PAPA JOHNS INTERNATIONAL INC
Form 10-Q
August 01, 2006

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

| | |
|---|---|
| [X] | **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**<br>**For the quarterly period ended June 25, 2006** |
| | **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 Johns Boulevard**
**Louisville, Kentucky 40299-2334**
(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 X 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 _X_ 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 _X__

At July 26, 2006, there were outstanding 31,924,603 shares of the registrant s common stock, par value $.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) | June 25, 2006 (Unaudited) | December 25, 2005 (Note) |
|---|---|---|
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 10,494 | $ 22,098 |
| Accounts receivable | 21,371 | 21,300 |
| Inventories | 24,444 | 26,030 |
| Prepaid expenses and other current assets | 12,501 | 13,456 |
| Deferred income taxes | 7,117 | 7,085 |
| Assets of discontinued operations held for sale | | 2,039 |
| **Total current assets** | 75,927 | 92,008 |
| Investments | 3,765 | 6,282 |
| Net property and equipment | 179,983 | 178,447 |
| Notes receivable | 11,443 | 7,667 |
| Deferred income taxes | 927 | 1,899 |
| Goodwill | 41,306 | 41,878 |
| Other assets | 16,815 | 13,772 |
| Assets of discontinued operations held for sale | | 8,609 |
| **Total assets** | $ 330,166 | $ 350,562 |
| **Liabilities and stockholders equity** | | |
| **Current liabilities:** | | |
| Accounts payable | $ 25,228 | $ 28,937 |
| Income and other taxes | 16,432 | 16,862 |
| Accrued expenses | 50,889 | 49,634 |
| Current portion of debt | 9,900 | 6,100 |
| **Total current liabilities** | 102,449 | 101,533 |
| Unearned franchise and development fees | 6,509 | 7,256 |
| Long-term debt, net of current portion | 35,514 | 49,016 |
| Other long-term liabilities | 27,752 | 31,478 |
| **Stockholders equity:** | | |
| Preferred stock | | |
| Common stock | 338 | 331 |
| Additional paid-in capital | 176,420 | 160,999 |
| Accumulated other comprehensive income (loss) | 1,405 | (290 ) |
| Retained earnings | 31,507 | 239 |
| Treasury stock | (51,728 ) | |
| **Total stockholders equity** | 157,942 | 161,279 |
| **Total liabilities and stockholders equity** | $ 330,166 | $ 350,562 |

Note: The balance sheet at December 25, 2005 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.*

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**Papa John s International, Inc. and Subsidiaries**
**Consolidated Statements of Income**
**(Unaudited)**

| (In thousands, except per share amounts) | Three Months Ended June 25, 2006 | Three Months Ended June 26, 2005 | Six Months Ended June 25, 2006 | Six Months Ended June 26, 2005 |
|---|---|---|---|---|
| **Domestic revenues:** | | | | |
| Company-owned restaurant sales | $ 105,424 | $ 110,558 | $ 212,164 | $ 221,272 |
| Variable interest entities restaurant sales | 2,691 | 2,293 | 5,137 | 7,460 |
| Franchise royalties | 13,964 | 12,908 | 28,202 | 26,273 |
| Franchise and development fees | 593 | 807 | 1,181 | 1,510 |
| Commissary sales | 100,968 | 95,496 | 203,660 | 196,408 |
| Other sales | 12,202 | 12,059 | 23,072 | 25,451 |
| **International revenues:** | | | | |
| Royalties and franchise and development fees | 1,839 | 1,469 | 3,296 | 3,027 |
| Restaurant and commissary sales | 3,912 | 3,085 | 7,230 | 5,911 |
| **Total revenues** | 241,593 | 238,675 | 483,942 | 487,312 |
| **Costs and expenses:** | | | | |
| **Domestic Company-owned restaurant expenses:** | | | | |
| Cost of sales | 19,650 | 23,585 | 40,528 | 48,825 |
| Salaries and benefits | 31,252 | 34,205 | 62,753 | 68,344 |
| Advertising and related costs | 9,821 | 9,946 | 19,013 | 19,557 |
| Occupancy costs | 6,364 | 6,561 | 12,526 | 13,161 |
| Other operating expenses | 13,774 | 14,025 | 27,577 | 28,091 |
| Total domestic Company-owned restaurant expenses | 80,861 | 88,322 | 162,397 | 177,978 |
| Variable interest entities restaurant expenses | 2,224 | 1,931 | 4,331 | 6,543 |
| **Domestic commissary and other expenses:** | | | | |
| Cost of sales | 81,866 | 78,477 | 165,409 | 160,905 |
| Salaries and benefits | 7,851 | 7,089 | 15,316 | 14,543 |
| Other operating expenses | 11,282 | 12,234 | 22,422 | 26,404 |
| Total domestic commissary and other expenses | 100,999 | 97,800 | 203,147 | 201,852 |
| Loss (income) from the franchise cheese purchasing program, net of minority interest | (5,189) | (167) | (9,765) | 842 |
| International operating expenses | 3,883 | 2,833 | 7,306 | 5,542 |
| General and administrative expenses | 26,386 | 21,908 | 50,630 | 43,205 |
| Minority interests and other general expenses | 1,327 | 1,305 | 3,025 | 3,222 |
| Depreciation and amortization | 6,603 | 7,264 | 13,164 | 14,608 |
| **Total costs and expenses** | 217,094 | 221,196 | 434,235 | 453,792 |
| **Operating income from continuing operations** | 24,499 | 17,479 | 49,707 | 33,520 |
| Net interest expense | (267) | (944) | (692) | (2,069) |
| **Income from continuing operations before income taxes** | 24,232 | 16,535 | 49,015 | 31,451 |
| Income tax expense | 8,966 | 6,118 | 18,136 | 11,637 |
| Income from continuing operations | 15,266 | 10,417 | 30,879 | 19,814 |
| Income from discontinued operations, net of tax | | 453 | 389 | 1,021 |
| **Net income** | $ 15,266 | $ 10,870 | $ 31,268 | $ 20,835 |
| **Basic earnings per common share:** | | | | |
| Income from continuing operations | $ 0.47 | $ 0.31 | $ 0.94 | $ 0.60 |
| Income from discontinued operations, net of tax | | 0.01 | 0.01 | 0.03 |
| **Basic earnings per common share** | $ 0.47 | $ 0.32 | $ 0.95 | $ 0.63 |
| **Earnings per common share assuming dilution:** | | | | |
| Income from continuing operations | $ 0.46 | $ 0.31 | $ 0.92 | $ 0.59 |
| Income from discontinued operations, net of tax | | 0.01 | 0.01 | 0.03 |
| **Earnings per common share assuming dilution** | $ 0.46 | $ 0.32 | $ 0.93 | $ 0.62 |
| Basic weighted average shares outstanding | 32,589 | 33,336 | 32,855 | 33,258 |
| Weighted average shares outstanding assuming dilution | 33,309 | 33,746 | 33,632 | 33,716 |

*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 26, 2004** | 33,460 | $ 650 | $ 242,331 | $ (555) | $ 317,142 | $ (420,345) | $ 139,223 |
| Comprehensive income: | | | | | | | |
| Net income | | | | | 20,835 | | 20,835 |
| Change in valuation of interest rate swap agreement, net of tax of $442 | | | | 678 | | | 678 |
| Other, net | | | | (85) | | | (85) |
| Comprehensive income | | | | | | | 21,428 |
| Issuance of common stock from treasury stock | 55 | | | | | 1,000 | 1,000 |
| Exercise of stock options | 1,224 | 12 | 16,845 | | | | 16,857 |
| Tax benefit related to exercise of non-qualified stock options | | | 1,966 | | | | 1,966 |
| Acquisition of treasury stock | (807) | | | | | (13,932) | (13,932) |
| Other | | | 890 | | | | 890 |
| **Balance at June 26, 2005** | 33,932 | $ 662 | $ 262,032 | $ 38 | $ 337,977 | $ (433,277) | $ 167,432 |
| **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 agreements, 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 treasury 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 |

At June 26, 2005, the accumulated other comprehensive gain of $38 was comprised of unrealized foreign currency translation gains of $323 and net unrealized gain on investments of $2, offset by net unrealized loss on the interest rate swap agreement of $287.

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

*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 June 25, 2006 | June 26, 2005 |
|---|---|---|
| **Operating activities** | | |
| Income from continuing operations | $ 30,879 | $ 19,814 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for uncollectible accounts and notes receivable | 1,887 | 1,327 |
| Depreciation and amortization | 13,164 | 14,608 |
| Deferred income taxes | 212 | (753) |
| Stock-based compensation expense | 1,882 | 912 |
| Excess tax benefit related to exercise of non-qualified stock options | (4,500) | |
| Other | 3,556 | 2,602 |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (2,274) | 4,549 |
| Inventories | 1,586 | 1,221 |
| Prepaid expenses and other current assets | 938 | 4,272 |
| Other assets and liabilities | (4,885) | (1,170) |
| Accounts payable | (3,709) | (7,944) |
| Income and other taxes | (430) | (3,088) |
| Accrued expenses | (354) | 325 |
| Unearned franchise and development fees | (747) | (148) |
| Net cash provided by operating activities from continuing operations | 37,205 | 36,527 |
| Operating cash flows from discontinued operations | 414 | 1,301 |
| Net cash provided by operating activities | 37,619 | 37,828 |
| **Investing activities** | | |
| Purchase of property and equipment | (14,068) | (6,658) |
| Proceeds from sale of property and equipment | 26 | 44 |
| Purchase of investments | (2,014) | (5,397) |
| Proceeds from sale or maturity of investments | 4,472 | 5,800 |
| Loans to franchisees and affiliates | (4,616) | (2,770) |
| Loan repayments from franchisees and affiliates | 6,410 | 3,630 |
| Acquisitions | (1,200) | |
| Proceeds from divestiture of discontinued operations | 8,020 | |
| Net cash used in investing activities | (2,970) | (5,351) |
| **Financing activities** | | |
| Net repayments from line of credit facility | (13,500) | (29,300) |
| Net proceeds from short-term debt variable interest entities | 3,800 | 225 |
| Proceeds from issuance of common stock | | 1,000 |
| Excess tax benefit related to exercise of non-qualified stock options | 4,500 | |
| Proceeds from exercise of stock options | 10,450 | 16,857 |
| Acquisition of common stock | (51,728) | (13,932) |
| Other | 172 | (123) |
| Net cash used in financing activities | (46,306) | (25,273) |
| Effect of exchange rate changes on cash and cash equivalents | 53 | (109) |
| Change in cash and cash equivalents | (11,604) | 7,095 |
| Cash and cash equivalents at beginning of period | 22,098 | 14,698 |
| Cash and cash equivalents at end of period | $ 10,494 | $ 21,793 |

*See accompanying notes.*

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**Papa John s International, Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**
(Unaudited)

**June 25, 2006**

## 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 June 25, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. 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 25, 2005.

## 2. Two-for-One Common Stock Split

In December 2005, our Board of Directors approved a two-for-one stock split of our outstanding shares of common stock. The stock split was effected in the form of a stock dividend and entitled each shareholder of record at the close of business on December 23, 2005 to receive one additional share for every outstanding share of common stock held on the record date. The stock dividend was distributed on January 13, 2006 with approximately 16.5 million shares of common stock distributed. All per share and share amounts in the accompanying condensed consolidated financial statements and notes to the financial statements have been adjusted to reflect the stock split.

In conjunction with the stock split, we retired all shares held in treasury as of December 23, 2005.

## 3. New Accounting Pronouncement

In June 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48 of FASB, *Accounting for Uncertainty in Income Taxes* (FIN 48). 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. FIN 48 is effective for the Company in fiscal 2007. We have not determined the impact, if any, of adopting FIN 48.

## 4. Discontinued Operations

In March 2006, the Company sold its Perfect Pizza operations, 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 to be retired by the purchaser over the next five years. There was no gain or loss recognized in connection with the sale of Perfect Pizza.

We have classified our Perfect Pizza operations as discontinued operations in the accompanying financial statements. The following summarizes the results of the discontinued operations for the three and six months ended June 25, 2006 and June 26, 2005 (in thousands, except per share data):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 25, 2006 | June 26, 2005 | June 25, 2006 | June 26, 2005 |
| Net sales | $ | $ 3,459 | $ 2,421 | $ 7,196 |
| Operating expenses | | 2,240 | 1,449 | 4,566 |
| G&A expenses | | 422 | 330 | 853 |
| Other expenses | | 77 | 25 | 156 |
| Income before income taxes | | 720 | 617 | 1,621 |
| Income tax expense | | 267 | 228 | 600 |
| Net income from discontinued operations | $ | $ 453 | $ 389 | $ 1,021 |
| Basic earnings per common share | $ | $ 0.01 | $ 0.01 | $ 0.03 |
| Earnings per common share assuming dilution | $ | $ 0.01 | $ 0.01 | $ 0.03 |

## 5. Accounting for Variable Interest Entities

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 corporation, 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 VIEs activities, is entitled to receive a majority of the VIEs residual returns (if no party absorbs a majority of the VIEs 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 VIEs 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 $35.6 million and $71.9 million of cheese from BIBP for the three and six months ended June 25, 2006, respectively, and $36.6 million and $74.4 million of cheese for the comparable periods in 2005, respectively.

As defined by FIN 46, we are the primary beneficiary of BIBP, a VIE, and we began consolidating the balance sheet of BIBP as of December 28, 2003. We recognize the operating losses generated by BIBP if BIBP s

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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 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 $0.22 per share) for the three and six months ended June 25, 2006, respectively, and pre-tax losses of $185,000 ($117,000 net of tax, which had no impact on earnings per share) and $1.8 million ($1.1 million net of tax, or $0.03 per share) for the comparable periods in 2005, respectively, from the consolidation of BIBP. The impact on future operating income from the consolidation of BIBP is expected to continue 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 June 25, 2006, BIBP had outstanding borrowings of $9.9 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 is deemed the primary beneficiary of three franchise entities as of June 25, 2006. These entities operate a total of 14 restaurants with annual revenues approximating $9.0 million. Our net loan balance receivable from these three entities is $1.2 million at June 25, 2006, 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 June 25, 2006 and December 25, 2005:

| | **June 25, 2006** | | | **December 25, 2005** | | |
|---|---|---|---|---|---|---|
| **(In thousands)** | **BIBP** | **Franchisees** | **Total** | **BIBP** | **Franchisees** | **Total** |
| **Assets:** | | | | | | |
| Cash and cash equivalents | $ 1,670 | $ 139 | $ 1,809 | $ | $ 174 | $ 174 |
| Accounts receivable | | 28 | 28 | | 30 | 30 |
| Accounts receivable Papa John s | 4,738 | | 4,738 | 5,484 | | 5,484 |
| Other assets | 1,147 | 349 | 1,496 | 1,315 | 435 | 1,750 |
| Net property and equipment | | 970 | 970 | | 1,195 | 1,195 |
| Goodwill | | 460 | 460 | | 460 | 460 |
| Deferred income taxes | 2,812 | | 2,812 | 7,153 | | 7,153 |
| Total assets | $ 10,367 | $ 1,946 | $ 12,313 | $ 13,952 | $ 2,294 | $ 16,246 |
| **Liabilities and stockholders equity (deficit):** | | | | | | |
| Accounts payable and accrued expenses | $ 5,047 | $ 414 | $ 5,461 | $ 6,693 | $ 440 | $ 7,133 |
| Short-term debt third party | 9,900 | | 9,900 | 6,100 | | 6,100 |
| Short-term debt Papa John s | | 1,218 | 1,218 | 13,053 | 1,532 | 14,585 |
| Total liabilities | 14,947 | 1,632 | 16,579 | 25,846 | 1,972 | 27,818 |
| Stockholders equity (deficit) | (4,580 ) | 314 | (4,266 ) | (11,894 ) | 322 | (11,572 ) |
| Total liabilities and stockholders equity (deficit) | $ 10,367 | $ 1,946 | $ 12,313 | $ 13,952 | $ 2,294 | $ 16,246 |

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## 6. Debt

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

| | June 25, 2006 | December 25, 2005 |
|---|---|---|
| Revolving line of credit | $ 35,500 | $ 49,000 |
| Debt associated with VIEs* | 9,900 | 6,100 |
| Other | 14 | 16 |
| Total debt | 45,414 | 55,116 |
| Less: current portion of debt | (9,900 ) | (6,100 ) |
| Long-term debt | $ 35,514 | $ 49,016 |

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

## 7. 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 June 25, 2006 | June 26, 2005 | Six Months Ended June 25, 2006 | June 26, 2005 |
|---|---|---|---|---|
| Basic earnings per common share: | | | | |
| Income from continuing operations | $ 15,266 | $ 10,417 | $ 30,879 | $ 19,814 |
| Weighted average shares outstanding | 32,589 | 33,336 | 32,855 | 33,258 |
| Basic earnings per common share | $ 0.47 | $ 0.31 | $ 0.94 | $ 0.60 |
| Earnings per common share assuming dilution: | | | | |
| Income from continuing operations | $ 15,266 | $ 10,417 | $ 30,879 | $ 19,814 |
| Weighted average shares outstanding | 32,589 | 33,336 | 32,855 | 33,258 |
| Dilutive effect of outstanding common stock options | 720 | 410 | 777 | 458 |
| Diluted weighted average shares outstanding | 33,309 | 33,746 | 33,632 | 33,716 |
| Earnings per common share assuming dilution | $ 0.46 | $ 0.31 | $ 0.92 | $ 0.59 |

## 8. Stock-Based Compensation

We award stock options from time to time under the Papa John s International, Inc. 1999 Team Member Stock Ownership Plan (the 1999 Plan ) and the Papa John s International, Inc. 2003 Stock Option Plan for Non-Employee Directors (the Directors Plan ) and other such agreements as may arise. Shares of common stock authorized for issuance under the 1999 Plan are approximately 6.3 million, which includes shares transferred in from the Papa John s International, Inc. 1993 Stock Ownership Incentive Plan (the 1993 Plan ), which terminated on April 15, 2003 and 700,000 shares under the Directors Plan. Options granted prior to 2003 generally expire ten years from the date of grant and vest over one to five-year periods, except for certain options awarded under a previous, multi-year operations compensation program that vested immediately upon grant. The options granted in 2003 and 2004 under the 1999 Plan and the Directors Plan generally expire 30 months from the date of grant and vest over a 12-month period. Options granted in 2005 and 2006 generally expire five years from the date of grant and vest over a 24-month period. There were 581,000 options granted during the second quarter of 2006.

Effective at the beginning of fiscal 2002, we elected to expense the cost of employee stock options in accordance with the fair value method contained in Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting and Disclosure of Stock-Based Compensation.* Under SFAS No. 123, the fair value for options is estimated at the date of grant using a Black-Scholes-Merton ( Black-Scholes ) option-pricing model, which requires the input of highly subjective assumptions including the expected stock price volatility. The election was effective as of the beginning of fiscal 2002 and applies to all stock options issued after the effective date.

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment,* which is a revision of FASB Statement No. 123. As required, we adopted the provisions of SFAS No. 123(R) effective at the beginning of our fiscal 2006, using the modified-prospective method. Upon adoption of SFAS No. 123(R), we elected to continue using the Black-Scholes option-pricing model. If we had adopted SFAS No. 123(R) in prior years, the impact on our 2005 operating income of that standard would have been minimal. SFAS No. 123(R) requires the benefit of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow in the accompanying consolidated statements of cash flows. Operating income and cash flow operating results for 2005 have not been restated for the adoption of SFAS No. 123(R).

We recorded stock-based employee compensation expense, net of tax effects, of $746,000 and $1.2 million for the three and six months ended June 25, 2006, respectively, and $430,000 and $574,000 for the comparable periods in 2005, respectively. At June 25, 2006, there was $6.8 million of unrecognized compensation cost related to nonvested option awards, of which the Company expects to recognize $2.8 million in 2006, $3.2 million 2007 and $800,000 in 2008.

During the six months ended June 25, 2006 and June 26, 2005, a total of 710,000 and 1.2 million options were exercised, respectively. The total intrinsic value of the options exercised during the six months ended June 25, 2006 and June 26, 2005 was $12.6 million and $6.4 million respectively. Cash received upon the exercise of stock options was $10.5 million and $16.9 million during the six months ended June 25, 2006 and June 26, 2005 and the related tax benefits realized were $4.7 million and $2.4 million during the corresponding periods.

The weighted average fair values per option at the date of grant for options granted in the first six months of 2006 and 2005 were $8.94 and $4.40, respectively, as valued using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Six Months Ended | |
|---|---|---|
| | **June 25, 2006** | **June 26, 2005** |
| Risk-free interest rate | | |