaurants have an effective royalty rate below 5% as negotiated under prior agreements (see below for the current domestic royalty fee).

In 2009, we initiated a 25th Anniversary Development Incentive Program for domestic restaurants that ran from March 3, 2009 through December 27, 2009. The program provided for a waiver of the \$25,000 franchise fee, waived royalties for 12 months after the opening date and provided a \$10,000 cash incentive paid to franchisees for opening the restaurant on or before the scheduled opening date. Additionally, in December 2009, we announced a 2010 Development Incentive Program, which runs from November 23, 2009 through November 21, 2010 and allows for a waiver of the \$25,000 franchise fee, reduced royalties for 12 months (waiver of 2.0% to 5.0% depending on the opening date) and a 24-month no-payment lease on two ovens with the option to purchase the ovens for \$50 per oven at the end of the 24-month lease.

Franchise Support Initiatives. During 2009, the Company provided domestic franchise system support initiatives in response to the declining economic and consumer climate. The initiatives included:

- Providing cheese cost relief by modifying the cheese pricing formula used by BIBP Commodities, Inc.;
- Providing food cost relief by lowering the commissary margin on certain commodities sold by PJFS to the franchise system;
- Providing additional system-wide national marketing contributions that amounted to \$7.7 million in 2009;
- Providing additional system-wide local print marketing contributions and certain system-wide incentives totaling \$1.9 million;

Table of Contents

- Providing targeted royalty relief and local marketing support to assist certain identified franchisees or markets, which amounted to \$4.7 million in 2009;
- Providing financing on a selected basis to assist new or existing franchisees with the acquisition of troubled franchise restaurants; and
- Suspending for the first eight months of 2009 the collection of the 0.25% royalty rate increase that was scheduled for January 2009 (the royalty rate remained at 4.25% of sales until September 2009 at which point the rate was increased to 4.5%).

For 2010, we plan to continue certain domestic franchise support initiatives such as additional contributions to the Marketing Fund and providing targeted royalty relief and local marketing support to assist certain identified franchisees or markets, although our expectation is that the amount of such support initiatives will be reduced from 2009 levels. We also announced that at the beginning of 2010, the domestic royalty rate will be increased to 4.75% of sales for those franchisees whose royalty rate is below the standard 5% due to negotiations under prior agreements. We expect to contribute the value of the 0.25% increase into the Marketing Fund for 2010.

We believe the support program will mitigate potential unit closures and strengthen our brand during this challenging economic environment. In addition to reducing unit closures, other important objectives of the support program include growing market share in a consolidating category and stabilizing transaction levels.

International Development and Franchise Agreements. We opened our first franchised restaurant outside the United States in 1998. We define international to be all markets outside the contiguous United States in which we have either a development agreement or a master franchise agreement with a franchisee for the opening of a specified number of restaurants within a defined period of time and specified geographic area. Under a master franchise agreement, the franchisee has the right to subfranchise a portion of the development to one or more subfranchisees approved by us. Under our current standard international development agreement (except for Hawaii and Alaska, in which the initial fees are the same as for domestic restaurants), the franchisee is required to pay total fees of \$25,000 per restaurant: \$5,000 at the time of signing the agreement and \$20,000 when the restaurant opens or the agreed-upon development date, whichever comes first. Under our current standard master franchise agreement, the master franchisee is required to pay total fees of \$25,000 per restaurant owned and operated by the master franchisee, under the same terms as the development agreement, and \$15,000 for each subfranchised restaurant \$5,000 at the time of signing the agreement and \$10,000 when the restaurant opens or the agreed-upon development date, whichever comes first.

Our current standard international master franchise and development agreement provides for payment to us of a royalty fee of 5% of sales (3% of sales by subfranchised restaurants), with no provision for increase during the initial term. The remaining terms applicable to the operation of individual restaurants are substantially equivalent to the terms of our domestic franchise agreement. From time to time, development agreements will be negotiated at other than standard terms for fees and royalties.

Non-traditional Restaurant Development. We have entered into a limited number of development and franchise agreements for non-traditional restaurants. For example, a total of 17 franchised net units operate in Six Flags theme parks as part of a five-year marketing and partnership agreement. These agreements generally cover venues or areas not originally targeted for traditional unit development and have terms differing from the standard agreement. To date, these agreements have not had a significant, direct impact on our pre-tax earnings.

Table of Contents

Franchise Restaurant Development. We provide assistance to Papa John's franchisees in selecting sites, developing restaurants and evaluating the physical specifications for typical restaurants. Each franchisee is responsible for selecting the location for its restaurants but must obtain our approval of restaurant design and location based on accessibility and visibility of the site and targeted demographic factors, including population density, income, age and traffic. Our domestic and international franchisees may purchase complete new store equipment packages through an approved third-party supplier.

Franchisee Loans. Selected franchisees have borrowed funds from our subsidiary, Capital Delivery, Ltd., principally for the purchase of restaurants from us or other franchisees or for use in the construction and development of new restaurants. Loans made to franchisees typically bear interest at fixed or floating rates and in most cases are secured by the fixtures, equipment and signage of the restaurant and/or guarantees from the franchisee's owners. At December 27, 2009, net loans outstanding totaled \$8.6 million, which were composed of loans to franchisees and a loan in connection with the 2006 sale of our former Perfect Pizza operations. See Note 9 of Notes to Consolidated Financial Statements for additional information.

We have a commitment to lend up to \$40.0 million to BIBP, a franchisee-owned corporation with an outstanding balance of \$24.6 million at December 27, 2009. See Notes 3 and 9 of Notes to Consolidated Financial Statements for additional information.

Franchise Insurance Program. Our franchisees have the opportunity to purchase various insurance policies, such as health insurance, non-owned automobile and workers' compensation, through our wholly-owned insurance agency, Risk Services Corp. (Risk Services). A third-party commercial insurance company provides fully-insured coverage to franchisees participating in the franchise insurance program offered by Risk Services. As of December 27, 2009, approximately 49% of domestic franchised restaurants had obtained insurance coverage through Risk Services. See Note 10 of Notes to Consolidated Financial Statements for additional information concerning our wholly-owned captive insurance company, which provided insurance to our franchisees from 2000 through 2004.

Franchise Training and Support. Our domestic field support structure consists of Franchise Business Directors (FBDs), each of whom is responsible for serving an average of approximately 100 franchised units. Our FBDs maintain open communication with the franchise community, relaying operating and marketing information and new initiatives between franchisees and us.

Every franchisee is required to have a principal operator approved by us who satisfactorily completes our required training program and who devotes his or her full business time and efforts to the operation of the franchisee's restaurants. Each franchised restaurant manager is also required to complete our Company-certified management training program. Domestically, we provide an on-site training team three days before and three days after the opening of a franchisee's first two restaurants. Internationally, we provide on-site training personnel five days before and five days after the opening of a franchisee's first two stores. Ongoing supervision of training is monitored by the operations services and training team. Multi-unit franchisees are encouraged to appoint training store general managers or hire a full-time training coordinator certified to deliver Company-approved programs in order to train new team members and management candidates for their restaurants. Internationally, training is monitored by our international operations support team, as well as regional vice presidents and international business managers assigned to specific franchisee territories.

Franchise Operations. All franchisees are required to operate their Papa John's restaurants in compliance with our policies, standards and specifications, including matters such as menu items, ingredients, materials, supplies, services, fixtures, furnishings, decor and signs. Each franchisee has full discretion to determine the prices to be charged to its customers.

Table of Contents

Franchise Advisory Council. We have a Franchise Advisory Council that consists of Company and franchisee representatives of domestic restaurants. The Franchise Advisory Council and subcommittees hold regular meetings to discuss new product and marketing ideas, operations, growth and other relevant issues. Certain franchisees have formed an operators' exchange group for the purpose of communicating and addressing issues, needs and opportunities among its members and the Company.

We currently communicate with, and receive input from, our franchisees in several forms, including through the Company's Franchise Advisory Council, annual operations conferences, newsletters, national conference calls and various regional meetings conducted with franchisees throughout the year. Monthly webcasts are also conducted by the Company to discuss current operational, marketing or other issues affecting the franchisees' business. We are committed to communicating with our franchisees and receiving input from them.

Reporting and Business Processes. We collect sales and other operating information from domestic Papa John's franchisees daily. We have agreements with substantially all Papa John's domestic franchisees permitting us to debit electronically the franchisees' bank accounts for substantially all required payments, including the payment of royalties, Marketing Fund contributions, risk management services, online ordering fees and purchases from our print and promotions operations and QC Centers. This system significantly reduces the resources needed to process receivables, improves cash flow and mitigates the amount of past-due accounts related to these items. Domestic franchisees are required to purchase and install the Papa John's PROFIT System in their traditional restaurants (see Company Operations' *Point of Sale Technology*).

Comprehensive Restaurant Measurement Program. As part of our effort to deliver on our brand promise of Better Ingredients. Better Pizza., we have implemented a comprehensive measurement program for all domestic and international restaurants. The measurement program focuses on the quality of the pizza and the customer service experience.

Industry and Competition

The United States Quick Service Restaurant pizza industry (QSR Pizza) is mature and highly competitive with respect to price, service, location, food quality and variety. There are well-established competitors with substantially greater financial and other resources than Papa John's. Competitors include international, national and regional chains, as well as a large number of local independent pizza operators. Some of our competitors have been in existence for substantially longer periods than Papa John's and can have higher levels of restaurant penetration and a stronger, more developed brand awareness in markets where we have restaurants. Based on independent third-party information, the QSR Pizza category, which includes dine-in, carry-out and delivery, had sales of approximately \$33.4 billion in 2009, of which Papa John's share was reported at 6.0%, an increase from 5.9% reported for 2008. Within the QSR Pizza category, we believe our primary competitors are the national pizza chains, including Pizza Hut, Domino's and Little Caesars, as well as several regional chains and take and bake concepts. A change in pricing or other marketing strategies of one or more of our competitors could have an adverse impact on our sales and earnings. The U.S. QSR Pizza category was negatively impacted in 2009 from the difficult economic environment. Consumers reduced discretionary spending during 2009 in response to increased unemployment and other factors. The QSR Pizza category sales were approximately 1.0% lower in 2009 as compared to 2008. In addition, other factors have contributed to the growth stagnation for the QSR Pizza category during the last few years, including a trend in consumers shifting dine-out occasions toward breakfast and lunch and away from dinner. Many non-pizza restaurant chains, including chains focusing on fresh sandwiches, have begun to emphasize dinner meals. In

Table of Contents

addition, many casual diners and other restaurants are emphasizing carryout and curbside offerings. Finally, supermarkets continue to increase fresh and frozen pizza offerings to consumers.

With respect to the sale of franchises, we compete with many franchisors of restaurants and other business concepts. In general, there is also active competition for management personnel and attractive commercial real estate sites suitable for our restaurants.

Government Regulation

We, along with our franchisees, are subject to various federal, state and local laws affecting the operation of our respective businesses. Each Papa John's restaurant is subject to licensing and regulation by a number of governmental authorities, which include health, safety, sanitation, building and fire agencies in the state or municipality in which the restaurant is located. Difficulties in obtaining, or the failure to obtain, required licenses or approvals could delay or prevent the opening of a new restaurant in a particular area. Our full-service QC Centers are licensed and subject to regulation by state and local health and fire codes, and the operation of our trucks is subject to Department of Transportation regulations. We are also subject to federal and state environmental regulations.

We are subject to Federal Trade Commission (FTC) regulation and various state laws regulating the offer and sale of franchises. The laws of several states also regulate substantive aspects of the franchisor-franchisee relationship. The FTC requires us to furnish to prospective franchisees a franchise disclosure document containing prescribed information. Substantive state laws that regulate the franchisor-franchisee relationship presently exist in a substantial number of states, and bills have been introduced in Congress from time to time that would provide for federal regulation of the franchisor-franchisee relationship in certain respects if such bills were enacted. The state laws often limit, among other things, the duration and scope of non-competition provisions and the ability of a franchisor to terminate or refuse to renew a franchise. Some foreign countries also have disclosure requirements and other laws regulating franchising and the franchisor-franchisee relationship. Further national, state and local government initiatives, such as mandatory health insurance coverage, living wage or other proposed increases in minimum wage rates and nutritional guidelines or disclosure requirements, could adversely affect Papa John's as well as the restaurant industry. As we expand internationally, we will be subject to applicable laws in each jurisdiction where franchised units are established.

Trademarks

Our rights in our principal trademarks and service marks are a significant part of our business. We are the owner of the federal registration of the trademark Papa John's. We have also registered Pizza Papa John's and design (our logo), Better Ingredients. Better Pizza. and Pizza Papa John's Better Ingredients. Better Pizza. and design as trademarks and service marks. We also own federal registrations for several ancillary marks, principally advertising slogans. We have also applied to register our primary trademark, Pizza Papa John's and design, in more than 90 foreign countries and the European Community. We are aware of the use by other persons in certain geographical areas of names and marks that are the same as or similar to our marks. It is our policy to pursue registration of our marks whenever possible and to oppose vigorously any infringement of our marks.

Table of Contents

Employees

As of December 27, 2009, we employed approximately 16,000 persons, of whom approximately 14,000 were restaurant team members, approximately 700 were restaurant management personnel, approximately 600 were corporate personnel and approximately 700 were QC Center and Preferred Marketing Solutions, Inc. personnel. Most restaurant team members work part-time and are paid on an hourly basis. None of our team members is covered by a collective bargaining agreement. We consider our team member relations to be excellent.

Item 1A. Risk Factors

We are subject to various risks that could have a negative effect on our business, financial condition and results of operations. These risks could cause actual operating results to differ from those expressed in certain forward looking statements contained in this Form 10-K as well as in other Company communications. Although we believe that our expectations are based on reasonable assumptions, actual results may differ materially from those in the forward-looking statements as a result of various factors, including but not limited to, the following:

Our growth strategy requires the opening of new Papa John's restaurants. We may not be able to achieve our planned growth targets due to factors outside of our control, including the current economic environment.

Our growth strategy depends on our and our franchisees' ability to open new restaurants and to operate them on a profitable basis. Planned growth targets and the ability to operate new and existing restaurants profitably are affected by the current economic conditions and the resulting impact on consumer buying habits. Our business is susceptible to adverse changes in domestic and global economic conditions, which could make it difficult and uncertain for us to forecast operating results. Continuing weakness in the residential real estate and mortgage markets, volatility in commodity and fuel costs, difficulties in the financial sector and credit markets, and other factors affecting consumer spending, such as continued higher levels of unemployment, could cause reduced sales of our products or make it difficult for us to execute our strategy. Insolvency of key suppliers could also negatively impact our business. We expect this challenging environment to continue in 2010.

The ability of the Papa John's system to continue to open new restaurants is affected by a number of factors, many of which are beyond our control. These factors include, among other things, the availability of financing, the selection and availability of suitable restaurant locations, increases in the cost of or sustained high levels of cost of food ingredients and other commodities, paper, utilities, fuel, employee compensation and benefits, insurance and similar costs, availability and negotiation of suitable lease or financing terms, constraints on permitting and construction of restaurants, higher than anticipated construction costs, and the hiring, training and retention of management and other personnel. Accordingly, there can be no assurance that, system-wide, Papa John's will be able to meet planned growth targets, open restaurants in markets now targeted for expansion or continue to operate in existing markets profitably.

We face substantial competition from other food industry competitors, and our results of operations can be negatively impacted by the actions of one or more of our major competitors.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

The restaurant industry is intensely competitive with respect to price, service, location and food quality, and there are many well-established competitors with substantially greater financial and other resources than the Papa John's system. Some of these competitors have been in existence for a substantially longer period than Papa John's and may be better established in the markets where restaurants operated by us or

Table of Contents

our franchisees are, or may be, located. Experience has shown that a change in pricing or other marketing or promotional strategies, including new product and concept developments, by one or more of our major competitors can have an adverse impact on our sales and earnings and our system-wide restaurant operations.

Our results of operations and the operating results of our franchisees may be adversely impacted by any increases in the cost of food ingredients and other commodities.

An increase in the cost or sustained high levels of the cost of cheese or other commodities could adversely affect the profitability of our system-wide restaurant operations. Cheese, historically representing 35% to 40% of our food cost, and other commodities are subject to cost fluctuations due to weather, availability, demand and other factors that are beyond our control. Additionally, sustained increases in fuel and utility costs could adversely affect the profitability of our restaurant and QC Center businesses. Our domestic franchisees buy substantially all of their food products from our QC Center business. Changes in franchisee buying patterns for food products not required to be purchased from our QC Center business could adversely impact the sales and profitability of that business.

Changes in consumer preferences or discretionary consumer spending or negative publicity could adversely impact our results.

Changes in consumer taste (for example, changes in dietary preferences that could cause consumers to avoid pizza in favor of foods that are perceived as more healthful), demographic trends, traffic patterns and the type, number and location of competing restaurants could adversely affect our restaurant business. Also, our success depends to a significant extent on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. Further adverse changes in these factors could reduce sales or impose practical limits on pricing, either of which could materially adversely affect our results of operations. Like other food industry competitors, we can also be materially adversely affected by negative publicity concerning food quality, illness, injury, publication of government or industry findings concerning food products served by us, or other health concerns or operating issues stemming from one restaurant or a limited number of restaurants.

We are subject to federal and state laws governing our workforce. Changes in these laws, including minimum wage increases, or additional laws could increase costs for our system-wide operations.

System-wide restaurant operations are subject to federal and state laws governing such matters as wage benefits, working conditions, citizenship requirements and overtime. A significant number of hourly personnel employed by our franchisees and us are paid at rates related to the federal and state minimum wage requirements. Accordingly, further increases in the federal minimum wage or the enactment of additional state or local minimum wage increases above federal wage rates will increase labor costs for our system-wide operations. Additionally, proposed legislation that may make it easier for workers to form unions or labor shortages in various markets could result in higher costs. Local government agencies have also implemented ordinances that restrict the sale of certain food products. The recently proposed national health care legislation could negatively impact our domestic system as our Company-owned and franchised restaurants may have to provide health care coverage that was not previously offered to certain team members. Additional government mandates, including proposed menu labeling legislation, could increase costs and be harmful to system-wide restaurant sales.

Table of Contents

Current credit markets may adversely impact the ability of our franchisees to obtain financing, which may hinder our ability to achieve our planned growth in restaurant openings.

Our growth strategy depends in large part on our ability and the ability of our franchisees to expand or open new restaurants and to operate those restaurants on a profitable basis. Delays or failures in opening new restaurants could materially and adversely affect our planned growth. The credit markets have experienced instability, resulting in declining real estate values, credit and liquidity concerns and increased loan default rates. Many lenders have subsequently reduced their willingness to make new loans and have tightened their credit requirements. Our franchisees depend on the availability of financing to expand existing locations or construct and open new restaurants. If our franchisees experience difficulty in obtaining adequate financing for these purposes, our growth strategy and franchise revenues may be adversely affected. The unavailability of credit has required and may continue to require the Company to provide financing to certain franchisees and prospective franchisees in order to mitigate store closings or allow new units to open. If we are unable or unwilling to provide such financing, our results of operations may be adversely impacted.

Our expansion into emerging or under-penetrated markets may present increased risks.

Any or all of the risks listed above potentially adversely impacting restaurant sales or costs could be especially harmful to the financial viability of franchisees in under-penetrated or emerging markets. A decline in or failure to improve financial performance for this group of franchisees could lead to unit closings at greater than anticipated levels and therefore impact contributions to marketing funds, our royalty stream, PJFS and support services efficiencies and other system-wide results.

We may be subject to impairment charges.

Impairment charges for Company-owned operations are possible if PJUK or previously acquired domestic restaurants perform below our expectations. This would result in a decrease in our reported assets value and reduction in our net income.

Contingent lease liabilities.

In connection with the 2006 sale of our former Perfect Pizza operations, we remain contingently liable for payment under approximately 62 lease arrangements primarily associated with Perfect Pizza restaurant sites. The Perfect Pizza franchisor is primarily liable for these leases, which have varying terms extending to 2017. As of December 27, 2009, the potential amount of undiscounted payments we could be required to make in the event of non-payment by Perfect Pizza and associated franchisees was approximately \$5.8 million, with such amount declining monthly as lease payments are made. We have not recorded a liability with respect to such leases as of December 27, 2009, as our cross-default provisions with the Perfect Pizza franchisor substantially reduce the risk that we will be required to make payments under these leases.

Our dependence on a sole or limited number of suppliers for some ingredients could result in disruptions to our business.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Domestically, we are dependent on sole suppliers for our cheese, flour, and thin crust dough products. Alternative sources may not be available on a timely basis to supply these key ingredients or be available on terms as favorable to us as under our current arrangements. Domestic restaurants purchase substantially all food and related products from our QC Centers. Accordingly, both our corporate and franchised restaurants could be harmed by any prolonged disruption in the supply of products from our QC Centers.

Table of Contents

Changes in purchasing practices by our domestic franchisees could harm our commissary business.

Although our domestic franchisees currently purchase substantially all food products from our QC Centers, they are only required to purchase tomato sauce and dough from our QC Centers. Any changes in purchasing practices by domestic franchisees, such as seeking alternative suppliers of food products, including cheese, could adversely affect the financial results of our QC Centers, including the recoverability of the BIBP cheese purchasing entity deficit, which approximated \$20.0 million at December 27, 2009.

We may be required to resort to litigation to protect our intellectual property rights, which could negatively affect our results of operations.

We depend on our Papa John's brand name and we rely on a combination of trademarks, copyrights, service marks and similar intellectual property rights to protect our brand. We believe that the success of our business depends on our continued ability to use our existing trademarks and service marks to increase brand awareness and further develop our brand, both domestically and abroad. We may not be able to adequately protect our intellectual property rights and we may be required to resort to litigation to enforce such rights. Litigation could result in high costs and diversion of resources, which could negatively affect our results of operations, regardless of the outcome.

Our business and brand may be harmed should the services of our Founder, John Schnatter, as Chief Executive Officer, Chairman and brand spokesman terminate for any reason.

John H. Schnatter, our Founder, Chairman and Chief Executive Officer (CEO), does not serve under an employment agreement and we do not maintain key man life insurance on Mr. Schnatter. We also depend on Mr. Schnatter's image and his services as spokesman in our advertising and promotion materials. While we have entered into a license agreement with Mr. Schnatter related to the use of certain intellectual property, our business and brand may be harmed if Mr. Schnatter's services as CEO, Chairman and brand spokesman were not available for any reason.

Our international operations are subject to increased risks and other factors that may make it more difficult to achieve or maintain profitability or meet planned growth rates.

Our international operations could be negatively impacted by significant changes in international economic, political and health conditions in the countries in which the Company or its franchisees operate. In addition, our international operations are subject to additional factors, including compliance with foreign laws, currency regulations and fluctuations, differing business and social cultures and consumer preferences, diverse government regulations and structures, availability and cost of land and construction, ability to source high-quality ingredients and other commodities in a cost-effective manner, and differing interpretation of the obligations established in franchise agreements with international franchisees. Accordingly, there can be no assurance that our international operations will achieve or maintain profitability or meet planned growth rates.

Disruptions of our critical business or information technology systems could harm our ability to conduct normal business.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Domestically and internationally, we are dependent on our technology systems operating correctly. Our systems could be damaged or interrupted by power loss, telecommunication failures, acts of God, computer viruses, physical or electronic break-ins or similar attacks. We may not have or be able to obtain adequate insurance for these events, which could damage our business and reputation and be expensive and difficult to remedy or repair. Although we have systems in place to prevent security

Table of Contents

breaches and theft of consumer information, failure to prevent fraud or security breaches could have a material adverse effect on our business.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 27, 2009, there were 3,469 Papa John's restaurants system-wide.

Company-owned Papa John's Restaurants

	Number of Restaurants
Arizona	45
Florida	46
Georgia	86
Illinois	4
Indiana	41
Kansas	12
Kentucky	42
Maryland	59
Missouri	40
North Carolina	79
South Carolina	6
Tennessee	27
Texas	75
Virginia	26
Total Domestic Company-owned Papa John's Restaurants	588
China	18
United Kingdom	8
Total Company-owned Papa John's Restaurants	614

Note: Company-owned Papa John's restaurants include restaurants owned by majority-owned joint ventures. There were 127 such restaurants at December 27, 2009 (75 in Texas, 26 in Virginia and 26 in Maryland).

Table of Contents**Domestic Franchised Papa John's Restaurants**

	Number of Restaurants
Alabama	67
Arizona	27
Arkansas	18
California	203
Colorado	45
Connecticut	1
Delaware	11
Florida	202
Georgia	56
Idaho	11
Illinois	70
Indiana	80
Iowa	24
Kansas	19
Kentucky	55
Louisiana	47
Maine	7
Maryland	34
Massachusetts	19
Michigan	37
Minnesota	46
Mississippi	24
Missouri	27
Montana	9
Nebraska	15
Nevada	20
New Hampshire	2
New Jersey	60
New Mexico	17
New York	102
North Carolina	57
North Dakota	5
Ohio	150
Oklahoma	26
Oregon	16
Pennsylvania	85
Rhode Island	5
South Carolina	45
South Dakota	7
Tennessee	64
Texas	137
Utah	25
Vermont	1
Virginia	97
Washington	56
West Virginia	21
Wisconsin	26
Wyoming	6
Washington, D.C.	9
Total Domestic Franchised Papa John's Restaurants	2,193

Table of Contents**International Franchised Papa John's Restaurants**

	Number of Restaurants
Alaska (a)	4
Bahrain	15
Canada	34
Cayman Islands	1
China	139
Costa Rica	14
Cyprus	5
Dominican Republic	3
Ecuador	7
Egypt	11
El Salvador	4
Hawaii (a)	15
India	24
Ireland	22
Jordan	2
Korea	63
Kuwait	15
Malaysia	4
Mexico	40
Nicaragua	2
Oman	9
Pakistan	1
Peru	14
Puerto Rico	12
Qatar	7
Russia	14
Saudi Arabia	25
Trinidad	5
Turkey	4
United Arab Emirates	11
United Kingdom	112
Venezuela	24
Total International Franchised Papa John's Restaurants	662

(a) We define domestic operations as units located in the contiguous United States and international operations as units located outside the contiguous United States.

Most Papa John's restaurants are located in leased space. The initial term of most domestic restaurant leases is generally five years with most leases providing for one or more options to renew for at least one additional term. Virtually all of our leases specify a fixed annual rent. Generally, the leases are triple net leases, which require us to pay all or a portion of the cost of insurance, taxes and utilities. Certain leases further provide that the lease payments may be increased annually, with a small number of escalations based on changes in the Consumer Price Index.

Table of Contents

We have 44 Company-owned restaurants that are located in buildings we own on land either owned or leased by us. These restaurants range from 1,000 to 3,000 square feet. Three of these restaurants are located in multi-bay facilities. These multi-bay facilities contain from 2,800 to 5,000 square feet, and the space not utilized by the Papa John's restaurant in each facility is leased or held for lease to third-party tenants.

At December 27, 2009, we had 120 Papa John's restaurants located in the United Kingdom (112 franchised and eight Company-owned). In addition to leasing the eight Company-owned restaurant sites, we lease and sublease to franchisees 77 of the 112 franchised Papa John's restaurant sites. The initial lease terms on the Company and franchised sites are generally 10 to 15 years. The initial lease terms of the franchisee subleases are generally five to ten years. Additionally, we leased 18 Company-owned restaurant sites in Beijing, China as of December 27, 2009.

Information with respect to our leased domestic QC Centers as of December 27, 2009 is set forth below:

Facility	Square Footage
Raleigh, NC	61,000
Denver, CO	32,000
Phoenix, AZ	57,000
Des Moines, IA	43,000
Portland, OR	37,000
Pittsburgh, PA	52,000
Cranbury, NJ	59,000

We own land in Orlando, Florida on which our 63,000 square foot full-service QC Center is located. We also own land and a 175,000 square foot facility in Dallas, Texas, of which 77,500 square feet is used by our full-service QC Center and the remaining space is leased to a third-party tenant. In addition, we own land in Louisville, Kentucky, on a portion of which is located a 42,000 square foot building housing our printing operations and a 247,000 square foot building, approximately 30% to 40% of which accommodates the Louisville QC Center operation and promotions division. The remainder of the larger building houses our corporate offices. A 49,000 square foot full-service QC Center is under construction on land we own in the United Kingdom that will service both our Company-owned and franchised restaurants.

The Papa John's UK management team is located in a leased office near London with a remaining lease term of seven years.

The Papa John's China management team leases an office and a QC Center in Beijing, China. The Papa John's Mexico management team and QC Center lease a facility in Mexico City, Mexico and another QC Center leases a facility in Cancun, Mexico.

Item 3. Legal Proceedings

We are subject to claims and legal actions in the ordinary course of our business. We believe that none of the claims and actions currently pending against us would have a material adverse effect on us if decided in a manner unfavorable to us.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Table of Contents**EXECUTIVE OFFICERS OF THE REGISTRANT**

Set forth below are the current executive officers of Papa John's:

Name	Age (a)	Position	First Elected Executive Officer
John H. Schnatter	48	Founder, Chairman and Chief Executive Officer	1985
Donna Alcorn	45	Senior Vice President, Global Research and Development and Quality Assurance	2009
J. David Flanery	52	Senior Vice President, Chief Financial Officer and Treasurer	1994
William M. Mitchell	45	President, Global Operations	2007
Timothy C. O'Hern	46	Senior Vice President, Development	2005
Charles W. Schnatter	47	Senior Vice President, Managing Director of Special Projects	1991
Christopher J. Sternberg	44	Senior Vice President, Corporate Communications and General Counsel	2008
Anthony Thompson	43	Senior Vice President, Papa John's Food Service, Inc.	2009
J. Jude Thompson	47	President and Chief Operating Officer	2009
Andrew M. Varga	44	Senior Vice President and Chief Marketing Officer	2009

(a) Ages are as of January 1, 2010.

John H. Schnatter created the Papa John's concept in 1984 and the first Papa John's restaurant opened in 1985. He currently serves as Founder, Chairman and Chief Executive Officer. He previously served as Interim Chief Executive Officer from December 2008 to April 2009, Executive Chairman of the Company from 2005 until May 2007, as Chairman of the Board and Chief Executive Officer from 1990 until 2005, and as President from 1985 to 1990 and from 2001 until 2005.

Donna Alcorn was named Senior Vice President, Global Research and Development and Quality Assurance, in 2009 after serving as Vice President of Global Research and Development beginning in 2008. From 2006 until 2008, Ms. Alcorn served as Vice President of Operations Services for PJ Food Service. From 1998 to 2006, she served in various other roles at Papa John's, including Director of Team Member Services, Business Analyst and International Development Manager. Prior to joining Papa John's from 1992 to 1998, she held various positions with United Parcel Service, Edy's/Dryer's Ice Cream and Alcoa Aluminum.

Table of Contents

J. David Flanery has served as Senior Vice President, Chief Financial Officer and Treasurer since 2004. He previously served as Senior Vice President of Finance since August 2002. He served as Vice President of Finance from 1995 through August 2002, after having joined Papa John's in 1994 as Corporate Controller. From 1979 to 1994, Mr. Flanery was with Ernst & Young LLP in a variety of positions, most recently as Audit Senior Manager. Mr. Flanery is a licensed Certified Public Accountant.

William M. Mitchell was named President, Global Operations in November 2009, after serving as President, USA since March 2009. From 2007 to 2009, he served as Senior Vice President, Domestic Operations. Mr. Mitchell served from 2005 to 2007 as a Division Vice President responsible for corporate and franchised restaurant operations in the Midwest. He served as one of our Operations Vice Presidents from 2000 to 2005. Prior to joining Papa John's, Mr. Mitchell served as Senior Director of Operations for AFCE/Popeye's from 1996 to 2000, responsible for company and franchise operations as well as Popeye's related acquisitions. From 1993 to 1996, he served as Vice President of Operations for RTM Restaurant Group.

Timothy C. O'Hern rejoined Papa John's as Senior Vice President, Development in June 2009, a position he previously held from 2005 until 2007. From 2002 until 2005 and from 2007 until 2009, he managed the operations of a Papa John's franchisee in which he has an ownership interest. Prior to his departure from Papa John's in 2002, Mr. O'Hern held various positions, including Vice President of Global Development from February 2001 to 2002, Vice President of U.S. Development from March 1997 to February 2001, Director of Franchise Development from December 1996 to March 1997 and Construction Manager from November 1995 to December 1996. He has been a franchisee since 1993.

Charles W. Schnatter was named Managing Director of Special Projects in 2009. Mr. Schnatter previously served as Senior Vice President and Chief Development Officer from 2001 to June 2009 and served as Secretary from 1991 until October 2005. He was a Senior Vice President from 1993 to June 2009. Mr. Schnatter also held the position of General Counsel from 1991 to 2002. From 1988 to 1991, he was an attorney with Greenebaum, Doll & McDonald PLLC. Mr. Schnatter has been a franchisee since 1989.

Christopher J. Sternberg was named General Counsel in June 2009, having served as Interim General Counsel from December 2008 until his appointment. Mr. Sternberg has served as Senior Vice President, Corporate Communications, since 2005, after serving as Vice President and Assistant to the Chairman from 2000 to 2005. Mr. Sternberg served as Vice President, Corporate Communications from 1997 to 2000. Mr. Sternberg joined the company in 1994 as Assistant Counsel in our Legal Department. From 1990 to 1994, he was an attorney with Greenebaum, Doll & McDonald PLLC.

Anthony Thompson was promoted to Senior Vice President, Papa John's Food Service, Inc., Papa John's food manufacturing and distribution subsidiary, in April 2009. Mr. Thompson joined Papa John's in 2006 as Vice President, QCC Operations. Prior to joining Papa John's, Thompson worked for the Scotts Company for six years as Plant Manager, Director of Marysville Operations and Director of Lawn and Controls Operations. Before joining the Scotts Company, Thompson spent four years with Conagra Grocery Products Company where he held positions as Operations Leader, Manufacturing Manager and Plant Manager. He also spent seven years in various roles with Gulf Coast Coca Cola.

J. Jude Thompson was appointed President and Chief Operating Officer of Papa John's in April 2009. He also serves as a member of our Board of Directors, which he joined in February 2008. From 2006 to 2008, Mr. Thompson served as Senior Vice President of WellPoint, Inc., and President, Individual Business of Anthem Blue Cross and Blue Shield. Mr. Thompson previously held positions of increasing

Table of Contents

responsibility with Anthem Blue Cross and Blue Shield, a division of WellPoint, or its affiliates since 1989.

Andrew Varga was appointed Senior Vice President and Chief Marketing Officer in August 2009. Mr. Varga joined Papa John's after 21 years with Brown-Forman Corporation. Mr. Varga served as Senior Vice President/Director of Marketing for Brown-Forman from 2007 until 2009, responsible for the company's Wines and Spirits portfolio in the North American Region. From 2004 to 2007, Mr. Varga was Senior Vice President/Managing Director, Wines Marketing, with global responsibility for the wine portfolio.

Charles Schnatter is the brother of John Schnatter, Founder, Chairman and Chief Executive Officer. There are no other family relationships among our executive officers and other key personnel.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock trades on The NASDAQ Global Select Market tier of The NASDAQ Stock Market under the symbol PZZA. As of February 16, 2010, there were approximately 800 record holders of common stock. However, there are significantly more beneficial owners of our common stock than there are record holders. The following table sets forth, for the quarters indicated, the high and low closing sales prices of our common stock, as reported by The NASDAQ Stock Market.

2009		High		Low
First Quarter	\$	25.72	\$	15.59
Second Quarter		28.47		22.77
Third Quarter		27.34		22.90
Fourth Quarter		24.70		21.47

2008		High		Low
First Quarter	\$	27.00	\$	20.93
Second Quarter		29.79		24.21
Third Quarter		30.48		25.36
Fourth Quarter		27.65		13.11

Since our initial public offering of common stock in 1993, we have not paid cash dividends on our common stock, and have no current plans to do so.

Papa John's Board of Directors has authorized the repurchase of up to \$775.0 million of common stock under a share repurchase program that began December 9, 1999, and runs through December 31, 2010. Through December 27, 2009, a total of 43.5 million shares with an aggregate cost of \$741.2 million and an average price of \$17.04 per share have been repurchased under this program. Subsequent to year-end (through

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

February 16, 2010), we acquired an additional 43,000 shares at an aggregate cost of \$967,000. As of February 16, 2010, approximately \$32.8 million remained available for repurchase of common stock under this authorization.

Table of Contents

The following table summarizes our repurchase activity by fiscal period during 2009 (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
12/29/2008 - 01/25/2009	138	\$ 17.63	42,327	\$ 59,842
01/26/2009 - 02/22/2009	127	\$ 18.37	42,454	\$ 57,515
02/23/2009 - 03/29/2009	10	\$ 19.71	42,464	\$ 57,316
03/30/2009 - 04/26/2009		*	42,464	\$ 57,316
04/27/2009 - 05/24/2009		*	42,464	\$ 57,316
05/25/2009 - 06/28/2009		*	42,464	\$ 57,316
06/29/2009 - 07/26/2009		*	42,464	\$ 57,316
07/27/2009 - 08/23/2009		*	42,464	\$ 57,316
08/24/2009 - 09/27/2009		*	42,464	\$ 57,316
09/28/2009 - 10/25/2009		*	42,464	\$ 57,316
10/26/2009 - 11/22/2009	347	\$ 22.53	42,811	\$ 49,500
11/23/2009 - 12/27/2009	697	\$ 22.52	43,508	\$ 33,798

*There were no share repurchases during this period.

The Company utilized a written trading plan under Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, 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 our Rule 10b5-1 trading plan or otherwise. The trading plan includes predetermined criteria and limitations and is scheduled to expire December 31, 2010, unless terminated sooner under plan provisions.

Table of Contents

Stock Performance Graph

The following performance graph compares the cumulative total return of the Company's common stock to the NASDAQ Stock Market (U.S.) Index and a group of the Company's peers consisting of U.S. companies listed on NASDAQ with standard industry classification (SIC) codes 5800-5899 (eating and drinking places). Relative performance is compared for the five-year period extending through the end of fiscal 2009. The graph assumes that the value of the investments in the Company's common stock and in each index was \$100 at the end of fiscal 2004, and, with respect to the index and peer group, that all dividends were reinvested.

Table of Contents**Item 6. Selected Financial Data**

The selected financial data presented for each of the years in the five-year period ended December 27, 2009, was derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes thereto included in Item 7 and Item 8, respectively, of this Form 10-K.

(In thousands, except per share data)	Dec. 27, 2009	Dec. 28, 2008	Year Ended (1) Dec. 30, 2007	Dec. 31, 2006	Dec. 25, 2005
Income Statement Data	52 weeks	52 weeks	52 weeks	53 weeks	52 weeks
Domestic revenues:					
Company-owned restaurant sales	\$ 503,818	\$ 533,255	\$ 504,330	\$ 447,938	\$ 434,525
Variable interest entities restaurant sales	37,735	8,328	7,131	7,859	11,713
Franchise royalties (2)	61,012	59,704	55,283	56,374	52,289
Franchise and development fees	519	1,600	4,758	2,597	3,026
Commissary sales	407,437	429,068	399,099	413,075	398,372
Other sales	54,045	61,415	61,820	50,505	50,474
International revenues:					
Royalties and franchise and development fees (3)	13,244	12,868	10,314	7,551	6,529
Restaurant and commissary sales (4)	28,223	25,849	20,860	15,658	11,860
Total revenues	1,106,033	1,132,087	1,063,595	1,001,557	968,788
Operating income (5)	95,279	65,486	53,072	99,446	73,334
Investment income	629	848	1,446	1,682	1,248
Interest expense	(5,714)	(7,536)	(7,465)	(3,480)	(4,316)
Income from continuing operations before income taxes	90,194	58,798	47,053	97,648	70,266
Income tax expense	28,985	19,980	13,293	33,171	25,364
Income from continuing operations, including noncontrolling interests	61,209	38,818	33,760	64,477	44,902
Income attributable to noncontrolling interests (6)	(3,756)	(2,022)	(1,025)	(1,491)	(634)
Income from continuing operations, net of noncontrolling interests	57,453	36,796	32,735	62,986	44,268
Income from discontinued operations, net of tax (7)				389	1,788
Net income	\$ 57,453	\$ 36,796	\$ 32,735	\$ 63,375	\$ 46,056
Basic earnings per common share:					
Income from continuing operations, net of noncontrolling interests	\$ 2.07	\$ 1.31	\$ 1.10	\$ 1.95	\$ 1.32
Income from discontinued operations, net of tax (7)				0.01	0.05
Basic earnings per common share	\$ 2.07	\$ 1.31	\$ 1.10	\$ 1.96	\$ 1.37
Earnings per common share - assuming dilution:					
Income from continuing operations, net of noncontrolling interests	\$ 2.06	\$ 1.30	\$ 1.09	\$ 1.91	\$ 1.29
Income from discontinued operations, net of tax (7)				0.01	0.05
Earnings per common share - assuming dilution	\$ 2.06	\$ 1.30	\$ 1.09	\$ 1.92	\$ 1.34
Basic weighted average shares outstanding	27,738	28,124	29,666	32,312	33,594

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Diluted weighted average shares outstanding	27,909	28,264	30,017	33,046	34,316
Balance Sheet Data					
Total assets	\$ 397,095	\$ 386,468	\$ 401,817	\$ 379,639	\$ 350,562
Total debt	99,050	130,654	142,706	97,036	55,116
Total stockholders equity (8)	185,037	138,238	134,938	152,395	167,311

Table of Contents

-
- (1) We operate on a 52-53 week fiscal year ending on the last Sunday of December of each year. The 2009, 2008, 2007 and 2005 fiscal years consisted of 52 weeks, and the 2006 fiscal year consisted of 53 weeks. The additional week resulted in additional revenues of approximately \$20.0 million and additional pre-tax income of approximately \$3.5 million, or \$0.07 per diluted share for 2006.
 - (2) Domestic Franchise royalties were derived from franchised restaurant sales of \$1.55 billion in 2009, \$1.50 billion in 2008, \$1.46 billion in 2007, \$1.51 billion in 2006 and \$1.38 billion in 2005.
 - (3) International Royalties were derived from franchised restaurant sales of \$251.8 million in 2009, \$221.0 million in 2008, \$176.2 million in 2007, \$139.3 million in 2006 and \$104.2 million in 2005.
 - (4) Restaurant sales for International Company-owned restaurants were \$10.3 million in 2009, \$8.1 million in 2008, \$4.0 million in 2007, \$1.7 million in 2006 and \$642,000 in 2005.
 - (5) The operating results include the consolidation of BIBP, which increased operating income approximately \$23.3 million in 2009, \$19.7 million in 2006 and \$5.8 million in 2005 and reduced operating income by \$8.6 million in 2008 and \$31.0 million in 2007. The 2006 operating results include the benefit of the 53rd week, which increased operating income approximately \$3.5 million. Operating income includes domestic and international restaurant closure, impairment and disposition losses of \$657,000 in 2009, \$8.8 million in 2008 and \$1.8 million in 2007, and gains of \$260,000 in 2006 and \$989,000 in 2005. See Notes 3 and 6 of Notes to Consolidated Financial Statements.
 - (6) Represents the noncontrolling interests ownership in two joint venture arrangements. Prior years results have been reclassified to conform to the current year presentation.
 - (7) The Perfect Pizza operations, which were sold in March 2006, are classified as discontinued operations.
 - (8) Prior years have been reclassified to conform to the current year presentation.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Papa John's International, Inc. (referred to as the Company, Papa John's or in the first person notations of we, us and our) began operations in 1985 with the opening of the first Papa John's restaurant in Jeffersonville, Indiana. At December 27, 2009, there were 3,469 Papa John's restaurants in operation, consisting of 614 Company-owned and 2,855 franchised restaurants. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, risk management services, and information systems and related services used in their operations.

New unit openings in 2009 were 216 as compared to 267 in 2008 and 263 in 2007 and unit closings in 2009 were 127 as compared to 95 in 2008 and 70 in 2007. We expect net unit growth of approximately 140 to 180 units during 2010.

We have continued to produce strong average sales from our domestic Company-owned restaurants even in a very competitive market environment. Our expansion strategy is to cluster restaurants in targeted markets, thereby increasing consumer awareness and enabling us to take advantage of operational, distribution and advertising efficiencies. Average annual Company-owned sales for our most recent comparable restaurant base were \$869,000 for 2009, compared to \$867,000 for 2008 and \$836,000 for 2007. Average sales volumes in new markets are generally lower than in those markets in which we have established a significant market position. The comparable sales for domestic Company-owned restaurants decreased 0.5% in 2009, increased 1.7% in 2008 and increased 0.5% in 2007. The comparable sales for domestic franchised units increased 0.1% in 2009, 0.6% in 2008 and 0.3% in 2007.

Table of Contents

We continually strive to obtain high-quality restaurant sites with good access and visibility, and to enhance the appearance and quality of our restaurants. We believe that these factors improve our image and brand awareness. The average property and equipment investment cost for 559 Company-owned restaurants included in our most recent comparable sales base is \$268,000. The average cash investment for the five domestic Company-owned restaurants opened during 2009 was approximately \$240,000, compared to the \$270,000 investment for the 14 units opened in 2008, exclusive of land and any tenant improvement allowances that we received in both years.

Approximately 40% of our revenues for 2009, compared to 41% of our revenues for 2008 and 43% of our revenues for 2007, were derived from the sale to our domestic and international franchisees of food and paper products, printing and promotional items, risk management services and information systems equipment and software and related services by us. We expect the percentage of revenues in 2010 to be consistent with 2009. We believe that, in addition to supporting both Company and franchised growth, these activities contribute to product quality and consistency and restaurant profitability throughout the Papa John's system.

Results of Operations and Critical Accounting Policies and Estimates

The results of operations are based on our consolidated financial statements, which were prepared in conformity with accounting principles generally accepted in the United States. The preparation of consolidated financial statements requires management to select accounting policies for critical accounting areas as well as estimates and assumptions that affect the amounts reported in the consolidated financial statements. The Company's significant accounting policies are more fully described in Note 2 of Notes to Consolidated Financial Statements. Significant changes in assumptions and/or conditions in our critical accounting policies could materially impact the operating results. We have identified the following accounting policies and related judgments as critical to understanding the results of our operations.

Allowance for Doubtful Accounts and Notes Receivable

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

Long-lived and Intangible Assets

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

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

The recoverability of indefinite-lived intangible assets (i.e., goodwill) is evaluated annually or more frequently if impairment indicators exist, on a reporting unit basis by comparing the estimated fair value to its carrying value. Our estimated fair value for Company-owned restaurants is comprised of two

Table of Contents

components. The first component is the estimated cash sales price that would be received at the time of the sale and the second component is an investment in the continuing franchise agreement, representing the discounted value of future royalties less any incremental direct operating costs, that would be collected under the ten-year franchise agreement.

During 2008, we sold to domestic franchisees a total of 62 Company-owned restaurants located primarily in three markets. As part of the sales of these restaurants, we recorded a \$3.6 million intangible asset for the investment in the continuing franchise agreement, representing the discounted value of the royalties we will receive over the next ten years from the purchaser/franchisee. The intangible asset will be amortized over the ten-year franchise agreement as a reduction in royalty income of \$360,000 annually. The intangible asset is recorded in other assets in the accompanying consolidated balance sheet at December 27, 2009 with a remaining value of approximately \$3.2 million.

At December 27, 2009, we had a net investment of approximately \$21.8 million associated with our United Kingdom subsidiary (PJUK). During 2008, we recorded a goodwill impairment charge of \$2.3 million associated with our PJUK operations (none in 2009 or 2007). We updated our evaluation of the fair value of our PJUK subsidiary in 2009. Our analysis indicated the fair value exceeded the carrying value by approximately 10%. The goodwill allocated to this entity approximated \$15.2 million at December 27, 2009. We have developed plans for PJUK to continue to improve its operating results. The plans include efforts to increase Papa John's brand awareness in the United Kingdom, improve sales and profitability for individual restaurants and increase net PJUK franchised unit openings over the next several years. We will continue to periodically evaluate our progress in achieving these plans.

We updated our evaluation of the fair value of our investment in our domestic Company-owned restaurants during 2009. We test for goodwill impairment at the region level, which is one step below the reporting segment level. Based on our evaluation, our West Region, which had goodwill of approximately \$20.8 million at December 27, 2009, was not subject to impairment since the estimated fair value of our West Region exceeded the carrying value by approximately 10%.

If our growth initiatives with PJUK and certain domestic markets are not successful, future impairment charges could occur.

Insurance Reserves

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

From October 2000 through September 2004, our captive insurance company, which provided insurance to our franchisees, was self-insured. Beginning in October 2004, a third-party commercial insurance company began providing fully-insured coverage to franchisees participating in the franchise insurance program. Accordingly, this new arrangement eliminates our risk of loss for franchise insurance coverage written after September 2004. Our operating income is still subject to potential adjustments for changes in estimated insurance reserves for policies written from the inception of the captive insurance company in October 2000 to September 2004.

Table of Contents

Deferred Income Tax Assets and Tax Reserves

Papa John's is 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. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax loss carryforwards. The effect on deferred taxes of changes in tax rates is recognized in the period in which the enactment date changes. As a result, our effective tax rate may fluctuate. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize.

As of December 27, 2009, we had a net deferred income tax asset balance of \$15.2 million, of which approximately \$7.1 million relates to the net operating loss carryforward of BIBP Commodities, Inc. (BIBP). We have not provided a valuation allowance for the deferred income tax assets associated with our domestic operations, including BIBP, since we believe it is more likely than not that future earnings will be sufficient to ensure the realization of the net deferred income tax assets for federal and state purposes.

Certain tax authorities periodically audit the Company. We provide reserves for potential exposures. We evaluate these issues on a quarterly basis to adjust for events, such as court rulings or audit settlements, which may impact our ultimate payment for such exposures. We recognized reductions of \$1.2 million, \$1.7 million and \$3.4 million in our customary income tax expense associated with the finalization of certain income tax issues in 2009, 2008 and 2007, respectively (see Note 13 of Notes to Consolidated Financial Statements).

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

BIBP is a franchisee-owned corporation that conducts a cheese-purchasing program on behalf of domestic Company-owned and franchised restaurants. We consolidate the financial results of BIBP, since we are deemed the primary beneficiary, as defined, of BIBP. We recognized pre-tax income of approximately \$22.5 million during 2009 and pre-tax losses of \$10.5 million during 2008 and \$31.7 million during 2007 from the consolidation of BIBP. We expect the consolidation of BIBP to continue to have a significant impact on Papa John's operating income in future periods due to the volatility of cheese prices, but BIBP's operating results are not expected to be cumulatively significant over time. Papa John's will recognize the operating losses generated by BIBP if the shareholders' equity of BIBP is in a net deficit position. Further, Papa John's will recognize subsequent operating income generated by BIBP up to the amount of BIBP losses previously recognized by Papa John's.

Recent Accounting Standards

Generally Accepted Accounting Principles

In June 2009, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Codification (Codification or ASC) which became the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles (GAAP). The Codification did not change GAAP but reorganized the literature and changed the naming mechanism by which topics are referenced. Companies were required

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

to begin using the Codification for interim and annual periods ending after September 15, 2009. As required, references to pre-codification accounting literature have

Table of Contents

been changed throughout this Annual Report on Form 10-K to appropriately reference the Codification. The consolidated results of the Company were not impacted by this change.

Fair Value Measurements and Disclosures

The Fair Value Measurements and Disclosures topic of the FASB's ASC requires companies to determine fair value based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. The Fair Value Measurements and Disclosures topic emphasizes that fair value is a market-based measurement, not an entity-specific measurement. The new guideline required a phase-in approach: (1) phase one was effective for financial assets and liabilities in our first quarter of 2008 and (2) phase two was effective for non-financial assets and liabilities in our first quarter of fiscal 2009. The new provisions did not have a significant impact on our 2008 or 2009 financial statements.

The guidance requires that assets and liabilities carried at fair value 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 and liabilities that were measured at fair value on a recurring basis as of December 27, 2009 and December 28, 2008 are as follows:

(In thousands)	Carrying Value	Level 1	Fair Value Measurements	
			Level 2	Level 3
<u>December 27, 2009</u>				
Financial assets:				
Investments	\$ 1,382	\$ 1,382	\$	\$
Non-qualified deferred compensation plan	11,754	11,754		
Financial liabilities:				
Interest rate swaps	4,044		4,044	
<u>December 28, 2008</u>				
Financial assets:				
Investments	\$ 530	\$ 530	\$	\$
Non-qualified deferred compensation plan	8,887	8,887		

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Financial liabilities:

Interest rate swaps	6,173	6,173
---------------------	-------	-------

Additionally, the adoption for non-financial assets and liabilities in fiscal 2009 did not have a significant impact on our estimated value related to long-lived and intangible assets, such as our annual fair value evaluation of our United Kingdom subsidiary, PJUK, and domestic Company-owned restaurants.

Table of Contents

Business Combinations

The Business Combinations topic of the ASC establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable financial statement users to evaluate the nature and financial effects of the business combination. The latest guidance in the Business Combinations topic of the ASC applies to business combinations for which the acquisition date is on or after December 15, 2008. The adoption of the new guidance had no impact on our 2009 consolidated financial statements.

Consolidation

Noncontrolling Interests

The Consolidation topic of the ASC requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements, but separate from the equity of the parent company. The Consolidation topic further requires that consolidated net income be reported at amounts attributable to the parent and the noncontrolling interest, rather than expensing the income attributable to the minority interest holder. Additionally, sufficient disclosures are required to clearly identify and distinguish between the interests of the parent company and the interests of the noncontrolling owners, including a disclosure on the face of the consolidated statements for income attributable to the noncontrolling interest holder. The presentation and disclosure requirements that became effective in 2009 were applied retrospectively for all periods presented, and thus, the prior year financial statements have been modified to incorporate the new requirements.

Variable Interest Entities

In 2009, the FASB amended the consolidation principles associated with variable interest entities (VIEs) accounting, as defined in the Consolidation topic of the ASC. The objective is to improve the financial reporting of companies involved with VIEs. As required, the provisions are applicable for entities previously considered qualifying special-purpose entities, as the concept of these entities was eliminated from the ASC's Transfers and Servicing topic. The new guidance amends previous accounting guidance by replacing the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in the VIE with a qualitative approach focused on identifying which company has the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. Additionally, a company is required to perform ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. Prior to this statement, a company was only required to reassess the status when specific events occurred.

We are required to adopt the new guidance specified in the Consolidation topic of the ASC for our first quarter of 2010. We expect the adoption to result in the deconsolidation of certain franchise entities that are presently consolidated in our financial statements. These entities reported revenues of approximately \$37.7 million during 2009, which are consolidated in our financial statements; however, the consolidation of the entities has had no impact on our operating results during the past three years.

Derivatives and Hedging

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

During 2009, Papa John's adopted the latest provisions of the ASC topic, Derivatives and Hedging. The guidance enhances the required disclosures regarding derivatives and hedging activities, including disclosures regarding how and why an entity uses derivative instruments, how derivative instruments and

Table of Contents

related hedged items are accounted, and how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. See Note 7 for additional information.

Subsequent Events

The Subsequent Events topic of the ASC requires public companies to evaluate subsequent events through the date the financial statements are issued. Accordingly, we evaluated for subsequent events occurring after December 27, 2009 (our financial statement date) through February 23, 2010 (the date this report was filed). We determined no subsequent events disclosures were required.

Percentage Relationships and Restaurant Data and Unit Progression

The following tables set forth the percentage relationship to total revenues, unless otherwise indicated, of certain income statement data, and certain restaurant data for the years indicated:

	Dec. 27, 2009	Year Ended (1) Dec. 28, 2008	Dec. 30, 2007
Income Statement Data:	52 weeks	52 weeks	52 weeks
Domestic revenues:			
Company-owned restaurant sales	45.6%	47.1%	47.4%
Variable interest entities restaurant sales	3.4	0.7	0.7
Franchise royalties	5.5	5.3	5.2
Franchise and development fees	0.0	0.2	0.4
Commissary sales	36.8	37.9	37.5
Other sales	4.9	5.4	5.8
International revenues:			
Royalties and franchise and development fees	1.2	1.1	1.0
Restaurant and commissary sales	2.6	2.3	2.0
Total revenues	100.0	100.0	100.0
Costs and expenses:			
Domestic Company-owned restaurant cost of sales (2)	20.0	22.6	22.4
Domestic Company-owned restaurant operating expenses (2)	58.2	58.9	59.3
Variable interest entities restaurant expenses (3)	78.6	88.4	84.4
Domestic commissary and other expenses (4)	90.8	90.5	89.1
Loss (income) from the franchise cheese purchasing program, net of minority interest (5)	(1.6)	0.6	2.1
International operating expenses (6)	86.3	88.3	89.7
General and administrative expenses	10.2	8.8	9.5
Other general expenses	1.5	1.7	0.6
Depreciation and amortization	3.0	2.9	3.0
Total costs and expenses	91.4	94.2	95.0
Operating income	8.6	5.8	5.0
Net interest expense	(0.5)	(0.6)	(0.6)

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Income before income taxes	8.1	5.2	4.4
Income tax expense	2.6	1.7	1.2
Net income, including noncontrolling interests	5.5	3.5	3.2
Less: income attributable to noncontrolling interests	(0.3)	(0.2)	(0.1)
Net income, net of noncontrolling interests	5.2%	3.3%	3.1%

Table of Contents

	Dec. 27, 2009	Year Ended (1) Dec. 28, 2008	Dec. 30, 2007
Restaurant Data:	52 weeks	52 weeks	52 weeks
Percentage increase in comparable domestic Company-owned restaurant sales (7)	-0.5%	1.7%	0.5%
Number of Company-owned restaurants included in the most recent full year's comparable restaurant base	559	566	541
Average sales for Company-owned restaurants included in the most recent comparable restaurant base	\$ 869,000	\$ 867,000	\$ 836,000
Papa John's Restaurant Progression:			
U.S. Company-owned:			
Beginning of period	592	648	577
Opened	5	14	20
Closed	(8)	(9)	(9)
Acquired from franchisees	11	1	61
Sold to franchisees	(12)	(62)	(1)
End of period	588	592	648
International Company-owned:			
Beginning of period	23	14	11
Opened	4	10	4
Closed	(1)	(2)	
Acquired from franchisees		1	2
Sold to franchisees			(3)
End of period	26	23	14
U.S. franchised:			
Beginning of period	2,200	2,112	2,080
Opened	79	98	140
Closed	(87)	(71)	(48)
Acquired from Company	12	62	1
Sold to Company	(11)	(1)	(61)
End of period	2,193	2,200	2,112
International franchised:			
Beginning of period	565	434	347
Opened	128	145	99
Closed	(31)	(13)	(13)
Acquired from Company			3
Sold to Company		(1)	(2)
End of period	662	565	434
Total Papa John's restaurants - end of period	3,469	3,380	3,208

-
- (1) We operate on a fiscal year ending on the last Sunday of December of each year.
(2) As a percentage of domestic Company-owned restaurant sales.
(3) As a percentage of domestic variable interest entities restaurant sales.
(4) As a percentage of domestic commissary sales and other sales on a combined basis.
(5) As a percentage of total Company revenues; the loss (income) is a result of the consolidation of BIBP, a VIE. The sales reported by BIBP are eliminated in consolidation.
(6) As a percentage of international restaurant and commissary sales.
(7) Includes only Company-owned restaurants open throughout the periods being compared.

Table of Contents

2009 Compared to 2008

Variable Interest Entities

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Our operating results include BIBP's operating results. The consolidation of BIBP had a significant impact on our operating results in both 2009 and 2008 (pre-tax income of \$22.5 million in 2009 and pre-tax loss of \$10.5 million in 2008) and is expected to have a significant ongoing impact on our future operating results and income statement presentation as described below.

Consolidation accounting requires the net impact from the consolidation of BIBP to be reflected primarily in three separate components of our statement of income. The first component is the portion of BIBP operating income or loss attributable to the amount of cheese purchased by Company-owned restaurants during the period. This portion of BIBP operating income (loss) is reflected as a reduction (increase) in the

Domestic Company-owned restaurant expenses - cost of sales line item. This approach effectively reports cost of sales for Company-owned restaurants as if the purchasing arrangement with BIBP did not exist and such restaurants were purchasing cheese at the spot market prices (i.e., the impact of BIBP is eliminated in consolidation).

The second component of the net impact from the consolidation of BIBP is reflected in the caption Loss (income) from the franchise cheese-purchasing program, net of minority interest. This line item represents BIBP's income or loss from purchasing cheese at the spot market price and selling to franchised restaurants at a fixed quarterly price, net of any income or loss attributable to the minority interest BIBP shareholders. The amount of income or loss attributable to the BIBP shareholders depends on its cumulative shareholders' equity balance and the change in such balance during the reporting period. The third component is reflected as investment income or interest expense, depending upon whether BIBP is in a net investment or net borrowing position during the reporting period.

In addition, Papa John's has extended loans to certain franchisees. Papa John's is deemed the primary beneficiary of certain franchisees even though we have no ownership interest in them.

The following table summarizes the impact of VIEs, prior to required consolidating eliminations, on our consolidated statements of income for the years ended December 27, 2009 and December 28, 2008 (in thousands):

	Year Ended December 27, 2009			Year Ended December 28, 2008		
	BIBP	Franchisees	Total	BIBP	Franchisees	Total
Variable interest entities						
restaurant sales	\$	\$ 37,735	\$ 37,735	\$	\$ 8,328	\$ 8,328
BIBP sales	142,407		142,407	165,449		165,449
Total revenues	142,407	37,735	180,142	165,449	8,328	173,777
Operating expenses	118,825	33,434	152,259	173,851	7,966	181,817
General and administrative expenses	233	1,548	1,781	187	378	565
Other general expense (income)		1,382	1,382		(89)	(89)
Depreciation and amortization		1,310	1,310		73	73
Total costs and expenses	119,058	37,674	156,732	174,038	8,328	182,366
Operating income (loss)	23,349	61	23,410	(8,589)		(8,589)
Interest expense	(806)	(61)	(867)	(1,951)		(1,951)
Income (loss) before income taxes	\$ 22,543	\$	\$ 22,543	\$ (10,540)	\$	\$ (10,540)

Table of Contents

Non-GAAP Measures

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

Summary of Operating Results

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

The Company follows a fiscal year ending on the last Sunday of December, generally consisting of 52 weeks made up of four 13-week quarters. The 13-week quarters consist of two four-week periods followed by one five-week period.

Discussion of Revenues

Total revenues, which decreased 2.3% to \$1.11 billion in 2009 compared to \$1.13 billion in 2008, primarily consisted of the following:

- Domestic Company-owned restaurant revenues decreased \$29.4 million, or 5.5%, reflecting a decrease in equivalent units due to the divestiture of 62 restaurants to franchisees during the fourth quarter of 2008. Comparable sales for 2009 decreased 0.5%. Equivalent units represents the number of restaurants open at the beginning of a given period, adjusted for restaurants opened, closed, acquired or sold during the period on a weighted average basis. Comparable sales represents sales generated by restaurants open for the entire twelve-month period reported.
- Variable interest entities restaurant sales increased \$29.4 million due to the consolidation of two additional franchise entities during 2009. We extended loans to these two entities in the fourth quarter of 2008 in conjunction with our sale of the Company-owned restaurants.
- Domestic commissary sales decreased \$21.6 million, or 5.0%, due to decreases in the prices of certain commodities, primarily cheese and wheat. The commissary charges a fixed-dollar markup on its cost of cheese, and cheese cost is based upon the BIBP block price, which decreased from an average of \$1.81 per pound in 2008 to an average of \$1.55 per pound in 2009 or a 14.4% decrease. The cost of wheat, as measured on domestic commodity markets, decreased approximately 37% in 2009 as compared to 2008.
- Other sales decreased \$7.4 million primarily due to a decline in sales at our print and promotions subsidiary, Preferred Marketing Solutions, reflecting the deterioration of the U.S. economy.
- International revenues increased \$2.8 million reflecting increases in both the number and average unit volumes of our Company-owned and franchised restaurants over the comparable period.

Table of Contents

Discussion of Operating Results

Franchise Support Initiatives

During 2009, the Company provided domestic franchise system support initiatives in response to the declining economic and consumer climate. The initiatives included:

- Providing cheese cost relief by modifying the cheese pricing formula used by BIBP Commodities, Inc.;
- Providing food cost relief by lowering the prices of certain commodities;
- Providing additional system-wide national marketing contributions that amounted to \$7.7 million in 2009;
- Providing additional system-wide local print marketing contributions and certain incentives totaling \$1.9 million;
- Providing targeted royalty relief and local marketing support to assist certain identified franchisee or markets, which amounted to \$4.7 million in 2009;
- Providing financing on a selected basis to assist new or existing franchisees with the acquisition of troubled franchise restaurants; and
- Suspending for the first eight months of 2009 the collection of the 0.25% royalty rate increase that was scheduled for January 2009 (the royalty rate remained at 4.25% of sales until September 2009 at which point the rate was increased to 4.5%). In January 2010, our domestic royalty rate increased to 4.75%.

For 2010, we plan to continue certain domestic franchise support initiatives such as additional contributions to the Marketing Fund and providing targeted royalty relief and local marketing support to assist certain identified franchisees or markets, although our expectation is that the amount of such support initiatives will be reduced from 2009 levels. We also announced that at the beginning of 2010, the domestic royalty rate will be increased to 4.75% of sales for those franchisees whose royalty rate is below the standard 5% due to negotiations under prior agreements. We expect to contribute the value of the 0.25% increase into the Marketing Fund for 2010.

We believe the support program will mitigate potential unit closures and strengthen our brand during this challenging economic environment. In addition to reducing unit closures, other important objectives of the support program include growing market share in a consolidating category and stabilizing transaction levels.

Table of Contents

Our income before income taxes, net of noncontrolling interests, totaled \$86.4 million in 2009, as compared to \$56.8 million in 2008 as summarized in the following table on an operating segment basis (in thousands):

	2009		2008		Increase (Decrease)
Domestic Company-owned restaurants	\$ 34,894	\$	19,997	\$	14,897
Domestic commissaries	29,393		30,235		(842)
Domestic franchising	53,690		53,610		80
International	(3,050)		(7,193)		4,143
All others	2,697		9,175		(6,478)
Unallocated corporate expenses	(49,755)		(36,154)		(13,601)
Elimination of intersegment profits	(218)		(332)		114
Income before income taxes, excluding variable interest entities	67,651		69,338		(1,687)
Variable interest entities	22,543		(10,540)		33,083
Total income before income taxes	90,194		58,798		31,396
Income attributable to noncontrolling interests	(3,756)		(2,022)		(1,734)
Total income before income taxes, net of noncontrolling interests	\$ 86,438	\$	56,776	\$	29,662

Excluding the impact of the consolidation of BIBP (pre-tax income of \$22.5 million or \$0.52 per diluted share in 2009 and pre-tax loss of \$10.5 million or \$0.24 per diluted share in 2008), 2009 income before income taxes, net of noncontrolling interests, was \$63.9 million (5.8% of total revenues), compared to \$67.3 million (5.9% of total revenues) in 2008. The \$3.4 million decrease in income before income taxes, net of noncontrolling interests (excluding the consolidation of BIBP), was principally due to the following:

- **Domestic Company-owned Restaurant Segment.** Domestic Company-owned restaurants operating income increased \$14.9 million over the prior year, comprised of the following (in thousands):

	December 27, 2009		Year Ended December 28, 2008		Increase (Decrease)
Operating income, excluding impairment and disposition losses	\$ 35,551	\$	26,515	\$	9,036
Impairment and disposition losses	(657)		(6,518)		5,861
Total segment operating income	\$ 34,894	\$	19,997	\$	14,897

The increase of \$9.0 million in 2009 as compared to 2008 in domestic Company-owned restaurants income from operations, excluding impairment and disposition losses, was primarily due to lower commodity costs and the sale of 62 restaurants in late 2008 that were collectively unprofitable.

Restaurant operating margin on an external basis was 21.8% in 2009 compared to 18.5% in 2008. Excluding the impact of the consolidation of BIBP, restaurant operating margin was 20.7% in 2009 compared to 18.9% in 2008.

The restaurant impairment and disposition losses recorded in 2008 primarily relate to the above-mentioned sale of restaurants.

Table of Contents

- Domestic Commissary Segment.** Domestic commissaries' operating income decreased approximately \$800,000 in 2009 as compared to 2008. The decline in operating income was primarily due to pricing reductions, \$800,000 of management transition costs and \$400,000 of costs associated with the closing of one of our commissaries. The decline in our operating income due to these factors was substantially offset by a decline in fuel costs for 2009.
- Domestic Franchising Segment.** Domestic franchising operating income increased approximately \$100,000 to \$53.7 million for the year ended December 27, 2009, from \$53.6 million in the prior comparable period. The increase was primarily due to an increase in franchise royalties resulting from a 0.25% increase in the royalty rate effective in the last four months of 2009.

This increase associated with royalties was substantially offset by lower franchise and development fees due to fewer unit openings in 2009 and \$500,000 in franchise renewal fees collected in 2008 in connection with the domestic franchise renewal program that were not replicated in 2009. The impact of the increased royalty rate for 2009 was also offset partially by additional development incentive programs offered by the Company in 2009. During 2009, incentive payments were made of \$440,000 to certain franchisees under our 25th Anniversary development incentive program for opening new units in advance of previously scheduled dates.

- International Segment.** The international segment reported an operating loss of \$3.1 million in 2009 as compared to a loss of \$7.2 million in 2008, comprised of the following (in thousands):

	December 27, 2009	Year Ended December 28, 2008	Increase (Decrease)
Operating income, excluding goodwill impairment and other charges	\$ (2,586)	\$ (4,893)	\$ 2,307
Goodwill impairment (a)		(2,300)	2,300
Other (b)	(464)		(464)
Total segment operating loss	\$ (3,050)	\$ (7,193)	\$ 4,143

(a) The goodwill impairment charge was associated with our United Kingdom operations.

(b) Includes pre-opening costs associated with our commissary in the United Kingdom that is under construction and costs associated with the closure of a Company-owned restaurant in China.

The improvement in operating losses, excluding goodwill impairment and other charges, reflects increased revenues due to growth in number of units and unit volumes. The year-over-year improvement declined in the last half of 2009 due to slowing sales and unit growth in response to general worldwide economic conditions.

- **All Others Segment.** Operating income for the All others reporting segment decreased approximately \$6.5 million for the year ended December 27, 2009, as compared to the corresponding 2008 period. The decrease was primarily due to a \$3.9 million decline in our online ordering system business, a \$1.3 million decline at our print and promotions subsidiary, Preferred Marketing Solutions, and due to the 2008 period including more favorable adjustments in claims loss reserves associated with our inactive captive insurance program. The decline in the

Table of Contents

online ordering system business reflected a reduction in the online fee percentage as we began to operate the online business at a break-even level beginning in 2009. The decline in profitability in our print and promotions business was due to lower sales in 2009, as compared to 2008, reflecting the challenging U.S. economic environment.

- **Unallocated Corporate Segment.** Unallocated corporate expenses increased \$13.6 million as compared to 2008. The components of the unallocated corporate segment were as follows (in thousands):

	Year Ended December 27, 2009		Year Ended December 28, 2008		Increase (Decrease)
General and administrative (a)	\$ 26,893	\$	16,372	\$	10,521
Net interest	4,251		4,961		(710)
Depreciation	8,684		7,770		914
Franchise support initiatives (b)	9,556		3,900		5,656
Provisions for uncollectible accounts and notes receivable (c)	1,172		4,082		(2,910)
Other income	(801)		(931)		130
Total unallocated corporate expenses	\$ 49,755	\$	36,154	\$	13,601

(a) The increase in unallocated general and administrative costs for the year ended December 27, 2009, was primarily due to the following factors (in thousands):

	Year Ended December 27, 2009		Year Ended December 28, 2008		Increase (Decrease)
Severance and other management transition costs (1)	\$ 1,607	\$	125	\$	1,482
Short- and long-term incentive compensation (2)	13,145		6,174		6,971
Litigation settlement	1,065				1,065
Sponsorship fees (3)	3,907		3,334		573
Other, net	7,169		6,739		430
Total unallocated general and administrative expenses	\$ 26,893	\$	16,372	\$	10,521

(1) In addition to routine management transition costs, the Company implemented a reduction-in-force during the third quarter of 2009 in which 35 positions were eliminated, mostly in corporate support areas. Severance and related costs associated with the reduction-in-force were approximately \$900,000, and this action is expected to reduce future general and administrative costs by approximately \$2.6 million annually.

Table of Contents

(2) The following table summarizes our recorded expense associated with our management incentive programs, which are included in unallocated general and administrative costs (in thousands):

	Year Ended December 27, 2009		Year Ended December 28, 2008		Increase (Decrease)
Equity compensation (i)	\$ 5,817	\$	2,564	\$	3,253
Performance unit plan			118		(118)
Management incentive bonus plan (ii)	7,328		3,492		3,836
Total expense	\$ 13,145	\$	6,174	\$	6,971

(i) Stock options were awarded to management and members of our board of directors in 2007, 2008 and 2009. The 2007 and 2008 awards follow either a two-year cliff-vesting period or a three-year graded vesting period. Substantially all of the 2009 awards follow a three-year graded vesting period. Additionally, we granted performance and/or time-based restricted stock in 2007, 2008 and 2009. The 2007 and 2008 awards are subject to a three-year cliff-vesting period while the 2009 awards are subject to a three-year graded vesting period. At December 27, 2009, there was \$5.7 million of unrecognized compensation cost related to non-vested options and restricted stock expected to be recognized during 2010, 2011 and 2012.

(ii) The annual management incentive bonus plan is based on the Company's annual operating income performance and certain sales and cost control measures as compared to pre-established targets.

(3) The sponsorship fees are primarily associated with certain non-traditional venues, such as Six Flags.

(b) Franchise support initiatives primarily consist of discretionary contributions to the national marketing fund and other local advertising cooperatives.

(c) The 2008 provisions for uncollectible accounts and notes receivable included a provision associated with our loan issued in connection with the 2006 sale of the Perfect Pizza operation and increased provisions for various loans to domestic franchisees.

- **Variable Interest Entities.** BIBP generated pre-tax income of \$22.5 million in 2009, which was primarily composed of income associated with cheese sold to domestic Company-owned restaurants and franchise restaurants of \$5.5 million and \$18.1 million, respectively. For 2008, BIBP reported a pre-tax loss of \$10.5 million, which was primarily composed of losses associated with cheese sold to domestic Company-owned restaurants and franchise

restaurants of \$2.1 million and \$6.3 million, respectively. BIBP also incurred interest expense on outstanding debt with a third-party bank and Papa John's in both 2009 and 2008. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk for additional information regarding BIBP and the movement in cheese prices.

Table of Contents

Diluted earnings per share were \$2.06 in 2009 (including a \$0.52 per share gain from the consolidation of BIBP and a \$0.04 gain from the finalization of certain income tax issues), compared to \$1.30 per diluted share in 2008 (including a \$0.24 loss from the consolidation of BIBP, a \$0.06 gain from the finalization of certain income tax issues and a \$0.20 loss from restaurant impairment and disposition losses). Since the inception of the share repurchase program in 1999 through the end of 2009, an aggregate of \$741.2 million of shares have been repurchased (representing 43.5 million shares, at an average price of \$17.04 per share). Share repurchase activity during 2009 increased earnings per diluted share by approximately \$0.03 (\$0.02 excluding the impact of the consolidation of BIBP).

Review of Operating Results

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Revenues. Domestic Company-owned restaurant sales were \$503.8 million for 2009 compared to \$533.3 million for 2008. The 5.5% decrease was primarily due to the sale of 62 Company-owned restaurants to franchisees during the fourth quarter of 2008.

Variable interest entities restaurant sales include restaurant sales for franchise entities to which we have extended loans that qualify as VIEs. Revenues from these restaurants totaled \$37.7 million in 2009 as compared to \$8.3 million in 2008. During 2009, we began consolidating the financial results of two additional franchise entities. We extended loans to these two entities in the fourth quarter of 2008 in connection with our sale of Company-owned restaurants. As previously noted, beginning in 2010, we will no longer consolidate the operating results of these franchise restaurant entities due to a change in the accounting standards for variable interest entities.

Domestic franchise sales increased 3.5% to \$1.55 billion in 2009, from \$1.50 billion in 2008, primarily resulting from an increase of 3.3% in equivalent units. The increase in equivalent units is due to the franchise entities' purchase of 62 restaurants from the Company during the fourth quarter of 2008. Domestic franchise royalties increased 2.2% to \$61.0 million in 2009 from \$59.7 million for the comparable period in 2008 primarily due to the increase in the royalty rate from 4.25% to 4.50% for the last four months of 2009 and an increase in equivalent units.

Average weekly sales for comparable units include restaurants that were open throughout the periods presented. The comparable sales base for Company-owned and franchised restaurants, respectively, includes restaurants acquired by the Company or divested to franchisees, as the case may be, during the previous twelve months. Average weekly sales for other units include restaurants that were not open throughout the periods presented and include non-traditional sites. Average weekly sales for non-traditional units not subject to continuous operation are calculated based upon actual days open.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Table of Contents

The comparable sales base and average weekly sales for 2009 and 2008 for domestic Company-owned and domestic franchised restaurants consisted of the following:

	Year Ended December 27, 2009		Year Ended December 28, 2008	
	Company- owned	Franchised	Company- owned	Franchised
Total domestic units (end of period)	588	2,193	592	2,200
Equivalent units	585	2,140	637	2,072
Comparable sales base units	569	2,026	612	1,930
Comparable sales base percentage	97.3%	94.7%	96.1%	93.1%
Average weekly sales - comparable units	\$ 16,628	\$ 13,948	\$ 16,276	\$ 13,978
Average weekly sales - traditional non-comparable units	\$ 15,823	\$ 11,477	\$ 12,552	\$ 10,798
Average weekly sales - non-traditional non-comparable units	\$ 7,577	\$ 20,840	\$ 7,577	\$ 26,621
Average weekly sales - total non-comparable units	\$ 13,902	\$ 14,234	\$ 11,737	\$ 13,276
Average weekly sales - all units	\$ 16,551	\$ 13,963	\$ 16,098	\$ 13,930

Domestic franchise and development fees were \$519,000 in 2009, or a decrease of \$1.1 million, from fees of \$1.6 million in 2008, consisting of the following (in thousands, except unit data):

	2009	2008	Increase (Decrease)
Total units opened	79	98	(19)
Units opening with no fees	63	57	6
Unit opening fees	\$ 273	\$ 780	\$ (507)
Franchise renewal fees	15	445	(430)
Cancellation, transfer and extension fees	231	375	(144)
Total franchise and development fees	\$ 519	\$ 1,600	\$ (1,081)

Domestic commissary sales decreased \$21.6 million, or 5.0%, to \$407.4 million for 2009, from \$429.1 million in 2008, due to decreases in the prices of certain commodities, primarily cheese and wheat. Our commissaries charge a fixed-dollar markup on the cost of cheese, and cheese cost is based upon an adjusted 40 lb. cheddar block price, which decreased from an average of \$1.81 per pound in 2008 to an average of \$1.55 per pound in 2009, a 14.4% decrease. The cost of wheat, as measured on domestic commodity markets, decreased approximately 37% in 2009 as compared to 2008.

Other sales, which include our online and print and promotions businesses as well as our insurance agency operations, decreased \$7.4 million to \$54.0 million from \$61.4 million in 2008. The decline was due to a decrease in revenues from our online ordering system business unit, reflecting a reduction in the online fee percentage charged to our franchisees and a decrease in sales at our print and promotions business reflecting the deterioration of the U.S. economic environment.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Our PJUK operations, denominated in British pounds sterling and converted to U.S. dollars, represent approximately 50% and 55% of international revenues in 2009 and 2008, respectively. International revenues increased 7.1% to \$41.5 million in 2009, from \$38.7 million in 2008, reflecting the increase in both the number and average unit volumes of our Company-owned and franchised restaurants over the prior year.

Table of Contents

Costs and Expenses. The restaurant operating margin at domestic Company-owned units was 21.8% in 2009 compared to 18.5% in 2008. Excluding the impact of consolidating BIBP, restaurant operating margin increased 1.8% to 20.7% for the year ended December 27, 2009 as compared to the corresponding period in 2008, consisting of the following differences:

- Cost of sales was 1.1% lower (excluding the consolidation of BIBP) in 2009 compared to 2008, primarily due to lower commodities costs.
- Salaries and benefits were 0.7% lower as a percentage of sales in 2009 compared to 2008, primarily due to the divestiture in late 2008 of 62 restaurants that had a higher labor cost as a percentage of sales.
- Advertising and related costs as a percentage of sales were relatively consistent with the 2008 period.
- Occupancy and other operating costs, on a combined basis, as a percentage of sales were relatively consistent with the 2008 period.

Domestic commissary and other margin was 9.2% in 2009, compared to 9.5% in 2008. Cost of sales was 74.1% of revenues in 2009, compared to 74.0% for the same period in 2008. Cost of sales, as a percentage of revenues, increased due to increases in the cost of certain commodities that were not passed along via price increases to domestic restaurants. Salaries and benefits were 7.3% of revenues in 2009, which was relatively consistent with the prior comparable year. Other operating expenses decreased approximately \$2.1 million in 2009 as compared to 2008, reflecting a decrease in distribution costs from lower fuel prices. The favorable impact that a lower cheese cost would be expected to have on gross margin percentage (given a fixed-dollar markup per pound) was offset by additional margin reductions on non-cheese products at the commissary during the year.

We recorded pre-tax income from the franchise cheese-purchasing program, net of minority interest, of \$18.1 million and a pre-tax loss of \$6.3 million in 2009 and 2008, respectively. These results only represent the portion of BIBP's operating income or loss related to the proportion of BIBP cheese sales to franchisees. The total impact of the consolidation of BIBP on Papa John's pre-tax income was pre-tax income of \$22.5 million in 2009 and a pre-tax loss of \$10.5 million in 2008 (see the previous table which summarizes BIBP's operating results for 2009 and 2008).

General and administrative expenses were \$112.9 million, or 10.2% of revenues for 2009, as compared to \$99.7 million or 8.8% of revenues for 2008. The increase is primarily due to the items noted as comprising the increases in unallocated general and administrative expenses for the Unallocated Corporate Segment in the Summary of Operating Results section, as well as certain management transition costs recorded by our domestic commissaries segment and an increase in VIE expenses.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Table of Contents

Other general expenses reflected net expense of \$15.7 million in 2009, as compared to \$19.0 million in 2008 as detailed below (in thousands):

	2009	2008	Increase (Decrease)
Restaurant impairment and disposition losses (a)	\$ 657	\$ 8,818	\$ (8,161)
Disposition and valuation-related costs	1,829	1,381	448
Provisions for uncollectible accounts and notes receivable (b)	1,378	4,511	(3,133)
Pre-opening restaurant costs	75	250	(175)
Franchise support initiatives (c)	9,556	4,267	5,289
25th Anniversary incentives	440		440
Commissary closing costs	369		369
Other (d)	1,424	(227)	1,651
Total other general expenses	\$ 15,728	\$ 19,000	\$ (3,272)

(a) The expense in 2008 primarily represents losses associated with the divestiture of 62 Company-owned domestic restaurants during 2008 and a goodwill impairment charge of \$2.3 million associated with our United Kingdom operations.

(b) In 2008 we recorded provisions associated with our loan issued in connection with the 2006 sale of the Perfect Pizza operation and increased provisions for various loans to domestic franchisees.

(c) Primarily consists of discretionary contributions to the national marketing fund and other local advertising cooperatives.

(d) Includes the consolidation of two additional VIE franchise entities in 2009.

Depreciation and amortization was \$32.8 million, or 3.0% of revenues, for 2009 as compared to \$32.8 million, or 2.9% of revenues, for 2008.

Net interest. Net interest expense was \$5.1 million in 2009, compared to \$6.7 million in 2008. The interest expense for 2009 and 2008 includes approximately \$169,000 and \$700,000, respectively, related to BIBP's debt with a third-party bank. The decrease in net interest expense reflects the decrease in our average outstanding debt balance and lower interest rates.

***Income Tax Expense.* We recognized reductions of \$1.2 million and \$1.7 million in our customary income tax expense associated with the finalization of certain income tax issues in 2009 and 2008, respectively. Our effective income tax rate was 32.1% in 2009 compared to 34.0% in 2008 (31.1% in 2009 and 34.1% in 2008, excluding BIBP). The primary reason for the lower effective tax rate in 2009 is the impact of the nontaxable funding mechanism for the non-qualified deferred compensation plan, which is not expected to impact future years in any consistent, similar manner.**

Income Tax Expense. We recognized reductions of \$1.2 million and \$1.7 million in our customary income tax expense.

2008 Compared to 2007

Variable Interest Entities

The consolidation of BIBP had a significant impact on our operating results in both 2008 and 2007 (pre-tax losses of \$10.5 million and \$31.7 million in 2008 and 2007). The following table summarizes the

Table of Contents

impact of VIEs, prior to required consolidating eliminations, on our consolidated statements of income for the years ended December 28, 2008 and December 30, 2007 (in thousands):

	Year Ended December 28, 2008			Year Ended December 30, 2007		
	BIBP	Franchisees	Total	BIBP	Franchisees	Total
Variable interest entities						
restaurant sales	\$	\$ 8,328	\$ 8,328	\$	\$ 7,131	\$ 7,131
BIBP sales	165,449		165,449	138,233		138,233
Total revenues	165,449	8,328	173,777	138,233	7,131	145,364
Operating expenses	173,851	7,966	181,817	170,665	6,526	177,191
General and administrative expenses	187	378	565	148	308	456
Gain from the franchise cheese-purchasing program, net of minority interest				(1,615)		(1,615)
Other general expense (income)		(89)	(89)		243	243
Depreciation and amortization		73	73		54	54
Total costs and expenses	174,038	8,328	182,366	169,198	7,131	176,329
Operating loss	(8,589)		(8,589)	(30,965)		(30,965)
Interest expense	(1,951)		(1,951)	(744)		(744)
Loss before income taxes	\$ (10,540)	\$	\$ (10,540)	\$ (31,709)	\$	\$ (31,709)

Summary of Operating Results

Total revenues, which increased 6.4% to \$1.13 billion in 2008 compared to \$1.06 billion in 2007, primarily consisted of the following:

- Domestic Company-owned restaurant revenues increased \$28.9 million reflecting an increase in comparable sales results of 1.7% and a 3.4% increase in equivalent units as compared to 2007. The increase in equivalent units was due to the acquisition of restaurants from franchisees during the third quarter of 2007, partially offset by the divestiture of restaurants to franchisees during the fourth quarter of 2008.
- Franchise royalties increased \$4.4 million, or 8.0%, in 2008 primarily due to the increase in the royalty rate from 4.0% to 4.25% for the majority of domestic franchise restaurants effective at the beginning of 2008. Comparable sales increased 0.6% in 2008.
- Franchise and development fees decreased \$3.2 million resulting from fees collected from the franchise renewal program in the fourth quarter of 2007. Additionally, there were fewer franchise openings during 2008 and a lower average fee per opening due to the existence of certain development incentive programs.
- Domestic commissary sales increased \$30.0 million, or 7.5%, due to increases in the prices of certain commodities, including cheese and wheat. The commissary charges a fixed-dollar markup on its cost of cheese, and cheese cost is based upon the BIBP block price, which increased from an average of \$1.45 per pound in 2007 to an average of \$1.81 per pound in 2008 or a 24.8% increase. The cost of wheat, as measured on domestic commodity markets, increased approximately 43% in 2008 as compared to 2007.

- International revenues increased \$7.5 million, or 24.2%, reflecting the increase in both the number and average unit volumes of our Company-owned and franchised restaurants over the past year.

Table of Contents

Our income before income taxes, net of noncontrolling interests, totaled \$56.8 million in 2008, as compared to \$46.0 million in 2007 as summarized in the following table on an operating segment basis (in thousands):

	2008		2007		Increase (Decrease)
Domestic Company-owned restaurants	\$ 19,997	\$	25,407	\$	(5,410)
Domestic commissaries	30,235		35,847		(5,612)
Domestic franchising	53,610		51,466		2,144
International	(7,193)		(8,734)		1,541
All others	9,175		6,348		2,827
Unallocated corporate expenses	(36,154)		(31,454)		(4,700)
Elimination of intersegment profits	(332)		(118)		(214)
Income before income taxes, excluding variable interest entities	69,338		78,762		(9,424)
Variable interest entities	(10,540)		(31,709)		21,169
Total income before income taxes	58,798		47,053		11,745
Income attributable to noncontrolling interests	(2,022)		(1,025)		(997)
Total income before income taxes, net of noncontrolling interests	\$ 56,776	\$	46,028	\$	10,748

Excluding the impact of the consolidation of BIBP (pre-tax losses of \$10.5 million or \$0.24 per diluted share in 2008 and \$31.7 million or \$0.68 per diluted share in 2007), 2008 income before income taxes, net of noncontrolling interests, was \$67.3 million (5.9% of total revenues), compared to \$77.7 million (7.3% of total revenues) in 2007. The \$10.4 million decrease in income before income taxes (excluding the consolidation of BIBP) was principally due to the following:

- **Domestic Company-owned Restaurant Segment.** Domestic Company-owned restaurants operating income decreased \$5.4 million over the prior year, comprised of the following (in thousands):

	December 28, 2008		Year Ended December 30, 2007		Increase (Decrease)
Operating income, excluding impairment and disposition losses	\$ 26,515	\$	26,620	\$	(105)
Impairment and disposition losses	(6,518)		(1,807)		(4,711)
Gain on lease termination			594		(594)
Total segment operating income	\$ 19,997	\$	25,407	\$	(5,410)

Domestic Company-owned restaurants income from operations, excluding impairment and disposition losses, was comparable to the 2007 results as the significant increase in commodities costs during 2008 was offset by the fixed cost leverage associated with the 1.7% increase in comparable sales for the year and the benefit from units acquired in the third quarter of 2007. Restaurant operating margin on an external basis, excluding the impact of the consolidation of BIBP, was 18.9% which was approximately 1.0% below the 2007 margin primarily due to increased commodities costs.

Table of Contents

We recorded restaurant impairment and disposition charges of \$6.5 million for the year ended December 28, 2008, compared to \$1.8 million in the comparable 2007 period. The charges were primarily associated with the divestiture of 62 Company-owned domestic units during 2008.

- **Domestic Commissary Segment.** Domestic commissaries' operating income decreased \$5.6 million, reflecting a decline in sales volumes, increases in distribution costs due to higher fuel prices and a reduction in gross margin resulting from increases in the cost of certain commodities that were not passed along via price increases to domestic restaurants.

- **Domestic Franchising Segment.** Domestic franchising operating income increased \$2.1 million to \$53.6 million for the year ended December 28, 2008, from \$51.5 million in the prior comparable period. The 2008 period benefited from the 0.25% increase in our royalty rate implemented at the beginning of 2008 (the royalty rate for the majority of domestic franchisees was 4.25% in 2008 as compared to 4.0% in 2007). The 2007 period included the collection of \$2.0 million in fees associated with the franchise renewal program.

- **International Segment.** The international segment reported an operating loss of \$7.2 million in 2008 as compared to a loss of \$8.7 million in 2007. The 2008 period included a goodwill impairment charge of \$2.3 million associated with our United Kingdom operations. Excluding the PJUK impairment charge in 2008, the operating loss was \$4.9 million or an improvement of \$3.8 million from the 2007 operating results. The improvement in the operating results reflects leverage on the international organizational structure from increased revenues due to growth in the number of units and unit volumes.

- **All Others Segment.** The All others reporting segment reported operating earnings of \$9.2 million in 2008 compared to \$6.3 million in 2007. The increase in operating income was primarily due to favorable adjustments in remaining claims loss reserves associated with our inactive captive insurance program and an increase in sales from our online operations.

- **Unallocated Corporate Segment.** Unallocated corporate expenses increased \$4.7 million as compared to 2007. The components of the unallocated corporate segment were as follows (in thousands):

	Year Ended December 28, 2008	Year Ended December 30, 2007	Increase (Decrease)
General and administrative (a)	\$ 16,372	\$ 17,515	\$ (1,143)
Net interest	4,961	5,891	(930)
Depreciation	7,770	6,702	1,068
Marketing contributions (b)	3,900	400	3,500

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Provisions for uncollectible accounts and notes receivable (c)	4,082	203	3,879
Other expense (income) (d)	(931)	743	(1,674)
Total unallocated corporate expenses	\$ 36,154	\$ 31,454	\$ 4,700

(a) The decrease of \$1.1 million in general and administrative costs was primarily due to our initiative to reduce administrative costs in 2008, including travel expenses and employee benefits, in response to the economic environment. Additionally, incentive compensation

Table of Contents

expense decreased due to non-vested awards forfeited upon resignation by our former CEO and other former members of management.

The following table summarizes our recorded expense (income) associated with our management incentive programs, which are included in unallocated general and administrative costs (in thousands):

	Year Ended December 28, 2008	Year Ended December 30, 2007
Equity compensation (1)	\$ 2,564	\$ 4,883
Performance unit plan (2)	118	(1,198)
Management incentive bonus plan (3)	3,492	2,711
Total expense	\$ 6,174	\$ 6,396
Decrease		\$ (222)

(1) Stock options were awarded to management and members of our board of directors in 2006, 2007 and 2008. The 2006 option awards follow a two-year cliff-vesting period. The 2007 and 2008 awards follow either a two-year cliff-vesting period or a three-year graded vesting period. Additionally, we granted performance and time-based restricted stock in 2006, 2007 and 2008. The 2006 and 2007 restricted stock grants were performance-based and are subject to a three-year cliff-vesting period. The 2008 restricted stock grants were both performance-based and time-based and are subject to a three-year cliff vesting period. At December 28, 2008, there was \$3.5 million of unrecognized compensation cost related to non-vested options and restricted stock expected to be recognized during 2009, 2010 and 2011.

(2) Performance units were awarded in 2005 and 2006 to certain members of management, with each award having a three-year performance period; no such awards were made prior to 2005 or after 2006. The ultimate cost associated with the performance units was based on the Company's ending stock price and total shareholder return relative to a peer group over the three-year performance period ending in December 2007 for the 2005 program and December 2008 for the 2006 program, with the award value paid in cash following the end of the respective performance periods. A 2007 change in employment status of our Founder Chairman impacted the cost associated with this incentive program in that year.

(3) The annual management incentive bonus plan is based on the Company's annual operating income performance and certain sales and cost control measures as compared to pre-established targets.

(b) The Company contributed discretionary contributions to the national marketing fund and other local advertising cooperatives in both 2007 and 2008. The majority of the 2008 contributions were in response to domestic franchise system support initiatives.

(c) The increases in the provisions for uncollectible accounts and notes receivable were primarily due to our evaluation of the collectability of our loan issued in connection with the 2006 sale of the Perfect Pizza operations and a loan issued to one domestic franchisee.

Table of Contents

(d) The 2007 results included the write-off of certain obsolete corporate equipment and software.

- **Variable Interest Entities.** BIBP incurred an operating loss of \$10.5 million in 2008, which was primarily composed of losses associated with cheese sold to domestic Company-owned restaurants and franchise restaurants of \$2.1 million and \$6.3 million, respectively. For 2007, BIBP reported an operating loss of \$31.7 million, which was primarily composed of losses associated with cheese sold to domestic Company-owned restaurants and franchise restaurants of \$8.0 million and \$22.9 million, respectively. The remainder of the loss in both 2008 and 2007 was primarily composed of interest expense on outstanding debt with a third-party bank and Papa John's.

Diluted earnings per share were \$1.30 in 2008 (including a \$0.24 loss from the consolidation of BIBP, a \$0.06 gain from the finalization of certain income tax issues and a \$0.20 loss from restaurant impairment and disposition losses) compared to \$1.09 per diluted share in 2007 (including a \$0.68 loss from the consolidation of BIBP, an \$0.11 gain from the finalization of certain income tax issues and a \$0.04 loss from restaurant impairment and disposition losses). Share repurchase activity during 2008 increased earnings per diluted share by approximately \$0.01 (\$0.02 excluding the impact of the consolidation of BIBP).

Review of Operating Results

Revenues. Domestic Company-owned restaurant sales were \$533.3 million for 2008 compared to \$504.3 million for 2007. The 5.7% increase was primarily due to increases of 1.7% and 3.4% in comparable sales and equivalent units, respectively. The increase in equivalent units was due to the acquisition of restaurants from franchisees during the third quarter of 2007, partially offset by the divestiture of restaurants to franchisees during the fourth quarter of 2008.

Variable interest entities restaurant sales include restaurant sales for franchise entities to which we have extended loans that qualify as VIEs. Revenues from these restaurants totaled \$8.3 million in 2008 as compared to \$7.1 million in 2007.

Domestic system-wide franchise sales increased 2.7% to \$1.50 billion in 2008, from \$1.46 billion for the comparable period in 2007, primarily resulting from increases of 0.6% and 1.8% in comparable sales and equivalent units, respectively. Domestic franchise royalties increased 8.0% to \$59.7 million in 2008 from \$55.3 million for the comparable period in 2007 primarily due to the increase in the royalty rate from 4.0% to 4.25% for the majority of domestic restaurants effective at the beginning of 2008.

Average weekly sales for comparable units include restaurants that were open throughout the periods presented. The comparable sales base for Company-owned and franchised restaurants, respectively, includes restaurants acquired by the Company or divested to franchisees, as the case may be, during the previous twelve months. Average weekly sales for other units include restaurants that were not open throughout the periods presented and include non-traditional sites.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Table of Contents

The comparable sales base and average weekly sales for 2008 and 2007 for domestic Company-owned and domestic franchised restaurants consisted of the following:

	Year Ended December 28, 2008		Year Ended December 30, 2007	
	Company- owned	Franchised	Company- owned	Franchised
Total domestic units (end of period)	592	2,200	648	2,112
Equivalent units	637	2,072	616	2,035
Comparable sales base units	612	1,930	586	1,918
Comparable sales base percentage	96.1%	93.1%	95.1%	94.3%
Average weekly sales - comparable units	\$ 16,276	\$ 13,978	\$ 16,016	\$ 13,852
Average weekly sales - traditional non-comparable units	\$ 12,552	\$ 10,798	\$ 10,625	\$ 11,239
Average weekly sales - non-traditional non-comparable units	\$ 7,577	\$ 26,621	\$ 8,272	\$ 25,757
Average weekly sales - total non-comparable units	\$ 11,737	\$ 13,276	\$ 10,292	\$ 13,652
Average weekly sales - all units	\$ 16,098	\$ 13,930	\$ 15,739	\$ 13,841

Domestic franchise and development fees were \$1.6 million in 2008, or a decrease of \$3.2 million, from fees of \$4.8 million in 2007, consisting of the following (in thousands, except unit data):

	2008	2007	Increase (Decrease)
Total units opened	98	140	(42)
Units opening with no fees	57	38	19
Unit opening fees	\$ 780	\$ 2,000	\$ (1,220)
Franchise renewal fees	445	2,108	(1,663)
Cancellation, transfer and extension fees	375	650	(275)
Total franchise and development fees	\$ 1,600	\$ 4,758	\$ (3,158)

Domestic commissary sales increased \$30.0 million, or 7.5%, to \$429.1 million for 2008, from \$399.1 million in 2007, due to increases in the prices of certain commodities, primarily cheese and wheat. Our commissaries charge a fixed-dollar markup on the cost of cheese and cheese cost is based upon the BIBP block price, which increased from an average of \$1.45 per pound in 2007 to an average of \$1.81 per pound in 2008, a 24.8% increase. Other sales, which include our online and print and promotions businesses, as well as our insurance agency operations, were \$61.4 million and \$61.8 million for the 2008 and 2007 periods, respectively.

Our PJUK operations, denominated in British pounds sterling and converted to U.S. dollars, represent approximately 55% and 64% of international revenues in 2008 and 2007, respectively. International revenues increased 24.2% to \$38.7 million in 2008, from \$31.2 million in 2007, reflecting the increase in both the number and average unit volumes of our Company-owned and franchised restaurants over the past year.

Table of Contents

Costs and Expenses. The restaurant operating margin at domestic Company-owned units was 18.5% in 2008 compared to 18.3% in 2007, consisting of the following differences as a percentage of Company-owned restaurant sales:

- Cost of sales was 0.3% higher as a percentage of sales in 2008 compared to 2007, primarily due to an increase in commodities costs (principally cheese and wheat). The consolidation of BIBP increased cost of sales 0.4% in 2008 and 1.6% in 2007.
- Salaries and benefits were 0.5% lower as a percentage of sales in 2008 compared to 2007, as increases resulting from federal and state minimum wage increases in the latter half of both 2007 and 2008 were more than offset by staffing efficiencies and the benefit of pricing increases.
- Advertising and related costs as a percentage of sales were 0.2% lower in 2008, as compared to 2007 reflecting leverage on the increased restaurant sales.
- Occupancy and other operating costs, on a combined basis, as a percentage of sales were 0.2% higher in 2008 due to increases in mileage reimbursements to our delivery drivers and increased occupancy costs, including utilities.

Domestic commissary and other margin was 9.5% in 2008, compared to 10.9% in 2007. Cost of sales was 74.0% of revenues in 2008, compared to 72.1% for the same period in 2007. Cost of sales, as a percentage of revenues, increased due to increases in the cost of certain commodities that were not passed along via price increases to domestic restaurants and due to the previously mentioned fixed-dollar markup on the cost of cheese. We chose to mitigate certain commodity cost increases at domestic restaurants by supporting the entire domestic system via reduced commissary margins. Salaries and benefits were \$35.1 million in 2008, which was relatively consistent with the prior comparable year. Other operating expenses increased approximately \$2.0 million in 2008 as compared to 2007, reflecting increases in distribution costs due to higher fuel prices.

We recorded pre-tax losses from the franchise cheese-purchasing program, net of minority interest, of \$6.3 million and \$22.9 million in 2008 and 2007, respectively. These results only represent the portion of BIBP's operating income or loss related to the proportion of BIBP cheese sales to franchisees. The total impact of the consolidation of BIBP on Papa John's pre-tax income was losses of \$10.5 million and \$31.7 million in 2008 and 2007, respectively (see the previous table which summarizes BIBP's operating results for 2008 and 2007).

General and administrative expenses were \$99.7 million, or 8.8% of revenues for 2008, as compared to \$101.3 million or 9.5% of revenues for 2007. The decrease of \$1.6 million in 2008 was primarily due to our initiative to reduce administrative costs in 2008, including travel expenses and employee benefits, in response to the economic environment. Additionally, incentive compensation expense decreased due to non-vested awards forfeited upon resignation by our former CEO and other former members of management and a reduction in the expected payments under certain cash and equity-based compensation programs.

Table of Contents

Other general expenses reflected net expense of \$19.0 million in 2008, as compared to \$6.9 million in 2007 as detailed below (in thousands):

	2008		2007		Increase (Decrease)
Restaurant impairment and disposition losses (a)	\$ 8,818	\$	1,807	\$	7,011
Disposition and valuation-related costs	1,381		2,981		(1,600)
Provisions for uncollectible accounts and notes receivable (b)	4,511		218		4,293
Pre-opening restaurant costs	250		371		(121)
Marketing contributions (c)	4,267		1,000		3,267
Other	(227)		537		(764)
Total other general expenses	\$ 19,000	\$	6,914	\$	12,086

(a) Primarily represents losses associated with the divestiture of 62 Company-owned domestic units during 2008. In addition, we recorded a goodwill impairment charge of \$2.3 million during 2008 associated with our United Kingdom operations.

(b) The increase in the provisions for uncollectible accounts and notes receivable was primarily due to our evaluation of the collectability of our loan issued in connection with the 2006 sale of the Perfect Pizza operations and a loan issued to one domestic franchisee.

(c) We contributed discretionary contributions to the national marketing fund and other local advertising cooperatives in both 2007 and 2008. The majority of the 2008 contributions were in response to our previously mentioned domestic franchise system support initiatives.

Depreciation and amortization was \$32.8 million (2.9% of revenues) for 2008, as compared to \$31.9 million (3.0% of revenues) for 2007. The primary reason for the dollar increase in depreciation and amortization in 2008, as compared to 2007, was due to the acquisition of 42 domestic franchised restaurants during the third quarter of 2007, capital additions we made within our restaurant operations and the addition of certain information technology assets.

Net interest. Net interest expense was \$6.7 million in 2008, compared to \$6.0 million in 2007. The interest expense for 2008 and 2007 included approximately \$700,000 and \$500,000, respectively, related to BIBP's debt with a third-party bank. The increase in our 2008 net interest expense reflected lower investment income than in the 2007 period.

***Income Tax Expense.* We recognized reductions of \$1.7 million and \$3.4 million in our customary income tax expense associated with the finalization of certain income tax issues in 2008 and 2007, respectively. Our effective income tax rate was 34.0% in 2008 compared to 28.3% in 2007.**

Table of Contents**Liquidity and Capital Resources**

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

	2009	2008
Revolving line of credit	\$ 99,000	\$ 123,500
Debt associated with VIEs*		7,075
Other	50	79
Total debt	99,050	130,654
Less: current portion of debt		(7,075)
Long-term debt	\$ 99,050	\$ 123,579

*Papa John's is the guarantor of BIBP's debt (none outstanding at December 27, 2009).

Our revolving line of credit allows us to borrow up to \$175.0 million until its expiration date of January 2011. Outstanding balances accrue interest at 50.0 to 100.0 basis points over the London Interbank Offered Rate (LIBOR) or other bank developed rates at our option. The commitment fee on the unused balance ranges from 12.5 to 20.0 basis points. The increment over LIBOR and the commitment fee are determined quarterly based upon the ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization (EBITDA), as defined in the line of credit.

The revolving line of credit contains customary affirmative and negative covenants, including the following financial covenants, as defined (the covenants exclude the impact of consolidating BIBP's operations):

	Permitted Ratio	Actual Ratio for the Year Ended December 27, 2009
Leverage Ratio	Not to exceed 2.5 to 1.0	1.1 to 1.0
Interest Coverage Ratio	Not less than 3.5 to 1.0	4.7 to 1.0

We were in compliance with all covenants at December 27, 2009 and December 28, 2008.

Cash flow provided by operating activities increased to \$100.9 million in 2009 from \$73.1 million in 2008. The consolidation of BIBP increased cash flow from operations by approximately \$22.5 million in 2009 and decreased cash flow from operations by approximately \$10.5 million in 2008 (as reflected in the net income and deferred income taxes captions in the accompanying Consolidated Statements of Cash Flows). Excluding the impact of the consolidation of BIBP, cash flow was \$78.4 million in 2009, as compared to \$83.6 million in 2008. The \$5.2 million

Income Tax Expense. We recognized reductions of \$1.7 million and \$3.4 million in our customary income tax expense.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

decrease in cash flow from operations, excluding the consolidation of BIBP, was primarily due to reductions in net income from operations, excluding impairment and disposition losses.

Cash flow provided by operating activities increased to \$73.1 million in 2008 from \$61.6 million in 2007. The consolidation of BIBP decreased cash flow from operations by approximately \$10.5 million in 2008 and \$31.7 million in 2007. Excluding the impact of the consolidation of BIBP, cash flow was \$83.6

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

Table of Contents

million in 2008 as compared to \$93.3 million in 2007. The \$9.7 million decrease was primarily due to a decrease in net income.

The Company's free cash flow for the last three years was as follows (in thousands):

	Dec. 27, 2009	Year Ended Dec. 28, 2008	Dec. 30, 2007
Net cash provided by operating activities	\$ 100,913	\$ 73,063	\$ 61,591
Gain (loss) from BIBP cheese purchasing entity	(22,543)	10,540	31,709
Purchase of property and equipment	(33,538)	(29,271)	(31,148)
Free cash flow (a)	\$ 44,832	\$ 54,332	\$ 62,152

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

During 2007, we acquired 63 Papa John's restaurants (no significant acquisitions in 2008 or 2009), as summarized below (dollars in thousands):

	Acquisition Month	Location	Number of Restaurants	Cash Paid	Recorded Goodwill
2007					
	Period 2	Pennsylvania	4	\$ 1,000	\$ 779
	Period 4	Georgia	13	7,400	6,465
	Period 7	Missouri and Kansas	31	10,306	7,266
	Period 8	Maryland	11	6,062	4,663
		Other	4	215	
Total 2007*			63	\$ 24,983	\$ 19,173

*Substantially all of the remaining purchase price was allocated to acquired property and equipment.

The restaurant acquisitions for 2007 were accounted for by the purchase method of accounting, whereby operating results subsequent to the acquisition are included in our consolidated financial results.

Income Tax Expense. We recognized reductions of \$1.7 million and \$3.4 million in our customary income tax expense in 2008 and 2007, respectively.

Edgar Filing: PAPA JOHNS INTERNATIONAL INC - Form 10-K

During 2008, we divested 62 Company-owned restaurants to franchisees (no significant divestitures in 2009 or 2007). Total consideration for the sale of the restaurants was \$10.5 million, consisting of cash proceeds of \$2.1 million and loans financed by Papa John's for \$8.4 million. The annual revenues of the divested restaurants approximated \$38 million.

We require capital primarily for the development, acquisition, renovation and maintenance of restaurants, the development, renovation and maintenance of commissary and print and promotions facilities and

Table of Contents

equipment and the enhancement of corporate systems and facilities. Purchases of property and equipment amounted to \$33.5 million, \$29.3 million and \$31.1 million in 2009, 2008 and 2007, respectively, and are summarized by operating segment in Note 20 of Notes to Consolidated Financial Statements.

Our Board of Directors has authorized the repurchase of our common stock through December 31, 2010. The following is a summary of our common share repurchases for the last three years (in thousands, except average price per share):

Fiscal Year	Number of Shares Repurchased	Total Cash Paid	Average Price Per Share
2007	2,684	\$ 72,871	\$ 27.15
2008	1,400	\$ 37,697	\$ 26.93
2009	1,319	\$ 28,477	\$ 21.59

Subsequent to year-end (through February 16, 2010), we acquired an additional 43,000 shares at an aggregate cost of \$967,000. As of February 16, 2010, approximately \$32.8 million remained available for repurchase of common stock under our authorization.

The outstanding principal balance under our revolving line of credit decreased from \$134.0 million in 2007 to \$123.5 million in 2008 and decreased to \$99.0 million in 2009. The decrease in the outstanding debt reflects the Company's cash flow from operations less amounts expended for capital and share repurchases.

Total 2010 capital expenditures are expected to approximate \$40 to \$45 million. The planned capital expenditures will include certain technology-based initiatives focused on enhancing our online ordering platform, improving productivity in Company-owned restaurants and commissaries, and the completion of our commissary in the United Kingdom.

We expect to fund the planned capital expenditures and any additional share repurchases of our common stock for the next twelve months from our cash on hand and operating cash flow. Our total debt was \$99.0 million at December 27, 2009, compared to \$130.7 million, including \$7.1 million associated with BIBP, at December 28, 2008 (no outstanding third party BIBP debt at December 27, 2009).

Our \$175 million revolving line of credit expires in January 2011. We plan to renew and extend the line of credit during 2010. We do not anticipate any problems in renewing the line of credit due to the level of historical cash flow generated from operating activities.

Table of Contents

Contractual obligations and payments as of December 27, 2009 due by year are as follows (in thousands):

	Less than	1-3	Payments Due by Period	After
			3-5	

Income Tax Expense. We recognized reductions of \$1.7 million and \$3.4 million in our customary income tax expense