

PAPA JOHNS INTERNATIONAL INC
Form 10-Q
August 07, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 1, 2007

OR

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

Commission File Number: 0-21660

PAPA JOHN S INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

61-1203323

(I.R.S. Employer
Identification number)

**2002 Papa Johns Boulevard
Louisville, Kentucky 40299-2367**
(Address of principal executive offices)

(502) 261-7272

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

At August 1, 2007, there were outstanding 29,872,378 shares of the registrant's common stock, par value \$0.01 per share.

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****Papa John's International, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets**

| (In thousands) | July 1, 2007 (Unaudited) | December 31, 2006 (Note) |
|---|-----------------------------|-----------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 19,933 | \$ 12,979 |
| Accounts receivable | 21,495 | 23,326 |
| Inventories | 24,936 | 26,729 |
| Prepaid expenses | 9,407 | 7,779 |
| Other current assets | 6,557 | 7,368 |
| Deferred income taxes | 7,507 | 6,362 |
| Total current assets | 89,835 | 84,543 |
| Investments | 583 | 1,254 |
| Net property and equipment | 199,723 | 197,722 |
| Notes receivable | 14,287 | 12,104 |
| Deferred income taxes | 5,997 | 1,643 |
| Goodwill | 74,580 | 67,357 |
| Other assets | 17,577 | 15,016 |
| Total assets | \$ 402,582 | \$ 379,639 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 26,804 | \$ 29,202 |
| Income and other taxes | 13,294 | 15,136 |
| Accrued expenses | 53,246 | 57,233 |
| Current portion of debt | 10,775 | 525 |
| Total current liabilities | 104,119 | 102,096 |
| Unearned franchise and development fees | 7,211 | 7,562 |
| Long-term debt, net of current portion | 116,009 | 96,511 |
| Other long-term liabilities | 28,238 | 27,302 |
| Stockholders' equity: | | |
| Preferred stock | | |
| Common stock | 347 | 341 |
| Additional paid-in capital | 203,187 | 187,990 |
| Accumulated other comprehensive income | 1,198 | 515 |
| Retained earnings | 84,392 | 63,614 |
| Treasury stock | (142,119) | (106,292) |
| Total stockholders' equity | 147,005 | 146,168 |
| Total liabilities and stockholders' equity | \$ 402,582 | \$ 379,639 |

Note: The balance sheet at December 31, 2006 has been derived from the audited consolidated financial statements at that date, but does not include all information and footnotes required by accounting principles generally accepted in the United States for a complete set of financial statements.

See accompanying notes.

Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

| (In thousands, except per share amounts) | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | July 1, 2007 | June 25, 2006 | July 1, 2007 | June 25, 2006 |
| Domestic revenues: | | | | |
| Company-owned restaurant sales | \$ 119,633 | \$ 105,424 | \$ 241,677 | \$ 212,164 |
| Variable interest entities restaurant sales | 1,602 | 2,691 | 3,289 | 5,137 |
| Franchise royalties | 13,746 | 13,964 | 28,198 | 28,202 |
| Franchise and development fees | 541 | 593 | 1,303 | 1,181 |
| Commissary sales | 96,224 | 100,968 | 196,423 | 203,660 |
| Other sales | 17,355 | 12,202 | 31,846 | 23,072 |
| International revenues: | | | | |
| Royalties and franchise and development fees | 2,223 | 1,839 | 4,671 | 3,296 |
| Restaurant and commissary sales | 4,932 | 3,912 | 9,473 | 7,230 |
| Total revenues | 256,256 | 241,593 | 516,880 | 483,942 |
| Costs and expenses: | | | | |
| Domestic Company-owned restaurant expenses: | | | | |
| Cost of sales | 25,829 | 19,650 | 50,917 | 40,528 |
| Salaries and benefits | 35,928 | 31,252 | 72,872 | 62,753 |
| Advertising and related costs | 11,159 | 9,821 | 22,062 | 19,013 |
| Occupancy costs | 7,520 | 6,364 | 14,809 | 12,526 |
| Other operating expenses | 16,411 | 13,774 | 32,804 | 27,577 |
| Total domestic Company-owned restaurant expenses | 96,847 | 80,861 | 193,464 | 162,397 |
| Variable interest entities restaurant expenses | 1,352 | 2,224 | 2,731 | 4,331 |
| Domestic commissary and other expenses: | | | | |
| Cost of sales | 80,944 | 81,866 | 162,719 | 165,409 |
| Salaries and benefits | 9,006 | 7,851 | 17,804 | 15,316 |
| Other operating expenses | 11,147 | 11,282 | 22,145 | 22,422 |
| Total domestic commissary and other expenses | 101,097 | 100,999 | 202,668 | 203,147 |
| Loss (income) from the franchise cheese purchasing program, net of minority interest | 6,277 | (5,189) | 6,178 | (9,765) |
| International operating expenses | 4,426 | 3,883 | 8,464 | 7,306 |
| General and administrative expenses | 25,221 | 26,386 | 50,621 | 50,630 |
| Minority interests and other general expenses | 999 | 1,327 | 2,936 | 3,025 |
| Depreciation and amortization | 7,589 | 6,603 | 15,484 | 13,164 |
| Total costs and expenses | 243,808 | 217,094 | 482,546 | 434,235 |
| Operating income from continuing operations | 12,448 | 24,499 | 34,334 | 49,707 |
| Investment income | 368 | 364 | 721 | 740 |
| Interest expense | (1,706) | (631) | (3,232) | (1,432) |
| Income from continuing operations before income taxes | 11,110 | 24,232 | 31,823 | 49,015 |
| Income tax expense | 4,101 | 8,966 | 11,659 | 18,136 |
| Income from continuing operations | 7,009 | 15,266 | 20,164 | 30,879 |
| Income from discontinued operations, net of tax | | | | 389 |
| Net income | \$ 7,009 | \$ 15,266 | \$ 20,164 | \$ 31,268 |
| Basic earnings per common share: | | | | |
| Income from continuing operations | \$ 0.23 | \$ 0.47 | \$ 0.67 | \$ 0.94 |
| Income from discontinued operations, net of tax | | | | 0.01 |
| Basic earnings per common share | \$ 0.23 | \$ 0.47 | \$ 0.67 | \$ 0.95 |
| Earnings per common share - assuming dilution: | | | | |
| Income from continuing operations | \$ 0.23 | \$ 0.46 | \$ 0.66 | \$ 0.92 |
| Income from discontinued operations, net of tax | | | | 0.01 |

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| | | | | |
|--|---------|---------|---------|---------|
| Earnings per common share - assuming dilution | \$ 0.23 | \$ 0.46 | \$ 0.66 | \$ 0.93 |
| Basic weighted average shares outstanding | 30,054 | 32,589 | 30,059 | 32,855 |
| Diluted weighted average shares outstanding | 30,600 | 33,309 | 30,623 | 33,632 |

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity

(Unaudited)

| (In thousands) | Common Stock Shares Outstanding | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock | Total Stockholders Equity |
|--|---------------------------------------|-----------------|----------------------------------|--|----------------------|-------------------|---------------------------------|
| Balance at December 25, 2005 | 33,081 | \$ 331 | \$ 160,999 | \$ (290) | \$ 239 | \$ | \$ 161,279 |
| Comprehensive income: | | | | | | | |
| Net income | | | | | 31,268 | | 31,268 |
| Change in valuation of interest rate swap agreement, net of tax of \$707 | | | | 1,192 | | | 1,192 |
| Other, net | | | | 503 | | | 503 |
| Comprehensive income | | | | | | | 32,963 |
| Exercise of stock options | 710 | 7 | 10,443 | | | | 10,450 |
| Tax benefit related to exercise of non-qualified stock options | | | 3,151 | | | | 3,151 |
| Acquisition of Company common stock | (1,645) | | | | | (51,728) | (51,728) |
| Other | | | 1,827 | | | | 1,827 |
| Balance at June 25, 2006 | 32,146 | \$ 338 | \$ 176,420 | \$ 1,405 | \$ 31,507 | \$ (51,728) | \$ 157,942 |
| Balance at December 31, 2006 | 30,696 | \$ 341 | \$ 187,990 | \$ 515 | \$ 63,614 | \$ (106,292) | \$ 146,168 |
| Cumulative effect of adoption of FIN No. 48 | | | | | 614 | | 614 |
| Adjusted balance at January 1, 2007 | 30,696 | 341 | 187,990 | 515 | 64,228 | (106,292) | 146,782 |
| Comprehensive income: | | | | | | | |
| Net income | | | | | 20,164 | | 20,164 |
| Change in valuation of interest rate swap agreements, net of tax of \$209 | | | | 363 | | | 363 |
| Other, net | | | | 320 | | | 320 |
| Comprehensive income | | | | | | | 20,847 |
| Exercise of stock options | 647 | 6 | 10,317 | | | | 10,323 |
| Tax benefit related to exercise of non-qualified stock options | | | 3,025 | | | | 3,025 |
| Acquisition of Company common stock | (1,223) | | | | | (35,827) | (35,827) |
| Other | | | 1,855 | | | | 1,855 |
| Balance at July 1, 2007 | 30,120 | \$ 347 | \$ 203,187 | \$ 1,198 | \$ 84,392 | \$ (142,119) | \$ 147,005 |

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At June 25, 2006, the accumulated other comprehensive gain of \$1,405 was comprised of net unrealized foreign currency translation gains of \$573, a net unrealized gain on investments of \$7 and a net unrealized gain on the interest rate swap agreement of \$825.

At July 1, 2007, the accumulated other comprehensive gain of \$1,198 was comprised of unrealized foreign currency translation gains of \$1,419, a net unrealized gain on investments of \$5 and a net unrealized gain on the interest rate swap agreements of \$358, partially offset by a \$584 pension plan liability for PJUK.

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

| (In thousands) | Six Months Ended | |
|---|------------------|---------------|
| | July 1, 2007 | June 25, 2006 |
| Operating activities | | |
| Net income | \$ 20,164 | \$ 31,268 |
| Results from discontinued operations (net of income taxes) | | (389) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for uncollectible accounts and notes receivable | 1,034 | 1,887 |
| Depreciation and amortization | 15,484 | 13,164 |
| Deferred income taxes | (5,709) | 212 |
| Stock-based compensation expense | 1,855 | 1,882 |
| Excess tax benefit related to exercise of non-qualified stock options | (3,025) | (4,500) |
| Other | 3,260 | 3,556 |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | 1,048 | (2,274) |
| Inventories | 1,785 | 1,586 |
| Prepaid expenses | (1,723) | 1,156 |
| Other current assets | 908 | (218) |
| Other assets and liabilities | (892) | (4,885) |
| Accounts payable | (2,437) | (3,709) |
| Income and other taxes | (1,228) | (430) |
| Accrued expenses | (3,929) | (354) |
| Unearned franchise and development fees | (351) | (747) |
| Net cash provided by operating activities from continuing operations | 26,244 | 37,205 |
| Operating cash flows from discontinued operations | | 414 |
| Net cash provided by operating activities | 26,244 | 37,619 |
| Investing activities | | |
| Purchase of property and equipment | (16,433) | (14,068) |
| Proceeds from sale of property and equipment | 27 | 26 |
| Purchase of investments | | (2,014) |
| Proceeds from sale or maturity of investments | 671 | 4,472 |
| Loans issued | (4,263) | (4,616) |
| Loan repayments | 2,029 | 6,410 |
| Acquisitions | (8,615) | (1,200) |
| Proceeds from divestiture of restaurants | 632 | |
| Net cash from continuing operations used in investing activities | (25,952) | (10,990) |
| Proceeds from divestiture of discontinued operations | | 8,020 |
| Net cash used in investing activities | (25,952) | (2,970) |
| Financing activities | | |
| Net proceeds (repayments) from line of credit facility | 19,500 | (13,500) |
| Net proceeds from short-term debt - variable interest entities | 10,250 | 3,800 |
| Excess tax benefit related to exercise of non-qualified stock options | 3,025 | 4,500 |
| Proceeds from exercise of stock options | 10,323 | 10,450 |
| Acquisition of Company common stock | (35,827) | (51,728) |
| Other | (675) | 172 |
| Net cash provided by (used in) financing activities | 6,596 | (46,306) |
| Effect of exchange rate changes on cash and cash equivalents | 66 | 53 |
| Change in cash and cash equivalents | 6,954 | (11,604) |
| Cash and cash equivalents at beginning of period | 12,979 | 22,098 |
| Cash and cash equivalents at end of period | \$ 19,933 | \$ 10,494 |

See accompanying notes.

Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

July 1, 2007

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the six months ended July 1, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ended December 30, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for Papa John's International, Inc. (referred to as the Company, Papa John's or in the first-person notations of we, us and our) for the year ended December 31, 2006.

2. Accounting for Uncertainty in Income Taxes (FIN 48)

The Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) on January 1, 2007. FIN 48 addresses the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. In addition, FIN 48 expands the disclosure requirements concerning unrecognized tax benefits as well as any significant changes that may occur in the next twelve months associated with such unrecognized tax benefits. As a result of the implementation of FIN 48, the Company recognized an approximate \$614,000 decrease in the liability for unrecognized tax benefits, which is accounted for as an increase to the January 1, 2007 balance of retained earnings. As of the adoption date, we had tax affected unrecognized benefits of approximately \$9.6 million. To the extent these unrecognized tax benefits are ultimately recognized, the effective tax rate will be impacted in a future period.

The Company files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company, with few exceptions, is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003. The Company is currently undergoing examinations by various state and local tax authorities. The Company anticipates that the finalization of these current examinations and the expiration of the applicable statute of limitations will result in a decrease in the liability for unrecognized tax benefits (and a decrease of income tax expense) of approximately \$2.0 million during 2007.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits as a part of income tax expense. The Company recognized interest and penalties of approximately \$163,000 and \$296,000 for the three months ended July 1, 2007 and June 25, 2006, respectively, and \$281,000 and \$377,000 for the six months ended July 1, 2007 and June 25, 2006, respectively. The Company had approximately \$2.4 million and \$2.5 million for the payment of interest and penalties accrued at July 1, 2007 and December 31, 2006, respectively.

3. Acquisitions

During the first quarter of 2007, we completed the acquisition of six restaurants located in Pennsylvania, Texas and Oklahoma. The purchase price for these restaurants totaled \$1.2 million, which was paid in cash, of which approximately \$779,000 was recorded as goodwill.

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During the second quarter, we completed the acquisition of 13 restaurants in Georgia. The purchase price for these restaurants totaled \$7.4 million, which was paid in cash, of which approximately \$6.4 million was recorded as goodwill.

Effective July 2, 2007 (the beginning of our third quarter 2007), we acquired 31 restaurants located in Missouri and Kansas. The purchase price for these restaurants totaled \$10.2 million, which was paid in cash and is subject to post-closing adjustments. Approximately \$7.4 million of the purchase price was recorded as goodwill. Effective July 30, 2007, we acquired 11 restaurants located in the Washington D.C. area. The purchase price for these restaurants was \$6.1 million, which was paid in cash and is subject to post-closing adjustments. Approximately \$4.7 million of the purchase price was recorded as goodwill.

The business combinations in the previous paragraphs were accounted for by the purchase method of accounting, whereby operating results subsequent to the acquisition date are included in our consolidated financial results.

4. Accounting for Variable Interest Entities

In 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46), which provides a framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements.

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

FIN 46 requires a VIE to be consolidated if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is obligated to absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party absorbs a majority of the VIE's losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary. Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value and subsequently account for the VIE as if it were consolidated based on majority voting interest. FIN 46 also requires disclosures about VIEs that the variable interest holder is not required to consolidate but in which it has a significant variable interest.

We have a purchasing arrangement with BIBP Commodities, Inc. (BIBP), a special-purpose entity formed at the direction of our Franchise Advisory Council in 1999 for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants. BIBP is an independent, franchisee-owned corporation. BIBP purchases cheese at the market price and sells it to our distribution subsidiary, PJ Food Service, Inc. (PJFS), at a fixed quarterly price based in part upon historical average market prices. PJFS in turn sells cheese to Papa John's restaurants (both Company-owned and franchised) at a set quarterly price. PJFS purchased \$29.4 million and \$61.0 million of cheese from BIBP for the three and six months ended July 1, 2007, respectively, and \$35.6 million and \$71.9 million of cheese for the comparable periods in 2006, respectively.

As defined by FIN 46, we are the primary beneficiary of BIBP, a VIE, and thus we consolidate the financial statements of BIBP. We recognize the operating losses generated by BIBP if BIBP's shareholders' equity is in a net deficit position. Further, we will recognize the subsequent operating income generated by BIBP up to the amount of any losses previously recognized.

We recognized pre-tax losses of \$8.3 million (\$5.3 million net of tax, or \$0.17 per share) and \$8.7 million (\$5.5 million net of tax, or \$0.18 per share) for the three and six months ended July 1, 2007, respectively, and pretax income of \$6.3 million (\$4.0 million net of tax, or \$0.12 per share) and \$11.7 million (\$7.4 million net of tax, or

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\$0.22 per share) for the three and six months ended June 25, 2006, respectively, from the consolidation of BIBP. The impact on future operating income from the consolidation of BIBP is expected to be significant for any given reporting period due to the noted volatility of the cheese market, but is not expected to be cumulatively significant over time.

BIBP has an \$18.0 million line of credit with a commercial bank, which is not guaranteed by Papa John's. Papa John's has agreed to provide additional funding in the form of a loan to BIBP. As of July 1, 2007, BIBP had outstanding borrowings of \$10.8 million and a letter of credit of \$3.0 million outstanding under the commercial line of credit facility.

In addition, Papa John's has extended loans to certain franchisees. Under FIN 46, Papa John's was deemed the primary beneficiary of two franchise entities as of July 1, 2007 and three franchise entities as of June 25, 2006, even though we had no ownership in them. The two franchise entities at July 1, 2007 operated a total of seven restaurants with annual revenues approximating \$6.0 million. Our net loan balance receivable from these entities was \$439,000 at July 1, 2007, with no further funding commitments. The consolidation of these franchise entities has had no significant impact on Papa John's operating results and is not expected to have a significant impact in future periods.

The following table summarizes the balance sheets for our consolidated VIEs as of July 1, 2007 and December 31, 2006:

| (In thousands) | July 1, 2007 | | | December 31, 2006 | | |
|--|--------------|-------------|-----------|-------------------|-------------|----------|
| | BIBP | Franchisees | Total | BIBP | Franchisees | Total |
| Assets: | | | | | | |
| Cash and cash equivalents | \$ 4,279 | \$ 245 | \$ 4,524 | \$ 144 | \$ 150 | \$ 294 |
| Accounts receivable - Papa John's | 372 | | 372 | 3,950 | | 3,950 |
| Other current assets | 979 | 41 | 1,020 | 1,397 | 26 | 1,423 |
| Net property and equipment | | 435 | 435 | | 464 | 464 |
| Goodwill | | 460 | 460 | | 460 | 460 |
| Deferred income taxes | 3,259 | | 3,259 | | | |
| Total assets | \$ 8,889 | \$ 1,181 | \$ 10,070 | \$ 5,491 | \$ 1,100 | \$ 6,591 |
| Liabilities and stockholders' equity (deficit): | | | | | | |
| Accounts payable and accrued expenses | \$ 3,653 | \$ 260 | \$ 3,913 | \$ 3,436 | \$ 220 | \$ 3,656 |
| Income and other taxes | | | | 506 | | 506 |
| Short-term debt - third party | 10,775 | | 10,775 | 525 | | 525 |
| Short-term debt - Papa John's | | 439 | 439 | | 517 | 517 |
| Total liabilities | 14,428 | 699 | 15,127 | 4,467 | 737 | 5,204 |
| Stockholders' equity (deficit) | (5,539) | 482 | (5,057) | 1,024 | 363 | 1,387 |
| Total liabilities and stockholders' equity (deficit) | \$ 8,889 | \$ 1,181 | \$ 10,070 | \$ 5,491 | \$ 1,100 | \$ 6,591 |

5. Debt

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

| | July 1, 2007 | December 31, 2006 |
|-------------------------------|-----------------|----------------------|
| Revolving line of credit | \$ 116,000 | \$ 96,500 |
| Debt associated with VIEs * | 10,775 | 525 |
| Other | 9 | 11 |
| Total debt | 126,784 | 97,036 |
| Less: current portion of debt | (10,775) | (525) |
| Long-term debt | \$ 116,009 | \$ 96,511 |

* The VIEs' third-party creditors do not have any recourse to Papa John's.

6. Calculation of Earnings Per Share

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|---------------|------------------|---------------|
| | July 1, 2007 | June 25, 2006 | July 1, 2007 | June 25, 2006 |
| Basic earnings per common share: | | | | |
| Income from continuing operations | \$ 7,009 | \$ 15,266 | \$ 20,164 | \$ 30,879 |
| Weighted average shares outstanding | 30,054 | 32,589 | 30,059 | 32,855 |
| Basic earnings per common share | \$ 0.23 | \$ 0.47 | \$ 0.67 | \$ 0.94 |
| Earnings per common share - assuming dilution: | | | | |
| Income from continuing operations | \$ 7,009 | \$ 15,266 | \$ 20,164 | \$ 30,879 |
| Weighted average shares outstanding | 30,054 | 32,589 | 30,059 | 32,855 |
| Dilutive effect of outstanding common stock options | 546 | 720 | 564 | 777 |
| Diluted weighted average shares outstanding | 30,600 | 33,309 | 30,623 | 33,632 |
| Earnings per common share - assuming dilution | \$ 0.23 | \$ 0.46 | \$ 0.66 | \$ 0.92 |

7. Comprehensive Income

Comprehensive income is comprised of the following:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|---------------|------------------|---------------|
| | July 1, 2007 | June 25, 2006 | July 1, 2007 | June 25, 2006 |
| Net income | \$ 7,009 | \$ 15,266 | \$ 20,164 | \$ 31,268 |
| Change in valuation of interest rate swap agreements, net of tax | 619 | 581 | 363 | 1,192 |
| Other, net | 202 | 433 | 320 | 503 |
| Comprehensive income | \$ 7,830 | \$ 16,280 | \$ 20,847 | \$ 32,963 |

8. Segment Information

We have defined five reportable segments: domestic restaurants, domestic commissaries, domestic franchising, international operations and variable interest entities (VIEs).

The domestic restaurant segment consists of the operations of all domestic (domestic is defined as contiguous United States) Company-owned restaurants and derives its revenues principally from retail sales of pizza and side items, such as breadsticks, cheesesticks, chicken strips, chicken wings, dessert pizza, and soft drinks to the general public. The domestic commissary segment consists of the operations of our regional dough production and product distribution centers and derives its revenues principally from the sale and distribution of food and paper products to domestic Company-owned and franchised restaurants. The domestic franchising segment consists of our franchise sales and support activities and derives its revenues from sales of franchise and development rights and collection of royalties from our domestic franchisees. The international operations segment principally consists of our Company-owned restaurants and distribution sales to franchised Papa John's restaurants located in the United Kingdom, China and Mexico and our franchise sales and support activities, which derive revenues from sales of franchise and development rights and the collection of royalties from our international franchisees. VIEs consist of entities in which we are deemed the primary beneficiary, as defined in Note 4, and include BIBP and certain franchisees to which we have extended loans. All other business units that do not meet the quantitative thresholds for determining reportable segments consist of operations that derive revenues from the sale, principally to Company-owned and franchised restaurants, of printing and promotional items, risk management services, and information systems and related services used in restaurant operations and certain partnership development activities.

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

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

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Our segment information is as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | July 1, 2007 | June 25, 2006 | July 1, 2007 | June 25, 2006 |
| Revenues from external customers: | | | | |
| Domestic Company-owned restaurants | \$ 119,633 | \$ 105,424 | \$ 241,677 | \$ 212,164 |
| Domestic commissaries | 96,224 | 100,968 | 196,423 | 203,660 |
| Domestic franchising | 14,287 | 14,557 | 29,501 | 29,383 |
| International | 7,155 | 5,751 | 14,144 | 10,526 |
| Variable interest entities(1) | 1,602 | 2,691 | 3,289 | 5,137 |
| All others | 17,355 | 12,202 | 31,846 | 23,072 |
| Total revenues from external customers | \$ 256,256 | \$ 241,593 | \$ 516,880 | \$ 483,942 |
| Intersegment revenues: | | | | |
| Domestic commissaries | \$ 29,684 | \$ 27,381 | \$ 60,529 | \$ 55,265 |
| Domestic franchising | 338 | 316 | 677 | 630 |
| International | 149 | 146 | 306 | 278 |
| Variable interest entities(1) | 29,430 | 35,634 | 61,017 | 71,887 |
| All others | 3,447 | 3,181 | 7,415 | 6,128 |
| Total intersegment revenues | \$ 63,048 | \$ 66,658 | \$ 129,944 | \$ 134,188 |
| Income (loss) from continuing operations before income taxes: | | | | |
| Domestic Company-owned restaurants(2) | \$ 7,535 | \$ 8,149 | \$ 15,750 | \$ 17,450 |
| Domestic commissaries(3) | 7,917 | 8,512 | 17,931 | 15,865 |
| Domestic franchising(4) | 12,065 | 12,737 | 25,108 | 25,751 |
| International(5) | (2,032) | (2,418) | (4,352) | (4,759) |
| Variable interest entities | (8,257) | 6,303 | (8,663) | 11,692 |
| All others | 1,679 | 1,218 | 2,724 | 2,717 |
| Unallocated corporate expenses(6) | (7,486) | (9,936) | (15,781) | (18,818) |
| Elimination of intersegment profits | (311) | (333) | (894) | (883) |
| Total income from continuing operations before income taxes | \$ 11,110 | \$ 24,232 | \$ 31,823 | \$ 49,015 |
| Property and equipment: | | | | |
| Domestic Company-owned restaurants | \$ 158,056 | | | |
| Domestic commissaries | 76,405 | | | |
| International | 6,067 | | | |
| Variable interest entities | 1,368 | | | |
| All others | 22,579 | | | |
| Unallocated corporate assets | 134,740 | | | |
| Accumulated depreciation and amortization | (199,492) | | | |
| Net property and equipment | \$ 199,723 | | | |

(1) The revenues from external customers for variable interest entities are attributable to the franchise entities to which we have extended loans that qualify as consolidated VIEs. The intersegment revenues for variable interest entities are attributable to BIBP.

(2) The operating results for domestic Company-owned restaurants decreased approximately \$614,000 and \$1.7 million for the three and six months ended July 1, 2007, respectively, primarily due to the impact of negative comparable sales, an increase in salaries for our general and assistant managers and the impact of minimum wage increases in certain states, partially offset by a \$594,000 pre-tax gain associated with the termination of a lease arrangement in the second quarter of 2007.

(3) The operating results for the domestic commissaries segment decreased approximately \$595,000 for the second quarter of 2007 principally due to an increase in delivery, utility and labor costs. Operating income increased \$2.1 million for the six-month period ended July 1, 2007 due to increased volumes of higher-margin fresh dough

products and improved margin from other commodities during the first quarter of 2007, partially offset by an increase in delivery, utility and labor costs.

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(4) The operating results for the domestic franchising segment decreased \$672,000 and \$643,000 for the three- and six-month periods ended July 1, 2007, respectively, principally due to a decrease in royalties as a result of the acquisition of franchise restaurants during late 2006 and the first half of 2007.

(5) The international segment, which excludes the Perfect Pizza operations that were sold in March 2006, reported operating losses of \$2.0 million and \$4.4 million for the three- and six-month periods ended July 1, 2007, respectively, compared to losses of \$2.4 million and \$4.8 million, respectively, in the same periods of the prior year. The improvements are due to the prior year results including a \$470,000 charge incurred in the second quarter related to costs associated with management reorganization in one of our international operating units. Increased current year revenues, which were due to growth in number of units and unit volumes, were substantially offset by increased personnel and infrastructure investment costs.

(6) The decrease of approximately \$2.4 million and \$3.0 million in unallocated corporate expenses for the three and six months ended July 1, 2007, respectively, as compared to the corresponding periods in 2006, are primarily due to lower general and administrative costs, including management incentives (bonuses and executive performance unit incentive plan), health insurance and legal costs.

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

Results of Operations and Critical Accounting Policies and Estimates

Papa John's International, Inc. (referred to as the Company, Papa John's or in the first-person notations of we, us and our) began operations in 1985. At July 1, 2007, there were 3,090 Papa John's restaurants (614 Company-owned and 2,476 franchised) operating in all 50 states and 27 countries. Our revenues are principally derived from retail sales of pizza and other food and beverage products to the general public by Company-owned restaurants, franchise royalties, sales of franchise and development rights, sales to franchisees of food and paper products, printing and promotional items, risk management services, and information systems and related services used in their operations.

We enter into agreements with our domestic franchisees upon the opening of a Papa John's restaurant, which are generally ten years, with an option to renew. A substantial number of our domestic franchise agreements were entered into in the late 1990's and are beginning to come up for renewal. We have recently modified certain aspects of our domestic franchise agreement in consultation with a task force of our Franchise Advisory Council. The completion of the revisions in the franchise agreement was a first step in the renewal process for all franchise agreements, especially those coming up for renewal over the next few years.

The results of operations are based on the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States. The preparation of consolidated financial statements requires management to select accounting policies for critical accounting areas and make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant changes in assumptions and/or conditions in our critical accounting policies could materially impact the operating results. We have identified the following accounting policies and related judgments as critical to understanding the results of our operations.

Allowance for Doubtful Accounts and Notes Receivable

We establish reserves for uncollectible accounts and notes receivable based on overall receivable aging levels and a specific evaluation of accounts and notes for franchisees with known financial difficulties. These reserves and corresponding write-offs could significantly increase if the identified franchisees 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 net realizable value for assets held for sale.

The recoverability of indefinite-lived intangible assets (*i.e.*, goodwill) is evaluated annually, or more frequently if impairment indicators exist, on a reporting unit basis by comparing the fair value derived from discounted expected cash flows of the reporting unit to its carrying value.

At July 1, 2007, our United Kingdom subsidiary, Papa John's UK (PJUK), had goodwill of approximately \$17.2 million. In addition to the sale of the Perfect Pizza operations, which occurred in March 2006, we have restructured management and developed plans for PJUK to improve its future operating results. The plans include efforts to increase Papa John's brand awareness in the United Kingdom and increase net PJUK franchise unit openings over the next several years. We will continue to periodically evaluate our progress in achieving these plans. If our initiatives are not successful, 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. 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 will still be 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. Such adjustments, if any, will be determined in part based upon periodic actuarial valuations.

Deferred Income Tax Assets and Tax Reserves

As of July 1, 2007, we had a net deferred income tax asset balance of \$13.5 million, of which approximately \$3.3 million relates to BIBP's net operating loss carryforward. We have not provided a valuation allowance for the deferred income tax assets since we believe it is more likely than not that the Company's future earnings, including BIBP, will be sufficient to ensure the realization of the net deferred income tax assets for federal and state purposes.

The Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) on January 1, 2007. FIN 48 addresses the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. In addition, FIN 48 expands the disclosure requirements concerning unrecognized tax benefits as well as any significant changes that may occur in the next twelve months associated with such unrecognized tax benefits. As a result of the implementation of FIN 48, the Company recognized an approximate \$614,000 decrease in the liability for unrecognized tax benefits, which is accounted for as an increase to the January 1, 2007 balance of retained earnings. As of the adoption date, we had tax affected unrecognized benefits of approximately \$9.6 million. To the extent these unrecognized tax benefits are ultimately recognized, the effective tax rate will be impacted in a future period.

Certain tax authorities periodically audit the Company. We provide reserves for potential exposures based on FIN 48 requirements described above. We evaluate these issues on a quarterly basis to adjust for events, such as court rulings or audit settlements that may impact our ultimate payment for such exposures.

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. As required by FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46), we consolidate the financial results of BIBP since we qualify as the primary beneficiary, as defined by FIN 46, of BIBP. We recognized pre-tax losses of \$8.3 million and \$8.7 million for the three and six months ended July 1, 2007, respectively, and pre-tax income of approximately \$6.3 million and \$11.7 million for the three and six months ended June 25, 2006, respectively, from the consolidation of BIBP. In future periods, we expect the consolidation of BIBP to have a significant impact on Papa John's operating income in any given reporting period due to the volatility of cheese prices, but is 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.

New Accounting Standard

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS No. 157 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. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. The effective date of SFAS No. 157 will be the first quarter of 2008. SFAS No. 157 could impact our future estimates of valuing long-lived and intangible assets such as our annual fair value evaluation of PJUK. We have not determined the impact, if any, of adopting SFAS No. 157.

Restaurant Progression:

| | Three Months Ended July 1, 2007 | June 25, 2006 | Six Months Ended July 1, 2007 | June 25, 2006 |
|--|------------------------------------|---------------|----------------------------------|---------------|
| Papa John's Restaurant Progression: | | | | |
| U.S. Company-owned: | | | | |
| Beginning of period | 586 | 506 | 577 | 502 |
| Opened | 9 | 4 | 13 | 6 |
| Closed | (2) | | (2) | (1) |
| Acquired from franchisees | 13 | | 19 | 3 |
| Sold to franchisees | | | (1) | |
| End of period | 606 | 510 | 606 | 510 |
| International Company-owned: | | | | |
| Beginning of period | 8 | 3 | 11 | 2 |
| Opened | | | | 1 |
| Acquired from franchisees | | 3 | | 3 |
| Sold to franchisees | | | (3) | |
| End of period | 8 | 6 | 8 | 6 |
| U.S. franchised: | | | | |
| Beginning of period | 2,086 | 2,101 | 2,080 | 2,097 |
| Opened | 38 | 36 | 60 | 56 |
| Closed | (15) | (12) | (26) | (25) |
| Acquired from Company | | | 1 | |
| Sold to Company | (13) | | (19) | (3) |
| End of period | 2,096 | 2,125 | 2,096 | 2,125 |
| International franchised: | | | | |
| Beginning of period | 364 | 314 | 347 | 325 |
| Opened | 18 | 28 | 36 | 40 |
| Closed | (2) | (20) | (6) | (43) |
| Acquired from Company | | | 3 | |
| Sold to Company | | (3) | | (3) |
| End of period | 380 | 319 | 380 | 319 |
| Total restaurants end of period | 3,090 | 2,960 | 3,090 | 2,960 |
| Perfect Pizza Restaurant Progression: | | | | |
| Franchised: | | | | |
| Beginning of period | | | | 112 |
| Closed | | | | (3) |
| Sold | | | | (109) |
| Total restaurants end of period | | | | |

Results of Operations

Variable Interest Entities

As required by FIN 46, our operating results include BIBP's operating results. The consolidation of BIBP had a significant impact on our operating results for the first six months of 2007 and the first six months and full year of 2006, and is expected to have a significant ongoing impact on our future operating results, including the full year of 2007, 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. Under the FIN 46 rules, Papa John's is deemed to be the primary beneficiary of certain franchisees even though we have no ownership interest in them. We consolidated the financial results of two franchise entities operating a total of seven restaurants with annual sales approximating \$6.0 million for the three and six months ended July 1, 2007, and three franchise entities operating a total of 14 restaurants with annual sales approximating \$9.0 million for the three and six months ended June 25, 2006.

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The following table summarizes the impact of VIEs, prior to required consolidating eliminations, on our consolidated statements of income for the three and six months ended July 1, 2007 and June 25, 2006 (in thousands):

| | Three Months Ended July 1, 2007 | | | Three Months Ended June 25, 2006 | | |
|---|------------------------------------|-------------|-------------|-------------------------------------|-------------|----------|
| | BIBP | Franchisees | Total | BIBP | Franchisees | Total |
| Variable interest entities restaurant sales | \$ | \$ 1,601 | \$ 1,601 | \$ | \$ 2,691 | \$ 2,691 |
| BIBP sales | 29,430 | | 29,430 | 35,634 | | 35,634 |
| Total revenues | 29,430 | 1,601 | 31,031 | 35,634 | 2,691 | 38,325 |
| Operating expenses | 37,607 | 1,464 | 39,071 | 29,122 | 2,427 | 31,549 |
| General and administrative expenses | 22 | 56 | 78 | 21 | 143 | 164 |
| Other general expenses | | 70 | 70 | | 107 | 107 |
| Depreciation and amortization | | 11 | 11 | | 14 | 14 |
| Total costs and expenses | 37,629 | 1,601 | 39,230 | 29,143 | 2,691 | 31,834 |
| Operating income (loss) | (8,199) | | (8,199) | 6,491 | | 6,491 |
| Net interest expense | (58) | | (58) | (188) | | (188) |
| Income (loss) before income taxes | \$ (8,257) | \$ | \$ (8,257) | \$ 6,303 | \$ | \$ 6,303 |

| | Six Months Ended July 1, 2007 | | | Six Months Ended June 25, 2006 | | |
|---|----------------------------------|-------------|-------------|-----------------------------------|-------------|-----------|
| | BIBP | Franchisees | Total | BIBP | Franchisees | Total |
| Variable interest entities restaurant sales | \$ | \$ 3,289 | \$ 3,289 | \$ | \$ 5,137 | \$ 5,137 |
| BIBP sales | 61,017 | | 61,017 | 71,887 | | 71,887 |
| Total revenues | 61,017 | 3,289 | 64,306 | 71,887 | 5,137 | 77,024 |
| Operating expenses | 69,553 | 2,965 | 72,518 | 59,598 | 4,707 | 64,305 |
| General and administrative expenses | 47 | 108 | 155 | 42 | 294 | 336 |
| Other general expenses | | 192 | 192 | | 17 | 17 |
| Depreciation and amortization | | 24 | 24 | | 119 | 119 |
| Total costs and expenses | 69,600 | 3,289 | 72,889 | 59,640 | 5,137 | 64,777 |
| Operating income (loss) | (8,583) | | (8,583) | 12,247 | | 12,247 |
| Net interest expense | (80) | | (80) | (555) | | (555) |
| Income (loss) before income taxes | \$ (8,663) | \$ | \$ (8,663) | \$ 11,692 | \$ | \$ 11,692 |

Discontinued Operations

In March 2006, the Company sold its Perfect Pizza operations in the United Kingdom, consisting of the franchise rights and leases related to the 109 franchised Perfect Pizza restaurants, as well as the distribution operations, with annual revenues in 2005 approximating \$13.6 million. The total proceeds from the sale were approximately \$13.0 million, with \$8.0 million received in cash at closing, and the balance to be received under the terms of an interest-bearing note through 2011. There was no gain or loss recognized in 2006 in connection with the sale of Perfect Pizza.

We have classified our Perfect Pizza operations as discontinued operations in the accompanying financial statements. For the first quarter of 2006, the net sales and net income of the Perfect Pizza discontinued operations were \$2.4 million and \$389,000 (\$0.01 per diluted share), respectively.

Summary of Operating Results from Continuing Operations

Total revenues were \$256.3 million for the second quarter of 2007, representing an increase of \$14.7 million, or 6.1%, from revenues of \$241.6 million for the same period in 2006. For the six-month period ending July 1, 2007, total revenues were \$516.9 million, representing an increase of \$32.9 million, or 6.8%, from revenues of \$483.9 million for the same period in 2006. The increases of \$14.7 million and \$32.9 million were primarily due to increases in domestic Company-owned restaurant revenues, reflecting the acquisition of 54 restaurants during the last five months of 2006 and the acquisition of 19 restaurants during the first six months of 2007, partially offset by a decrease in comparable sales. Other sales increased in both the three- and six-month periods due to expanded commercial volumes at our print and promotions operations.

Our income from continuing operations before income taxes totaled \$11.1 million and \$31.8 million for the three and six months ended July 1, 2007 compared to income of \$24.2 million and \$49.0 million for the corresponding periods in 2006 as summarized in the following table on an operating segment basis (in thousands):

| | Three Months Ended | | | Six Months Ended | | |
|---|--------------------|------------------|------------------------|------------------|------------------|------------------------|
| | July 1, 2007 | June 25, 2006 | Increase (Decrease) | July 1, 2007 | June 25, 2006 | Increase (Decrease) |
| Domestic Company-owned restaurants | \$ 7,535 | \$ 8,149 | \$ (614) | \$ 15,750 | \$ 17,450 | \$ (1,700) |
| Domestic commissaries | 7,917 | 8,512 | (595) | 17,931 | 15,865 | 2,066 |
| Domestic franchising | 12,065 | 12,737 | (672) | 25,108 | 25,751 | (643) |
| International | (2,032) | (2,418) | 386 | (4,352) | (4,759) | 407 |
| Variable interest entities | (8,257) | 6,303 | (14,560) | (8,663) | 11,692 | (20,355) |
| All others | 1,679 | 1,218 | 461 | 2,724 | 2,717 | 7 |
| Unallocated corporate expenses | (7,486) | (9,936) | 2,450 | (15,781) | (18,818) | 3,037 |
| Elimination of intersegment profits | (311) | (333) | 22 | (894) | (883) | (11) |
| Total income from continuing operations before income taxes | \$ 11,110 | \$ 24,232 | \$ (13,122) | \$ 31,823 | \$ 49,015 | \$ (17,192) |

Excluding the impact of the consolidation of BIBP, second quarter 2007 income from continuing operations before taxes was \$19.4 million, an increase of \$1.5 million over 2006 comparable results and income from continuing operations before income taxes for the six months ended July 1, 2007 was \$40.5 million, an increase of \$3.2 million over 2006 comparable results. The increases of \$1.5 million and \$3.2 million, respectively, for the three- and six-month periods ended July 1, 2007 (excluding the consolidation of BIBP) were principally due to the following (analyzed on an operating segment basis):

- **Domestic Company-owned Restaurant Segment.** Domestic Company-owned restaurants operating income was \$7.5 million and \$15.8 million for the three- and six-month periods ended July 1, 2007, respectively, as compared to \$8.1 million and \$17.5 million for the same periods in 2006, respectively. The decreases of \$614,000 and \$1.7 million for the three- and six-month periods, respectively, were principally due to the impact of negative comparable sales and an increase in salaries for our general and assistant managers and the impact of minimum wage increases in certain states, partially offset by a \$594,000 gain associated with the termination of a lease arrangement in the second quarter of 2007.
- **Domestic Commissary Segment.** Domestic commissaries operating income decreased approximately \$595,000 for the second quarter of 2007 principally due to an increase in delivery, utility and labor costs. Operating income increased \$2.1 million for the six-month period ended July 1, 2007, due to increased volumes of higher-margin fresh dough products and improved margin from other commodities during the first quarter of 2007 partially offset by an increase in delivery, utility and labor costs.
- **Domestic Franchising Segment.** Domestic franchising operating income decreased \$672,000 and \$643,000 for the three- and six-month periods ended July 1, 2007, respectively, principally due to a decrease in royalties as a result of the previously mentioned acquisition of franchised restaurants during late 2006 and the first half of 2007.

- International Segment.** The international segment, which excludes the Perfect Pizza operations that were sold in March 2006, reported operating losses of \$2.0 million and \$4.4 million for the three and six months ended July 1, 2007, respectively, compared to losses of \$2.4 million and \$4.8 million, respectively, in the prior comparable periods. The improvements in the operating results were due to the prior year results including a \$470,000 charge incurred in the second quarter related to costs associated with management reorganization with one of our international operating units. Increased current year revenues due to growth in number of units and unit volumes were substantially offset by increased personnel and infrastructure investment costs.
- All Others Segment.** The operating income for the All others reporting segment increased approximately \$461,000 to \$1.7 million for the three months ended July 1, 2007, as compared to the corresponding 2006 period and was \$2.7 million for the six-month period ended July 1, 2007, which was substantially the same as the comparable period of the prior year. The increase in operating income for the three-month period ended July 1, 2007 was primarily due to an improvement in the operating results of our print and promotions operations reflecting an increase in our sales to commercial customers, which more than offset the shortfall in sales and operating income for the business in the first quarter.
- Unallocated Corporate Segment.** Unallocated corporate expenses decreased approximately \$2.5 million and \$3.0 million for the three- and six-month periods ended July 1, 2007, respectively, as compared to the corresponding periods of 2006. The decreases are primarily due to lower general and administrative costs, including management incentives (as more fully discussed below), health insurance and legal costs. In addition, the Company collected \$650,000, which had previously been reserved, from Papa Card, Inc., a nonstock, nonprofit corporation, which administers the Papa John's gift card program. These decreases were partially offset by increased marketing efforts, including our previously disclosed multi-year deals with Six Flags, Inc. and Live Nation.

The following table summarizes our recorded expense associated with our management incentive programs:

| | Three Months Ended | | Six Months Ended | |
|---------------------------------|--------------------|----------|------------------|----------|
| | Jun-07 | Jun-06 | Jun-07 | Jun-06 |
| Stock option expense | \$ 889 | \$ 1,184 | \$ 1,855 | \$ 1,882 |
| Restricted stock | 185 | 48 | 248 | 48 |
| Performance unit plan | (652) | 565 | (150) | 1,353 |
| Management incentive bonus plan | 125 | 1,966 | 1,750 | 3,952 |
| Total expense | \$ 547 | \$ 3,763 | \$ 3,703 | \$ 7,235 |

The decrease in the executive performance unit incentive plan expense was primarily due to the forfeiture of units by our Founder Chairman due to a change in status from an employee director of the Company to a non-employee director.

The annual management incentive bonus plan is based on the Company's annual operating income performance and certain sales measures as compared to pre-established targets. The decrease in the expense for the three- and six-month periods in 2007, as compared to the corresponding prior year periods, was principally due to updated sales and operating income projections for the full year and the transition of the Founder Chairman to a non-employee director status.

Net interest expense, which is included in the unallocated corporate segment, increased approximately \$1.2 million and \$2.4 million for the three- and six-month periods ended July 1, 2007, respectively, as compared to the corresponding 2006 period, principally due to a higher average debt balance resulting from our share repurchase program and franchise restaurant acquisitions during the last twelve months.

The increase in net interest costs was offset, in this operating segment, by an increase in allocations to the operating units for the three and six months ended July 1, 2007, as compared to the corresponding periods of 2006, partially due to an increase in the number of Company-owned restaurants that are supported.

Diluted earnings per share from continuing operations was \$0.23 (including a \$0.17 per share loss from the consolidation of BIBP) in the second quarter of 2007, compared to \$0.46 (including a \$0.12 per share gain from the consolidation of BIBP) in the second quarter of 2006. For the six months ended July 1, 2007, diluted earnings per share from continuing operations were \$0.66 per share (including a \$0.18 per share loss from the consolidation of BIBP), compared to \$0.92 per share (including a \$0.22 per share gain from the consolidation of BIBP) for the comparable period in 2006. In 1999, we began a repurchase program for our common stock. Through July 1, 2007, an aggregate of \$638.0 million shares have been repurchased (representing 39.3 million shares, at an average price of \$16.22 per share). The share repurchase activity increased earnings per share from continuing operations by approximately \$0.02 for the six-month period ended July 1, 2007 (no impact on the second quarter of 2007).

Review of Operating Results

Revenues. Domestic Company-owned restaurant sales were \$119.6 million for the three months ended July 1, 2007, compared to \$105.4 million for the same period in 2006, and \$241.7 million for the six months ended July 1, 2007, compared to \$212.2 million for the same period in 2006. The increases for the three- and six-month periods were primarily due to increases of 18.5% and 17.2%, respectively, in equivalent Company-owned units, reflecting the acquisition of 54 restaurants during the last five months of 2006 and 19 restaurants during the first six months of 2007. Our Company-owned restaurants reported decreases in comparable sales of 1.5% and 0.4% for the three and six months ended July 1, 2007, respectively.

Variable interest entities restaurant sales include restaurant sales for franchise entities to which we have extended loans. Revenues from these restaurants totaled \$1.6 million and \$3.3 million for the three and six months ended July 1, 2007, respectively, as compared to \$2.7 million and \$5.1 million for the three and six months ended June 25, 2006, respectively. During the third quarter of 2006, one of the franchisees, with seven restaurants and annual revenues approximating \$4.0 million, sold its restaurants to a third party, which eliminated the VIE classification of such restaurants under FIN 46, and the related consolidation of its operating results at the time of the sale.

Domestic franchise sales for the three and six months ended July 1, 2007 decreased 3.7% to \$364.1 million and decreased 2.2% to \$740.5 million, from \$378.1 million and \$757.2 million for the same periods in 2006, primarily resulting from decreases of 2.1% and 1.8% in equivalent franchise units for the three- and six-month periods ended July 1, 2007, respectively. The decrease in equivalent units reflects the previously mentioned divestiture of 54 franchised restaurants during the last five months of 2006 and 19 restaurants during the first six months of 2007. Domestic franchise comparable sales were negative 0.9% and 0.4% for the three and six months ended July 1, 2007, respectively. Domestic franchise royalties were \$13.7 million for the three months ended July 1, 2007, representing a decrease of 1.6% over the prior comparable period, and \$28.2 million for the six months ended July 1, 2007, which was substantially the same as the prior comparable period. The decrease for the three-month period is due to the previously mentioned decrease in equivalent units, partially offset by a reduction in royalty waivers. For the six-month period, the decrease in equivalent units was completely offset by a reduction in royalty waivers.

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Average weekly sales for comparable units include restaurants that were open throughout the periods presented below. Average weekly sales for other units include restaurants that were not open throughout the periods presented below and include non-traditional sites such as Six Flags theme parks and Live Nation concert amphitheaters. The comparable sales base and average weekly sales for 2007 and 2006 for domestic Company-owned and domestic franchised restaurants consisted of the following:

| | Three Months Ended | | | |
|---------------------------------------|--------------------|------------|---------------|------------|
| | July 1, 2007 | | June 25, 2006 | |
| | Company | Franchised | Company | Franchised |
| Total domestic units (end of period) | 606 | 2,096 | 510 | 2,125 |
| Equivalent units | 598 | 2,047 | 504 | 2,091 |
| Comparable sales base units | 569 | 1,932 | 492 | 1,971 |
| Comparable sales base percentage | 95.2 | % 94.4 | % 97.6 | % 94.3 |
| Average weekly sales comparable units | \$ 15,711 | \$ 13,645 | \$ 16,206 | \$ 13,938 |
| Average weekly sales other units | \$ 9,153 | \$ 14,362 | \$ 11,134 | \$ 13,509 |
| Average weekly sales all units | \$ 15,397 | \$ 13,685 | \$ 16,083 | \$ 13,913 |

| | Six Months Ended | | | |
|---------------------------------------|------------------|------------|---------------|------------|
| | July 1, 2007 | | June 25, 2006 | |
| | Company | Franchised | Company | Franchised |
| Total domestic units (end of period) | 606 | 2,096 | 510 | 2,125 |
| Equivalent units | 589 | 2,044 | 502 | 2,082 |
| Comparable sales base units | 562 | 1,935 | 491 | 1,967 |
| Comparable sales base percentage | 95.5 | % 94.7 | % 97.8 | % 94.5 |
| Average weekly sales comparable units | \$ 16,071 | \$ 13,961 | \$ 16,362 | \$ 14,078 |
| Average weekly sales other units | \$ 9,746 | \$ 13,429 | \$ 11,023 | \$ 12,448 |
| Average weekly sales all units | \$ 15,788 | \$ 13,932 | \$ 16,241 | \$ 13,987 |

Domestic franchise and development fees were \$541,000 for the three months ended July 1, 2007, including approximately \$140,000 recognized upon development cancellation or franchise renewal and transfer, compared to \$593,000, including \$257,000 recognized upon development cancellation or franchise renewal and transfer, for the same period in 2006 and increased to \$1.3 million for the six months ended July 1, 2007, including approximately \$377,000 recognized upon development cancellation or franchise renewal and transfer, from \$1.2 million for the same period in 2006. There were 38 and 60 domestic franchised restaurant openings, including the opening of 13 units at Live Nation concert amphitheaters during the second quarter of 2007, during the three and six months ended July 1, 2007, respectively, compared to 36 and 56 openings, respectively, during the same periods in 2006.

Domestic commissary sales decreased 4.7% to \$96.2 million for the three months ended July 1, 2007, from \$101.0 million for the comparable 2006 period and decreased 3.6% to \$196.4 million for the six months ended July 1, 2007, from \$203.7 million for the comparable 2006 period primarily due to lower pricing charged to restaurants, primarily cheese. The average equivalent block price per pound of cheese as sold from BIBP to PJ Food Service was \$1.379 for the second quarter of 2007 as compared to \$1.482 for the same quarter of the prior year and \$1.362 for the first six months of 2007 as compared to \$1.515 for the same period of the prior year. Other sales increased to \$17.4 million and \$31.8 million for the three and six months ended July 1, 2007, respectively, from \$12.2 million and \$23.1 million for the comparable periods in 2006, respectively, primarily as a result of expanded commercial volumes at our print and promotions operations.

International revenues, which exclude the Perfect Pizza discontinued operations sold in March 2006, consist primarily of the PJUK continuing operations, denominated in British Pounds Sterling and converted to U.S. dollars (approximately 63% of international revenues in 2007). International revenues were \$7.2 million and

\$14.1 million for the three and six months ended July 1, 2007, respectively, compared to \$5.8 million and \$10.5 million for the comparable periods in 2006, respectively, primarily due to the acquisition of five restaurants in Beijing, China in December 2006 and higher royalty revenue from additional franchise units.

Costs and Expenses. The restaurant operating margin for domestic Company-owned units was 19.0% and 19.9% for the three and six months ended July 1, 2007, respectively, compared to 23.3% and 23.5% for the same periods in 2006. Excluding the impact of consolidating BIBP, the restaurant operating margin decreased 1.4% to 20.6% in the second quarter of 2007 from 22.0% in the same quarter of the prior year, and decreased 1.4% to 20.9% for the six months ended July 1, 2007 from 22.3% in the corresponding period of 2006, consisting of the following differences:

- Cost of sales increased 0.1% for the three-month period ended July 1, 2007 and decreased 0.2% for the six-month period in 2007 compared to the same periods in 2006. The decrease for the six-month period is primarily due to a decline in the price of commodities (principally cheese).
- Salaries and benefits were 0.4% and 0.6% higher as a percentage of sales for the three and six months ended July 1, 2007, compared to the 2006 corresponding periods, reflecting increased labor costs, including the impact of minimum wage increases in certain states.
- Advertising and related costs were 9.3% of sales in both three-month periods and were 0.2% higher for the six-month period in 2007 as compared to the corresponding period in 2006.
- Occupancy costs and other operating costs, on a combined basis, as a percentage of sales, were 0.9% and 0.8% higher in 2007 for the three- and six-month periods, respectively, due to increases in rent and maintenance expense as well as an increase in credit card expenses associated with increased use by our customers.

Domestic commissary and other margin was 11.0% and 11.2% for the three and six months ended July 1, 2007, respectively, compared to 10.8% and 10.4% for the same periods in 2006. Cost of sales was 71.3% of revenues for the three months ended July 1, 2007, compared to 72.3% for the same period in 2006, and 71.3% for the six months ended July 1, 2007, compared to 73.0% for the same period in 2006. The decreases are primarily due to lower cheese costs incurred by the commissaries (cheese has a fixed-dollar as opposed to a fixed-percentage mark-up). The six-month decrease in cost of sales was also impacted by the mix of higher-margin fresh dough products sold during the first quarter of 2007. Salaries and benefits were 7.9% and 7.8% of revenues for the three and six months ended July 1, 2007 as compared to 6.9% and 6.8% for the same periods in 2006. The increase is due to additional staff to support additional volumes for our commissary and print operations. Other operating expenses decreased to 9.8% and 9.7% of sales for the three- and six-month periods in 2007 from 10.0% and 9.9% in the corresponding periods in 2006.

The loss (income) from the franchise cheese-purchasing program, net of minority interest, was a loss of \$6.3 million for the three months ended July 1, 2007 compared to income of \$5.2 million for the comparable period in 2006. For the six months ended July 1, 2007, the Company recorded a loss of \$6.2 million compared to income of \$9.8 million for the comparable period in 2006. These results only represent the portion of BIBP's operating income related to the proportion of BIBP cheese sales to franchisees. The total impact of the consolidation of BIBP on Papa John's pre-tax income from continuing operations were losses of \$8.3 million and \$8.7 million for the three- and six-month periods ended July 1, 2007, and income of \$6.3 million and \$11.7 million for the comparable periods in 2006.

International operating margin was approximately \$506,000 and \$1.0 million for the three and six months ended July 1, 2007, respectively, as compared to an operating margin of \$29,000 and an operating loss of \$76,000 for the corresponding periods in 2006. The increased margins reflect an improvement in our United Kingdom subsidiary and the addition of our Beijing, China operations, which were purchased in December 2006.

General and administrative (G&A) expenses were \$25.2 million or 9.8% of revenues, for the three months ended July 1, 2007 compared to \$26.4 million or 10.9% of revenues in the same period of 2006, and \$50.6 million, or 9.8% of revenues, for the six months ended July 1, 2007, compared to \$50.6 million, or 10.5% of revenues, for the same period in 2006. The decrease of \$1.2 million for the three-month period is primarily attributable to the

previously mentioned decreases in management incentives (bonuses and an executive performance unit incentive plan), health insurance and legal costs. The decreases were partially offset by increased marketing efforts, including our previously disclosed multi-year deals with Six Flags, Inc. and Live Nation and increases in the continued development of our support infrastructure for our commissary, international and print and promotions operations. For the six-month period, G&A expenses were impacted by the same factors as discussed for the quarter, even though the total expense was substantially the same in both six-month periods.

Minority interests and other general expenses reflected net expense of \$999,000 and \$2.9 million for the three and six months ended July 1, 2007, respectively, compared to \$1.3 million and \$3.0 million, respectively, for the comparable periods in 2006 as detailed below (in thousands):

| | Three Months Ended | | | Six Months Ended | | |
|--|--------------------|------------------|------------------------|------------------|------------------|------------------------|
| | July 1, 2007 | June 25, 2006 | Increase (Decrease) | July 1, 2007 | June 25, 2006 | Increase (Decrease) |
| Minority interests | \$ 380 | \$ 483 | \$ (103) | \$ 967 | \$ 1,002 | \$ (35) |
| Disposition and valuation-related costs of other assets | 1,038 | 405 | 633 | 1,406 | 1,156 | 250 |
| Gain associated with a terminated lease arrangement | (594) | | (594) | (594) | | (594) |
| Provision for uncollectible accounts and notes receivable, net of recoveries | (102) | 321 | (423) | 354 | 717 | (363) |
| Pre-opening costs | 184 | 45 | 139 | 242 | 145 | 97 |
| Contribution to Marketing Fund | | | | 400 | | 400 |
| Other | 93 | 73 | 20 | 161 | 5 | 156 |
| Total minority interests and other general expenses | \$ 999 | \$ 1,327 | \$ (328) | \$ 2,936 | \$ 3,025 | \$ (89) |

As previously discussed, the Company recorded a \$594,000 gain associated with the termination of a lease arrangement in the second quarter of 2007. The Company made a \$400,000 contribution to the Papa John's Marketing Fund in the first quarter of 2007 to assist the system with certain national advertising costs.

Depreciation and amortization was \$7.6 million (3.0% of revenues) for the three months ended July 1, 2007 compared to \$6.6 million (2.7% of revenues) for the comparable period in 2006 and \$15.5 million (3.0% of revenues) for the six months ended July 1, 2007 compared to \$13.2 million (2.7% of revenues) for the comparable period in 2006. The increase in depreciation expense is principally due to the capital additions we have made within our restaurant operations, including the previously mentioned acquisitions over the last 12 months, and in our print and promotions operations.

Net interest. Net interest expense was \$1.3 million in the second quarter of 2007 as compared to \$267,000 in 2006, and \$2.5 million for the six months ended July 1, 2007, compared to \$692,000 for the comparable period in 2006. The increase in net interest expense reflects the increase in our average outstanding debt balance resulting from our share repurchase program and restaurant acquisitions during the last 12 months.

Income Tax Expense. The effective income tax rate was 36.9% and 36.6% for the three and six months ended July 1, 2007 and 37.0% for the same periods in 2006.

Liquidity and Capital Resources

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

| | July 1, 2007 | December 31, 2006 |
|-------------------------------|-------------------------|------------------------------|
| Revolving line of credit | \$ 116,000 | \$ 96,500 |
| Debt associated with VIEs * | 10,775 | 525 |
| Other | 9 | 11 |
| Total debt | 126,784 | 97,036 |
| Less: current portion of debt | (10,775) | (525) |
| Long-term debt | \$ 116,009 | \$ 96,511 |

* The VIEs' third-party creditors do not have any recourse to Papa John's.

The revolving line of credit allows us to borrow up to \$175.0 million with an 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.

Cash flow from operating activities from continuing operations was \$26.2 million in the first six months of 2007 compared to \$37.2 million for the same period in 2006. The consolidation of BIBP decreased cash flow from operations by \$8.7 million in 2007 and increased cash flow from operations by \$11.7 million in the corresponding 2006 period (as reflected in the income from continuing operations and deferred income taxes captions in the accompanying Consolidated Statements of Cash Flows). Excluding the impact of the consolidation of BIBP, cash flow from continuing operations for the first six months of 2007 increased \$9.4 million, as compared to the corresponding 2006 period, primarily due to an increase in net income.

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 equipment and the enhancement of corporate systems and facilities. Additionally, we began a common stock repurchase program in 1999. During the six months ended July 1, 2007, common stock repurchases of \$35.8 million, capital expenditures of \$16.4 million and acquisitions of \$8.6 million were funded primarily by cash flow from operations, proceeds from stock option exercises, access to our revolving line of credit and from available cash and cash equivalents.

Our Board of Directors has authorized the repurchase of up to an aggregate \$675.0 million of our common stock through December 30, 2007. As of July 1, 2007, a total of 39.3 million shares have been repurchased for \$638.0 million at an average price of \$16.22 per share since the repurchase program started in 1999. Subsequent to July 1, 2007 (through August 1, 2007), we acquired an additional 249,000 shares at an aggregate cost of \$7.2 million. As of August 1, 2007, approximately \$29.8 million remains available for repurchase of common stock under this authorization.

We expect to fund planned capital expenditures and any additional share repurchases of our common stock for the remainder of 2007 from operating cash flows and the \$34.9 million remaining availability under our line of credit, which is reduced for certain outstanding letters of credit.

Forward-Looking Statements

Certain information contained in this quarterly report, particularly information regarding future financial performance and plans and objectives of management, is forward-looking. Certain factors could cause actual results to differ materially from those expressed in forward-looking statements. These factors include, but are not limited to: the uncertainties associated with litigation; changes in pricing or other marketing or promotional strategies by competitors which may adversely affect sales; new product and concept developments by food industry competitors; the ability of the Company and its franchisees to meet planned growth targets and operate new and existing restaurants profitably; general economic conditions; increases in or sustained high cost levels of food, paper, utilities, fuel, employee compensation and benefits, insurance and similar costs; the ability to obtain ingredients from alternative suppliers, if needed; health- or disease-related disruptions or consumer concerns about commodities supplies; the selection and availability of suitable restaurant locations; negotiation of suitable lease or financing terms; constraints on permitting and construction of restaurants; local governmental agencies' restrictions on the sale of certain food products; higher-than-anticipated construction costs; the hiring, training and retention of management and other personnel; changes in consumer taste, demographic trends, traffic patterns and the type, number and location of competing restaurants; franchisee relations; the possibility of impairment charges if PJUK or recently acquired restaurants perform below our expectations; federal and state laws governing such matters as wages, benefits, working conditions, citizenship requirements and overtime, including legislation to further increase the federal and state minimum wage; and labor shortages in various markets resulting in higher required wage rates. The above factors might be especially harmful to the financial viability of franchisees or Company-owned operations in under-penetrated or emerging markets, leading to greater unit closings than anticipated. Increases in projected claims losses for the Company's self-insured coverage or within the captive franchise insurance program could have a significant impact on our operating results. Additionally, domestic franchisees are only required to purchase seasoned sauce and dough from our quality control centers (QC Centers) and changes in purchasing practices by domestic franchisees could adversely affect the financial results of our QC Centers. Our international operations are subject to additional factors, including political and health conditions in the countries in which the Company or its franchisees operate; currency regulations and fluctuations; differing business and social cultures and consumer preferences; diverse government regulations and structures; 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. See Part I. Item 1A. - Risk Factors of the Annual Report on Form 10-K for the fiscal year ended December 31, 2006 for additional factors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our debt at July 1, 2007 was principally comprised of a \$116.0 million outstanding principal balance on the \$175.0 million unsecured revolving line of credit. The interest rate on the revolving line of credit is variable and is based on LIBOR plus a 50.0 to 100.0 basis point spread, tiered based upon debt and cash flow levels.

We have two interest rate swap agreements that provide for fixed rates of 4.98% and 5.18%, as compared to LIBOR, on the following amount of floating rate debt:

| | Floating Rate Debt | Fixed Rates | |
|---|-------------------------------|------------------------|---|
| <i>The first interest rate swap agreement:</i> | | | |
| March 15, 2006 to January 16, 2007 | \$ 50 million | 4.98 | % |
| January 16, 2007 to January 15, 2009 | \$ 60 million | 4.98 | % |
| January 15, 2009 to January 15, 2011 | \$ 50 million | 4.98 | % |
| <i>The second interest rate swap agreement:</i> | | | |
| March 1, 2007 to January 31, 2009 | \$ 30 million | 5.18 | % |

The effective interest rate on the line of credit, including the impact of the two interest rate swap agreements, was 5.73% as of July 1, 2007. An increase in the present interest rate of 100 basis points on the line of credit balance outstanding as of July 1, 2007, as mitigated by the interest rate swap based on present interest rates, would increase interest expense approximately \$260,000. The annual impact of a 100 basis point increase in interest rates on the debt associated with BIBP would be \$108,000.

Substantially all of our business is transacted in U.S. dollars. Accordingly, foreign exchange rate fluctuations do not have a significant impact on our operating results.

Cheese costs, historically representing 35% to 40% of our total food cost, are subject to seasonal fluctuations, weather, availability, demand and other factors that are beyond our control. As previously discussed in Results of Operations and Critical Accounting Policies and Estimates, we have a purchasing arrangement with a third-party entity, BIBP, formed at the direction of our Franchise Advisory Council for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants. Under this arrangement, domestic Company-owned and franchised restaurants are able to purchase cheese at a fixed price per pound throughout a given quarter, based in part on historical average cheese prices. Gains and losses incurred by BIBP are used as a factor in determining adjustments to the selling price to restaurants over time. Accordingly, for any given quarter, the price paid by the domestic Company-owned and franchised restaurants may be less than or greater than the prevailing average market price.

As a result of the adoption of FIN 46, Papa John's began consolidating the operating results of BIBP in 2004. Consolidation accounting requires the portion of BIBP operating income (loss) related to domestic Company-owned restaurants to be reflected as a reduction (increase) in the Domestic Company-owned restaurant expenses - cost of sales - line item, thus reflecting the actual market price of cheese had the purchasing arrangement not existed. The consolidation of BIBP had a significant impact on the first six months of 2007 as well as the first six months of 2006 and is expected to have a significant impact on future operating results in any given reporting period depending on the prevailing spot block market price of cheese as compared to the price charged to domestic restaurants. Over time, we expect BIBP to achieve break-even financial results.

The following table presents the actual average block price for cheese and the BIBP block price by quarter as projected through the second quarter of 2008 (based on the August 1, 2007 Chicago Mercantile Exchange (CME) milk futures market prices) and the actual prices in 2006 and 2007 to date:

| | 2008 | | 2007 | | 2006 | |
|-----------|-------------|-------------|-------------|-------------|-------------|-------------|
| | BIBP | Actual | BIBP | Actual | BIBP | Actual |
| | Block Price | Block Price | Block Price | Block Price | Block Price | Block Price |
| Quarter 1 | \$ 1.533 * | \$ 1.569 * | \$ 1.344 | \$ 1.341 | \$ 1.548 | \$ 1.268 |
| Quarter 2 | 1.682 * | 1.563 * | 1.379 | 1.684 | 1.482 | 1.182 |
| Quarter 3 | N/A | N/A | 1.497 | 1.862 * | 1.525 | 1.215 |
| Quarter 4 | N/A | N/A | 1.570 * | 1.708 * | 1.447 | 1.306 |
| Full Year | N/A | N/A | \$ 1.448 * | \$ 1.649 * | \$ 1.501 | \$ 1.243 |

* Amounts are estimates based on futures prices.

N/A - not available

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The following table presents the 2006 impact by quarter on our pre-tax income due to consolidating BIBP (in thousands):

| | Actual 2006 |
|-----------|------------------------|
| Quarter 1 | \$ 5,389 |
| Quarter 2 | 6,303 |
| Quarter 3 | 5,336 |
| Quarter 4 | 1,959 |
| Full Year | \$ 18,987 |

Additionally, based on the CME milk futures market prices as of August 1, 2007, and the actual third quarter and projected fourth quarter of 2007 and first and second quarters of 2008, cheese costs to restaurants as determined by the BIBP pricing formula, the consolidation of BIBP is projected to decrease our 2007 pre-tax income as follows (in thousands):

| | |
|----------------|---------------|
| Quarter 1 2007 | \$ (406) |
| Quarter 2 2007 | (8,257) |
| Quarter 3 2007 | (8,841)* |
| Quarter 4 2007 | (3,686)* |
| Full Year 2007 | \$ (21,190)* |
| Quarter 1 2008 | \$ (874)* |
| Quarter 2 2008 | \$ 2,996 * |

* The projections above are based upon current futures market prices. Historically, actual results have been subject to large fluctuations and have differed significantly from previous projections using the futures market prices.

Over the long-term, we expect to purchase cheese at a price approximating the actual average market price and therefore we do not generally make use of financial instruments to hedge commodity prices.

Item 4. Controls and Procedures

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

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

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

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

Item 1.A. Risk Factors

In addition to the other information set forth in this report, the factors discussed in Part I, Item 1.A. Risk Factors in our Annual Report on Form 10-K for our 2006 fiscal year could materially affect the Company's business, financial condition or operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that it currently deems to be immaterial also may adversely affect our business, financial condition or operating results.

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

The Papa John's Board of Directors has authorized the repurchase of up to \$675.0 million of common stock under a share repurchase program that began in 1999, and runs through December 30, 2007. Through July 1, 2007, a total of 39.3 million shares with an aggregate cost of \$638.0 million and an average price of \$16.22 per share have been repurchased under this program. The following table summarizes our repurchases by fiscal period during the first six months of 2007 (in thousands, except per-share amounts):

| Fiscal Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|-------------------------|----------------------------------|------------------------------|--|--|
| 01/01/2007 - 01/28/2007 | 732 | \$ 29.00 | 38,837 | \$ 51,598 |
| 01/29/2007 - 02/25/2007 | 61 | \$ 27.93 | 38,898 | \$ 49,897 |
| 02/26/2007 - 04/01/2007 | 87 | \$ 30.31 | 38,985 | \$ 47,267 |
| 04/02/2007 - 04/29/2007 | 82 | \$ 29.81 | 39,067 | \$ 44,807 |
| 04/30/2007 - 05/27/2007 | 33 | \$ 30.95 | 39,100 | \$ 43,795 |
| 05/28/2007 - 07/01/2007 | 228 | \$ 29.78 | 39,328 | \$ 37,016 |

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

Our annual meeting of stockholders was held on May 10, 2007 at our corporate offices in Louisville, Kentucky.

At the meeting, our stockholders elected four directors to serve until the 2010 annual meeting of stockholders. The vote counts were as follows:

| | Affirmative | Withheld |
|-----------------------|-------------|----------|
| F. William Barnett | 27,898,944 | 72,275 |
| Norborne P. Cole, Jr. | 27,899,198 | 72,021 |
| John O. Hatab | 27,896,363 | 74,856 |
| William M. Street | 27,899,082 | 72,137 |

Our other directors continue to serve terms expiring at either the 2008 or the 2009 annual meetings, in accordance with their previous election: Wade S. Oney, John H. Schnatter, Nigel Travis, Philip Guarascio and Olivia F. Kirtley. On June 25, 2007, the Company announced the appointment of Alex W. Smith to the Company's Board of Directors, effective June 21, 2007. Mr. Smith will serve for a term expiring at the Company's 2008 annual meeting of stockholders.

At the meeting, our stockholders ratified the selection of Ernst & Young LLP as our independent auditors for the fiscal year ending December 30, 2007, by a vote of 27,795,482 affirmative to 134,514 negative, with 41,221 abstention votes.

Item 6. Exhibits

Exhibit

| Number | Description |
|---------------|--|
| 10.1 | Amendment to Employment Agreement between Nigel Travis and Papa John's International, Inc. Exhibit 10.1 to our report on Form 8-K dated May 9, 2007 is incorporated herein by reference. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-15(e), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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SIGNATURES

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

**PAPA JOHN S INTERNATIONAL,
INC.**
(Registrant)

Date: August 7, 2007

/s/ J. David Flanery
J. David Flanery
Senior Vice President and
Chief Financial Officer

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