PAPA JOHNS INTERNATIONAL INC
Form 10-K
February 26, 2008

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 30, 2007

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)

(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 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. o

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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, July 1, 2007, was approximately $665,784,682.

As of February 19, 2008 there were 28,847,782 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 May 8, 2008.

TABLE OF CONTENTS

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

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

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

PART IV
Item 15. Exhibits, Financial Statement Schedules

PART I

Item 1. Business

General

Papa John s International, Inc. (referred to as the Company , Papa John s or in the first person notations of we , us and our) operates and fra 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 30, 2007, there were 3,208 Papa John s restaurants in operation, consisting of 662 Company-owned and 2,546 franchised restaurants operating domestically in all 50 states, the District of Columbia and Puerto Rico and in 28 countries.

Papa John s has defined five reportable segments: domestic restaurants, domestic commissaries (Quality Control Centers), domestic franchising, international operations and variable interest entities. See Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 22 of Notes to Consolidated Financial Statements for financial information about these segments for the years ended December 30, 2007, December 31, 2006 and December 25, 2005.

All of our periodic and current reports filed with the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, as amended, are available, free of charge, through our web site located at www.papajohns.com, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports. Those documents are available through our website as soon as reasonably practicable after we electronically file them with the SEC. 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 reference to these website addresses does 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 pizzerias internationally. 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 pizza and canned or bottled soft drinks. 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.

1

In addition to our fresh dough, we offer a thin crust pizza and Papa s Perfect Pan Pizza, which features a square, thick buttery-tasting crust made with olive oil, and a zesty robusto pizza sauce with chunks of tomato and flavored with garlic, Italian herbs and spices. Both the thin and pan crusts are par-baked products produced by third-party vendors. Each traditional crust and pan 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 will continue to test new product offerings both domestically and internationally. The new products can become a part of the permanent menu if they meet certain established guidelines.

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

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

Marketing. Our marketing strategy consists of both national and local components. Our domestic national strategy includes national advertising on television, through print and direct mail and via the Internet. Seven national television campaigns aired in 2007 to support new product launches and DVD promotions.

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

Additionally, we have developed joint cross-marketing plans with certain third-party companies. For example, we entered into marketing and partnership agreements with Six Flags theme parks and Live Nation amphitheaters, which provide for cross-marketing activities. We will continue to explore additional cross-marketing opportunities with third-party companies.

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 seasoned sauce from our QC Centers and to purchase all other supplies from our QC Centers or approved suppliers. QC Centers outside the U.S. or in remote areas may be operated by franchisees pursuant to 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 high-quality suppliers located in-country or regional suppliers to the extent possible.

Unit Economics

In 2007, the 541 domestic Company-owned restaurants included in the full year s comparable restaurant base generated average annual sales of $836,000, average cash flow (restaurant operating income plus depreciation) of $156,000 and average restaurant operating income of $132,000. Average cash flow and average restaurant operating income includes food costs as purchased directly from suppliers (i.e. excludes margin earned by our QC Centers). This average operating income represents 15.8% of average sales and the average cash flow represents 59.0% of the $265,000 average investment in property and equipment for these Company-owned restaurants.

Franchise operating income returns may differ from Company-owned restaurants for a variety of reasons, including lower average sales volumes for under-penetrated markets, lower average investment costs and differences in compensation and other costs.

The average cash investment for the 20 domestic Company-owned restaurants opened during the 2007 fiscal year, exclusive of land, was approximately $270,000, excluding tenant improvement allowances that we received. We expect the average cash investment for the 10 to 15 domestic Company-owned restaurants expected to open in 2008 to be approximately $270,000, excluding any anticipated tenant improvement allowances. Substantially all domestic restaurants do not offer dine-in areas, which reduces our restaurant capital investment.

Development

A total of 263 Papa John s restaurants were opened during 2007, consisting of 24 Company-owned (20 domestic and four international) and 239 franchised restaurants (140 domestic and 99 international), while 70 Papa John s restaurants closed during 2007, consisting of nine domestic Company-owned and 61 franchised restaurants (48 domestic and 13 international).

During 2008, we plan to open approximately 160 to 190 net new units (openings, net of closings). We expect to open 20 to 25 Company-owned restaurants (10 to 15 domestically and 10 internationally) and 240 to 265 franchise restaurants (105 to 115 domestically and 135 to 150 internationally). We also expect approximately 100 Papa John s restaurants to close during 2008, 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 North America, the United Kingdom, the Middle East and Asia. We expect our expansion in Asia to include a significant focus in China and Korea.

Our Company-owned expansion strategy is to continue to open domestic restaurants in existing markets, thereby increasing consumer awareness and enabling us to take advantage of operational and advertising efficiencies. Our experience in developing markets indicates that market penetration through the opening of multiple restaurants within a particular market results in increased average restaurant sales in that market over time. We have co-developed markets with some franchisees or divided markets among franchisees, and will continue to utilize market co-development in the future, where appropriate. During 2005 and 2006, we implemented a buy and build strategy in one large metropolitan market. Under this

strategy, the Company purchased franchised restaurants in an under-penetrated or emerging domestic market with the intention of building additional Company-owned restaurants to increase market awareness. During 2007 and 2006, we acquired restaurants with a total purchase price of $52.0 million for a variety of reasons including implementing the previously mentioned buy and build strategy, opportunities to purchase restaurants in markets where we have a significant Company-owned restaurant presence and opportunities to expand in growing metropolitan areas.

The Company plans to implement a formal refranchising initiative during 2008, the goal of which is to increase the percentage of franchised units in the domestic restaurant portfolio over time. The Company believes shifting the domestic restaurant portfolio mix more toward franchised units will improve the absolute level and consistency of operating margin percentage and be more consistent with the trend in franchise business models in the domestic restaurant category. Of the total 2,760 domestic units open as of December 30, 2007, 648 or 23.5% were Company-owned (including 128 units owned in joint venture arrangements with franchisees in which the Company has a majority ownership position). The Company believes that through a combination of net openings more heavily weighted toward franchise units and the selective refranchising of certain Company-owned markets, the percentage of Company-owned units can be decreased below 20% over the next few years. Any such unit sales completed during 2008 are not expected to have a significant impact on 2008 operating income.

Internationally, we own and operate six restaurants in the United Kingdom and eight in Beijing, China. During 2008, we plan to add five Company-owned restaurants in the United Kingdom and five Company-owned restaurants in China.

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

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

We consider the location of a 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.

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

4

equipment packages through an approved third party supplier. We sell replacement smallwares and related items to our franchisees through our support services subsidiary, Preferred Marketing Solutions, Inc.

Quality Control (QC) Centers; Strategic Supply Chain Management

Our domestic QC Centers, comprised of ten regional production and distribution centers in 2007, 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 costs. Our full-service QC Centers are located in Louisville, Kentucky; Dallas, Texas; Pittsburgh, Pennsylvania; Orlando, Florida; Raleigh, North Carolina; Denver, Colorado; Rotterdam, New York; Portland, Oregon; Des Moines, Iowa; and Phoenix, Arizona. 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 QC Center system capacity sufficient to accommodate domestic restaurant development for the next several years.

Our subsidiary, Papa John s UK (PJUK), leased a distribution center in the United Kingdom until it was sold in March 2006. Our PJUK subsidiary presently purchases its products from our previously owned distribution center. In addition, we acquired full-service QC Centers in Mexico City, Mexico and Beijing, China in 2006. The primary difference between a full-service QC Center and a distribution center is that full-service QC Centers produce fresh pizza dough in addition to providing other food and paper products used in our restaurants. International full-service QC Centers, licensed to franchisees and non-franchisee third parties, 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 seasoned sauce and dough from our QC Centers. Franchisees may purchase other goods directly from our QC Centers or approved suppliers. National purchasing agreements with most of our suppliers generally result in volume discounts to us, allowing us to sell products to our restaurants at prices we believe are below those generally available in the marketplace. Within our domestic QC Center system, products are distributed to restaurants by refrigerated trucks leased and operated by us or transported by a dedicated logistics company.

PJ Food Service, Inc. (PJFS), our wholly owned subsidiary that operates our domestic Company-owned QC Centers, has a purchasing arrangement with BIBP Commodities, Inc. (BIBP), a third-party entity formed by franchisees for the sole purpose of reducing cheese price volatility to domestic system-wide restaurants. Under this arrangement, PJFS purchases cheese from BIBP at a fixed quarterly price based in part on historical average cheese prices. Gains and losses incurred by BIBP are passed to the QC Centers via adjustments to the selling price over time. Ultimately, PJFS purchases cheese at a price approximating the actual average market price, but with more predictability and less price volatility. See Management s Discussion and Analysis of Financial Condition and Results of Operations Consolidation of BIBP Commodities, Inc. (BIBP) as a Variable Interest Entity, and Note 5 of Notes to Consolidated Financial Statements for additional information concerning BIBP and the purchasing arrangement, and the related financial statement treatment of BIBP s results.

Marketing Programs

All domestic Company-owned and franchised Papa John s restaurants within a defined market are required to join an area advertising cooperative (Co-op). Each member restaurant contributes a percentage of sales to the Co-op for market-wide programs, such as radio, television and print advertising. The rate of contribution and uses of the monies collected are determined by a majority vote of the Co-op s members (in most cases the contribution rate cannot be below 2.0% without approval from Papa John s). The restaurant-level and Co-op marketing efforts are supported by print and electronic advertising materials that are produced by the Papa John s Marketing Fund, Inc., a non-profit corporation (the Marketing Fund). The Marketing Fund produces and buys air time for Papa John s national television commercials, in addition to other brand-building activities, such as consumer research and public relations activities. All domestic Company-owned and franchised Papa John s restaurants are required to contribute a certain percentage of sales to the Marketing Fund. The contribution rate to the Marketing Fund can be increased above the required contribution rate if a majority of the domestic restaurants agree to such increase. The contribution percentage was 2.7% during 2007, 2.6% during 2006 and 2.25% during 2005. The contribution percentage to the Marketing Fund is currently set at 2.7% for 2008.

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 couponing. The local marketing efforts also include a variety of community-oriented activities with schools, sports teams and other organizations. In markets in which Papa John s has a significant presence, local marketing efforts are supplemented with local radio and television advertising.

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

We have developed joint cross-marketing plans with certain third-party companies. For example, in 2006 we entered into a five-year marketing and partnership agreement with Six Flags theme parks and in 2007, we entered into a four-year agreement with Live Nation amphitheaters. Both agreements provide for cross-marketing activities. We will continue to explore additional cross-marketing opportunities with third-party companies.

We have developed a system by which domestic Papa John s restaurant customers in areas we service are able to place orders online via the Internet, including the plan ahead ordering advance ordering feature and Spanish-language ordering capability. In addition, beginning in late 2007, our customers can order via text messaging. We receive a percentage-based fee from domestic franchisees for online sales, in addition to royalties, for this service.

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

Company Operations

Restaurant Personnel. A typical Papa John s restaurant employs a restaurant manager, one or two assistant managers and approximately 20 to 25 hourly team members, most of whom work part-time. The manager is responsible for the day-to-day operation of the restaurant and maintaining Company-established operating standards. The operating standards and other resources are contained in a comprehensive operations manual supplied to each restaurant. We seek to hire experienced restaurant managers and staff, provide comprehensive training on operations and managerial skills, and motivate and retain them 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. The operations vice presidents report to division vice presidents, who currently number four. These team members are eligible to earn performance-based financial incentives.

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

Point of Sale Technology. Point of sale technology (our proprietary PROFIT 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. We believe the PROFIT System enhances restaurant-level marketing capabilities through the development of a database containing information on customers and their buying habits with respect to our products. Polling capabilities allow us to obtain restaurant operating information, thereby improving the speed, accuracy and efficiency of restaurant-level reporting. The PROFIT System is also closely integrated with our online ordering system in all domestic traditional Papa John s restaurants, enabling Papa John s to offer nationwide online ordering to our customers.

Reporting. Management at Company-owned restaurants reviews and evaluates daily reports of sales, cash deposits and operating costs. Physical inventories of all food and beverage items are taken nightly.

Joint Ventures. We operate 128 Company-owned restaurants under two joint venture arrangements. Under the first arrangement, we own 70% of an entity operating 48 Papa John s restaurants located in Virginia and Maryland. Under the second arrangement, we own 51% of an entity operating 80 Papa John s restaurants located in Texas and Oklahoma. 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.

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 30, 2007, there were 2,546 franchised Papa John s restaurants operating in all 50 states, the District of Columbia, Puerto Rico and 28 countries. As of December 30, 2007, we have development agreements with our franchisees for approximately 310 additional domestic franchised restaurants committed to open through 2016 and agreements for 873 additional international franchised restaurants to open through 2017. 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 2007, 239 (140 domestic and 99 international) franchised Papa John s restaurants were opened.

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

Domestic Development and Franchise Agreements. We enter into development agreements with our domestic franchisees for the opening of a specified number of restaurants within a defined period of time and specified geographic area. Substantially all existing franchise agreements have an initial 10-year term with a 10-year renewal option. Many state franchise laws limit the ability of a franchisor to terminate or refuse to renew a franchise. In October 2007, the Company initiated its domestic Franchise Agreement Renewal Program (the Renewal Program) as more fully described below.

Our previous standard domestic franchise agreement provided for a term of ten years (with one ten-year renewal option) and payment to us of a royalty fee of 4% of sales. Prior to the Renewal Program, substantially all franchise agreements allowed us to increase the royalty fee up to 5% of sales.

During 2007, the Company collaborated with the Franchise Advisory Council, which consists of Company and franchisee representatives of domestically owned restaurants, to develop a revised form of franchise agreement (the Negotiated Agreement). As of February 19, 2008, approximately 95% of the franchise units executed the renewal (75% as of December 30, 2007). Under the Renewal Program, the Company offered certain renewal fee discounts to encourage all existing franchisees to renew under the Negotiated Agreement. Existing franchisees electing not to renew under the Negotiated Agreement are subject to the new standard form of the franchise agreement (the New Standard Agreement) upon their subsequent renewal. The primary objectives of the revised form of franchise agreement included:

- Providing visibility to franchisees as to the potential timing and amount of future royalty rate increases;
- Ensuring minimum funding levels for the National Marketing Fund, given the scale advantages of our larger competitors;
- Providing a funding mechanism for continued investment in maintaining and enhancing our online technological capabilities; and
- Addressing alternative marketing or other business developments to ensure the new form of franchise agreement is consistent and up to date.

Key provisions of the Negotiated Agreement in comparison to existing franchise agreements and the New Standard Agreement are as follows:

Royalty Rate Under the form of franchise agreement to which substantially all franchisees were subject prior to the Renewal Program, the royalty rate can be increased from 4% to 5% at any time at the discretion of the Company. The Negotiated Agreement limits the royalty rate increase to a maximum of one-quarter percent per year beginning in 2008, reaching 5% no earlier than 2011, and further limits the royalty rate to a maximum of 5% through 2020. Royalty rate increases subsequent to 2020 are also limited to one-quarter percent per year and cannot exceed 5.5% through 2025, with a maximum rate of 6% thereafter. The royalty rate increase provisions of the Negotiated Agreement are more favorable to the franchisees than the provisions of either the majority of existing agreements as noted above or the New Standard Agreement, which provides for a minimum 5% royalty rate that can be increased to 6% at any time at the discretion of the Company.

Marketing Expenditures The Negotiated Agreement provides for certain minimum contributions as a percentage of sales to the National Marketing Fund and a minimum level of spending as a percentage of sales on all marketing activities, consisting of contributions to both the National Marketing Fund and local marketing cooperatives, as well as local store marketing initiatives.

Online Ordering System Fees The Negotiated Agreement limits the fee charged for online transactions to 3% of the amount of the transaction. Additionally, once the Company has recovered a certain portion of its initial investment in the development of the online system via the net operating profits of the system, the online business unit will be operated at a break-even level through either a reduction in the fee percentage or a contribution of any net operating profits into the National Marketing Fund.

The Negotiated Agreement also addresses several other issues, including sharing of profits from partnership marketing or alternative sales channels activities, development of a process for defining trade areas for alternative ordering methodologies and marketing contribution requirements for non-traditional units.

The financial implications of this renewal activity for the Company are as follows:

- Collections from franchisees approximated $2.0 million in the fourth quarter of 2007 due to the renewal program.

- The royalty rate increased to 4.25% effective December 31, 2007 (beginning of fiscal 2008), for those franchisees who renewed subject to the Negotiated Agreement. The royalty rate for most franchisees who choose not to renew under the Negotiated Agreement increased to 5%. The current annual impact of a one-quarter percent royalty rate increase is approximately $3.5 to $4.0 million; however, given the current and projected cost environment for 2008, the Company anticipates that a portion of the incremental royalty income to be received in 2008 as a result of the rate increase will be expended in the form of investments in the system, including additional marketing in support of under-penetrated markets.

- The Company has communicated its intention to further increase the royalty rate under the Negotiated Agreement to 4.50% in 2009, 4.75% in 2010 and 5.00% in 2011, in accordance with the terms of the negotiation. Facts and circumstances existing at such future dates may impact the Company s final determination as to whether to reinvest any of the funds for the benefit of the system.

- The Company recognized approximately $3.0 million of operating income from the online ordering system business unit in 2007 and expects to recognize a similar amount in 2008, completing the negotiated amount of recovery of the Company s initial investment in the development of the system. As noted above, this business unit will subsequently be operated at a break-even level and, accordingly, the amount of operating income recognized by the Company related to this business unit is expected to be approximately $3.0 million less in 2009 than in 2008.

Under our current standard 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.

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.

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

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

We have entered into a limited number of development and franchise agreements for non-traditional restaurants. As an example, a total of 17 franchised net units opened in Six Flags theme parks in 2006 and 2007 as part of a five-year marketing and partnership agreement, and 23 franchised units opened in Live Nation amphitheaters in 2007 as a part of our four-year marketing and partnership agreement. These agreements generally cover venues or areas not originally targeted for development and have terms differing from the standard agreement. To date, these agreements have not had a significant 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 accessibility and visibility of the site and targeted demographic factors, including population, density, income, age and traffic. Our domestic franchisees may purchase complete new store equipment packages through an approved third-party supplier. Internationally, our franchisees buy their equipment from approved third-party suppliers.

Franchisee Loans. Selected franchisees have borrowed funds from our subsidiary, Capital Delivery, Ltd., principally for use in the construction and development of their restaurants. We have also entered into loan agreements with certain franchisees that purchased restaurants from us or other franchisees. Loans made to franchisees typically bear interest at fixed or floating rates and in most cases are secured by the fixtures, equipment and signage (and where applicable, the land) of the restaurant and the ownership interests in the franchisee. At December 30, 2007, loans outstanding totaled $11.8 million, which were composed of $7.0 million of loans to franchisees and a loan balance of $4.8 million with the purchaser of

10

our Perfect Pizza operations. See Note 11 of Notes to Consolidated Financial Statements for additional information.

We have a commitment to lend up to $30.0 million to BIBP, a franchisee-owned corporation with an outstanding balance of $20.5 million at December 30, 2007. See Notes 5 and 11 of Notes to Consolidated Financial Statements for additional information.

Franchise Insurance Program. Our franchisees have the opportunity to purchase various insurance policies, such as non-owned automobile and workers compensation, through our insurance agency, Risk Services Corp. (Risk Services). In October 2000, we established a captive insurance company (Captive) domiciled in Bermuda, RSC Insurance Services, Ltd., to accommodate this business.

Beginning in October 2004, a third-party commercial insurance company began providing fully-insured coverage to franchisees participating in the franchise insurance program. Accordingly, this new agreement eliminates our risk of loss for franchise insurance coverage written after September 2004. As of December 30, 2007, approximately 50% of domestic franchised restaurants had obtained insurance coverage through Risk Services. See Note 12 of Notes to Consolidated Financial Statements for additional information concerning the Captive.

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

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

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

Franchise Advisory Council. We have a Franchise Advisory Council that consists of Company and franchisee representatives of domestic restaurants. The Franchise Advisory Council and subcommittees hold regular meetings to discuss new marketing ideas, operations, growth and other relevant issues such as the previously discussed franchise agreement that was negotiated during 2007. The Company is aware that certain franchisees have formed an operators exchange group for the purpose of communicating and addressing issues, needs and opportunities among its members and the Company.

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

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

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

Industry and Competition

The United States Quick Service Restaurant pizza industry (QSR Pizza) is mature and highly competitive with respect to price, service, location, food quality and variety. There are well-established competitors with substantially greater financial and other resources than Papa John s. Competitors include international, national and regional chains, as well as a large number of local independent pizza operators. Some of our competitors have been in existence for substantially longer periods than Papa John s and can have higher levels of restaurant penetration and a stronger, more developed brand awareness in markets where we have restaurants. Based on independent third-party information, the QSR Pizza category, which includes dine-in, carry-out and delivery, had sales of approximately $33.9 billion in 2007, of which Papa John s share was reported at 5.6%, an increase from 5.4% reported for 2006. Within the QSR Pizza category, we believe our primary competitors are the national pizza chains, including Pizza Hut, Domino s and Little Caesars, as well as several regional chains and take and bake concepts. A change in pricing or other marketing strategies of one or more of our competitors could have an adverse impact on our sales and earnings. Additionally, a continued increased emphasis on drive-through, carryout and curbside pickup availability by casual dining and other restaurants, as well as improved quality of fresh and frozen supermarket offerings, could also have an adverse impact on our sales and earnings.

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

Government Regulation

We, along with our franchisees, are subject to various federal, state and local laws affecting the operation of our respective businesses. Each Papa John s restaurant is subject to licensing and regulation by a number of governmental authorities, which include health, safety, sanitation, building and fire agencies in the state or municipality in which the restaurant is located. Difficulties in obtaining, or the failure to obtain, required licenses or approvals could delay or prevent the opening of a new restaurant in a

12

particular area. Our full-service QC Centers are licensed and subject to regulation by state and local health and fire codes, and the operation of our trucks is subject to Department of Transportation regulations. We are also subject to federal and state environmental regulations.

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

Trademarks

Our rights in our principal trademarks and service marks are a significant part of our business. We are the owner of the federal registration of the trademark Papa John s. We have also registered Pizza Papa John s and design (our logo), Better Ingredients. Better Pizza. and Pizza Papa John Better Ingredients. Better Pizza. and design as trademarks and service marks. We also own federal registrations for several ancillary marks, principally advertising slogans. We have also applied to register our primary trademark, Pizza Papa John s and design, in more than 100 foreign countries and the European Community. We are aware of the use by other persons in certain geographical areas of names and marks that are the same as or similar to our marks. It is our policy to pursue registration of our marks whenever possible and to oppose vigorously any infringement of our marks.

Employees

As of December 30, 2007, we employed approximately 17,800 persons, of whom 15,600 were restaurant team members, 800 were restaurant management personnel, 600 were corporate personnel and 800 were QC Center and support services personnel. Most restaurant team members work part-time and are paid on an hourly basis. None of our team members are covered by a collective bargaining agreement. We consider our team member relations to be excellent.

Item 1A. Risk Factors

This Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended (the Act), including information within Management s Discussion and Analysis of Financial Condition and Results of Operations. The following cautionary statements are being made pursuant to the provisions of the Act and with the intention of obtaining the benefits of the safe harbor provisions of the Act. Although we believe that our expectations are based on reasonable assumptions, actual results may differ materially from those in the forward-looking statements as a result of various factors, including but not limited to, the following:

1. The ability of the Papa John s system to continue to open new restaurants is affected by a number of factors, many of which are beyond our control. These factors include, among other things, the

uncertainties associated with litigation, selection and availability of suitable restaurant locations, increases in the cost of or sustained high levels of cost of food ingredients and other commodities, paper, utilities, fuel, employee compensation and benefits, insurance and similar costs, negotiation of suitable lease or financing terms, constraints on permitting and construction of restaurants, higher than anticipated construction costs, and the hiring, training and retention of management and other personnel. Accordingly, there can be no assurance that, system-wide, Papa John s will be able to meet planned growth targets, open restaurants in markets now targeted for expansion or continue to operate in existing markets profitably.

2. The restaurant industry is intensely competitive with respect to price, service, location and food quality, and there are many well-established competitors with substantially greater financial and other resources than the Papa John s system. Some of these competitors have been in existence for a substantially longer period than Papa John s and may be better established in the markets where restaurants operated by us or our franchisees are, or may be, located. Experience has shown that a change in the pricing or other marketing or promotional strategies, including new product and concept developments, of one or more of our major competitors can have an adverse impact on our sales and earnings and our system-wide restaurant operations.

3. An increase in the cost of or sustained high levels of the cost of cheese or other commodities could adversely affect the profitability of our system-wide restaurant operations. Cheese costs, historically representing 35% to 40% of our food cost, and other commodities are subject to fluctuations, weather, availability, demand and other factors that are beyond our control. Additionally, sustained increases in fuel and utility costs could adversely affect the profitability of our restaurant and QC Center businesses.

4. Changes in consumer taste (for example, changes in dietary preferences that could cause consumers to avoid pizza in favor of foods that are perceived as more healthful), demographic trends, traffic patterns and the type, number and location of competing restaurants could adversely affect our restaurant business.

5. Health- or disease-related disruptions or consumer concerns about commodities supplies or our food products could negatively impact the availability and/or cost of commodities and adversely impact restaurant operations and our financial results.

6. System-wide restaurant operations are subject to federal and state laws governing such matters as wage benefits, working conditions, citizenship requirements and overtime. A significant number of hourly personnel employed by our franchisees and us are paid at rates related to the federal and state minimum wage requirements. Accordingly, further increases in the federal minimum wage or the enactment of additional state or local minimum wage increases above federal wage rates will increase labor costs for our system-wide operations. Additionally, labor shortages in various markets could result in higher required wage rates. Local government agencies have also implemented ordinances, which restrict the sale of certain food products. Additional local government ordinances could be harmful to system-wide restaurant sales.

7. Our growth strategy depends in large part on our ability and the ability of our franchisees to expand or open new restaurants and to operate those restaurants on a profitable basis. Delays or failures in opening new restaurants could materially and adversely affect our planned growth. In recent months, the credit markets have experienced instability, resulting in declining real estate values, credit and liquidity concerns and increased loan default rates. Many lenders have subsequently reduced their willingness to make new loans and have tightened their credit requirements. Our franchisees depend on the availability of financing to expand existing locations or construct and open new restaurants. If

our franchisees experience difficulty in obtaining adequate financing for these purposes, our growth strategy and franchise revenues may be adversely affected.

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

9. Impairment charges for Company-owned operations are possible if PJUK or recently acquired restaurants perform below our expectations. In addition, we remain contingently liable for payment under approximately 74 lease arrangements with a total value of $10.3 million associated with the sold Perfect Pizza operations.

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

11. Domestic franchisees are only required to purchase seasoned sauce and dough from our QC Centers and changes in purchasing practices by domestic franchisees could adversely affect the financial results of our QC Centers.

12. Beginning in October 2004, a third-party commercial insurance company began providing fully-insured coverage to franchisees participating in our franchise insurance program, thus eliminating our risk of loss for franchise insurance coverage written after September 2004. However, with respect to self-insurance coverage by our captive insurance company prior to October 2004, the Captive s relatively immature claims history limits the predictive value of estimating the costs of incurred and future claims; accordingly, our operating income is subject to potential significant adjustments for changes in estimated insurance reserves for policies written from the Captive s inception in October 2000 through September 2004.

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 30, 2007, there were 3,208 Papa John s restaurants system-wide.

Company-owned Papa John s Restaurants

	Number of Restaurants
Arizona	45
Florida	34
Georgia	86
Illinois	9
Indiana	41
Kansas	13
Kentucky	43
Maryland	60
Missouri	37
New Jersey	14
New Mexico	10
North Carolina	76
Ohio	17
Oklahoma	1
Pennsylvania	27
South Carolina	5
Tennessee	27
Texas	79
Virginia	24
Total Domestic Company-owned Papa John s Restaurants	648
China	8
United Kingdom	6
Total Company-owned Papa John s Restaurants	662

Note: Company-owned Papa John s restaurants include restaurants owned by majority-owned joint ventures. There were 128 such restaurants at December 30, 2007 (79 in Texas, one in Oklahoma, 24 in Virginia and 24 in Maryland).

Domestic Franchised Papa John s Restaurants

	Number of Restaurants
Alabama	62
Arizona	29
Arkansas	15
California	199
Colorado	50
Connecticut	3
Delaware	11
Florida	207
Georgia	56
Idaho	10
Illinois	65
Indiana	78
Iowa	23
Kansas	17
Kentucky	54
Louisiana	41
Maine	7
Maryland	30
Massachusetts	23
Michigan	43
Minnesota	50
Mississippi	21
Missouri	30
Montana	9
Nebraska	15
Nevada	20
New Hampshire.	2
New Jersey	33
New Mexico	8
New York	98
North Carolina	55
North Dakota	

By comparison, for the three months ended March 31, 2017, the actual total return of BNO as measured by changes in its per share NAV was (7.64)%. This was based on an initial per share NAV of $15.70 as of December 31, 2016 and an ending per share NAV as of March 31, 2017 of $14.50. During this time period, BNO made no distributions to its shareholders. However, if BNO's daily changes in its per share NAV had instead exactly tracked the changes in the daily total return of the Benchmark Futures Contract, BNO would have had an estimated per share NAV of $14.51 as of March 31, 2017, for a total return over the relevant time period of (7.58)%. The difference between the actual per share NAV total return of BNO of (7.64)% and the expected total return based on the Benchmark Futures Contract of (7.58)% was an error over the time period of (0.06)%, which is to say that BNO's actual total return underperformed the benchmark result by that percentage. BNO incurs expenses primarily composed of the management fee, brokerage commissions for the buying and selling of futures contracts, and other expenses. The impact of these expenses, offset by interest and dividend income, and net of positive or negative execution, tended to cause daily changes in the per share NAV of BNO to track slightly lower than daily changes in the price of the Benchmark Futures Contract.

There are currently three factors that have impacted or are most likely to impact BNO's ability to accurately track Benchmark Futures Contract.

First, BNO may buy or sell its holdings in the then current Benchmark Futures Contract at a price other than the closing settlement price of that contract on the day during which BNO executes the trade. In that case, BNO may pay a price that is higher, or lower, than that of the Benchmark Futures Contract, which could cause the changes in the daily per share NAV of BNO to either be too high or too low relative to the daily changes in the Benchmark Futures Contract. During the three months ended March 31, 2018, USCF attempted to minimize the effect of these transactions by seeking to execute its purchase or sale of the Benchmark Futures Contract at, or as close as possible to, the end of the day settlement price. However, it may not always be possible for BNO to obtain the closing settlement price and there is no assurance that failure to obtain the closing settlement price in the future will not adversely impact BNO's attempt to track the Benchmark Futures Contract over time.

Second, BNO incurs expenses primarily composed of the management fee, brokerage commissions for the buying and selling of futures contracts, and other expenses. The impact of these expenses tends to cause daily changes in the per share NAV of BNO to track slightly lower than daily changes in the price of the Benchmark Futures Contract. At the same time, BNO earns dividend and interest income on its cash, cash equivalents and Treasuries. BNO is not required to distribute any portion of its income to its shareholders and did not make any distributions to shareholders during the three months ended March 31, 2018. Interest payments, and any other income, were retained within the portfolio and added to BNO's NAV. When this income exceeds the level of BNO's expenses for its management fee, brokerage commissions and other expenses (including ongoing registration fees, licensing fees and the fees and expenses of the independent directors of USCF), BNO will realize a net yield that will tend to cause daily changes in the per share NAV of BNO to track slightly higher than daily changes in the Benchmark Futures Contract. If short-term interest rates rise above the current levels, the level of deviation created by the yield would decrease. Conversely, if short-term interest rates were to decline, the amount of error created by the yield would increase. When short-term yields drop to a level lower than the combined expenses of the management fee and the brokerage commissions, then the tracking error becomes a negative number and would tend to cause the daily returns of the per share NAV to underperform the daily returns of the Benchmark Futures Contract. USCF anticipates that interest rates may continue to increase over the near future from historical lows. However, it is anticipated that fees and expenses paid by BNO may continue to be higher than interest earned by BNO. As such, USCF anticipates that BNO will continue to underperform its benchmark until such a time when interest earned at least equals or exceeds the fees and expenses paid by BNO.

Third, BNO may hold Other Crude Oil-Related Investments in its portfolio that may fail to closely track the Benchmark Futures Contract's total return movements. In that case, the error in tracking the Benchmark Futures Contract could result in daily changes in the per share NAV of BNO that are either too high, or too low, relative to the daily changes in the Benchmark Futures Contract. During the three months ended March 31, 2018, BNO did not hold any Other Crude Oil-Related Investments. If BNO increases in size, and due to its obligations to comply with regulatory limits, BNO may invest in Other Crude Oil-Related Investments which may have the effect of increasing transaction related expenses and may result in increased tracking error.

Term Structure of Crude Oil Futures Prices and the Impact on Total Returns. Several factors determine the total return from investing in futures contracts. One factor arises from “rolling” futures contracts that will expire at the end of the current month (the “near” or “front” month contract) forward each month prior to expiration. For a strategy that entails holding the near month contract, the price relationship between that futures contract and the next month futures contract will impact returns. For example, if the price of the near month futures contract is higher than the next futures month contract (a situation referred to as “backwardation”), then absent any other change, the price of a next month futures contract tends to rise in value as it becomes the near month futures contract and approaches expiration. Conversely, if the price of a near month futures contract is lower than the next month futures contract (a situation referred to as “contango”), then absent any other change, the price of a next month futures contract tends to decline in value as it becomes the near month futures contract and approaches expiration.

As an example, assume that the price of Brent crude oil for immediate delivery, is $50 per barrel, and the value of a position in the near month futures contract is also $50. Over time, the price of Brent crude oil will fluctuate based on a number of market factors, including demand for oil relative to supply. The value of the near month futures contract will likewise fluctuate in reaction to a number of market factors. If an investor seeks to maintain a position in a near month futures contract and not take delivery of physical barrels of Brent crude oil, the investor must sell the current near month futures contract as it approaches expiration and invest in the next month futures contract. In order to continue holding a position in the current near month futures contract, this “roll” forward of the futures contract must be executed every month.

Contango and backwardation are natural market forces that have impacted the total return on an investment in BNO’s shares during the past year relative to a hypothetical direct investment in Brent crude oil. In the future, it is likely that the relationship between the market price of BNO’s shares and changes in the spot prices of Brent crude oil will continue to be impacted by contango and backwardation. It is important to note that this comparison ignores the potential costs associated with physically owning and storing Brent crude oil, which could be substantial.

If the futures market is in backwardation, e.g., when the price of the near month futures contract is higher than the price of the next month futures contract, the investor would buy a next month futures contract for a lower price than the current near month futures contract. Assuming the price of the next month futures contract was $49 per barrel, or 2% cheaper than the $50 near month futures contract, then, hypothetically, and assuming no other changes (e.g., to either prevailing Brent crude oil prices or the price relationship between the spot price, the near month contract and the next month contract, and, ignoring the impact of commission costs and the income earned on cash and/or cash equivalents), the value of the $49 next month futures contract would rise to $50 as it approaches expiration. In this example, the value of an investment in the next month futures contract would tend to outperform the spot price of Brent crude oil. As a result, it would be possible for the new near month futures contract to rise 12% while the spot price of Brent crude oil may have risen a lower amount, e.g., only 10%. Similarly, the spot price of Brent crude oil could have fallen 10% while the value of an investment in the futures contract might have fallen another amount, e.g., only 8%. Over time, if backwardation remained constant, this difference between the spot price and the futures contract price would continue to increase.

If the futures market is in contango, an investor would be buying a next month futures contract for a higher price than the current near month futures contract. Again, assuming the near month futures contract is $50 per barrel, the price of the next month futures contract might be $51 per barrel, or 2% more expensive than the front month futures contract. Hypothetically, and assuming no other changes, the value of the $51 next month futures contract would fall to $50 as it approaches expiration. In this example, the value of an investment in the second month would tend to underperform the spot price of Brent crude oil. As a result, it would be possible for the new near month futures contract to rise only 10% while the spot price of Brent crude oil may have risen a higher amount, e.g., 12%. Similarly, the spot price of Brent crude oil could have fallen 10% while the value of an investment in the second month futures contract might have fallen another amount, e.g., 12%. Over time, if contango remained constant, this difference between the spot price and the futures contract price would continue to increase.

The chart below compares the daily price of the near month Brent crude oil futures contract to the price of 13th month Brent crude oil futures contract (i.e., a contract one year forward) over the last 10 years. When the price of the near month futures contract is higher than the price of the 13th month futures contract, the market would be described as being in backwardation. When the price of the near month futures contract is lower than the 13th month futures contract, the market would be described as being in contango. Although the price of the near month futures contract and the price of the 13th month futures contract tend to move together, it can be seen that at times the near month futures contract prices are higher than the 13th month futures contract prices (backwardation) and, at other times, the near month futures contract prices are lower than the 13th month futures contract prices (contango).

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

An alternative way to view the same data is to subtract the dollar price of the 13th month Brent crude oil futures contract from the dollar price of the near month Brent crude oil futures contract, as shown in the chart below. When the difference is positive, the market is in backwardation. When the difference is negative, the market is in contango. The Brent crude oil market spent time in both backwardation and contango during the last ten years. The chart below shows the results from subtracting the average dollar price of the near 12-month contracts from the near month price for the 10-year period between March 31, 2008 and March 31, 2018. Investors will note that the Brent crude oil market spent time in both backwardation and contango.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Historically, the crude oil futures markets have experienced periods of contango and backwardation, with backwardation being in place roughly as often as contango since oil futures trading started in 1982. Following the global financial crisis in the fourth quarter of 2008, the crude oil market moved into contango and remained in contango for a period of several years. U.S. benchmarked WTI crude oil experienced a period of backwardation from late-2013 to mid-2014, while Brent crude oil moved into a state of backwardation from 2011 until mid-2014. However, global crude oil inventories grew rapidly after the Organization of the Petroleum Exporting Countries ("OPEC") decided to defend its market share against U.S. shale-oil producers in late-2014. Record surpluses in global inventories resulted in another period of contango that has persisted through December 31, 2017. However, with lower inventories Brent crude oil has shifted into backwardation for 2018.

Periods of contango or backwardation do not materially impact BNO's investment objective of having the daily percentage changes in its per share NAV track the daily percentage changes in the price of the Benchmark Futures Contract since the impact of backwardation and contango tend to equally impact the daily percentage changes in price of both BNO's shares and the Benchmark Futures Contract. It is impossible to predict with any degree of certainty whether backwardation or contango will occur in the future. It is likely that both conditions will occur during different periods.

Brent Crude Oil Market. During the three months ended March 31, 2018, Brent crude oil prices have traded in a range between \$62 to \$71. Crude charged into the new year, completing a 56% uptrend from September to January as global inventories fell dramatically. Continued OPEC restraint clashed with ongoing non-OPEC production growth. Equity volatility, global tensions, and a dynamic news cycle also led to choppy markets. Brent crude ended the quarter at \$70.27, up 5.1% for the quarter. Looking ahead, expected demand growth appears strong while OPEC has proved its commitment to restoring a balanced market. Should global demand growth forecasts fail to be realized, or if OPEC is unable to counter growing U.S. production, there is a meaningful possibility that crude prices could fall again. On the other hand, increasing global tensions and the possibility of any number of conflicts escalating could lead to price shocks to the upside.

Brent Crude Oil Price Movements in Comparison to Other Energy Commodities and Investment Categories. USCF believes that investors frequently measure the degree to which prices or total returns of one investment or asset class move up or down in value in concert with another investment or asset class. Statistically, such a measure is usually done by measuring the correlation of the price movements of the two different investments or asset classes over some period of time. The correlation is scaled between 1 and -1, where 1 indicates that the two investment options move up or down in price or value together, known as "positive correlation," and -1 indicates that they move in completely opposite directions, known as "negative correlation." A correlation of 0 would mean that the movements of the two are neither positively nor negatively correlated, known as "non-correlation." That is, the investment options sometimes move up and down together and other times move in opposite directions.

For the ten-year time period between March 31, 2008 and March 31, 2018, the table below compares the monthly movements of Brent crude oil prices versus the monthly movements of the prices of several other energy commodities, such as natural gas, diesel-heating oil, and unleaded gasoline, as well as several major non-commodity investment asset classes, such as large cap U.S. equities, U.S. government bonds and global equities. It can be seen that over this particular time period, the movement of Brent crude oil on a monthly basis was somewhat correlated with the movements of large cap U.S. equities and global equities. However, movements in Brent crude oil were strongly correlated with movements in U.S. West Texas Intermediate (WTI) crude oil and unleaded gasoline. Movements in Brent crude oil futures exhibited a somewhat inverse correlation with U.S. government bonds and limited to little correlation with diesel-heating oil.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Correlation Matrix March 31, 2008 – March 31, 2018*	Large Cap U.S. Equities (S&P 500)	U.S. Gov't. Bonds (EFFAS U.S. Gov't. Bond Index)	Global Equities (FTSE World Index)	Crude Oil	Unleaded Gasoline	Diesel-Heating Oil	Brent Oil
Large Cap U.S. Equities (S&P 500)	1.000	(0.259)	0.968	0.485	0.460	0.459	0.478
U.S. Gov't. Bonds (EFFAS U.S. Gov't. Bond Index)		1.000	(0.231)	(0.393)	(0.347)	(0.337)	(0.375)
Global Equities (FTSE World Index)			1.000	0.526	0.493	0.490	0.528
Crude Oil (WTI)				1.000	0.697	0.804	0.930
Unleaded Gasoline					1.000	0.727	0.757
Diesel-Heating Oil						1.000	0.214
Brent Oil							1.000

Source: Bloomberg, NYMEX

26

The table below covers a more recent, but much shorter, range of dates than the above table. It can be seen that over the one-year period ended March 31, 2018, movement of Brent crude oil was somewhat correlated with the movements of large cap U.S. equities and global equities. However, movements in Brent crude oil were strongly correlated with movements in U.S. West Texas Intermediate (WTI) crude oil. Movements in Brent crude oil futures exhibited a somewhat inverse correlation with U.S. government bonds and diesel-heating oil and little to no correlation with unleaded gasoline.

***PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS**

Correlation Matrix 12 Months ended March 31, 2018*	Large Cap U.S. Equities (S&P 500)	U.S. Gov't. Bonds (EFFAS U.S. Gov't. Bond Index)	Global Equities (FTSE World Index)	Crude Oil	Unleaded Gasoline	Diesel-Heating Oil	Brent Oil
Large Cap U.S. Equities (S&P 500)	1.000	(0.327)	0.970	0.679	0.081	0.360	0.558
U.S. Gov't. Bonds (EFFAS U.S. Gov't. Bond Index)		1.000	(0.199)	(0.464)	0.496	0.253	(0.248)
Global Equities (FTSE World Index)			1.000	0.624	0.143	0.411	0.523
Crude Oil (WTI)				1.000	(0.220)	0.572	0.936
Unleaded Gasoline					1.000	0.430	(0.074)
Diesel-Heating Oil						1.000	(0.256)
Brent Oil							1.000

Source: Bloomberg, NYMEX

Investors are cautioned that the historical price relationships between Brent crude oil and various other energy commodities, as well as other investment asset classes, as measured by correlation may not be reliable predictors of future price movements and correlation results. The results pictured above would have been different if a different range of dates had been selected. USCF believes that Brent crude oil has historically not demonstrated a strong correlation with equities or bonds over long periods of time. However, USCF also believes that in the future it is possible that Brent crude oil could have long-term correlation results that indicate prices of Brent crude oil more closely track the movements of equities or bonds. In addition, USCF believes that, when measured over time periods shorter than ten years, there will always be some periods where the correlation of Brent crude oil to equities and bonds will be either more strongly positively correlated or more strongly negatively correlated than the long-term historical results suggest.

The correlations between Brent crude oil, WTI Crude Oil, diesel-heating oil and gasoline are relevant because USCF endeavors to invest BNO's assets in Futures Contracts and Other Crude Oil-Related Investments so that daily changes in percentage terms in BNO's per share NAV correlate as closely as possible with daily changes in percentage terms in the price of the Benchmark Futures Contract. If certain other fuel-based commodity futures contracts do not closely correlate with the Benchmark Futures Contract, then their use could lead to greater tracking error. As noted above, USCF also believes that the changes in percentage terms in the price of the Benchmark Futures Contract will closely correlate with changes in percentage terms in the spot price of Brent crude oil.

Critical Accounting Policies

Preparation of the condensed financial statements and related disclosures in compliance with accounting principles generally accepted in the United States of America requires the application of appropriate accounting rules and guidance, as well as the use of estimates. BNO's application of these policies involves judgments and actual results may differ from the estimates used.

USCF has evaluated the nature and types of estimates that it makes in preparing BNO's condensed financial statements and related disclosures and has determined that the valuation of its investments, which are not traded on a United States or internationally recognized futures exchange (such as forward contracts and OTC swaps) involves a critical accounting policy. The values which are used by BNO for its Futures Contracts are provided by its commodity broker who uses market prices when available, while OTC swaps are valued based on the present value of estimated future cash flows that would be received from or paid to a third party in settlement of these derivative contracts prior to their delivery date and valued on a daily basis. In addition, BNO estimates interest and dividend income on a daily basis using prevailing rates earned on its cash and cash equivalents. These estimates are adjusted to the actual amount received on a monthly basis and the difference, if any, is not considered material.

Liquidity and Capital Resources

BNO has not made, and does not anticipate making, use of borrowings or other lines of credit to meet its obligations. BNO has met, and it is anticipated that BNO will continue to meet, its liquidity needs in the normal course of business from the proceeds of the sale of its investments, or from the Treasuries, cash and/or cash equivalents that it intends to hold at all times. BNO's liquidity needs include: redeeming shares, providing margin deposits for its existing Futures Contracts or the purchase of additional Futures Contracts and posting collateral for its OTC swaps, if applicable, and payment of its expenses, summarized below under *"Contractual Obligations."*

BNO currently generates cash primarily from: (i) the sale of baskets consisting of 50,000 shares ("Creation Baskets") and (ii) income earned on Treasuries, cash and/or cash equivalents. BNO has allocated substantially all of its net assets to trading in Crude Oil Interests. BNO invests in Crude Oil Interests to the fullest extent possible without being leveraged or unable to satisfy its current or potential margin or collateral obligations with respect to its investments in Futures Contracts and Other Crude Oil-Related Investments. A significant portion of BNO's NAV is held in cash and cash equivalents that are used as margin and as collateral for its trading in Crude Oil Interests. The balance of the assets is held in BNO's account at its custodian bank and in Treasuries at the FCM. Income received from BNO's investments in money market funds and Treasuries is paid to BNO. During the three months ended March 31, 2018, BNO's expenses did not exceed the income BNO earned and the cash earned from the sale of Creation Baskets and the redemption of Redemption Baskets.

BNO's investments in Crude Oil Interests may be subject to periods of illiquidity because of market conditions, regulatory considerations and other reasons. For example, most commodity exchanges limit the fluctuations in futures contracts prices during a single day by regulations referred to as “daily limits.” During a single day, no trades may be executed at prices beyond the daily limit. Once the price of a futures contract has increased or decreased by an amount equal to the daily limit, positions in the contracts can neither be taken nor liquidated unless the traders are willing to effect trades at or within the specified daily limit. Such market conditions could prevent BNO from promptly liquidating its positions in Futures Contracts. During the three months ended March 31, 2018, BNO did not purchase or liquidate any of its positions while daily limits were in effect; however, BNO cannot predict whether such an event may occur in the future.

Since the initial offering of shares, BNO has been responsible for expenses relating to: (i) management fees, (ii) brokerage fees and commissions, (iii) licensing fees for the use of intellectual property, (iv) ongoing registration expenses in connection with offers and sales of its shares subsequent to the initial offering, (v) other expenses, including tax reporting costs, (vi) fees and expenses of the independent directors of USCF and (vii) other extraordinary expenses not in the ordinary course of business, while USCF has been responsible for expenses relating to the fees of BNO's Marketing Agent, Administrator and Custodian and registration expenses relating to the initial offering of shares. If USCF and BNO are unsuccessful in raising sufficient funds to cover these respective expenses or in locating any other source of funding, BNO will terminate and investors may lose all or part of their investment.

Market Risk

Trading in Futures Contracts and Other Crude Oil-Related Investments, such as forwards, involves BNO entering into contractual commitments to purchase or sell crude oil at a specified date in the future. The aggregate market value of the contracts will significantly exceed BNO's future cash requirements since BNO intends to close out its open positions prior to settlement. As a result, BNO is generally only subject to the risk of loss arising from the change in value of the contracts. BNO considers the “fair value” of its derivative instruments to be the unrealized gain or loss on the contracts. The market risk associated with BNO's commitments to purchase crude oil is limited to the aggregate market value of the contracts held. However, should BNO enter into a contractual commitment to sell crude oil, it would be required to make delivery of the crude oil at the contract price, repurchase the contract at prevailing prices or settle in cash. Since there are no limits on the future price of crude oil, the market risk to BNO could be unlimited.

BNO's exposure to market risk depends on a number of factors, including the markets for crude oil, the volatility of interest rates and foreign exchange rates, the liquidity of the Futures Contracts and Other Crude Oil-Related Investments markets and the relationships among the contracts held by BNO. Drastic market occurrences could ultimately lead to the loss of all or substantially all of an investor’s capital.

Credit Risk

When BNO enters into Futures Contracts and Other Crude Oil-Related Investments, it is exposed to the credit risk that the counterparty will not be able to meet its obligations. The counterparty for the Futures Contracts traded on the ICE Futures and on most other futures exchanges is the clearinghouse associated with the particular exchange. In general, in addition to margin required to be posted by the clearinghouse in connection with cleared trades, clearinghouses are backed by their members who may be required to share in the financial burden resulting from the nonperformance of one of their members and, therefore, this additional member support should significantly reduce credit risk. BNO is not currently a member of any clearinghouse. Some foreign exchanges are not backed by their clearinghouse members but may be backed by a consortium of banks or other financial institutions. There can be no assurance that any counterparty, clearinghouse, or their members or their financial backers will satisfy their obligations to BNO in such circumstances.

USCF attempts to manage the credit risk of BNO by following various trading limitations and policies. In particular, BNO generally posts margin and/or holds liquid assets that are approximately equal to the market value of its obligations to counterparties under the Futures Contracts and Other Crude Oil-Related Investments it holds. USCF has implemented procedures that include, but are not limited to, executing and clearing trades only with creditworthy parties and/or requiring the posting of collateral or margin by such parties for the benefit of BNO to limit its credit exposure. An FCM, when acting on behalf of BNO in accepting orders to purchase or sell Futures Contracts on United States exchanges, is required by CFTC regulations to separately account for and segregate as belonging to BNO, all assets of BNO relating to domestic Futures Contracts trading. These FCMs are not allowed to commingle BNO's assets with their other assets. In addition, the CFTC requires commodity brokers to hold in a secure account BNO's assets related to foreign Futures Contracts trading. During the three months ended March 31, 2018, the only foreign exchange on which BNO made investments was the ICE Futures, which is a London based futures exchange,. Those crude oil contracts are denominated in U.S. dollars.

In the future, BNO may purchase OTC swaps, see *"Item 3. Quantitative and Qualitative Disclosures About Market Risk"* in this quarterly report on Form 10-Q for a discussion of OTC swaps.

As of March 31, 2018, BNO held cash deposits and investments in Treasuries and money market funds in the amount of $89,188,555 with the custodian and FCM. Some or all of these amounts held by a custodian or an FCM, as applicable, may be subject to loss should BNO's custodian or FCM, as applicable, cease operations.

29

Off Balance Sheet Financing

As of March 31, 2018, BNO had no loan guarantee, credit support or other off-balance sheet arrangements of any kind other than agreements entered into in the normal course of business, which may include indemnification provisions relating to certain risks that service providers undertake in performing services which are in the best interests of BNO. While BNO's exposure under these indemnification provisions cannot be estimated, they are not expected to have a material impact on BNO's financial position.

European Sovereign Debt

BNO had no direct exposure to European sovereign debt as of March 31, 2018 and has no direct exposure to European sovereign debt as of the filing of this quarterly report on Form 10-Q.

Redemption Basket Obligation

In order to meet its investment objective and pay its contractual obligations described below, BNO requires liquidity to redeem shares, which redemptions must be in blocks of 50,000 shares called “Redemption Baskets.” BNO has to date satisfied this obligation by paying from the cash or cash equivalents it holds or through the sale of its Treasuries in an amount proportionate to the number of shares being redeemed.

Contractual Obligations

BNO's primary contractual obligations are with USCF. In return for its services, USCF is entitled to a management fee calculated daily and paid monthly as a fixed percentage of BNO's NAV, currently 0.75% of NAV on its average daily total net assets.

USCF agreed to pay the start-up costs associated with the formation of BNO, primarily its legal, accounting and other costs in connection with USCF’s registration with the CFTC as a CPO and the registration and listing of BNO and its shares with the SEC, FINRA and NYSE Arca (formerly, AMEX), respectively. However, since BNO’s initial offering of shares, offering costs incurred in connection with registering and listing additional shares of BNO have been directly borne on an ongoing basis by BNO, and not by USCF.

USCF pays the fees of the Marketing Agent and the fees of BBH&Co., as well as BBH&Co.’s fees for performing administrative services, including those in connection with the preparation of BNO's condensed financial statements and its SEC, NFA and CFTC reports. BNO pays the fees and expenses associated with its tax accounting and reporting requirements. USCF has paid certain expenses normally borne by BNO on a discretionary basis where such expenses exceeded 0.15% (15 basis points) of BNO’s NAV, on an annualized basis. USCF has no obligation to continue such payments into subsequent periods. This voluntary expense waiver is in addition to those amounts USCF is contractually obligated to pay as described in *Note 4* to the *Notes to Condensed Financial Statements (Unaudited)* in *Item 1* of this quarterly report on Form 10-Q.

In addition to USCF’s management fee, BNO pays its brokerage fees (including fees to an FCM), OTC dealer spreads, any licensing fees for the use of intellectual property, and, subsequent to the initial offering, registration and other fees paid to the SEC, FINRA, or other regulatory agencies in connection with the offer and sale of shares, as well as legal, printing, accounting and other expenses associated therewith, and extraordinary expenses. The latter are expenses not incurred in the ordinary course of BNO’s business, including expenses relating to the indemnification of any person against liabilities and obligations to the extent permitted by law and under the LP Agreement, the bringing or defending of actions in law or in equity or otherwise conducting litigation and incurring legal expenses and the settlement of claims and litigation. Commission payments to an FCM are on a contract-by-contract, or round turn, basis. BNO also pays a portion of the fees and expenses of the independent directors of USCF. See *Note 3* to the *Notes to Condensed Financial Statements (Unaudited)* in *Item 1* of this quarterly report on Form 10-Q.

The parties cannot anticipate the amount of payments that will be required under these arrangements for future periods, as BNO's per share NAVs and trading levels to meet its investment objective will not be known until a future date. These agreements are effective for a specific term agreed upon by the parties with an option to renew, or, in some cases, are in effect for the duration of BNO's existence. Either party may terminate these agreements earlier for certain reasons described in the agreements.

As of March 31, 2018, BNO's portfolio consisted of 1,324 Brent Crude Oil Futures CO Contracts traded on the ICE Futures. As of March 31, 2018, BNO did not hold any Futures Contracts traded on the NYMEX. For a list of BNO's current holdings, please see BNO's website at www.uscfinvestments.com.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Commodity Price Risk.

BNO is exposed to commodity price risk. In particular, BNO is exposed to Brent crude oil price risk through its holdings of Futures Contracts together with any other derivatives in which it may invest, which are discussed below. As a result, fluctuations in the value of the Futures Contracts that BNO holds in its portfolio, as described in *"Contractual Obligations"* under *"Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations"* above, are expected to directly affect the value of BNO's shares.

OTC Contract Risk

BNO may purchase OTC Brent Oil Interests, such as forward contracts or swap or spot contracts. Unlike most exchange-traded futures contracts or exchange-traded options on such futures, each party to an OTC swap bears the credit risk that the other party may not be able to perform its obligations under its contract.

BNO may enter into certain transactions where an OTC component is exchanged for a corresponding futures contract ("Exchange for Related Position" or "EFRP" transactions). In the most common type of EFRP transaction entered into by BNO, the OTC component is the purchase or sale of one or more baskets of BNO shares. These EFRP transactions may expose BNO to counterparty risk during the interim period between the execution of the OTC component and the exchange for a corresponding futures contract. Generally, the counterparty risk from the EFRP transaction will exist only on the day of execution.

Swap transactions, like other financial transactions, involve a variety of significant risks. The specific risks presented by a particular swap transaction necessarily depend upon the terms and circumstances of the transaction. In general, however, all swap transactions involve some combination of market risk, credit risk, counterparty credit risk, funding risk, liquidity risk and operational risk.

Highly customized swap transactions in particular may increase liquidity risk, which may result in a suspension of redemptions. Highly leveraged transactions may experience substantial gains or losses in value as a result of relatively small changes in the value or level of an underlying or related market factor.

In evaluating the risks and contractual obligations associated with a particular swap transaction, it is important to consider that a swap transaction may be modified or terminated only by mutual consent of the original parties and subject to agreement on individually negotiated terms. Therefore, it may not be possible for USCF to modify, terminate or offset BNO's obligations or its exposure to the risks associated with a transaction prior to its scheduled termination date.

To reduce the credit risk that arises in connection with such contracts, BNO will generally enter into an agreement with each counterparty based on the Master Agreement published by the International Swaps and Derivatives Association that provides for the netting of its overall exposure to its counterparty, if the counterparty is unable to meet its obligations to BNO due to the occurrence of a specified event, such as the insolvency of the counterparty.

USCF assesses or reviews, as appropriate, the creditworthiness of each potential or existing counterparty to an OTC swap pursuant to guidelines approved by USCF’s board of directors (the "Board"). Furthermore, USCF on behalf of BNO only enters into OTC swaps with counterparties who are, or are affiliates of, (a) banks regulated by a United States federal bank regulator, (b) broker-dealers regulated by the SEC, (c) insurance companies domiciled in the United States, or (d) producers, users or traders of energy, whether or not regulated by the CFTC. Any entity acting as a counterparty shall be regulated in either the United States or the United Kingdom unless otherwise approved by the Board after consultation with its legal counsel. Existing counterparties are also reviewed periodically by USCF. BNO will also require that the counterparty be highly rated and/or provide collateral or other credit support. Even if collateral is used to reduce counterparty credit risk, sudden changes in the value of OTC transactions may leave a party open to financial risk due to a counterparty default since the collateral held may not cover a party’s exposure on the transaction in such situations.

In general, valuing OTC derivatives is less certain than valuing actively traded financial instruments such as exchange-traded futures contracts and securities or cleared swaps because the price and terms on which such OTC derivatives are entered into or can be terminated are individually negotiated, and those prices and terms may not reflect the best price or terms available from other sources. In addition, while market makers and dealers generally quote indicative prices or terms for entering into or terminating OTC swaps, they typically are not contractually obligated to do so, particularly if they are not a party to the transaction. As a result, it may be difficult to obtain an independent value for an outstanding OTC derivatives transaction.

During the three month reporting period ended March 31, 2018, BNO limited its OTC activities to EFRP transactions.

BNO anticipates that the use of Other Crude Oil-Related Investments together with its investments in Futures Contracts will produce price and total return results that closely track the investment goals of BNO. However, there can be no assurance of this. OTC swaps may result in higher transaction-related expenses than the brokerage commissions paid in connection with the purchase of Futures Contracts, which may impact BNO's ability to successfully track the Benchmark Futures Contract.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

BNO maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in BNO’s periodic reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the SEC’s rules and forms.

The duly appointed officers of USCF, including its chief executive officer and chief financial officer, who perform functions equivalent to those of a principal executive officer and principal financial officer of BNO if BNO had any officers, have evaluated the effectiveness of BNO’s disclosure controls and procedures and have concluded that the disclosure controls and procedures of BNO have been effective as of the end of the period covered by this quarterly report on Form 10-Q.

Change in Internal Control Over Financial Reporting

There were no changes in BNO’s internal control over financial reporting during BNO’s last fiscal quarter that have materially affected, or are reasonably likely to materially affect, BNO’s internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

Not applicable.

Item 1A. Risk Factors.

There have been no material changes to the risk factors previously disclosed in BNO's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed on March 14, 2018.

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

(a) None.

(b) Not applicable.

(c) BNO does not purchase shares directly from its shareholders. In connection with its redemption of baskets held by Authorized Participants, BNO redeemed 12 baskets (comprising 600,000 shares) during the first quarter of the year ending December 31, 2018. The following table summarizes the redemptions by Authorized Participants during the three months ended March 31, 2018:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Redeemed	Average Price Per Share
1/1/18 to 1/31/18	150,000	$ 18.73
2/1/18 to 2/28/18	—	NA
3/1/18 to 3/31/18	450,000	$ 18.17
Total	600,000	

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Monthly Account Statements

Pursuant to the requirement under Rule 4.22 under the Commodity Exchange Act, each month BNO publishes an account statement for its shareholders, which includes a Statement of Income (Loss) and a Statement of Changes in Net Asset Value. The account statement is furnished to the SEC on a current report on Form 8-K pursuant to Section 13 or 15(d) of the Exchange Act and posted each month on BNO's website at www.uscfinvestments.com.

Item 6. Exhibits.

Listed below are the exhibits, which are filed as part of this quarterly report on Form 10-Q (according to the number assigned to them in Item 601 of Regulation S-K):

Exhibit Number	Description of Document
31.1(1)	Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2(1)	

	Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1(1)	Certification by Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2(1)	Certification by Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.

(1) Filed herewith.

SIGNATURES

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

United States Brent Oil Fund, LP (Registrant)

By: United States Commodity Funds LLC, its general partner

By: /s/ John P. Love
John P. Love
President and Chief Executive Officer
(Principal executive officer)

Date: May 10, 2018

By: /s/ Stuart P. Crumbaugh
Stuart P. Crumbaugh
Chief Financial Officer
(Principal financial and accounting officer)

Date: May 10, 2018