PAPA JOHNS INTERNATIONAL INC
Form 10-K
February 22, 2011

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

FORM 10-K

(Mark One)
x Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 26, 2010
or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ____________________ to ______________________

Commission File Number: 0-21660

PAPA JOHN'S INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware	61-1203323
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2002 Papa Johns Boulevard Louisville, Kentucky	40299-2367
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.	Yes x	No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.	Yes o	No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).	Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.	x

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

The aggregate market value of the common stock held by non-affiliates of the Registrant, computed by reference to the closing sale price on The NASDAQ Stock Market as of the last business day of the Registrant's most recently completed second fiscal quarter, June 27, 2010, was approximately $500,242,651.

As of February 15, 2011, there were 25,664,898 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Part III are incorporated by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 28, 2011.

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PART I

Item 1. Business

General

Papa John’s International, Inc. (referred to as the “Company”, “Papa John’s” or in the first person notations of “we”, “us” a “our”) operates and franchises pizza delivery and carryout restaurants and, in certain international markets, dine-in and restaurant-based delivery restaurants under the trademark “Papa John’s”. The first Company-owned Papa John’s restaurant opened in 1985 and the first franchised restaurant opened in 1986. At December 26, 2010, there were 3,646 Papa John’s restaurants in operation, consisting of 612 Company-owned and 3,034 franchised restaurants operating domestically in all 50 states, the District of Columbia and Puerto Rico and in 32 countries.

Papa John’s has defined six reportable segments: domestic restaurants, domestic commissaries (Quality Control Centers), domestic franchising, international operations, variable interest entities and “all other” business units. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Note 19” of “Notes to Consolidated Financial Statements” for financial information about these segments for the fiscal years ended December 26, 2010, December 27, 2009 and December 28, 2008.

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

Strategy

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

Menu. Domestic Papa John’s restaurants offer a menu of high-quality pizza along with side items, including breadsticks, cheesesticks, chicken strips and wings, dessert items and canned or bottled beverages. Papa John’s traditional crust pizza is prepared using fresh dough (never frozen). Papa John’s pizzas are made from a proprietary blend of wheat flour, cheese made from 100% real mozzarella, fresh-packed pizza sauce made from vine-ripened tomatoes (not from concentrate) and a proprietary mix of savory spices, and a choice of high-quality meat (100% beef, pork and chicken with no fillers) and vegetable toppings. Domestically, all ingredients and toppings can be purchased from our Quality Control Center (“QC Center”) system, which delivers to individual restaurants twice weekly. Internationally, the menu may be more diverse than in our domestic operations to meet local tastes and customs.

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

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

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

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

Marketing. Our marketing strategy consists of both national and local components. Our domestic national strategy includes national advertising on television, through print, direct mail and online. Ten national television campaigns aired in 2010. Our online marketing activities have increased significantly over the past few years in response to increasing consumer use of online and mobile web technology.

Our local restaurant-level marketing programs target consumers within the delivery area of each restaurant through the use of local TV, print materials, targeted direct mail, store-to-door flyers, email marketing, text messages and local social media. Local marketing efforts also include a variety of community-oriented activities within schools, sports venues and other organizations supported with some of the same advertising vehicles mentioned above.

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

Franchise System. We are committed to maintaining and developing a strong franchise system by attracting experienced operators, supporting them to expand and grow their business and monitoring their compliance with our high standards. We seek to attract franchisees with experience in restaurant or retail operations and with the financial resources and management capability to open single or multiple locations. To ensure consistent food quality, each domestic franchisee is required to purchase dough and tomato sauce from our QC Centers and to purchase all other supplies from our QC Centers or approved suppliers. QC Centers outside the U.S. may be operated by franchisees pursuant to license agreements or by other third parties. We devote significant resources to provide Papa John’s franchisees with assistance in restaurant operations, management training, team member training, marketing, site selection and restaurant design. We also provide significant assistance to licensed international QC Centers in sourcing approved high-quality suppliers located in-country or approved regional suppliers to the extent possible.

International Operations. As of December 26, 2010, we had 775 Papa John's restaurants operating in 32 countries, Puerto Rico, Hawaii, and Alaska (Hawaii and Alaska units were included in our international operations for reporting purposes through December 26, 2010. See below for our realignment beginning in 2011). Substantially all of the Papa John's international units are franchised operations (we own and operate 21 restaurants in Beijing/North China). During 2010 and 2009 we opened 87 and 100 international net new units (new unit openings less unit closings), respectively. We plan to continue to grow our international franchise units during the next several years. Our total international development pipeline as of December 26, 2010 included approximately 1,200 restaurants with approximately 40% scheduled to open in the next three years.

Beginning in our fiscal 2011, we realigned management responsibility for Hawaii, Alaska and Canada from international to domestic operations in order to better leverage existing infrastructure and systems. Hawaii, Alaska and Canada consist solely of franchise operations, and the realigned reporting segment will be referred to as North America Franchising. This realignment will initially be reflected in our financial information beginning in the first quarter 2011 earnings release and Form 10-Q. Prior year financial results, including segment reporting, will be reclassified at that time to be presented consistently with the new alignment. The realignment will shift $1.3 million of operating income from the International reporting segment to the North America Franchising reporting segment for 2010 and 2009 and approximately $1.0 million for 2008.

Unit Sales and Investment Costs

In 2010, the 578 domestic Company-owned restaurants included in the full year’s comparable restaurant base generated average sales of $863,000. Domestic franchise sales on average are lower than Company-owned restaurants as a higher percentage of our Company-owned restaurants are located in more heavily penetrated markets.

The average cash investment for the five domestic Company-owned restaurants opened during the 2010 fiscal year, exclusive of land, was approximately $250,000 per unit, excluding tenant allowances that we received. We expect the average cash investment for the eight domestic Company-owned restaurants expected to open in 2011 to approximate $240,000 per unit. Substantially all domestic restaurants do not offer dine-in areas, which reduces our restaurant capital investment.

Development

A total of 325 Papa John’s restaurants were opened during 2010, consisting of 13 Company-owned (five domestic and eight international) and 312 franchised restaurants (169 domestic and 143 international), while 148 Papa John’s restaurants closed during 2010, consisting of four Company-owned restaurants (two domestic and two international) and 144 franchised restaurants (82 domestic and 62 international). The 82 domestic franchise closings included the closure of 13 non-traditional event-based units, which had a minimal net financial impact to the Company, in connection with the termination of a sponsorship agreement. The international franchise closings included the closure of all 25 units in Saudi Arabia in connection with a franchisee restructuring. The closing of these units also had minimal net financial impact to the Company due to their low sales volumes. A 75-unit development agreement was signed as part of the restructuring in Saudi Arabia, and new unit development is expected to begin in 2011.

During 2011, we expect net unit growth of approximately 190 to 220 units. We expect to open 13 to 15 Company-owned restaurants (seven to eight domestic and six to seven international) and 297 to 325 franchised restaurants (154 to 168 domestic and 143 to 157 international). We also expect approximately 120 restaurants to close during 2011, the majority of which are expected to be domestic franchised units. Domestic and international franchised unit expansion is expected to continue with an emphasis on markets in the Americas, the United Kingdom, the Middle East and Asia. We expect our expansion in Asia to include a significant focus in China.

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Our Company-owned expansion strategy is to continue to open domestic restaurants in existing markets as appropriate, although most of our Company-owned markets are well penetrated, thereby increasing consumer awareness and enabling us to take advantage of operational and marketing efficiencies. Our experience in developing markets indicates that market penetration through the opening of multiple restaurants in a particular market results in increased average restaurant sales in that market over time. We have co-developed domestic markets with some franchisees or divided markets among franchisees, and will continue to utilize market co-development in the future, where appropriate.

Of the total 2,871 domestic units open as of December 26, 2010, 591 or 21% were Company-owned (including 127 units owned in joint venture arrangements with franchisees in which the Company has a majority ownership position). The Company expects the percentage of domestic Company-owned units to decline over the next several years, because future net openings will be more heavily weighted toward franchise units.

Restaurant Design and Site Selection

Backlit awnings, neon window designs and other visible signage characterize the exterior of most Papa John's restaurants. A typical inline or endcap domestic Papa John's restaurant averages 1,100 to 1,500 square feet. Papa John's restaurants are designed to facilitate a smooth flow of food orders through the restaurant. The layout includes specific areas for order taking, pizza preparation and routing, resulting in simplified operations, lower training and labor costs, increased efficiency and improved consistency and quality of food products. The typical interior of a Papa John's restaurant has a vibrant color scheme, and includes a bright menu board, custom counters and a customer carryout area. The counters are designed to allow customers to watch the team members slap out the dough and put sauce and toppings on pizzas. A substantial majority of domestic restaurants are required to have an approved lobby enhancement re-design package installed by the end of 2011. The estimated cost of the new package ranges from $15,000 to $20,000 for each restaurant. Approximately 400 Company-owned units will be required to install the new design package during 2011.

Most of our international Papa John's restaurants are between 900 and 1,400 square feet; however, in order to meet certain local customer preferences, many international restaurants have been opened in larger spaces to accommodate both dine-in and restaurant-based delivery service, typically with 35 to 100 seats. We expect the substantial majority of our future international openings to focus on delivery and carryout units with limited seating.

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

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

We provide layout and design services and recommendations for subcontractors, signage installers and telephone systems to Papa John’s franchisees. Our franchisees can purchase complete new store equipment packages through an approved third-party supplier. In addition, we sell replacement smallwares and related items to our franchisees.

QC Center System; Strategic Supply Chain Management

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

We own full-service QC Centers in the United Kingdom; Mexico City, Mexico; and Beijing, China. Other international full-service QC Centers are licensed to franchisees and non-franchisee third parties, and are generally located in the markets where our franchisees have restaurants. We expect future international QC Centers to be licensed to franchisees or non-franchisee third parties; however, we may open Company-owned QC Centers at our discretion. We also have the right to acquire licensed QC Centers from our international licensees in certain circumstances.

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

PJ Food Service, Inc. (“PJFS”), our wholly-owned subsidiary that operates our domestic Company-owned QC Centers, had a purchasing agreement with BIBP Commodities, Inc. (“BIBP”), a third-party entity formed by franchisees for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants through fiscal 2010. Under this agreement, PJFS purchased cheese from BIBP on a monthly basis at the projected spot market price, plus a certain adjustment based on BIBP’s cumulative financial position. Gains and losses incurred by BIBP were passed on to PJFS and therefore to Company-owned and franchised restaurants through adjustments to the selling price. Over time, PJFS purchased cheese at a price approximating the actual average market price, but with more short-term predictability. See “Franchise Program – Franchise Support Initiatives” for the change in our purchasing agreement for cheese beginning in fiscal 2011. See also “Management’s Discussion and Analysis of Financial Condition and Results of

Operations – Consolidation of BIBP Commodities, Inc. ("BIBP") as a Variable Interest Entity" and "Note 3" of "Notes to Consolidated Financial Statements" for additional information concerning BIBP and the related financial statement treatment of BIBP's results.

Marketing Programs

All domestic Company-owned and franchised Papa John's restaurants within a defined market are required to join an area advertising cooperative ("Co-op"). Each member restaurant contributes a percentage of sales to the Co-op for market-wide programs, such as radio, television and print advertising. The rate of contribution and uses of the monies collected are determined by a majority vote of the Co-op's members. Prior to 2011, the contribution rate could not be below 2.0% without approval from Papa John's. For the period 2011 to 2013, the contribution rate cannot be below 1.5% without approval from Papa John's.

The restaurant-level and Co-op marketing efforts are supported by print, digital and electronic advertising materials that are produced by Papa John's Marketing Fund, Inc., a non-profit corporation (the "Marketing Fund"). The Marketing Fund produces and buys air time for Papa John's national television commercials, buys digital media such as banner advertising, paid search-engine advertising and email, in addition to other brand-building activities, such as consumer research and public relations activities. All domestic Company-owned and franchised Papa John's restaurants are required to contribute a certain minimum percentage of sales to the Marketing Fund. The contribution rate to the Marketing Fund can be increased above the required minimum contribution rate if approved by the governing board of the Marketing Fund up to certain levels, and beyond those levels if approved by a supermajority of domestic restaurants. The contribution percentage averaged 3.05% in 2010. The rate was 2.82% for the last nine months of 2009, which increased from 2.7% effective for the first quarter of 2009 and for full-year 2008. The contribution percentage to the Marketing Fund is currently set at 4.0% for 2011.

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

We provide both Company-owned and franchised restaurants with pre-approved marketing materials and with catalogs for the purchase of uniforms and promotional items. We also provide direct marketing services to Company-owned and franchised restaurants using customer information gathered by our proprietary point-of-sale technology (see "Company Operations – Point of Sale Technology"). In addition, we provide database tools and automated training that allows operators to set their own local email marketing, text messaging and social media.

During the fourth quarter of 2010 we launched a redesigned website and digital ordering platform. Our domestic online ordering sales currently exceed 28% of our total sales and we expect to increase our online sales with the redesigned platform, which includes "plan ahead ordering" and Spanish-language ordering capability. In addition, the new platform enhances mobile web ordering for our customers, as well as allowing ordering from a new Papa John's iPhone® application. We receive a percentage-based fee from domestic franchisees for online sales, in addition to royalties, to cover the cost of this service, although the aggregate fees collected in 2010 were not sufficient to cover these costs due primarily to incremental costs associated with the development of this new platform. We have agreed to reduce the fee in 2011 and cap the fee in 2012 and 2013, which is expected to result in additional losses related to the online/digital ordering platform. While the Company has the right to recoup these losses over time, there is no assurance that such losses will be recouped.

During 2010, we also implemented an online loyalty point program that we believe will increase consumer use of our online/digital ordering platform.

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

Company Operations

Restaurant Personnel. A typical Papa John’s Company-owned domestic restaurant employs a restaurant manager and approximately 20 to 25 hourly team members, most of whom work part-time. The manager is responsible for the day-to-day operation of the restaurant and maintaining Company-established operating standards. We seek to hire experienced restaurant managers and staff, provide comprehensive training on operations and managerial skills, and motivate and retain personnel by providing opportunities for advancement and performance-based financial incentives.

We also employ directors of operations who are responsible for overseeing an average of seven Company-owned restaurants. The directors of operations report to operations vice presidents, who are each responsible for the management of approximately 100 Company-owned restaurants in specific geographic regions. Effective in late 2010, the operations vice presidents began reporting directly to the Senior Vice President, Operations and Global Operations Support and Training. These team members are eligible to earn performance-based financial incentives.

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

Point of Sale Technology. Point of sale technology (“POS”), our proprietary PROFIT SystemTM, is in place in all domestic traditional Papa John’s restaurants. We believe this technology facilitates faster and more accurate order-taking and pricing, reduces paperwork and allows the restaurant manager to better monitor and control food and labor costs, including facilitation of managing food inventory and placing orders from the domestic QC Centers. We believe the PROFIT System enhances restaurant-level marketing capabilities through the development of a database containing information on customers and their buying habits with respect to our products. Polling capabilities allow us to obtain restaurant operating information, thereby improving the speed, accuracy and efficiency of restaurant-level reporting. The PROFIT System is also closely integrated with our online ordering system in all domestic traditional Papa John’s restaurants, enabling Papa John’s to offer nationwide online and mobile web ordering to our customers.

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

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

International Operations

The international reporting segment operations structure consists of international business managers responsible for supporting one or more franchisees. The international business managers report to one of three regional vice presidents who report to the Senior Vice President, International. Various support functions for the International business such as marketing, supply chain, research and development and quality assurance, are managed centrally as global functions, with regional field support personnel as appropriate. The Company owns and operates restaurants in Beijing/North China (21 units at December 26, 2010) and has a local management structure in place to support those operations.

Franchise Program

General. We continue to attract franchisees with significant restaurant and retail experience. We consider our franchisees to be a vital part of our system's continued growth and believe our relationship with our franchisees is good. As of December 26, 2010, there were 3,034 franchised Papa John's restaurants operating in all 50 states, the District of Columbia, Puerto Rico and 32 countries. As of December 26, 2010, we have development agreements with our franchisees for more than 300 additional domestic franchised restaurants, the majority of which are committed to open over the next five years, and agreements for approximately 1,200 additional international franchised restaurants, the majority of which are scheduled to open over the next eight years. There can be no assurance that all of these restaurants will be opened or that the development schedule set forth in the development agreements will be achieved. During 2010, 312 (169 domestic and 143 international) franchised Papa John's restaurants were opened.

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

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

Under our standard domestic development agreement, the franchisee is required to pay, at the time of signing the agreement, a non-refundable fee of $25,000 for the first restaurant and $5,000 for any additional restaurants. The non-refundable fee is credited against the standard $25,000 franchise fee payable to us upon signing the franchise agreement for a specific location. Generally, a franchise agreement is executed when a franchisee secures a location. Our current standard development agreement requires the franchisee to pay a royalty fee of 5% of sales and the majority of our existing franchised restaurants also have a 5% royalty rate effective December 27, 2010.

Domestic Franchise Development Incentives. In 2009 and 2010 we provided development incentives to domestic restaurants. Such incentives included the waiver of the $25,000 franchise fee and reduced royalties for 12 months following the opening date (2009 included a waiver of 100% of the standard royalty rate and 2010 included a waiver of 40% to 100% of the standard royalty rate depending on the opening date). Additionally, under the 2009 program, a $10,000 cash incentive was paid to franchisees opening a restaurant on or before the scheduled opening date. The program was expanded in 2010 to offer either the $10,000 cash incentive or a 24-month no-payment lease on two ovens with the option to purchase the ovens for $50 per oven at the end of the 24-month lease. The 2011 incentive program for traditional unit openings includes: (1) no franchise fee, (2) the waiver of the 5% royalty fee - waived for twelve months from opening if opened January through June, for nine months from opening if opened July through September and for six months from opening if opened October through December, (3) a 24-month no-payment lease on two ovens with the option to purchase the ovens for $50 per oven at the end of the 24-month lease, and (3) a $3,300 credit to be applied toward a future POS purchase, under certain circumstances. We believe the development incentive programs have increased unit openings in 2009 and 2010, and expect they will continue to do so in 2011. See Franchise Support Initiatives for additional information.

Franchise Support Initiatives. During 2009 and 2010, the Company provided domestic franchise system support initiatives in response to the difficult economic environment. The initiatives included:

- Providing cheese cost relief by modifying the cheese pricing formula used by BIBP beginning in 2009;
- Providing food cost relief by lowering the commissary margin on certain commodities sold by PJFS to the franchise system and by providing incentive rebate opportunities in 2010 to the franchise system;
- Providing additional system-wide national marketing contributions that amounted to $6.0 million in 2010 and $7.7 million in 2009;
- Providing additional system-wide local print marketing contributions and certain system-wide incentives totaling $500,000 in 2010 and $1.9 million in 2009;
- Providing targeted royalty relief and local marketing support to assist certain identified franchisees or markets, which amounted to $5.1 million in 2010 and $4.7 million in 2009;
- Providing restaurant opening incentives of $1.0 million in 2010 and $400,000 in 2009; and
- Providing financing on a selected basis to assist new or existing franchisees with the acquisition of troubled franchise restaurants.

For 2011, we plan to continue certain domestic franchise support initiatives such as offering incentive programs to franchisees to increase comparable sales, comparable transactions and online sales, make certain re-image improvements to their restaurants and provide targeted royalty relief and local marketing support to assist certain identified franchisees or markets, although our expectation is that the amount of such support initiatives will be reduced from 2010 levels.

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

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

National Marketing Fund Contribution Rate – Domestic Company-owned and franchised restaurants will contribute 4.0% of sales to the Marketing Fund in 2011 and have agreed to a minimum contribution rate in 2012 and 2013. The Company expects this agreement to primarily represent a shift, as opposed to an increase, in total marketing spend, and believes an increase in marketing spend on a national basis will improve the consistency of the overall marketing message and favorably impact brand awareness, particularly in regions of the country where the brand is currently underpenetrated.

BIBP’s Accumulated Deficit – BIBP had an accumulated deficit (representing prior purchases of cheese by PJFS from BIBP at below market prices) of $14.2 million at December 26, 2010. PJFS agreed to pay to BIBP the amount equal to the accumulated deficit at December 26, 2010. Accordingly, BIBP recorded a decrease of $14.2 million in cost of sales and PJFS recorded a corresponding increase in cost of sales. This transaction did not have any impact on the Company's 2010 consolidated income statement results since both PJFS and BIBP are fully consolidated.

Cheese Purchasing Agreement – In order to facilitate franchisees' planning of food costs and promotions moving forward, PJFS agreed to continue to lock in the price of cheese to the system on a period-by-period basis for franchisees willing to sign a cheese purchasing agreement with PJFS. The cheese purchasing agreement requires the franchisee to commit to purchase cheese through PJFS, or to pay the franchisee's pro rata portion of any accumulated cheese liability upon ceasing to purchase cheese from PJFS when a cheese liability exists.

Online Ordering System Fees – The Company agreed to reduce the online ordering fee paid by domestic franchisees by 0.5% for 2011, and agreed to limit the fee for 2012 and 2013.

Royalty Rebate Program – The standard royalty rate in 2011 is 5.0% of sales. Franchisees can earn up to a 0.25% quarterly royalty rebate for 2011 to 2013 by meeting certain sales growth targets, and an additional 0.20% royalty rebate in 2011 by making specified re-imaging restaurant lobby investments. The Company agreed to consider a similar capital investment based royalty rebate opportunity for franchisees in 2012 and 2013 as well.

International Development and Franchise Agreements. We opened our first franchised restaurant outside the United States in 1998. Through 2010, we defined “international” to be all markets outside the contiguous United States in which we have either a development agreement or a master franchise agreement with a franchisee for the opening of a specified number of restaurants within a defined period of time and specified geographic area (see “Strategy – International Operations” for 2011 reporting changes to the International business unit). Under a master franchise agreement, the franchisee has the right to subfranchise a portion of the development to one or more subfranchisees approved by us. Under our current standard international development agreement, the franchisee is required to pay total fees of $25,000 per restaurant: $5,000 at the time of signing the agreement and $20,000 when the restaurant opens or the agreed-upon development date, whichever comes first. Under our current standard master franchise agreement, the master franchisee is required to pay total fees of $25,000 per restaurant owned and operated by the master franchisee, under the same terms as the development agreement, and $15,000 for each subfranchised restaurant – $5,000 at the time of signing the agreement and $10,000 when the restaurant opens or the agreed-upon development date, whichever comes first. We expect that future development agreements may limit the amount of potential subfranchising.

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

Non-traditional Restaurant Development. We have entered into a limited number of development and franchise agreements for non-traditional restaurants. These agreements generally cover venues or areas not originally targeted for traditional unit development and have terms differing from the standard agreement. While we expect to have a significant increase in the number of non-traditional units in the future, to date, these agreements have not had a significant, direct impact on our pre-tax earnings.

Franchise Restaurant Development. We provide assistance to Papa John's franchisees in selecting sites, developing restaurants and evaluating the physical specifications for typical restaurants. Each franchisee is responsible for selecting the location for its restaurants but must obtain our approval of restaurant design and location based on