LUBYS INC
Form 10-Q
March 20, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended February 11, 2009

or

¨ **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 001-08308

Luby s, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**74-1335253**
(State or other jurisdiction of	***(IRS Employer***
incorporation or organization)	***Identification Number)***

13111 Northwest Freeway, Suite 600

Houston, Texas 77040

(Address of principal executive offices) (Zip Code)

(713) 329-6800

(Registrant s telephone number, including area code)

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

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

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

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

As of March 10, 2009, there were 27,972,162 shares of the registrant s common stock outstanding.

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Luby s, Inc.

Form 10-Q

Quarter ended February 11, 2009

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We file reports with the Securities and Exchange Commission, including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The public may read and copy any materials we file with the SEC at its Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We are an electronic filer, and the SEC maintains an Internet site at *http://www.sec.gov* that contains the reports, proxy and information statements, and other information that we file electronically. Our website address is *http://www.lubys.com*. Please note that our website address is provided as an inactive textual reference only. We make available free of charge through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. The information provided on our website is not part of this report, and is therefore not incorporated by reference unless such information is specifically referenced elsewhere in this report.

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Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Luby s, Inc.

Consolidated Balance Sheets

(In thousands, except share data)

	February 11, 2009 *(Unaudited)*	August 27, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,361	$ 4,566
Trade accounts and other receivables, net	4,139	3,368
Food and supply inventories	3,076	3,048
Prepaid expenses	1,663	1,627
Deferred income taxes	1,892	1,580
Total current assets	13,131	14,189
Property and equipment, net	196,088	198,118
Long-term investments	7,895	8,525
Property held for sale	6,101	5,282
Other assets	361	407
Total assets	$ 223,576	$ 226,521
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 11,305	$ 14,268
Accrued expenses and other liabilities	14,479	17,712
Total current liabilities	25,784	31,980
Credit facility debt	6,000	
Deferred rent	2,898	2,985
Other liabilities	2,264	3,607
Total liabilities	36,946	38,572
Commitments and Contingencies		
SHAREHOLDERS EQUITY		
Common stock, $0.32 par value; 100,000,000 shares authorized; Shares issued were 28,472,162 and 28,439,214, respectively; Shares outstanding were 27,972,162 and 27,939,214, respectively	9,111	9,101
Paid-in capital	21,122	20,405
Retained earnings	161,172	163,218
Less cost of treasury stock, 500,000 shares	(4,775)	(4,775)
Total shareholders equity	186,630	187,949
Total liabilities and shareholders equity	$ 223,576	$ 226,521

The accompanying notes are an integral part of these consolidated financial statements.

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Luby s, Inc.

Consolidated Statements of Operations (unaudited)

(In thousands except per share data)

	Quarter Ended		Two Quarters Ended	
	February 11, 2009 *(12 weeks)*	February 13, 2008 *(12 weeks)*	February 11, 2009 *(24 weeks)*	February 13, 2008 *(24 weeks)*
SALES:				
Restaurant sales	$ 67,669	$ 70,972	$ 133,614	$ 142,606
Culinary contract services	3,031	1,668	6,033	3,396
TOTAL SALES	70,700	72,640	139,647	146,002
COSTS AND EXPENSES:				
Cost of food	18,884	19,938	37,129	39,595
Payroll and related costs	23,956	24,495	48,598	48,934
Other operating expenses	14,299	15,590	30,822	31,333
Opening costs	340	22	494	22
Cost of culinary contract services	2,681	1,500	5,341	3,078
Depreciation and amortization	4,339	4,014	8,704	7,970
General and administrative expenses	5,638	6,888	11,748	12,856
Provision for asset impairments, net	233		233	717
Net (gain) loss on disposition of property and equipment	65	(222)	(145)	94
Total costs and expenses	70,435	72,225	142,924	144,599
INCOME (LOSS) FROM OPERATIONS	265	415	(3,277)	1,403
Interest income	40	375	159	673
Interest expense	(56)	(49)	(142)	(100)
Impairment charge for decrease in fair value of investments	(130)		(130)	
Interest income (reversal) related to income taxes		(578)		1,319
Other income, net	231	229	491	411
Income (loss) before income taxes and discontinued operations	350	392	(2,899)	3,706
Provision (benefit) for income taxes	154	85	(952)	(1,409)
Income (loss) from continuing operations	196	307	(1,947)	5,115
Loss from discontinued operations, net of income taxes	(50)	(21)	(99)	(58)
NET INCOME (LOSS)	$ 146	$ 286	$ (2,046)	$ 5,057
Income (loss) per share from continuing operations:				
Basic	$ 0.01	$ 0.01	$ (0.07)	$ 0.18
Assuming dilution	0.01	0.01	(0.07)	0.18
Loss per share from discontinued operations:				
Basic	$	$	$	$
Assuming dilution				
Net income (loss) per share:				
Basic	$ 0.01	$ 0.01	$ (0.07)	$ 0.18

Assuming dilution	0.01	0.01	(0.07)	0.18
Weighted average shares outstanding:				
Basic	27,965	28,408	27,955	27,645
Assuming dilution	28,077	28,518	27,955	28,057

The accompanying notes are an integral part of these consolidated financial statements.

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Luby s, Inc.

Consolidated Statement of Shareholders Equity (unaudited)

(In thousands)

	Common Stock						
	Issued		Treasury				Total
	Shares	Amount	Shares	Amount	Paid-In Capital	Retained Earnings	Shareholders Equity
BALANCE AT AUGUST 27, 2008	28,439	$ 9,101	(500)	$ (4,775)	$ 20,405	$ 163,218	$ 187,949
Net loss						(2,046)	(2,046)
Common stock issued under nonemployee director benefit plans	19	6			126		132
Share-based compensation expense	14	4			591		595
BALANCE AT FEBRUARY 11, 2009	28,472	$ 9,111	(500)	$ (4,775)	$ 21,122	$ 161,172	$ 186,630

The accompanying notes are an integral part of these consolidated financial statements.

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Luby s, Inc.

Consolidated Statements of Cash Flows (unaudited)

(In thousands)

	Two Quarters Ended February 11, 2009 *(24 weeks)*	Two Quarters Ended February 13, 2008 *(24 weeks)*
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (2,046)	$ 5,057
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for asset impairments, net of gains and losses on property sales	88	811
Depreciation and amortization	8,704	7,970
Impairment charge for decrease in fair value of investments	130	
Amortization of debt issuance cost	40	21
Non-cash compensation expense	132	113
Share-based compensation expense	595	559
Interest related to income taxes		(1,319)
Deferred tax provision	(1,267)	(931)
Cash provided by operating activities before changes in operating assets and liabilities	6,376	12,281
Changes in operating assets and liabilities:		
Increase in trade accounts and other receivables, net	(771)	(978)
Increase in food and supply inventories	(28)	(302)
(Increase) decrease in prepaid expenses and other assets	(29)	127
Decrease in accounts payable, accrued expenses and other liabilities	(6,595)	(302)
Net cash provided by (used in) operating activities	(1,047)	10,826
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from redemption or maturity of short-term investments		16,600
Purchases of short-term investments		(25,650)
Proceeds from redemption or maturity of long-term investments	500	
Proceeds from disposal of assets and property held for sale	1,117	2,300
Purchases of property and equipment	(8,775)	(14,799)
Net cash used in investing activities	(7,158)	(21,549)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Credit facility borrowings	11,000	
Credit facility repayments	(5,000)	
Proceeds received on the exercise of stock options		11,205
Net cash provided by financing activities	6,000	11,205
Net increase (decrease) in cash and cash equivalents	(2,205)	482
Cash and cash equivalents at beginning of period	4,566	17,514
Cash and cash equivalents at end of period	$ 2,361	$ 17,996
Cash paid for:		
Income taxes	$	$ 302

Interest	102	56

The accompanying notes are an integral part of these consolidated financial statements.

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Luby s, Inc.

Notes to Consolidated Financial Statements (unaudited)

February 11, 2009

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Luby s, Inc. (the Company or Luby s) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are prepared for the Company s Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the period ended February 11, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending August 26, 2009.

The balance sheet dated August 27, 2008, included in this Form 10-Q, has been derived from the audited financial statements at that date. However, this Form 10-Q does not include all of the information and footnotes required by GAAP for an annual filing of complete financial statements. Therefore, these financial statements should be read in conjunction with the consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the fiscal year ended August 27, 2008.

Certain accounts and prior period results have been reclassified to provide more meaningful comparability to the Company s current presentation.

Note 2. Hurricane Ike

Hurricane Ike struck southeast Texas in September 2008 causing massive power outages and inflicting wide-spread damage in the greater Houston area. Over 40 Luby s locations in the Houston area were closed over varying lengths of time due to the storm. Restaurant sales were negatively impacted by approximately 273 days in the aggregate when some locations were unable to open due to storm damage or loss of power. The Company estimates approximately $1.5 million in lost sales from these store closures partially offset by post hurricane sales. During the two quarters ended February 11, 2009, the Company incurred direct costs of $1.3 million for damages, auxiliary power, food loss and other miscellaneous costs. The Company continues to seek to recover a portion of lost profits, property damages, and some expenses incurred through insurance claims.

In March 2009, the Company received insurance proceeds of approximately $0.6 million related to a hurricane property damage claim arising due to the hurricane. These proceeds were received subsequent to February 11, 2009 and will be recognized in income in the third quarter.

Note 3. Fair Value Measurement

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements* (FAS 157), which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. FAS 157 applies whenever other statements require or permit asset or liabilities to be measured at fair value. The Company adopted the provisions of FAS 157 at the beginning of the first quarter of fiscal year 2009.

FAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. These tiers include:

Level 1: Defined as observable inputs such as quoted prices in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Defined as pricing inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures.

Level 3: Defined as pricing inputs that are unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value.

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As of February 11, 2009, the Company held auction rate securities, which are classified as available-for-sale investments in long-term investments on the balance sheet and are required to be measured at fair value on a recurring basis. As discussed in Note 5 below, the continued illiquidity in the auction rate market has affected the fair market value of the Company s auction rate securities because the auctions continue to fail. Therefore, in the absence of an active market, the Company estimated the fair value of these investments using price submissions from traders specializing in the securities. These traders considered, among other things, the collateralization underlying the security, the creditworthiness of the counterparty, the timing of the expected future cash flows, the investments interest rate compared to similar investments, the current illiquidity of the investments, and the estimated next successful auction of the security.

Although management currently has the intent and believes it has the ability to hold the Company s auction rate securities until maturity or until the securities can be sold for par value, there is no certainty in the long-term. The market for the Company s auction rate securities has not been liquid for an extended time and the credit risk of the security issuers and related insurers is uncertain. Therefore, the Company considers the impairment of its auction rate securities to be other-than-temporary .

As a result of the other-than-temporary decline in the fair value of the Company s auction rate securities investments, the Company recorded a realized holding loss of approximately $0.8 million during the fourth quarter of fiscal year 2008 and $0.1 million during the quarter ended February 11, 2009. Any recoveries of previous recognized losses will not be recorded until the security is sold. Any future decrease in fair value related to these investments will increase the Company s realized loss.

The assets measured at fair value on a recurring basis subject to the disclosure requirements of FAS 157 were as follows:

	Fair Value Measurement at February 11, 2009 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
		(In thousands)	
Auction rate securities investments:			
Balance at August 27, 2008	$	$	$ 8,525
Sale of long-term investments			(500)
Total gains or losses (realized and unrealized):			
Included in net income (loss)			(130)
Balance at February 11, 2009	$	$	$ 7,895

Note 4. Accounting Periods

The Company s fiscal year ends on the last Wednesday in August. As such, each fiscal year normally consists of 13 four-week periods, accounting for 364 days. Each of the first three quarters of each fiscal year consists of three four-week periods (12 weeks), while the fourth quarter normally consists of four four-week periods (16 weeks). Comparability between accounting periods will be affected by varying lengths of the periods, as well as the seasonality associated with the restaurant business.

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Note 5. Investments

Short-term Investments

Short-term investments include two types of securities: held-to-maturity and available-for-sale. Securities held-to-maturity are reported at amortized cost. Available-for-sale securities are reported at fair value with unrealized gains and losses excluded from earnings and reported in shareholders equity unless such losses are considered other-than-temporary . At February 11, 2009 and August 27, 2008, the Company held no securities as short-term investments.

Long-term Investments

At February 11, 2009, the Company held $8.9 million, par value ($7.9 million, fair value), of auction rate municipal bonds as long-term investments. Adjustments to fair value were recorded in the fourth quarter of fiscal year 2008 and the quarter ended February 11, 2009 based on the continued illiquidity of the auction rate securities market and an assessment of the securities. During the first quarter of fiscal year 2009, $0.5 million of auction rate municipal bonds were called at their par value by the issuer. No gain or loss was recognized. The $1.0 million loss was considered other-than-temporary and was recorded as a charge to earnings.

Currently, there are no active markets for the Company s auction rate securities. Therefore, the Company estimated the fair value using price submissions from traders specializing in these securities. Based on the price submissions and on the possible long-term illiquidity of the markets, the Company recognized an other than temporary impairment in the fourth quarter of fiscal year 2008 and in the second quarter of fiscal year 2009.

The auction rate municipal securities are long-term debt obligations that are secured by certain revenue streams (sewer, hospital, etc.). These auction rate securities have insurance policies guaranteeing the payment of principal and accrued interest, as scheduled, on each of the bonds if the issuer is unable to service the debt. These securities have been issued ratings ranging from A2 Aa3 (Moody s) and A AAA (Standard and Poor s). The bonds have experienced this disparity in credit ratings because of the insurance company s revised credit ratings issued by Moody s and Standard and Poor s. If these securities continue to fail at auction, interest income will continue to accrue at a designated benchmark rate plus a premium; otherwise, they will be sold. At each of the resets between February 12, 2008 and February 11, 2009, the Company received all accrued interest due.

When the market stopped normal trading on February 12, 2008 and auctions overwhelmingly began to fail, the Company had sell orders on all of its holdings. Since that date, several of its holdings have experienced partial or full calls while auctions for the remaining bonds have continued to fail. Of the bonds that were successfully sold or called since February 12, 2008, the Company received par value of $8.8 million plus accrued interest on the bonds.

These municipal bonds have underlying maturity dates ranging from June 1, 2019 through February 1, 2042 and had taxable equivalent yield rates ranging from 0.76% to 3.45% during the quarter ended February 11, 2009. Historically, the auction process allowed investors to obtain immediate liquidity by selling the securities at their face amounts. Liquidity for these securities was historically provided by entering sell orders through a Dutch-auction process that resets interest rates on these securities every 7, 28 or 35 days. However, the disruptions in the credit markets have continued to adversely affect the auction market for these types of securities.

Although the Company intends to hold the investments until liquidity returns to the auction rate securities market or the bonds are called or refunded by the issuer or other types of remedy, the Company has recorded these available-for-sale securities as long-term investments and recorded a realized loss as other-than-temporary impairment in the consolidated statement of operations because a majority of auction sell orders have failed. The length of time required for liquidity to return to the market by normal or other means is uncertain.

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Note 6. Income Taxes

For the two quarters ended February 11, 2009, including both continuing and discontinued operations, the Company generated a gross taxable loss of approximately $1.4 million. No cash payments of estimated income taxes were made during the two quarters ended February 11, 2009.

Deferred tax assets and liabilities are recorded based on differences between the financial reporting basis and the tax basis of assets and liabilities using currently enacted rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are recognized to the extent future taxable income is expected to be sufficient to utilize those assets prior to their expiration. If current available information raises doubt about the realization of the deferred tax assets, a valuation allowance would be necessary. A valuation allowance for deferred tax assets may be required if recovery of prior taxes by carrying back current losses to prior years is not available, if the Company projects lower levels of future taxable income, or if the Company recently experienced consecutive pretax losses. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect the Company s reported operating results. Through the two quarters ended February 11, 2009, the Company did not record a charge to establish a valuation allowance against its deferred tax assets.

Management believes that adequate provisions for income taxes have been reflected in the financial statements and is not aware of any significant exposure items that have not been reflected in the financial statements. Amounts considered probable of settlement within one year have been included in the accrued expenses and other liabilities in the accompanying consolidated balance sheet. We do not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next thirteen four-week periods.

Note 7. Property and Equipment

The cost and accumulated depreciation of property and equipment at February 11, 2009 and August 27, 2008, together with the related estimated useful lives used in computing depreciation and amortization, were as follows:

	February 11, 2009	August 27, 2008	Estimated Useful Lives
	(In thousands)		
Land	$ 53,270	$ 53,904	
Restaurant equipment and furnishings	119,087	120,426	3 to 15 years
Buildings	185,972	183,385	20 to 33 years
Leasehold and leasehold improvements	21,433	20,923	Lesser of lease term or estimated useful life
Office furniture and equipment	6,187	6,029	3 to 10 years
Construction in progress	3,349	880	
	389,298	385,547	
Less accumulated depreciation and amortization	(193,210)	(187,429)	
Property and equipment, net	$ 196,088	$ 198,118	

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Note 8. Impairment of Long-Lived Assets and Property Held for Sale

Impairment of Long-Lived Assets and Store Closings

The Company periodically evaluates long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company estimates future cash flows expected to result from the use and possible disposition of the asset and will recognize an impairment loss when the sum of the undiscounted estimated future cash flows is less than the carrying amounts of such assets. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management s subjective judgments. The span of time for which future cash flows are estimated is often lengthy, which increases the sensitivity to assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. The Company considers the likelihood of possible outcomes in determining the best estimate of future cash flows. The measurement for such an impairment loss is then based on the fair value of the asset as determined by either discounted cash flows, appraisals or the estimated net proceeds upon sale. With respect to continuing operations, write-downs associated with these impairment analyses, as well as actual exit costs incurred for store closings are reflected in the Consolidated Statements of Operations in Provision for asset impairments, net .

Property Held for Sale

Property held for sale consists of already-closed restaurant properties and are valued at the lower of net depreciable value or net realizable value.

At August 27, 2008, the Company had a total of six owned properties and three ground leases recorded at approximately $5.3 million in property held for sale.

In the first quarter of fiscal year 2009, one owned property was sold and removed from property held for sale. Also, in the first quarter of fiscal year 2009, one owned property and one ground lease property were closed and classified as property held for sale.

In the second quarter of fiscal year 2009, impairment charges totaling approximately $0.2 million reduced the net realizable value of the remaining property held for sale.

At February 11, 2009, the Company had six owned properties and four ground leases recorded at approximately $6.1 million in property held for sale. The Company is actively marketing the locations currently classified as property held for sale.

Subsequent to February 11, 2009, the Company sold one owned property for $0.9 million, which was approximately the property s net book value.

The Company s results of discontinued operations will be affected by the disposal of two of the ten properties held for sale to the extent proceeds from the sales exceed or are less than net book value.

Note 9. Commitments and Contingencies

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Pending Claims

Certain current and former hourly restaurant employees filed a lawsuit against the Company in the U. S District Court for the Southern District of Texas alleging violations of the Fair Labor Standards Act with respect to the inclusion of certain employees in a tip pool. The lawsuit seeks penalties and attorney s fees and was conditionally certified as a collective action in October 2008. The Company intends to vigorously defend its position. It is not possible at this time to reasonably estimate the possible loss or range of loss, if any.

From time to time, the Company is subject to various other private lawsuits, administrative proceedings and claims that arise in the ordinary course of its business. A number of these lawsuits, proceedings and claims may exist at any given time. These matters typically involve claims from guests, employees and others related to issues common to the restaurant industry. At this time, management believes that the ultimate resolution of pending legal proceedings will not have a material adverse effect on the Company s results of operations, financial position or cash flows.

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Construction Activity

From time to time, the Company enters into non-cancelable contracts for the construction of its new restaurants. This construction activity exposes the Company to the risks inherent in new construction including but not limited to rising material prices, labor shortages, delays in getting required permits and inspections, adverse weather conditions and injuries sustained by workers. During the second quarter ended February 11, 2009, the Company paid $0.1 million to terminate a construction contract.

Note 10. Related Parties

Affiliate Services

The Company s Chief Executive Officer, Christopher J. Pappas, and Chief Operating Officer, Harris J. Pappas, own two restaurant entities (the Pappas entities) that may provide services to the Company and its subsidiaries, as detailed in the Master Sales Agreement dated December 9, 2005 among the Company and the Pappas entities.

Under the terms of the Master Sales Agreement, the Pappas entities may provide specialized (customized) equipment fabrication and basic equipment maintenance, including stainless steel stoves, shelving, rolling carts, and chef tables. The total costs under the Master Sales Agreement of custom-fabricated and refurbished equipment in the two quarters ended February 11, 2009 and February 13, 2008 were $0.3 million and $0.2 million, respectively. Services provided under this agreement are subject to review and approval by the Finance and Audit Committee.

Operating Leases

The Company previously leased from the Pappas entities property that was used to accommodate the Company s in-house repair and fabrication center, and which was referred to as the Houston Service Center. The Company terminated this lease in August 2008. The Company paid zero and $34,000 pursuant to the terms of this lease in the two quarters ended February 11, 2009 and February 13, 2008, respectively. The Company leases from an unrelated third party a new property that combines both the offices of the Company s Facility Services and Warehouse Operations. The property is approximately 60,000 square feet.

The Company also previously leased from the Pappas entities approximately 27,000 square feet of warehouse space to complement the Houston Service Center, at a monthly rate of approximately $0.21 per square foot. The Company paid zero and $27,800 pursuant to the terms of this lease in the two quarters ended February 11, 2009 and February 13, 2008, respectively. On February 29, 2008, the Company terminated this lease.

In the third quarter of fiscal year 2004, Messrs. Pappas became partners in a limited partnership which purchased a retail strip center in Houston, Texas. Messrs. Pappas collectively own a 50% limited partnership interest and a 50% general partnership interest in the limited partnership. A third party company manages the center. One of the Company s restaurants has rented approximately 7% of the space in that center since July 1969. No changes were made to the Company s lease terms as a result of the transfer of ownership of the center to the new partnership. The Company made payments of $0.1 million and $0.1 million in the two quarters ended February 11, 2009 and February 13, 2008, respectively, under the lease agreement which currently includes an annual base rate of $14.64 per square foot.

On November 22, 2006, the Company executed a new lease agreement with respect to this shopping center. Effective upon the Company s relocation and occupancy into the new space in July 2008, the new lease agreement provides for a primary term of approximately twelve years with two subsequent five-year options and gives the landlord an option to buy out the tenant on or after the calendar year 2015 by paying the then unamortized cost of improvements to the tenant. The Company owed, under the lease, $16.65 per square foot plus maintenance, taxes, and insurance for the calendar year 2008. For calendar year 2009 the Company will pay $20.00 per square foot plus maintenance, taxes and insurance. Thereafter, the lease provides for reasonable increases in rent at set intervals. The new lease agreement was approved by the Finance and Audit Committee.

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Affiliated rents paid for the Houston Service Center, the separate storage facility and the Houston property leases combined represented 5.1% and 8.2% of total rents for continuing operations for the two quarters ended February 11, 2009 and February 13, 2008, respectively.

	Two Quarters Ended February 11, 2009 (24 weeks)	February 13, 2008 (24 weeks)
	(In thousands, except percentages)	
AFFILIATED COSTS INCURRED:		
General and administrative expenses professional and other costs	$ 64	$ 75
Capital expenditures custom-fabricated and refurbished equipment and furnishings	280	201
Other operating expenses and opening costs, including property leases	144	192
Total	$ 488	$ 468
RELATIVE TOTAL COMPANY COSTS:		
General and administrative expenses	$ 11,748	$ 12,856
Capital expenditures	8,775	14,799
Other operating expenses and opening costs	31,316	31,355
Total	$ 51,839	$ 59,010
AFFILIATED COSTS INCURRED AS A PERCENTAGE OF RELATIVE TOTAL COMPANY COSTS		
Fiscal year to date	0.94%	0.79%

Board of Directors

Pursuant to the terms of a separate Purchase Agreement dated March 9, 2001, entered into by and among the Company, Christopher J. Pappas and Harris J. Pappas, the Company agreed to submit three persons designated by Christopher J. Pappas and Harris J. Pappas as nominees for election at the 2002 Annual Meeting of Shareholders. Messrs. Pappas designated themselves and Frank Markantonis as their nominees for directors, all of whom were subsequently elected. Christopher J. Pappas and Harris J. Pappas are brothers. Frank Markantonis is an attorney whose principal client is Pappas Restaurants, Inc., an entity owned by Harris J. Pappas and Christopher J. Pappas.

As amended in June 2004, the Purchase Agreement allows Messrs. Pappas to continue to nominate persons for election to the board, which, if such nominees are elected, would result in Messrs. Pappas having nominated three of the then-serving directors of the Company. Messrs. Pappas retain their right for so long as they both are executive officers of the Company.

Christopher J. Pappas is a member of the advisory board of Amegy Bank, National Association, which is a lender and syndication agent under the Company s 2007 Revolving Credit Facility.

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Key Management Personnel

In November 2005, Christopher and Harris Pappas entered into new employment agreements that were subsequently amended in November 2008 to extend the termination date thereof to August 2010. Both continue to devote their primary time and business efforts to the Company while maintaining their roles at Pappas Restaurants, Inc.

Ernest Pekmezaris, the former Chief Financial Officer of the Company, became a consultant to the Company on April 20, 2007. Mr. Pekmezaris is also the Treasurer of Pappas Restaurants, Inc. Compensation for the services provided by Mr. Pekmezaris to Pappas Restaurants, Inc. is paid entirely by that entity.

Peter Tropoli, Senior Vice President, Administration, General Counsel and Secretary of the Company, is an attorney who, in the past, has provided litigation services to entities controlled by Christopher J. Pappas and Harris J. Pappas. Mr. Tropoli is the stepson of Frank Markantonis, who is a director of the Company.

Paulette Gerukos, Vice President of Human Resources of the Company, is the sister-in-law of Harris J. Pappas, the Chief Operating Officer.

Note 11. Share-Based Compensation

Stock Options

The Company has an Incentive Stock Plan for officers and employees together (Employee Stock Plans) and a Non-employee Director Stock Option Plan for non-employee directors. These plans authorize the granting of stock options, restricted stock and other types of awards consistent with the purpose of the plans. The number of shares authorized for issuance under the Company s plans as of February 11, 2009 totals approximately 2.9 million, of which approximately 1.4 million shares are available for future issuance. Stock options granted under the Incentive Stock Plan and the Non-employee Director Stock Option Plan have an exercise price equal to the market price of the Company s common stock at the date of grant. Option awards under the Employee Stock Plans generally vest 25% each year on the anniversary of the grant date and expire six to ten years from the grant date. Option awards under the Non-employee Director Stock Option Plan generally vest 100% on the first anniversary of the grant date and expire ten years from the grant date.

A summary of the Company s stock option activity for the two quarters ended February 11, 2009 is presented below:

	Shares Under Fixed Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term *(Years)*	Aggregate Intrinsic Value *(In thousands)*
Outstanding at August 27, 2008	689,254	$ 10.73	3.90	$ 145
Granted	363,010	5.27		
Exercised				
Forfeited or Expired	(18,701)	13.59		
Outstanding at February 11, 2009	1,033,563	8.76	5.12	48
Exercisable at February 11, 2009	402,728	$ 10.46	3.46	$ 48

Restricted Stock

Restricted stock grants consist of the Company s common stock and generally vest after three years, with the exception of grants under the Nonemployee Director Stock Option Plan, which vest when granted because they are granted in lieu of a cash payment. All restricted stock grants are cliff-vested. Restricted stock awards are valued at the average market price of the Company s common stock at the date of grant.

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A summary of the Company s restricted stock activity during the two quarters ended February 11, 2009 is presented in the following table:

	Restricted Stock Units	Fair Value *(Per share)*	Weighted-Average Remaining Contractual Term *(Years)*	Weighted-Average Grant Date
Unvested at August 27, 2008	95,190	$ 10.04	1.79	6/11/07
Granted	18,998	5.61		11/26/08
Vested	(32,948)	8.45		8/18/07
Unvested at February 11, 2009	81,240	$ 9.64	1.60	9/16/07

Note 12. Earnings Per Share

Basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted net income per share, the basic weighted average number of shares is increased by the dilutive effect of restricted stock, phantom stock, and stock options determined using the treasury stock method. Stock options with exercise prices exceeding current market prices that were excluded from the computation of net income per share amounted to approximately 659,000 shares and 292,000 shares for the two quarters ended February 11, 2009 and February 13, 2008, respectively.

The components of basic and diluted net income per share are as follows:

	Quarter Ended		Two Quarters Ended	
	February 11, 2009 *(12 weeks)*	February 13, 2008 *(12 weeks)*	February 11, 2009 *(24 weeks)*	February 13, 2008 *(24 weeks)*
	(In thousands except share data)			
Numerator:				
Income (loss) from continuing operations	$ 196	$ 307	$ (1,947)	$ 5,115
Net income (loss)	$ 146	$ 286	$ (2,046)	$ 5,057
Denominator:				
Denominator for basic earnings per share weighted-average shares	27,965	28,408	27,955	27,645
Effect of potentially dilutive securities:				
Employee and non-employee stock options				320
Phantom stock	30	30		30
Restricted stock	82	80		