PAPA JOHNS INTERNATIONAL INC
Form 10-Q
November 06, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

Commission File Number: 0-21660

PAPA JOHN'S INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	61-1203323

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

2002 Papa John's Boulevard

Louisville, Kentucky 40299-2367

(Address of principal executive offices)

(502) 261-7272

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

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

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

At October 30, 2018, there were outstanding 31,541,761 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

(Unaudited)

(In thousands, except per share amounts)	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 24,880	$ 22,345
Accounts receivable, net	53,157	64,644
Notes receivable, net	6,466	4,333
Income tax receivable	11,051	3,903
Inventories	29,311	30,620
Prepaid expenses	20,106	28,522
Other current assets	7,400	9,494
Assets held for sale	—	6,133
Total current assets	152,371	169,994
Property and equipment, net	224,510	234,331
Notes receivable, less current portion, net	16,097	15,568
Goodwill	84,830	86,892
Deferred income taxes, net	700	585
Other assets	72,654	48,183
Total assets	$ 551,162	$ 555,553
Liabilities and stockholders' (deficit)		
Current liabilities:		
Accounts payable	$ 32,355	$ 32,006
Income and other taxes payable	8,964	10,561
Accrued expenses and other current liabilities	100,081	70,293
Deferred revenue current	2,389	—
Current portion of long-term debt	20,000	20,000
Total current liabilities	163,789	132,860
Deferred revenue	14,946	2,652
Long-term debt, less current portion, net	555,755	446,565
Deferred income taxes, net	7,812	12,546
Other long-term liabilities	77,604	60,146

Total liabilities	819,906	654,769
Redeemable noncontrolling interests	5,979	6,738
Stockholders' (deficit):		
Preferred stock ($0.01 par value per share; no shares issued)	—	—
Common stock ($0.01 par value per share; issued 44,299 at September 30, 2018 and 44,221 at December 31, 2017)	443	442
Additional paid-in capital	190,135	184,785
Accumulated other comprehensive income (loss)	3,605	(2,117)
Retained earnings	267,580	292,251
Treasury stock (12,933 shares at September 30, 2018 and 10,290 shares at December 31, 2017, at cost)	(751,895)	(597,072)
Total stockholders' (deficit), net of noncontrolling interests	(290,132)	(121,711)
Noncontrolling interests in subsidiaries	15,409	15,757
Total stockholders' (deficit)	(274,723)	(105,954)
Total liabilities, redeemable noncontrolling interests and stockholders' (deficit)	$ 551,162	$ 555,553

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30, 2018	Three Months Ended September 24, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 24, 2017
Revenues:				
Domestic Company-owned restaurant sales	$ 158,285	$ 196,267	$ 529,906	$ 605,919
North America franchise royalties and fees	12,806	25,567	61,524	79,762
North America commissary	146,240	164,028	461,408	495,427
International	25,653	28,771	84,836	81,638
Other revenues	21,023	17,076	61,661	53,007
Total revenues	364,007	431,709	1,199,335	1,315,753
Costs and expenses:				
Operating costs (excluding depreciation and amortization shown separately below):				
Domestic Company-owned restaurant expenses	135,836	161,867	440,936	489,719
North America commissary	137,928	155,572	432,909	465,001
International expenses	15,184	17,910	52,462	50,973
Other expenses	22,002	15,906	63,658	50,935
General and administrative expenses	55,462	35,758	133,903	112,420
Depreciation and amortization	11,585	11,181	34,855	32,292
Total costs and expenses	377,997	398,194	1,158,723	1,201,340
Refranchising loss, net	—	—	(1,918)	—
Operating (loss) income	(13,990)	33,515	38,694	114,413
Net Interest expense	(5,963)	(2,566)	(16,580)	(6,135)
(Loss) Income before income taxes	(19,953)	30,949	22,114	108,278
Income tax (benefit) expense	(7,359)	8,280	4,663	30,728
Net (loss) income before attribution to noncontrolling interests	(12,594)	22,669	17,451	77,550
Income attributable to noncontrolling interests	(439)	(852)	(1,956)	(3,767)
Net (loss) income attributable to the Company	$ (13,033)	$ 21,817	$ 15,495	$ 73,783
Calculation of (loss) income for (loss) earnings per share:				
Net (loss) income attributable to the Company	$ (13,033)	$ 21,817	$ 15,495	$ 73,783
Change in noncontrolling interest redemption value	—	237	—	1,419
Net income attributable to participating securities	—	(89)	(147)	(305)
Net (loss) income attributable to common shareholders	$ (13,033)	$ 21,965	$ 15,348	$ 74,897
Basic (loss) earnings per common share	$ (0.41)	$ 0.61	$ 0.48	$ 2.05

Diluted (loss) earnings per common share	$ (0.41)	$ 0.60	$ 0.47	$ 2.02
Basic weighted average common shares outstanding	31,573	36,146	32,265	36,563
Diluted weighted average common shares outstanding	31,573	36,581	32,489	37,047
Dividends declared per common share	$ 0.225	$ 0.225	$ 0.675	$ 0.625

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive (Loss) Income

(Unaudited)

(In thousands)	Three Months Ended September 30, 2018	Three Months Ended September 24, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 24, 2017
Net (loss) income before attribution to noncontrolling interests	$ (12,594)	$ 22,669	$ 17,451	$ 77,550
Other comprehensive (loss) income, before tax:				
Foreign currency translation adjustments (1)	(154)	2,894	(3,466)	4,315
Interest rate swaps (2)	1,960	641	11,512	(1,684)
Other comprehensive income, before tax	1,806	3,535	8,046	2,631
Income tax effect:				
Foreign currency translation adjustments (1)	35	(1,071)	780	(1,597)
Interest rate swaps (3)	(477)	(237)	(2,649)	623
Income tax effect (4)	(442)	(1,308)	(1,869)	(974)
Other comprehensive income, net of tax	1,364	2,227	6,177	1,657
Comprehensive (loss) income before attribution to noncontrolling interests	(11,230)	24,896	23,628	79,207
Less: comprehensive loss (income), redeemable noncontrolling interests	378	(352)	(26)	(1,891)
Less: comprehensive income, nonredeemable noncontrolling interests	(817)	(500)	(1,930)	(1,876)
Comprehensive (loss) income attributable to the Company	$ (11,669)	$ 24,044	$ 21,672	$ 75,440

(1) On June 15, 2018, the Company refranchised 34 Company-owned restaurants and a quality control center located in China. In conjunction with the transaction, approximately $1,300 of accumulated other comprehensive income and $300 associated deferred tax related to foreign currency translation were reversed. See "Note 7" of "Notes to Condensed Consolidated Financial Statements" for additional information.

(2) Amounts reclassified out of accumulated other comprehensive income (loss) into net interest expense included $19 and $216 for the three and nine months ended September 30, 2018, respectively, and $54 and $378 for the three and nine months ended September 24, 2017, respectively.

(3) The income tax effects of amounts reclassified out of accumulated other comprehensive income (loss) were $4 and $50 for the three and nine months ended September 30, 2018, respectively, and $20 and $140 for the three and nine months ended September 24, 2017, respectively.

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

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended	
(In thousands)	September 30, 2018	September 24, 2017
Operating activities		
Net income before attribution to noncontrolling interests	$ 17,451	$ 77,550
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible accounts and notes receivable	4,047	(353)
Depreciation and amortization	34,855	32,292
Deferred income taxes	(227)	1,283
Stock-based compensation expense	7,073	8,094
Loss on refranchising	1,918	—
Other	6,952	3,004
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	7,410	(5,131)
Income tax receivable	(7,373)	1,795
Inventories	986	(3,234)
Prepaid expenses	7,663	9,262
Other current assets	5,016	(1,297)
Other assets and liabilities	(4,899)	(4,092)
Accounts payable	769	(2,480)
Income and other taxes payable	(1,597)	1,779
Accrued expenses and other current liabilities	18,772	(3,229)
Deferred revenue	(4)	(326)
Net cash provided by operating activities	98,812	114,917
Investing activities		
Purchases of property and equipment	(30,593)	(43,195)
Loans issued	(3,511)	(2,376)
Repayments of loans issued	3,872	3,151
Acquisitions, net of cash acquired	—	(21)
Proceeds from divestitures of restaurants	7,707	—
Other	160	25
Net cash used in investing activities	(22,365)	(42,416)
Financing activities		
Proceeds from issuance of term loan	—	400,000
Repayments of term loan	(15,000)	—
Net proceeds (repayments) of revolving credit facility	123,600	(300,575)
Debt issuance costs	—	(3,181)
Cash dividends paid	(21,861)	(22,886)
Tax payments for equity award issuances	(1,474)	(2,411)
Proceeds from exercise of stock options	2,592	5,974
Acquisition of Company common stock	(158,049)	(121,705)

Distributions to noncontrolling interest holders	(3,928)	(4,606)
Other	276	580
Net cash used in financing activities	(73,844)	(48,810)
Effect of exchange rate changes on cash and cash equivalents	(68)	289
Change in cash and cash equivalents	2,535	23,980
Cash and cash equivalents at beginning of period	22,345	15,563
Cash and cash equivalents at end of period	$ 24,880	$ 39,543

See accompanying notes.

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Papa John's International, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2018

1.Basis of Presentation

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

2.Significant Accounting Policies

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Significant items that are subject to such estimates and assumptions include allowance for doubtful accounts and notes receivable, intangible assets, contract assets and contract liabilities including the online customer loyalty program obligation, insurance reserves and tax reserves. Although management bases its estimates on historical experience and assumptions that are believed to be reasonable under the circumstances, actual results could significantly differ from these estimates.

Noncontrolling Interests

At the beginning of 2018, Papa John's had five joint venture arrangements in which there were noncontrolling interests held by third parties. In the first quarter of 2018, one joint venture was divested, and a second joint venture was divested in the third quarter of 2018.

As of September 30, 2018, there were 183 restaurants that comprise these joint ventures as compared to 222 restaurants at September 24, 2017. See Note 7 for more information on these related divestitures.

We are required to report the consolidated net (loss) income at amounts attributable to the Company and the noncontrolling interests. Additionally, disclosures are required to clearly identify and distinguish between the interests of the Company and the interests of the noncontrolling owners, including a disclosure on the face of the Condensed Consolidated Statements of Operations attributable to the noncontrolling interest holders.

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The income before income taxes attributable to these joint ventures for the three and nine months ended September 30, 2018 and September 24, 2017 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 24, 2017	September 30, 2018	September 24, 2017
Papa John's International, Inc.	$ 1,512	$ 1,469	$ 4,384	$ 6,172
Noncontrolling interests	439	852	1,956	3,767
Total income before income taxes	$ 1,951	$ 2,321	$ 6,340	$ 9,939

The following summarizes the redemption feature, location and related accounting within the Condensed Consolidated Balance Sheets for these joint venture arrangements:

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

Revenue Recognition

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

As further described in Accounting Standards Adopted and Note 3, the Company adopted ASC Topic 606, "Revenue from Contracts with Customers" ("Topic 606"), in the first quarter of 2018. Prior year revenue recognition follows ASC Topic 605, Revenue Recognition.

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

Company-owned Restaurant Sales

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

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

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Commissary Sales

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

Franchise Royalties and Fees

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

The majority of initial franchise license fees and area development exclusivity fees are from international locations. Initial franchise license fees are billed at the store opening date. Area development exclusivity fees are billed upon execution of the development agreements which grant the right to develop franchised restaurants in future periods in specific geographic areas. Area development exclusivity fees are included in deferred revenue in the Condensed Consolidated Balance Sheets and allocated on a pro rata basis to all stores opened under that specific development agreement. Franchise license renewal fees for both domestic and international locations, which generally occur every 10 years, are billed before the renewal date. The pre-opening services provided to franchisees do not contain separate and distinct performance obligations from the franchise right; thus, the fees collected will be amortized on a straight-line basis beginning at the store opening date through the term of the franchise agreement, which is typically 10 years. Fees received for future license renewal periods are amortized over the life of the renewal period. For periods prior to adoption of Topic 606, revenue was recognized when we performed our obligations related to such fees, primarily the store opening date for initial franchise fees and area development fees, or the date the renewal option was effective for license renewal fees.

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

Other Revenues

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

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

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

Franchise Marketing Fund revenues represent contributions collected by various international and domestic marketing funds (“Co-op” or “Co-operative”) where we have determined that we have control over the activities of the fund. Contributions are based on a percentage of monthly restaurant sales. The adoption of Topic 606 revised the principal versus agent determination of these arrangements. When we are determined to be the principal in these arrangements, advertising fund contributions and expenditures are reported on a gross basis in the Condensed Consolidated Statements of Operations. Our obligation related to these funds is to develop and conduct advertising activities in a specific country,

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region, or market, including the placement of electronic and print materials. Marketing fund contributions are billed monthly.

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

Deferred Income Tax Accounts and Tax Reserves

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

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences reverse. Deferred tax assets are also recognized for the estimated future effects of tax attribute carryforwards (e.g., net operating losses, capital losses, and foreign tax credits). The effect on deferred taxes of changes in tax rates is recognized in the period in which the new tax rate is enacted. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts we expect to realize.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted, significantly decreasing the U.S. federal income tax rate for corporations effective January 1, 2018. On that same date, the Securities and Exchange Commission staff also issued Staff Accounting Bulletin (SAB) 118, which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740, "Income Taxes." As a result, we remeasured our deferred tax assets, liabilities and related valuation allowances in 2017. This remeasurement yielded a benefit of approximately $7.0 million due to the lower income tax rate in 2017. During the third quarter of 2018, the Company updated the provisional amounts previously recorded based on its completed 2017 federal income tax return. This resulted in an additional tax benefit of $2.4 million. Given the substantial changes associated with the Tax Act, the estimated financial impacts for 2017 are provisional and subject to further interpretation and clarification of the Tax Act during the remainder of 2018. Our net deferred income tax liability was approximately $7.1 million at September 30, 2018.

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

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

Fair Value Measurements and Disclosures

The Company is required to determine the fair value of financial assets and liabilities based on the price that would be received to sell the asset or paid to transfer the liability to a market participant. Fair value is a market-based measurement, not an entity specific measurement. The fair value of certain assets and liabilities approximates carrying value because of the short-term nature of the accounts, including cash and cash equivalents, accounts receivable and accounts payable. The carrying value of our notes receivable, net of allowances, also approximates fair value. The fair value of the amount outstanding under our term debt and revolving credit facility approximates their carrying values due to the variable market-based interest rate (Level 2).

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

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are not corroborated by market data.

Our financial assets that were measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 are as follows (in thousands):

	Carrying	Fair Value Measurements		
	Value	Level 1	Level 2	Level 3
September 30, 2018				
Financial assets:				
Cash surrender value of life insurance policies (a)	$ 31,495	$ 31,495	$ —	$ —
Interest rate swaps (b)	12,163	—	12,163	—
December 31, 2017				
Financial assets:				
Cash surrender value of life insurance policies (a)	$ 28,645	$ 28,645	$ —	$ —
Interest rate swaps (b)	651	—	651	—

(a) Represents life insurance policies held in our non-qualified deferred compensation plan.
(b) The fair value of our interest rate swaps is based on the sum of all future net present value cash flows. The future cash flows are derived based on the terms of our interest rate swaps, as well as considering published discount factors, and projected London Interbank Offered Rates (“LIBOR”).

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

There were no transfers among levels within the fair value hierarchy during the nine months ended September 30, 2018.

Variable Interest Entity

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

Accounting Standards Adopted

Revenue from Contracts with Customers

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

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multiple performance obligations, we allocate the transaction price using our best estimate of the standalone selling price to each distinct good or service in the contract.

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

Certain Tax effects from Accumulated Other Comprehensive Income (Loss)

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

Accounting Standards to be Adopted in Future Periods

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” (“ASU 2016-02”), which amends leasing guidance by requiring companies to recognize a right-of-use asset and a lease liability for all operating and capital leases (financing) with lease terms greater than twelve months. The lease liability will be equal to the present value of lease payments. The lease asset will be based on the lease liability, subject to adjustment, such as for initial direct costs. For income statement purposes, leases will continue to be classified as operating or capital (financing) with lease expense in both cases calculated substantially the same as under the prior leasing guidance. In July 2018, the FASB issued the following amendments to clarify the implementation guidance: ASU 2018-10, “Codification Improvements to Topic 842, Leases,” and ASU 2018-11, “Leases (Topic 842): Targeted Improvements.” The amendment allows for a modified retrospective adoption approach and new required lease disclosures for all leases existing or entered into after either the beginning of the year of adoption or the earliest comparative period in the consolidated financial statements. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. The Company has not yet determined the full impact of the adoption on its consolidated financial statements but expects the adoption will result in a significant increase in the non-current assets and liabilities reported on our Consolidated Balance Sheet.

Goodwill

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other,” (“ASU 2017-04”), which simplifies the accounting for goodwill. ASU 2017-04 eliminates the second step of the goodwill impairment test, which requires a hypothetical purchase price allocation. The goodwill impairment is the difference between the carrying value and fair value, not to exceed the carrying amount. ASU 2017-04 is effective for annual and interim periods in fiscal years beginning after December 15, 2019. We plan to early adopt this guidance in the fourth quarter of 2018; we do not anticipate the impact will be material to our consolidated financial statements.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected versus incurred losses for financial assets held. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, with early adoption permitted for annual periods beginning after December 15, 2018. The Company is currently assessing the impact of adopting this standard on our consolidated financial position, results of operations and cash flows.

Reclassification

Certain prior year amounts have been reclassified in the Condensed Consolidated Statements of Operations. See Note 11 for additional information.

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

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

The cumulative effect adjustment of $21.5 million was recorded as a reduction to retained earnings as of January 1, 2018 to reflect the impact of adopting Topic 606. The impact of applying Topic 606 for the three and nine months ended September 30, 2018 was an increase in revenues of $1.5 million and $5.7 million respectively and a decrease in pre-tax income of $1.2 million and $3.1 million, respectively.

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

Cumulative adjustment from adoption

As previously noted, an after-tax reduction of $21.5 million was recorded to retained earnings in the first quarter of 2018 to reflect the cumulative impact of adopting Topic 606. This consists of $10.8 million related to franchise fees, $8.0 million related to the customer loyalty program and $2.7 million related to marketing funds.

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

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

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

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

(In thousands, except per share amounts)	As Reported September 30, 2018	Total Adjustments	Balance Sheet Without Adoption of Topic 606
Assets			
Current assets:			
Cash and cash equivalents	$ 24,880	$ (4,420)	$ 20,460
Accounts receivable, net	53,157	(396)	52,761
Notes receivable, net	6,466	—	6,466
Income tax receivable	11,051	—	11,051
Inventories	29,311	—	29,311
Prepaid expenses	20,106	5,435	25,541
Other current assets	7,400	—	7,400
Assets held for sale	—	—	—
Total current assets	152,371	619	152,990
Property and equipment, net	224,510	—	224,510
Notes receivable, less current portion, net	16,097	—	16,097
Goodwill	84,830	—	84,830
Deferred income taxes, net	700	—	700
Other assets	72,654	907	73,561
Total assets	$ 551,162	$ 1,526	$ 552,688
Liabilities and stockholders' equity (deficit)			
Current liabilities:			
Accounts payable	$ 32,355	$ 799	$ 33,154
Income and other taxes payable	8,964	—	8,964
Accrued expenses and other current liabilities	100,081	(16,743)	83,338
Deferred revenue current	2,389	(2,389)	—
Current portion of long-term debt	20,000	—	20,000
Total current liabilities	163,789	(18,333)	145,456
Deferred revenue	14,946	(11,159)	3,787
Long-term debt, less current portion, net	555,755	—	555,755
Deferred income taxes, net	7,812	6,958	14,770
Other long-term liabilities	77,604	—	77,604
Total liabilities	819,906	(22,534)	797,372
Redeemable noncontrolling interests	5,979	—	5,979
Stockholders' (deficit):			
Preferred stock ($0.01 par value per share; no shares issued)	—	—	—
Common stock ($0.01 par value per share; issued 44,299 at September 30, 2018)	443	—	443
Additional paid-in capital	190,135	—	190,135
Accumulated other comprehensive income (loss)	3,605	—	3,605

Retained earnings	267,580	24,018	291,598
Treasury stock (12,933 shares at September 30, 2018, at cost)	(751,895)	—	(751,895)
Total stockholders’ (deficit), net of noncontrolling interests	(290,132)	24,018	(266,114)
Noncontrolling interests in subsidiaries	15,409	42	15,451
Total stockholders’ (deficit)	(274,723)	24,060	(250,663)
Total liabilities, redeemable noncontrolling interests and stockholders’ (deficit)	$ 551,162	$ 1,526	$ 552,688

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(In thousands, except per share amounts)	As Reported Three Months Ended September 30, 2018	Total Adjustments	Statement of Operations Without Adoption of Topic 606
Revenues:			
Domestic Company-owned restaurant sales	$ 158,285	$ 1,185	$ 159,470
North America franchise royalties and fees	12,806	91	12,897
North America commissary	146,240	—	146,240
International	25,653	(112)	25,541
Other revenues	21,023	(2,650)	18,373
Total revenues	364,007	(1,486)	362,521
Costs and expenses:			
Operating costs (excluding depreciation and amortization shown separately below):			
Domestic Company-owned restaurant expenses	135,836	(126)	135,710
North America commissary	137,928	—	137,928
International expenses	15,184	—	15,184
Other expenses	22,002	(2,282)	19,720
General and administrative expenses	55,462	(317)	55,145
Depreciation and amortization	11,585	—	11,585
Total costs and expenses	377,997	(2,725)	375,272
Refranchising loss, net	—	—	—
Operating (loss) income	(13,990)	1,239	(12,751)
Net Interest expense	(5,963)	—	(5,963)
(Loss) Income before income taxes	(19,953)	1,239	(18,714)
Income tax (benefit) expense			