

LUBYS INC  
Form 10-Q  
June 10, 2011  
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**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 May 4, 2011

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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**74-1335253**  
(IRS Employer  
Identification No.)

**13111 Northwest Freeway, Suite 600**

**Houston, Texas**  
(Address of principal executive offices)

**77040**  
(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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:

Large accelerated filer  Accelerated filer   
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

As of June 3, 2011 there were 28,140,887 shares of the registrant's common stock outstanding.

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Luby's, Inc.

Form 10-Q

Quarter ended May 4, 2011

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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.

**Table of Contents****Part I - FINANCIAL INFORMATION****Item 1. Financial Statements****Luby's, Inc.****Consolidated Balance Sheets***(In thousands, except share data)*

|  | <b>May 4,<br/>2011</b> | <b>August 25,<br/>2010</b> |
|--|------------------------|----------------------------|
|  | <i>(Unaudited)</i>     |                            |
| <b>ASSETS</b>  |                        |                            |
| Current Assets:  |                        |                            |
| Cash and cash equivalents  | \$ 1,232               | \$ 2,300                   |
| Trade accounts and other receivables, net  | 3,734                  | 2,213                      |
| Food and supply inventories  | 4,010                  | 3,097                      |
| Prepaid expenses   | 1,563                  | 1,041                      |
| Assets related to discontinued operations  | 206                    | 78                         |
| Deferred income taxes  | 831                    | 431                        |
| <b>Total current assets</b>  | <b>11,576</b>          | <b>9,160</b>               |
| Property held for sale   | 1,074                  | 1,828                      |
| Assets related to discontinued operations  | 11,929                 | 18,419                     |
| Property and equipment, net  | 165,929                | 172,040                    |
| Intangible assets, net   | 28,323                 | 29,292                     |
| Goodwill   | 195                    | 195                        |
| Deferred incomes taxes   | 9,665                  | 9,672                      |
| Other assets   | 1,413                  | 1,737                      |
| <b>Total assets</b>  | <b>\$ 230,104</b>      | <b>\$ 242,343</b>          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                        |                            |
| Current Liabilities:   |                        |                            |
| Accounts payable   | \$ 12,873              | \$ 12,514                  |
| Liabilities related to discontinued operations   | 340                    | 923                        |
| Credit facility debt   | 31,000                 |                            |
| Accrued expenses and other liabilities   | 17,999                 | 19,008                     |
| <b>Total current liabilities</b>   | <b>62,212</b>          | <b>32,445</b>              |
| Credit facility debt   |                        | 41,500                     |
| Liabilities related to discontinued operations   | 494                    | 940                        |
| Other liabilities  | 5,462                  | 6,097                      |
| <b>Total liabilities</b>   | <b>68,168</b>          | <b>80,982</b>              |
| Commitments and Contingencies  |                        |                            |
| <b>SHAREHOLDERS' EQUITY</b>  |                        |                            |
| Common stock, \$0.32 par value; 100,000,000 shares authorized; shares issued were 28,619,887 and 28,564,024, respectively; shares outstanding were 28,119,887 and 28,064,024, respectively | 9,158                  | 9,140                      |
| Paid-in capital  | 23,527                 | 23,089                     |

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|   |                |                |
|---|----------------|----------------|
| Retained earnings                           | 134,026        | 133,907        |
| Less cost of treasury stock, 500,000 shares | (4,775)        | (4,775)        |
| <b>Total shareholders' equity</b>           | <b>161,936</b> | <b>161,361</b> |
| Total liabilities and shareholders' equity  | \$ 230,104     | \$ 242,343     |

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

**Table of Contents****Luby's, Inc.****Consolidated Statements of Operations (unaudited)***(In thousands except share and per share data)*

|  | <b>Quarter Ended</b>   |                        | <b>Three Quarters Ended</b> |                        |
|--|------------------------|------------------------|-----------------------------|------------------------|
|  | <b>May 4,<br/>2011</b> | <b>May 5,<br/>2010</b> | <b>May 4,<br/>2011</b>      | <b>May 5,<br/>2010</b> |
|  | <i>(12 weeks)</i>      | <i>(12 weeks)</i>      | <i>(36 weeks)</i>           | <i>(36 weeks)</i>      |
| <b>SALES:</b>  |                        |                        |                             |                        |
| Restaurant sales   | \$ 78,077              | \$ 53,947              | \$ 220,124                  | \$ 153,774             |
| Culinary contract services   | 3,560                  | 3,262                  | 10,018                      | 9,514                  |
| Franchise revenue  | 1,602                  |                        | 4,622                       |                        |
| Vending revenue  | 160                    |                        | 445                         |                        |
| <b>TOTAL SALES</b>   | <b>83,399</b>          | <b>57,209</b>          | <b>235,209</b>              | <b>163,288</b>         |
| <b>COSTS AND EXPENSES:</b>   |                        |                        |                             |                        |
| Cost of food   | 22,011                 | 14,796                 | 64,270                      | 41,909                 |
| Payroll and related costs  | 26,259                 | 18,932                 | 76,493                      | 55,809                 |
| Other operating expenses   | 17,237                 | 10,520                 | 52,273                      | 33,471                 |
| Opening costs  | 34                     | 31                     | 178                         | 183                    |
| Cost of culinary contract services                                     | 3,316                  | 2,945                  | 9,180                       | 8,660                  |
| Depreciation and amortization  | 3,889                  | 3,443                  | 12,070                      | 10,484                 |
| General and administrative expenses                                    | 6,981                  | 5,163                  | 19,985                      | 15,648                 |
| Provision for asset impairments, net                                   |                        |                        |                             | 32                     |
| Net loss (gain) on disposition of property and equipment               | 28                     | (237)                  | 1                           | (961)                  |
| <b>Total costs and expenses</b>  | <b>79,755</b>          | <b>55,593</b>          | <b>234,450</b>              | <b>165,235</b>         |
| <b>INCOME (LOSS) FROM OPERATIONS</b>                                   | <b>3,644</b>           | <b>1,616</b>           | <b>759</b>                  | <b>(1,947)</b>         |
| Interest income  |                        | 7                      | 4                           | 23                     |
| Interest expense   | (579)                  | (127)                  | (1,751)                     | (300)                  |
| Impairment charges for decrease in fair value of investments           |                        |                        |                             | (438)                  |
| Other income, net  | 384                    | 205                    | 944                         | 618                    |
| <b>Income (loss) before income taxes and discontinued operations</b>   | <b>3,449</b>           | <b>1,701</b>           | <b>(44)</b>                 | <b>(2,044)</b>         |
| Provision (benefit) for income taxes                                   | 1,393                  | 479                    | 212                         | (332)                  |
| <b>Income (loss) from continuing operations</b>                        | <b>2,056</b>           | <b>1,222</b>           | <b>(256)</b>                | <b>(1,712)</b>         |
| <b>Income (loss) from discontinued operations, net of income taxes</b> | <b>(365)</b>           | <b>(492)</b>           | <b>375</b>                  | <b>(1,697)</b>         |
| <b>NET INCOME (LOSS)</b>   | <b>\$ 1,691</b>        | <b>\$ 730</b>          | <b>\$ 119</b>               | <b>\$ (3,409)</b>      |
| <b>Income (loss) per share from continuing operations:</b>             |                        |                        |                             |                        |
| Basic  | \$ 0.07                | \$ 0.04                | \$ (0.01)                   | \$ (0.06)              |
| Assuming dilution  | 0.07                   | 0.04                   | (0.01)                      | (0.06)                 |
| <b>Loss per share from discontinued operations:</b>                    |                        |                        |                             |                        |
| Basic  | \$ (0.01)              | \$ (0.01)              | \$ 0.01                     | \$ (0.06)              |
| Assuming dilution  | (0.01)                 | (0.01)                 | 0.01                        | (0.06)                 |
| <b>Net income (loss) per share:</b>                                    |                        |                        |                             |                        |
| Basic  | \$ 0.06                | \$ 0.03                | \$                          | \$ (0.12)              |

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|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Assuming dilution                           | 0.06   | 0.03   |        | (0.12) |
| <b>Weighted average shares outstanding:</b> |        |        |        |        |
| Basic                                       | 28,257 | 28,145 | 28,224 | 28,125 |
| Assuming dilution                           | 28,304 | 28,151 | 28,224 | 28,125 |

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

**Table of Contents****Lubys, Inc.****Consolidated Statement of Shareholders' Equity (unaudited)***(In thousands)*

|  | Common Stock |          | Treasury |            | Paid-In   | Retained   | Total        |
|--|--------------|----------|----------|------------|-----------|------------|--------------|
|  | Issued       | Amount   | Shares   | Amount     | Capital   | Earnings   | Shareholders |
|  | Shares       |          |          |            |           |            | Equity       |
| BALANCE AT AUGUST 25, 2010                           | 28,564       | \$ 9,140 | (500)    | \$ (4,775) | \$ 23,089 | \$ 133,907 | \$ 161,361   |
| Net income   |              |          |          |            |           | 119        | 119          |
| Common stock issued under nonemployee director plans | 2            | 1        |          |            | 3         |            | 4            |
| Common stock issued under employee benefit plans     | 5            | 2        |          |            | 21        |            | 23           |
| Excess tax benefits from stock options               |              |          |          |            | (61)      |            | (61)         |
| Share-based compensation expense                     | 49           | 15       |          |            | 475       |            | 490          |
| BALANCE AT MAY 4, 2011                               | 28,620       | \$ 9,158 | (500)    | \$ (4,775) | \$ 23,527 | \$ 134,026 | \$ 161,936   |

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



**Table of Contents****Lubys, Inc.****Consolidated Statements of Cash Flows (unaudited)***(In thousands)*

|  | <b>Three Quarters Ended</b> |                        |
|--|-----------------------------|------------------------|
|  | <b>May 4,<br/>2011</b>      | <b>May 5,<br/>2010</b> |
|  | <i>(36 weeks)</i>           | <i>(36 weeks)</i>      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                             |                        |
| Net income (loss)  | \$ 119                      | \$ (3,409)             |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                             |                        |
| Net gains on property sales and provision for asset impairments                          | (1,501)                     | (2,501)                |
| Depreciation and amortization  | 12,072                      | 10,732                 |
| Impairment charge for decrease in fair value of investments, net of gains                |                             | 438                    |
| Amortization of debt issuance cost   | 619                         | 187                    |
| Non-cash compensation expense  | 135                         | 198                    |
| Share-based compensation expense   | 355                         | 691                    |
| Excess tax on stock option expense   | 61                          |                        |
| Deferred tax benefit   | (26)                        | (1,317)                |
| Cash provided by operating activities before changes in operating assets and liabilities | 11,834                      | 5,019                  |
| Changes in operating assets and liabilities:   |                             |                        |
| Increase in trade accounts and other receivables, net                                    | (1,521)                     | (17)                   |
| Increase (decrease) in food and supply inventories                                       | (913)                       | 261                    |
| Increase (decrease) in prepaid expenses and other assets                                 | (715)                       | 80                     |
| Decrease in accounts payable, accrued expenses and other liabilities                     | (2,087)                     | (5,099)                |
| Net cash provided by operating activities  | 6,598                       | 244                    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                             |                        |
| Proceeds from sale and redemption of long-term investments                               |                             | 1,414                  |
| Proceeds from disposal of assets, property insurance proceeds and property held for sale | 8,494                       | 7,802                  |
| Acquisition of Fuddrucker's assets   | (265)                       |                        |
| Purchases of property and equipment  | (5,140)                     | (2,266)                |
| Net cash provided by investing activities  | 3,089                       | 6,950                  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                             |                        |
| Credit facility borrowings   | 95,750                      | 21,300                 |
| Credit facility repayments   | (106,250)                   | (21,300)               |
| Debt issuance costs  | (221)                       | (378)                  |
| Tax benefit on stock options   | (61)                        |                        |
| Proceeds received on the exercise of stock options                                       | 27                          |                        |
| Net cash used in financing activities  | (10,755)                    | (378)                  |
| Net (decrease) increase in cash and cash equivalents                                     | (1,068)                     | 6,816                  |
| Cash and cash equivalents at beginning of period   | 2,300                       | 882                    |
| Cash and cash equivalents at end of period   | \$ 1,232                    | \$ 7,698               |

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|                |  |       |    |
|----------------|--|-------|----|
| Cash paid for: |  |       |    |
| Income taxes   |  | \$    | \$ |
| Interest       |  | 1,185 | 94 |

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)**

May 4, 2011

**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 adjustments) considered necessary for a fair presentation have been included. Operating results for the period ended May 4, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending August 31, 2011.

The consolidated balance sheet dated August 25, 2010, included in this Form 10-Q, has been derived from the audited consolidated 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 audited consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the fiscal year ended August 25, 2010.

The results of operations, assets and liabilities for all units included in the disposal plan discussed in Note 7 have been reclassified to discontinued operations in the statements of operations and balance sheets for all periods presented.

**Note 2. 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.

**Note 3. Acquisition**

Luby s, Inc., through its subsidiary, Luby s Fuddruckers Restaurants, LLC ( LFR ), purchased substantially all of the assets of Fuddruckers, Inc., Magic Brands, LLC and certain of their affiliates (collectively, Fuddruckers ) on July 26, 2010 for \$63.1 million in cash. LFR assumed \$4.3 million of Fuddruckers obligations, real estate leases and contracts. The Company funded the purchase with cash and an expansion of its credit facility. During the first quarter ended November 17, 2010, the Company acquired one additional Fuddruckers location for additional consideration of approximately \$0.3 million.

The allocation of the purchase price for the acquisition required extensive use of accounting estimates and judgments to allocate the purchase price to tangible and intangible assets acquired and liabilities assumed based on respective fair values. The purchase price for the Company s acquisition of substantially all of the assets of Fuddruckers and the assumption of certain liabilities is based on estimates of fair values at the acquisition date. Such valuations require significant estimates and assumptions. The Company believes the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions. The fair value estimates for the purchase price allocation for the Company s acquisition are considered final.

The trade name primarily relates to Fuddruckers, which the Company believes has an estimated accounting life of 21 years based on the expected use of its assets and the restaurant environment in which it is being used. The value assigned to the trade name will be amortized over the estimated accounting life of 21 years. The trade name represents a respected brand with positive customer loyalty; which the Company intends to cultivate and protect the use of the trade name. The franchise agreements, after considering renewal periods, have an estimated accounting life of 21 years and will be amortized over this period of time. The Company recorded \$1.0 million of amortization expense during the first three quarters of fiscal year 2011, which is classified as depreciation and amortization expense in the accompanying consolidated statement of operations. The full year amortization of the trade name and the franchise agreements is expected to total \$1.4 million. Because the value of these assets will be amortized using the straight-line method over 21 years, the annual amortization will be the same total each year.



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A portion of the acquired lease portfolio contained favorable and unfavorable leases. Acquired lease terms were compared to current market lease terms to determine if the acquired leases were below or above the current rates tenants would pay for similar leases. The favorable lease assets totaled \$0.7 million and \$0.8 million at May 4, 2011 and August 25, 2010, respectively, and are recorded in other assets and, after considering renewal periods, have an estimated weighted average life of approximately 5.6 years at May 4, 2011. The unfavorable leases totaled \$2.5 million and \$2.9 million at May 4, 2011 and August 25, 2010, respectively, and are recorded in other liabilities and, after considering renewal periods, have an estimated weighted average life of approximately 6.7 years at May 4, 2011. The favorable and unfavorable leases are amortized to rent expense on a straight line basis over the lives of the related leases.

The following table shows the prospective amortization of the favorable lease assets and unfavorable lease liabilities:

|             | August 31,<br>2011 | August 29,<br>2012 | Fiscal Year Ended<br>August 28,<br>2013<br><i>(In thousands)</i> | August 27,<br>2014 | August 26,<br>2015 |
|-------------|--------------------|--------------------|--|--------------------|--------------------|
| Favorable   | \$ 130             | \$ 130             | \$ 130   | \$ 130             | \$ 130             |
| Unfavorable | \$ 570             | \$ 448             | \$ 380   | \$ 380             | \$ 228             |

The Company also recorded an intangible asset for goodwill in the amount of \$0.2 million. Goodwill is considered to have an indefinite useful life and is not amortized. Goodwill was \$0.2 million as of May 4, 2011 and August 25, 2010.

**Note 4. Fair Value Measurements**

GAAP establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. Fair value measurements guidance applies whenever other statements require or permit asset or liabilities to be measured at fair value.

GAAP 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.

Non-recurring fair value measurements related to impaired property and equipment consisted of the following:

| Three quarters ended<br>May 4, 2011 | Fair Value Measurement Using                 |  |  | Total<br>Impairments |
|-------------------------------------|--|--|--|----------------------|
|                                     | Quoted<br>Prices in<br>Active<br>Markets for | Significant<br>Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                      |

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Identical  
Assets  
(Level  
1)  
(Level 2)

|  |    |       |    |    |    |       |    |       |
|--|----|-------|----|----|----|-------|----|-------|
| Long-lived assets related to discontinued operations | \$ | 5,093 | \$ | \$ | \$ | 5,093 | \$ | (592) |
|--|----|-------|----|----|----|-------|----|-------|

There were no impairments of assets related to discontinued operations during the three quarters ended May 5, 2010.

As of May 4, 2011 and August 25, 2010, the Company had no assets required to be measured at fair value on a recurring basis. The carrying value of cash and cash equivalents, trade accounts and other receivable, accounts payable, accrued expenses and debt approximate fair value based on the short-term nature of these accounts.

**Table of Contents****Note 5. Income Taxes**

No cash payments of estimated federal income taxes were made during the three quarters ended May 4, 2011.

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 and projected future results raises doubt about the realization of the deferred tax assets, a valuation allowance is necessary. Such a valuation allowance was established in the fourth quarter ended August 26, 2009 through a charge to income tax expense which adversely affected the Company's reported operating results. Management concluded that for the quarter ended November 17, 2010, an increase in the valuation allowance of \$0.1 million was necessary. No adjustments were made to the valuation allowance for the quarters ended February 9, 2011 and May 4, 2011. The valuation allowance partially offsets the Company's deferred tax assets related to net operating loss carryovers to future years and its carryover of employment tax credits.

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. The Company does not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next thirteen four-week periods.

**Note 6. Property and Equipment**

The cost, net of impairment, and accumulated depreciation of property and equipment at May 4, 2011 and August 25, 2010, together with the related estimated useful lives used in computing depreciation and amortization, were as follows:

|  | May 4,<br>2011        | August 25,<br>2010 | Estimated<br>Useful Lives                                   |
|--|-----------------------|--------------------|---|
|  | <i>(In thousands)</i> |                    |   |
| Land   | \$ 55,468             | \$ 55,468          |   |
| Restaurant equipment and furnishings           | 103,480               | 100,118            | 3 to 15 years   |
| Buildings                                      | 164,818               | 164,421            | 20 to 33 years  |
| Leasehold and leasehold improvements           |                       |                    | Lesser of lease<br><br>term or estimated<br><br>useful life |
| Office furniture and equipment                 | 28,004                | 27,516             | 3 to 10 years   |
| Construction in progress                       | 6,636                 | 6,322              |   |
|  | 421                   | 336                |   |
|  | 358,827               | 354,181            |   |
| Less accumulated depreciation and amortization | (192,898)             | (182,141)          |   |
| Property and equipment, net                    | \$ 165,929            | \$ 172,040         |   |

**Note 7. Impairment of Long-Lived Assets, Discontinued Operations and Property Held for Sale*****Impairment of Long-Lived Assets and Store Closings***

The Company periodically evaluates long-lived assets held for use and held for sale whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. The Company analyzes historical cash flows of operating locations and compares results of poorer performing locations to more profitable locations. The Company also analyzes lease terms, condition of the assets and related need for capital expenditures or repairs, as well as construction activity and the economic and market conditions in the surrounding area.

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For assets held for use, the Company estimates future cash flows using assumptions based on possible outcomes of the areas analyzed. If the undiscounted future cash flows are less than the carrying value of the location's assets, the Company records an impairment loss based on an estimate of discounted cash flows. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. Assumptions and estimates used include operating results, changes in working capital, discount rate, growth rate, anticipated net proceeds from disposition of the property and if applicable, lease terms. The span of time for which future cash flows are estimated is often lengthy, increasing the sensitivity to assumptions made. The time span is longer and could be 20 to 25 years for newer properties, but only 5 to 10 years for older properties. 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 discounted cash flows.



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The Company recognized the following impairment charges (credits) to income from operations:

|  | Three Quarters ended                         |                              |
|--|--|------------------------------|
|  | May 4,<br>2011<br>(36<br>weeks)              | May 5,<br>2010<br>(36 weeks) |
|  | <i>(In thousands, except per share data)</i> |                              |
| Provision for asset impairments                          | \$   | \$ 32                        |
| Net (gain) loss on disposition of property and equipment | 1  | (961)                        |
|  | \$ 1   | \$ (929)                     |

Effect on EPS:

|                   |        |
|-------------------|--------|
| Basic             | (0.03) |
| Assuming dilution | (0.03) |

The net gain for the three quarters ended May 5, 2010 includes the results of normal asset retirements, the sale of one previously closed restaurant property that was held for sale and the sale of an easement right associated with a restaurant property.

**Discontinued Operations**

As a result of the first quarter fiscal year 2010 adoption of the Company's Cash Flow Improvement and Capital Redeployment Plan (the Plan), the Company reclassified 23 operating stores and one previously closed location to discontinued operations. The results of operations, assets and liabilities for all units included in the Plan have been reclassified to discontinued operations in the statement of operations and balance sheets for all periods presented.

The following table sets forth the assets and liabilities for all discontinued operations:

|  | May 4,<br>2011        | August 25,<br>2010 |
|--|-----------------------|--------------------|
|  | <i>(in thousands)</i> |                    |
| Prepaid expenses   | \$ 80                 | \$ 78              |
| Deferred income taxes  | 126                   |                    |
| Assets related to discontinued operations - current          | \$ 206                | \$ 78              |
| Property and equipment                                       | \$ 11,859             | \$ 17,692          |
| Deferred income taxes  | 62                    | 717                |
| Other assets   | 8                     | 10                 |
| Assets related to discontinued operations - non-current      | \$ 11,929             | \$ 18,419          |
| Deferred income taxes  | \$                    | \$ 162             |
| Accrued expenses and other liabilities                       | 340                   | 761                |
| Liabilities related to discontinued operations - current     | \$ 340                | \$ 923             |
| Other liabilities  | \$ 494                | \$ 940             |
| Liabilities related to discontinued operations - non-current | \$ 494                | \$ 940             |

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No impairments related to discontinued operations were recognized in the first three quarters of fiscal year 2010. However, in the first three quarters of fiscal year 2011, five properties were further impaired by a total of \$0.6 million.

In the third quarter of fiscal year 2011, the Company sold one closed property and recognized no gain or loss. In the second quarter of fiscal year 2011, three closed properties were sold and a gain of \$1.9 million was recognized. One property was sold in the first quarter of fiscal year 2011 and a gain of \$0.2 million was recognized. The Company also terminated two in-line (strip shopping center) lease agreements and negotiated a settlement and termination of a ground lease that was a former restaurant location in the first quarter of fiscal year 2011.

As of August 25, 2010, the Company had 23 properties with a total carrying value of \$17.7 million classified as assets related to discontinued operations. The carrying values of the ground leases and in-line leases have previously been impaired to zero.

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As of May 4, 2011, the Company had 15 properties with a total carrying value of \$11.9 million classified as discontinued operations. The carrying values of the ground leases have previously been impaired to zero.

The Company is actively marketing these properties for lease or sale and the Company's results of discontinued operations will be affected by the disposal of properties related to discontinued operations to the extent proceeds from the sales exceed or are less than net book value.

The following table sets forth the sales and pretax losses reported for all discontinued locations:

|   | <b>Three Quarters Ended</b>                          |                                       |
|---|--|---------------------------------------|
|   | <b>May 4,<br/>2011<br/>(36<br/>weeks)</b>            | <b>May 5,<br/>2010<br/>(36 weeks)</b> |
|   | <i>(In thousands, except discontinued locations)</i> |                                       |
| Sales   | \$   | \$ 3,145                              |
| Pretax gains (losses)                                     | 525  | (2,609)                               |
| Income tax benefit (provision) on discontinued operations | (150)  | 912                                   |
| Income (loss) on discontinued operations                  | 375  | (1,697)                               |
| Discontinued locations closed during the period           | 0  | 22                                    |

The Company incurred zero and \$0.7 million in employee settlement costs in the first three quarters of fiscal years 2011 and 2010, respectively.

The following table summarizes discontinued operations for the first three quarters of fiscal years 2011 and 2010:

|  | <b>Three Quarters ended</b>                  |                                       |
|--|--|---------------------------------------|
|  | <b>May 4,<br/>2011<br/>(36 weeks)</b>        | <b>May 5,<br/>2010<br/>(36 weeks)</b> |
|  | <i>(In thousands, except per share data)</i> |                                       |
| Impairments  | \$ (592)                                     | \$                                    |
| Gains  | 2,094  | 1,572                                 |
| Net gains  | 1,502  | 1,572                                 |
| Other  | (1,127)                                      | (3,269)                               |
| Discontinued operations                            | \$ 375                                       | \$ (1,697)                            |
| Effect on EPS from discontinued operations - basic | \$ 0.01                                      | \$ (0.06)                             |

Within discontinued operations, the Company offsets gains from applicable property disposals against total impairments. The amounts in the table described as "Other" include employment termination and shut-down costs, as well as operating losses through each restaurant's closing date and carrying costs until the locations are finally disposed.

The impairment charges included above relate to properties closed and designated for immediate disposal. The assets of these individual operating units have been written down to their net realizable values. In turn, the related properties have either been sold or are being actively marketed for sale. All dispositions are expected to be completed within one to three years. Within discontinued operations, the Company also recorded the related fiscal year-to-date net operating results, employee terminations and basic carrying costs of the closed units.

**Property Held for Sale**

The Company periodically reviews long-lived assets against its plans to retain or ultimately dispose of properties. If the Company decides to dispose of a property, it will be moved to property held for sale and actively marketed. The Company analyzes market conditions each reporting period and records additional impairments due to declines in market values of like assets. The fair value of the property is determined by

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observable inputs such as appraisals and prices of comparable properties in active markets for assets like the Company's. Gains are not recognized until the properties are sold.

Property held for sale includes unimproved land, closed restaurant properties and related equipment for locations not classified as discontinued operations. The specific assets are valued at the lower of net depreciable value or net realizable value.

At May 4, 2011, the Company had a total of two owned properties and one ground lease recorded at approximately \$1.1 million in property held for sale. At August 25, 2010, the Company had three owned properties and one ground lease recorded at approximately \$1.8 million in property held for sale. The Company is actively marketing the locations currently classified as property held for sale.

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The Company sold one property held for sale during the three quarters ended May 4, 2011 resulting in a gain of \$35,000.

The Company's results of continuing operations will be affected to the extent proceeds from sales exceed or are less than net book value.

### **Note 8. 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 sought back wages, penalties and attorney's fees and was conditionally certified as a collective action in October 2008. On October 22, 2010, the Company agreed to a court settlement amount of \$1.6 million, recognized in general and administrative expenses in the fourth quarter fiscal year 2010. The Company has made related payments of \$1.4 million as of May 4, 2011, and will continue making payments during fiscal year 2011 as required by the settlement and expects to complete all payments by the end of calendar year 2011.

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. The Company currently believes that the final disposition of these types of lawsuits, proceedings and claims will not have a material adverse effect on the Company's financial position, results of operations or liquidity. It is possible, however, that the Company's future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to lawsuits, proceedings or claims.

#### ***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. The Company has no non-cancelable contracts as of May 4, 2011.

### **Note 9. Related Parties**

#### ***Affiliate Services***

Christopher J. Pappas, the Company's Chief Executive Officer, and Harris J. Pappas, director and former Chief Operating Officer of the Company, own two restaurant entities (the Pappas entities) that from time to time 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 three quarters ended May 4, 2011 and May 5, 2010 were \$27,000 and \$33,000, respectively. Services provided under this agreement are subject to review and approval by the Finance and Audit Committee of the Company's Board of Directors.

**Table of Contents****Operating Leases**

The Company leases from an unrelated third party a property that combines both the offices of the Company's Facility Services and Warehouse Operations. The property is approximately 60,000 square feet.

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 and occupied space in that center since July of 1969. In November of 2006, the Company executed a new lease agreement with respect to this restaurant along with a relocation into a new space in that center in July of 2008. The new lease agreement was approved by the Finance and Audit Committee of our Board of Directors.

On November 22, 2006, the Company executed a new lease agreement in connection with the replacement of the existing restaurant with a new prototype restaurant in the retail strip center described above. The new restaurant opened in July 2008 and the new lease agreement provides for a primary term of approximately twelve years with two subsequent five-year options. The new lease also gives the landlord an option to buy out the agreement on or after the calendar year 2015 by paying the unamortized cost of the Company's improvements. The Company is currently obligated to pay rent of \$20.00 per square foot (\$22.00 per square foot beginning January 2014) plus maintenance, taxes, and insurance during the primary term of the lease. Thereafter, the lease provides for increases in rent at set intervals. The Company made payments of \$263,000 and \$228,000 in the three quarters ended May 4, 2011 and May 5, 2010, respectively. The new lease agreement was approved by the Finance and Audit Committee and full Board of Directors.

Affiliated rents paid for a Houston restaurant property lease represented 3.1% and 6.1% of total rents for continuing operations for the three quarters ended May 4, 2011 and May 5, 2010, respectively.

|  | <b>Three Quarters Ended</b>               |   |
|--|---|---|
|  | <b>May 4,<br/>2011<br/>(36<br/>weeks)</b> | <b>May 5,<br/>2010<br/>(36<br/>weeks)</b> |
|  | <i>(In thousands, except percentages)</i> |   |
| <b>AFFILIATED COSTS INCURRED:</b>  |   |   |
| General and administrative expenses professional and other costs                 | \$ 42                                     | \$ 50                                     |
| Capital expenditures custom-fabricated and refurbished equipment and furnishings | 27  | 33  |
| Other operating expenses and opening costs, including property leases            | 266                                       | 240                                       |
| <b>Total</b>   | <b>\$ 335</b>                             | <b>\$ 323</b>                             |
| <b>RELATIVE TOTAL COMPANY COSTS:</b>   |   |   |
| General and administrative expenses  | \$ 19,985                                 | \$ 15,648                                 |
| Capital expenditures   | 5,140                                     | 2,266                                     |
| Other operating expenses and opening costs                                       | 52,451                                    | 33,654                                    |
| <b>Total</b>   | <b>\$ 77,576</b>                          | <b>\$ 51,568</b>                          |
| <b>AFFILIATED COSTS INCURRED AS A PERCENTAGE OF RELATIVE TOTAL COMPANY COSTS</b> |   |   |
|  | 0.43%                                     | 0.63%                                     |

**Board of Directors**

Pursuant to the terms of a 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 and Frank Markantonis is an attorney whose principal

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client is Pappas Restaurants, Inc., an entity owned by Harris J. Pappas and Christopher J. Pappas.

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 revolving credit facility.

**Table of Contents****Key Management Personnel**

In November 2005, Christopher Pappas entered into a new employment agreement that was subsequently amended in April 2011 to extend the termination date thereof to August 2012. Mr. Pappas continues to devote his primary time and business efforts to the Company while maintaining his role at Pappas Restaurants, Inc.

On July 26, 2010, Christopher and Harris Pappas guaranteed the payment of up to \$13.0 million of the Company's indebtedness under the revolving credit facility in connection with the expansion of the Company's revolving credit facility that accompanied the Company's acquisition of substantially all of the assets of Fuddruckers. The maximum amount of this guaranty was reduced to \$9.5 million on February 28, 2011 and was reduced to \$6.0 million on May 31, 2011.

On February 1, 2011, the Board of Directors of the Company approved the renewal of a consultant agreement with Ernest Pekmezaris, the Company's former Chief Financial Officer. Under the agreement, Mr. Pekmezaris will continue to furnish to the Company advisory and consulting services related to finance and accounting matters and other related consulting services. The agreement was renewed for twelve months at the same monthly rate, expiring on January 31, 2012. 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.

On April 20, 2011, Harris Pappas retired as Chief Operating Officer of the Company but continues to serve as a member of the Company's Board of Directors. In addition, pursuant to the Company's plan of succession, the Board of Directors appointed Peter Tropoli as Chief Operating Officer of the Company. Mr. Tropoli formerly served as Senior Vice President, Administration, General Counsel and Secretary of the Company. In the past, Mr. Tropoli 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, who is a director of the Company and the former Chief Operating Officer.

**Note 10. Share-Based Compensation****Stock Options**

The Company has an Incentive Stock Plan for officers and employees ( 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. Approximately 2.7 million shares were authorized for issuance under the Company's plans as of May 4, 2011, of which approximately 0.9 million shares were 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 three quarters ended May 4, 2011 is presented below:

|                                | Shares Under<br>Fixed Options | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term<br>(Years) | Aggregate Intrinsic<br>Value<br>(In thousands) |
|--------------------------------|-------------------------------|------------------------------------|--|--|
| Outstanding at August 25, 2010 | 1,296,887                     | \$ 7.53                            | 4.4  | \$ 711   |
| Granted                        | 106,533                       | 5.39                               | 2.5  |  |
| Exercised                      | 7,125                         | 3.77                               |  |  |
| Forfeited or Expired           | 34,473                        | 9.00                               |  |  |
| Outstanding at May 4, 2011     | 1,361,822                     | \$ 7.35                            | 4.2  | \$ 486   |
| Exercisable at May 4, 2011     | 807,656                       | \$ 9.16                            | 2.6  | \$ 153   |



***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 for the three quarters ended May 4, 2011 is presented in the following table:

|                             | Restricted Stock<br>Units | Weighted-Average<br>Fair Value<br>(Per share) | Weighted-Average<br>Remaining<br>Contractual Term<br>(Years) |
|-----------------------------|---------------------------|---|--|
| Unvested at August 25, 2010 | 65,189                    | \$ 8.13                                       | 0.8  |
| Granted                     | 77,769                    | 5.39  | 2.5  |
| Vested                      | 51,189                    | 9.42  |  |
| Forfeited                   |                           |   |  |
| Unvested at May 4, 2011     | 91,769                    | \$ 5.10                                       | 2.4  |

**Note 11. 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 and unvested restricted stock 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 stock options determined using the treasury stock method. Stock options with exercise prices exceeding current market prices that were excluded from the computations of net income per share amounted to approximately 1,033,000 and 974,000 shares for the quarters ended May 4, 2011 and May 5, 2010. Due to losses from continuing operations for the three quarters ended May 4, 2011 and May 5, 2010, the denominator for earnings per share assuming dilution is equal to the denominator for basic earnings per share.

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

|  | Quarter Ended                |                              | Three Quarters Ended         |                              |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
|  | May 4,<br>2011<br>(12 weeks) | May 5,<br>2010<br>(12 weeks) | May 4,<br>2011<br>(36 weeks) | May 5,<br>2010<br>(36 weeks) |
| <i>(In thousands except share data)</i>                            |                              |                              |                              |                              |
| <b>Numerator:</b>  |                              |                              |                              |                              |
| Income (loss) from continuing operations                           | \$ 2,056                     | \$ 1,222                     | \$ (256)                     | \$ (1,712)                   |
| Income (loss) from discontinued operations                         | (365)                        | (492)                        | 375                          | (1,697)                      |
| Net income (loss)  | \$ 1,691                     | \$ 730                       | \$ 119                       | \$ (3,409)                   |
| <b>Denominator:</b>  |                              |                              |                              |                              |
| Denominator for basic earnings per share - weighted-average shares | 28,257                       | 28,145                       | 28,224                       | 28,125                       |
| Effect of potentially dilutive securities:                         |                              |                              |                              |                              |
| Employee and non-employee stock options                            | 47                           | 6                            |                              |                              |
| Denominator for earnings per share assuming dilution               | 28,304                       | 28,151                       | 28,224                       | 28,125                       |
| <b>Income (loss) per share from continuing operations:</b>         |                              |                              |                              |                              |
| Basic  | \$ 0.07                      | \$ 0.04                      | \$ (0.01)                    | \$ (0.06)                    |
| Assuming dilution  | \$ 0.07                      | \$ 0.04                      | \$ (0.01)                    | \$ (0.06)                    |
| <b>Loss per share from discontinued operations:</b>                |                              |                              |                              |                              |
| Basic  | \$ (0.01)                    | \$ (0.01)                    | \$ 0.01                      | \$ (0.06)                    |
| Assuming dilution  | \$ (0.01)                    | \$ (0.01)                    | \$ 0.01                      | \$ (0.06)                    |

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Net income (loss) per share:

|                   |         |         |    |           |
|-------------------|---------|---------|----|-----------|
| Basic             | \$ 0.06 | \$ 0.03 | \$ | \$ (0.12) |
| Assuming dilution | \$ 0.06 | \$ 0.03 | \$ | \$ (0.12) |

**Table of Contents****Note 12. New Adopted Accounting Pronouncements**

In December 2009, the Financial Accounting Standards Board ( FASB ) issued ASU 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, which codifies SFAS No. 167, Amendments to FASB Interpretation No. 46(R). ASU 2009-17 eliminates exceptions to consolidating qualifying special-purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. ASU 2009-17 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting or similar rights should be consolidated and also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purposes and design and a company's ability to direct the activities of the entity that most significantly impacts the entity's economic performance. ASU 2009-17 is effective for the Company's 2011 fiscal year, and its implementation had no material effect on the Company's consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. This guidance amends the disclosure requirements related to recurring and nonrecurring fair value measurements and requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for the Company's 2011 fiscal year, and its implementation had no material effect on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU No. 2010-20, *Receivables (Topic 310)*, which provides guidance to enhance disclosures about the credit quality of a creditor's financing receivables and the adequacy of its allowance for credit losses. The guidance became effective as of May 4, 2011 and its implementations had no material effect on the Company's consolidated financial statements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements and footnotes for the period ended May 4, 2011 included in Item 1 of Part I of this Quarterly Report on Form 10-Q, and the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended August 25, 2010.*

The following presents an analysis of the results and financial condition of our continuing operations. Except where indicated otherwise, the results of discontinued operations are excluded from this discussion.

**Overview**

Luby's, Inc. is a multi-branded company operating in the restaurant industry and the contract food services industry. Our primary brands include Luby's Cafeterias, Luby's Culinary Contract Services and Fuddruckers. Also included in our brands are Luby's, Etc. and Koo Koo Roo Chicken Bistro. We purchased substantially all of the assets of Fuddruckers, Inc., Magic Brands, LLC and certain of their affiliates (collectively, Fuddruckers) in July 2010; accordingly, the first quarter ended November 17, 2010 represents the first full fiscal quarter in which the operations of Fuddruckers branded restaurants are included in our results of operations.

As of May 4, 2011, we owned and operated 155 restaurants, of which 95 are traditional cafeterias, 56 are gourmet hamburger restaurants, 3 are upscale fast serve chicken restaurants, and one primarily serves seafood. These establishments are located in close proximity to retail centers, business developments and residential areas mostly throughout the United States.

Also as of May 4, 2011, we operated 18 culinary contract service facilities. These facilities are located within healthcare and education settings in Texas and Louisiana. These facilities provide food service options to varied populations including in-hospital-room patient meal service, retail food-court style restaurant dining, and coffee/snack kiosks.

Also as of May 4, 2011, we are a franchisor for a network of 127 Fuddruckers restaurants. The owners of these franchise units pay royalty revenue to us as a franchisor.



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### ***Accounting Periods***

Our fiscal year ends on the last Wednesday in August. As such, each fiscal year normally consists of 13 four-week periods, or accounting periods, accounting for 364 days in the aggregate. Each of the first three quarters of each fiscal year consists of three four-week periods, while the fourth quarter normally consists of four four-week periods. Comparability between quarters may be affected by varying lengths of the quarters, as well as the seasonality associated with the restaurant business.

### ***Same-Store Sales***

The restaurant business is highly competitive with respect to food quality, concept, location, price, and service, all of which may have an effect on same-store sales. Our same-store sales calculation measures the relative performance of a certain group of restaurants. To qualify for inclusion in this group, a store must have been in operation for 18 consecutive accounting periods. Our Fuddruckers units will not be included in this measurement until after we have operated them for the required period. Stores that close on a permanent basis are removed from the group in the fiscal quarter when operations cease at the restaurant, but remain in the same-store group for previously reported fiscal quarters. Although management believes this approach leads to more effective year-over-year comparisons, neither the time frame nor the exact practice may be similar to those used by other restaurant companies.

## **RESULTS OF OPERATIONS**

### ***For the Third Quarter and Year-to-Date Fiscal Year 2011 versus the Third Quarter and Year-to-Date Fiscal Year 2010***

#### ***Sales***

Total sales increased approximately \$26.2 million, or 45.8%, in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010, consisting of a \$24.1 million increase in restaurant sales, \$1.6 million in Fuddruckers franchise revenue, a \$0.3 million increase in Culinary Contract sales, and \$0.2 million in vending revenue from our Company-operated Fuddruckers units. The \$24.1 million increase in restaurant sales included a \$1.9 million increase in sales at Luby's Cafeteria-branded restaurants and \$22.2 million in sales from Fuddruckers-branded restaurants in the quarter ended May 4, 2011. On a same-store basis, restaurant sales at the Luby's Cafeteria restaurants increased 3.5% during the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010. The year-over-year same store sales increase of 3.5% in the quarter ended May 4, 2011 compared to a year-over-year decrease of 4.8% in the quarter ended May 5, 2010. The improved same store sales is primarily due to improving economic conditions and our focus on local restaurant marketing efforts and limited time offers used to generate customer traffic at the Luby's Cafeteria restaurant units as well as the contribution from offering breakfast on the weekends at the majority of our cafeteria restaurants in the quarter ended May 4, 2011.

Total sales increased approximately \$71.9 million, or 44.0%, in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010, consisting of a \$66.3 million increase in restaurant sales, \$4.6 million in Fuddruckers franchise revenue, a \$0.5 million increase in Culinary Contract sales, and \$0.4 million in vending revenue from our Company-operated Fuddruckers units. The \$66.3 million increase in restaurant sales included a \$5.3 million increase in sales at Luby's Cafeteria-branded restaurants and \$61.0 million in sales from Fuddruckers-branded restaurants in the three quarters ended May 4, 2011. On a same-store basis, restaurant sales at the Luby's Cafeteria restaurants increased 3.9% during the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010. The improved same-store sales is primarily due to improving economic conditions and our focus on local restaurant marketing efforts and limited time offers used to generate customer traffic at the Luby's Cafeteria restaurant units as well as the contribution from offering breakfast on the weekends at approximately 66.0% of our cafeteria restaurants in the three quarters ended May 4, 2011.

The prior year results of restaurants closed as part of our Cash Flow Improvement and Capital Redeployment Plan (the Plan) have been reclassified to discontinued operations.

#### ***Cost of Food***

Food costs increased approximately \$7.2 million, or 48.8%, in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010 due to the inclusion in our operations of the Fuddruckers units acquired in July 2010. As a percentage of restaurant sales, food costs increased 0.8%, to 28.2%, in the quarter ended May 4, 2011 compared to 27.4% in the quarter ended May 5, 2010, primarily due to (1) higher food commodity costs, particularly in the areas of beef, seafood, poultry, and fresh produce; (2) adding the all-you-can eat breakfast offer on the weekends in approximately 66.0% of our cafeteria units; and (3) offering select menu items at a lower price on a limited time basis to generate customer traffic.

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Food costs increased approximately \$22.4 million, or 53.4%, in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010, due to the inclusion in our operations of the Fuddruckers units acquired in July 2010. As a percentage of restaurant sales, food costs increased 1.9%, to 29.2% in the three quarters ended May 4, 2011 compared to 27.3% in the three quarters ended May 5, 2010, primarily due to (1) higher food commodity costs, particularly in the areas of beef, seafood, poultry, and fresh produce; (2) adding the all-you-can eat breakfast offer on the weekends in approximately 66.0% of our cafeteria units; and (3) offering select menu items at a lower price on a limited time basis to generate customer traffic.

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**Table of Contents*****Payroll and Related Costs***

Payroll and related costs increased approximately \$7.3 million in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010. Payroll and related expenses increased due to the inclusion in our operations of the Fuddruckers units. As a percentage of restaurant sales, these costs decreased 1.5%, to 33.6%, in the quarter ended May 4, 2011 compared to 35.1% in the quarter ended May 5, 2010, due to inclusion of lower restaurant labor costs associated with the acquired Fuddruckers units partially offset by deployment of additional hourly labor to accommodate the increased customer traffic at our Luby's Cafeteria units driven by longer operating hours at approximately 66.0% of units that now serve breakfast on the weekends, as well as increased customer traffic from limited time offers. The restaurant labor costs as a percentage of restaurant sales at a Fuddruckers unit are typically lower than that of a Luby's Cafeteria unit due to the smaller size and lower complexity of operations.

Payroll and related costs increased approximately \$20.7 million in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010, due to the inclusion in our operations of the Fuddruckers units acquired in July 2010. As a percentage of restaurant sales, these costs decreased 1.6%, to 34.7%, in the three quarters ended May 4, 2011 compared to 36.3% in the three quarters ended May 5, 2010, due to inclusion of lower restaurant labor costs associated with the acquired Fuddruckers units partially offset by higher worker's compensation expense, additional hourly labor to accommodate the increased customer traffic at our Luby's Cafeteria units driven by longer operating hours at approximately 66.0% of units that now serve breakfast on the weekends, as well as increased customer traffic from limited time offers.

***Other Operating Expenses***

Other operating expenses primarily include restaurant-related expenses for utilities, repairs and maintenance, advertising, insurance, services, supplies and occupancy costs. Other operating expenses increased by approximately \$6.7 million, or 63.8%, in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010, primarily due to the inclusion in our operations of the Fuddruckers units acquired in July 2010, partially offset by lower utility costs of approximately \$0.2 million at our cafeteria units. As a percentage of restaurant sales, other operating expenses increased 2.6%, to 22.1%, in the quarter ended May 4, 2011 compared to 19.5% in the quarter ended May 5, 2010, due to (1) the increase in the mix of leased units with the acquisition of substantially all of the assets of Fuddruckers, (2) higher repairs, maintenance, and supplies costs related to upgrades at Fuddruckers units, partially offset by (3) lower utility expenses.

Other operating expenses increased by approximately \$18.8 million, or 56.2%, in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010, primarily due to the inclusion in our operations of the Fuddruckers units acquired in July 2010, partially offset by lower marketing and advertising costs of approximately \$0.9 million. As a percentage of restaurant sales, other operating expenses increased 1.9%, to 23.7%, in the three quarters ended May 4, 2011 compared to 21.8% in the three quarters ended May 5, 2010, due to (1) the increase in the mix of leased units with the acquisition of substantially all of the assets of Fuddruckers, (2) higher repairs, maintenance, and supplies costs related to upgrades at Fuddruckers units, partially offset by (3) lower marketing and advertising expenses, and (4) lower utility expenses.

***Opening Costs***

Opening costs include labor, supplies, occupancy, and other costs necessary to support the restaurant through its opening period. Opening costs were approximately \$34 thousand in the quarter ended May 4, 2011 compared to approximately \$31 thousand in the quarter ended May 5, 2010. The quarter ended May 4, 2011 and the quarter ended May 5, 2010 included carrying costs of locations to be developed for future restaurant openings.

Opening costs were approximately \$0.2 million in the three quarters ended May 4, 2011 compared to approximately \$0.2 million in the three quarters ended May 5, 2010. Opening costs in the three quarters ended May 4, 2011 and the three quarters ended May 5, 2010 included the carrying costs of locations to be developed for future restaurant openings. The three quarters ended May 4, 2011 also included the opening costs for one Company-operated unit that was previously operated as a franchisee unit, and the support costs associated with franchisees opening two units. The three quarters ended May 5, 2010 also included an impairment charge of less than \$0.1 million for assets that will not be fully incorporated into the final design of the unit.



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***Cost of Culinary Contract Services***

Cost of culinary contract services increased by approximately \$0.4 million in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010. Cost of culinary contract services includes the food, labor, and other direct operating expenses associated with culinary contract services. During the quarter ended May 4, 2011, culinary contract services operated 18 facilities compared to 17 for the quarter ended May 5, 2010.

Cost of culinary contract services increased by approximately \$0.5 million in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010.

***Depreciation and Amortization***

Depreciation and amortization expense increased by approximately \$0.4 million, or 13.0%, in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010 due to the acquisition of substantially all of the assets of Fuddruckers.

Depreciation and amortization expense increased by approximately \$1.6 million, or 15.1%, in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010 due to the acquisition of substantially all of the assets of Fuddruckers.

***General and Administrative Expenses***

General and administrative expenses include corporate salaries and benefits-related costs, including restaurant area leaders, share-based compensation, professional fees, travel and recruiting expenses and other office expenses. General and administrative expenses increased by approximately \$1.8 million, or 35.2%, in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010. The increase was due to (1) an increase of \$1.1 million in salaries and benefits expense, primarily as a result of the addition of staff related to the Fuddruckers-branded restaurants acquired in July 2010 and (2) an increase in travel, supplies, insurance, and professional fees, also primarily related to supporting the Fuddruckers-branded restaurants, which have a larger geographic footprint. As a percentage of total sales, general and administrative expenses decreased to 8.4% in the quarter ended May 4, 2011 compared to 9.0% in the quarter ended May 5, 2010.

General and administrative expenses increased by approximately \$4.3 million, or 27.7%, in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010. The increase was due to (1) an increase of \$1.9 million in salaries and benefits expense as the addition of corporate staff related to the Fuddruckers-branded restaurants acquired in July 2010 was partially offset by the reductions in corporate staffing in the prior year; (2) an increase of \$1.0 million in professional fees and corporate services; (3) an increase of \$0.8 million in travel and supplies, largely related to supporting the Fuddruckers-branded restaurants, which have a larger geographic footprint; and (4) an increase of \$0.5 million in insurance and other corporate-related expenses. As a percentage of total sales, general and administrative expenses decreased to 8.5% in the three quarters ended May 4, 2011 compared to 9.6% in the three quarters ended May 5, 2010.

***Net Loss (Gain) on Disposition of Property and Equipment***

The net loss on disposition of property and equipment was approximately \$28 thousand in the quarter ended May 4, 2011. The net gain on disposition of property and equipment was approximately \$0.2 million in the quarter ended May 5, 2010. The net gain in the quarter ended May 5, 2010 was primarily from the gain on the sale of one closed restaurant property offset by normal asset retirement activity in our restaurant units.

The disposition of property and equipment in the three quarters ended May 4, 2011 resulted in a net loss of approximately \$1,000. The net gain on disposition of property and equipment was approximately \$1.0 million in the three quarters ended May 5, 2010 which included a gain on the sale of an easement right and the sale of one unit in excess of net book value, partially offset by normal asset retirement activity in our restaurant units.

***Interest Income***

Interest income decreased by approximately \$7 thousand in the quarter ended May 4, 2011 compared to the quarter ended May 5, 2010, primarily related to lower cash and cash equivalents.

Interest income decreased by approximately \$19 thousand in the three quarters ended May 4, 2011 compared to the three quarters ended May 5, 2010, primarily related to lower cash and cash equivalents.



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### ***Interest Expense***

Interest expense in the quarter ended May 4, 2011 increased approximately \$0.5 million compared to the interest expense in the quarter ended May 5, 2010, due to higher outstanding debt balances resulting from borrowings related to the acquisition of substantially all of the assets of Fuddruckers.

Interest expense in the three quarters ended May 4, 2011 increased approximately \$1.5 million in the three quarters ended February 11, 2010 compared to the three quarters ended May 5, 2010, due to higher outstanding debt balances resulting from borrowings related to the acquisition of substantially all of the assets of Fuddruckers.

### ***Gain on Sales and Redemptions (Impairment of Fair Market Value) of Investments***

The impairment charge for decrease in fair market value of investments of \$0.4 million in the three quarters ended May 5, 2010 was due to the illiquidity of the market for auction rate securities investments. The reduction in fair value of the investments was derived through valuation and was considered other than temporary. However, the investments were sold at par by the end of fiscal year 2010 and the loss was recouped.

The Company has no similar investments as of the quarter ended May 4, 2011.

### ***Other Income, Net***

Other income, net consisted primarily of the following components: net rental property income and expenses relating to property for which we are the landlord; prepaid sales tax discounts earned through our participation in state tax prepayment programs; and oil and gas royalty income. Other income, net in the quarter ended May 4, 2011 increased approximately \$0.2 million compared to the quarter ended May 5, 2010. The increase was primarily due to (1) net rental income on properties that we lease to third parties; (2) oil and gas royalty income; and (3) higher prepaid sales tax discounts earned on a higher sales volume with the inclusion of sales from Fuddruckers restaurants.

Other income, net in the three quarters ended May 4, 2011 increased approximately \$0.3 million compared to the three quarters ended May 5, 2010. The increase was partially due to (1) net rental income on properties that we lease to third parties; (2) higher prepaid sales tax discounts earned on a higher sales volume with the inclusion of sales from Fuddruckers units; and (3) oil and gas royalty income.

### ***Taxes***

For the quarter ended May 4, 2011, the income taxes related to continuing operations resulted in a tax provision of \$1.4 million compared to a tax provision of \$0.5 million for the quarter ended May 5, 2010. For the quarters ended May 4, 2011 and May 5, 2010 there was no change to the valuation allowance related to deferred tax assets.

For the three quarters ended May 4, 2011, the income taxes related to continuing operations resulted in a tax provision of \$0.2 million compared to a tax benefit of \$0.3 million for the three quarters ended May 5, 2010. The primary reason for the difference is the reduction in the loss from continuing operations from \$2.0 million for the three quarters ended May 5, 2010 to almost zero for the three quarters ended May 4, 2011.

Additionally, the income tax provision of \$0.2 million related to continuing operations for the three quarters ended May 4, 2011 is the sum of (1) estimated taxes based on income from continuing operations, (2) an increase of \$0.1 million in the valuation allowance, (3) the tax impact of finalizing estimated amounts after filing our federal income tax return and paying a state income tax extension payment during the quarter ended May 4, 2011 and (4) foreign withholding on royalty payments from franchisees.

### ***Discontinued Operations***

The loss from discontinued operations was \$0.4 million in the quarter ended May 4, 2011 compared to a \$0.5 million loss in the quarter ended May 5, 2010. The loss for the quarter ended May 4, 2011 included (1) a \$0.1 million loss on sales of assets related to discontinued operations; (2) \$0.3 million in carrying costs associated with assets that are related to discontinued operations; and (3) a \$0.1 million impairment charge for assets related to discontinued operations, partially offset by a \$0.1 million income tax benefit related to discontinued operations.

The loss from discontinued operations of \$0.5 million in the quarter ended May 5, 2010 included \$0.7 million in carrying costs associated with assets related to discontinued operations, offset by a net tax benefit of \$0.2 million related to discontinued operations.



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The income from discontinued operations was \$0.4 million in the three quarters ended May 4, 2011 compared to a \$1.7 million loss in the three quarters ended May 5, 2010. The income for the three quarters ended May 4, 2011 included \$2.0 million in gains on the sale of assets related to discontinued operations, partially offset by (1) \$1.0 million in carrying costs associated with assets related to discontinued operations; (2) \$0.6 million impairment charge for assets related to discontinued operations; and (3) a \$0.1 million income tax provision related to discontinued operations.

The loss from discontinued operations of \$1.7 million in the three quarters ended May 5, 2010 included \$4.2 million in carrying costs associated with assets related to discontinued operations, offset by (1) a \$1.6 million gain on the sale of assets related to discontinued operations and (2) a tax benefit of \$0.9 million related to discontinued operations.

**LIQUIDITY AND CAPITAL RESOURCES*****Cash and Cash Equivalents***

***General.*** Our primary sources of short-term and long-term liquidity are cash flows from operations, proceeds from the sale of assets and our revolving credit facility. Net cash provided by operating activities was \$6.6 million for the three quarters ended May 4, 2011 compared to \$0.2 million cash used in operating activities for the three quarters ended May 5, 2010. We plan to continue the level of capital and repair and maintenance expenditures necessary to keep our restaurants attractive and operating efficiently.

Our cash requirements consist principally of

repayments of debt under our 2009 Credit Facility (as defined below),

capital expenditures for culinary contract services development and construction, restaurant renovations and upgrades and information technology, and

working capital primarily for our owned restaurants and culinary contract service agreements.

As of May 4, 2011, we had \$31.0 million outstanding under our 2009 Credit Facility. Under the current terms, the outstanding balance matures and the 2009 Credit Facility expires on September 1, 2011. We expect to refinance any remaining portion of the debt and renew or replace our existing credit facility prior to September 1, 2011. We may not be able to refinance the existing facility or enter into a new facility on a timely basis or on terms that are acceptable to us, and our inability to refinance the 2009 Credit Facility could have a material adverse effect on our financial condition.

As is common in the restaurant industry, we maintain relatively low levels of accounts receivable and inventories, and our vendors grant trade credit for purchases such as food and supplies. However, high levels of accounts receivable are typical for culinary contract services.

Cash and cash equivalents decreased to \$1.2 million at May 4, 2011 from \$2.3 million at the beginning of the fiscal year. This decrease was primarily due to cash used to repay debt of \$10.5 million, capital expenditures of \$5.1 million and the acquisition of one additional Fuddrucker's location for \$0.3 million, offset by proceeds from sale of assets of \$8.5 million and cash provided by operating activities of \$6.6 million. We generally reinvest available cash flows from operations to develop new restaurants, enhance existing restaurants and to support culinary contract services.

The following table summarizes our cash flows from operating, investing and financing activities:

| <b>Three Quarters ended</b> |                   |
|-----------------------------|-------------------|
| <b>May 4,</b>               | <b>May 5,</b>     |
| <b>2011</b>                 | <b>2010</b>       |
| <b>(36</b>                  |                   |
| <b>weeks)</b>               | <b>(36 weeks)</b> |

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|                                       | <i>(In thousands)</i> |          |
|---------------------------------------|-----------------------|----------|
| Total cash provided by (used in):     |                       |          |
| Operating activities                  | \$ 6,598              | \$ 244   |
| Investing activities                  | 3,089                 | 6,950    |
| Financing activities                  | (10,755)              | (378)    |
| <br>                                  |                       |          |
| Increase in cash and cash equivalents | \$ (1,068)            | \$ 6,816 |

Operating Activities. In the three quarters ended May 4, 2011, cash provided by operating activities increased \$6.4 million compared to the three quarters ended May 5, 2010. Cash provided by operating activities before changes in operating assets and liabilities was \$11.8 million for the three quarters ended May 4, 2011 compared to \$5.0 million for the three quarters ended May 5, 2010, an increase of \$6.8 million. Changes in operating assets and liabilities used \$5.2 million cash for the three quarters ended May 4, 2011 compared to \$4.8 million for the three quarters ended May 5, 2010, an increase of \$0.4 million.

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***Investing Activities.*** Cash provided by investing activities was \$3.1 million in the three quarters ended May 4, 2011 compared to \$7.0 million of cash flows provided by investing activities in the three quarters ended May 5, 2010. The \$3.9 million change is due to a \$1.4 million reduction in proceeds from the redemption of investments, a \$0.7 million increase in proceeds from the disposal of assets and property held for sale, a \$2.9 million increase in purchases of property and equipment and \$0.3 million for the acquisition of one additional Fuddruckers location. Our purchase of property and equipment includes, among other things, restaurant remodeling, information technology enhancements and Culinary Contract Service locations. We expect to spend approximately \$8.0 million to \$10.0 million on capital expenditures in fiscal year 2011.

***Financing Activities.*** Cash used in financing activities increased from \$0.4 million to \$10.8 million, compared to the three quarters ended May 5, 2010, due primarily to net repayment of prior net borrowings under our 2009 Credit Facility during the three quarters ended May 4, 2011.

### ***Status of Trade Accounts and Other Receivables, Net***

We monitor the aging of our receivables, including Fuddruckers franchising related receivables, and record provisions for uncollectability as appropriate. Credit terms of accounts receivable associated with our culinary contract service business vary from 30 to 60 days based on contract terms.

### ***Working Capital***

We had a working capital deficit of \$50.6 million as of May 4, 2011, compared to a working capital deficit of \$23.3 million as of August 25, 2010. The \$27.3 million increase in the deficit is primarily due to the \$31.0 million outstanding under the 2009 Credit Facility and decreases in cash of \$1.1 million offset by decreases in accounts payable and accrued expenses and other liabilities of \$1.2 million partially offset by increased accounts receivable, food and supply inventories and prepaid expenses of \$3.5 million. We expect to meet our working capital requirements through cash flows from operations, sales of properties and availability under our 2009 Credit Facility.

### ***Capital Expenditures***

Capital expenditures consist of purchases of real estate for future restaurant sites, new units construction, purchases of new and replacement restaurant furniture and equipment, and ongoing remodeling programs. Capital expenditures for the three quarters ended May 4, 2011 were approximately \$5.1 million, and related to maintaining our investment in existing operating units. We expect to be able to fund all capital expenditures in fiscal year 2011 using cash flows from operations and availability under our 2009 Credit Facility. We expect to spend approximately \$8.0 million to \$10.0 million on capital expenditures in fiscal year 2011.

## **DEBT**

### ***Revolving Credit Facility***

In November 2009, we entered into a revolving credit facility with Wells Fargo Bank, National Association, as Administrative Agent, and Amegy Bank, National Association, as Syndication Agent. The following description summarizes the material terms of the revolving credit facility, as subsequently amended as of January 31, 2010, July 26, 2010, September 30, 2010 and October 31, 2010 (the revolving credit facility, together with all amendments thereto, is referred to as the 2009 Credit Facility ).

The aggregate amount of the lenders' commitments under the 2009 Credit Facility currently is \$43.9 million as of May 31, 2011 and will be reduced to \$40.0 million on August 31, 2011. The 2009 Credit Facility also provides for the issuance of letters of credit in a maximum aggregate amount of \$15.0 million outstanding at any one time.

The 2009 Credit Facility is guaranteed by all of our present or future subsidiaries. In addition, in connection with the expansion of the 2009 Credit Facility that accompanied our acquisition of substantially all of the assets of Fuddruckers in July 2010, Christopher J. Pappas, our President and Chief Executive Officer, and Harris J. Pappas, a member of our Board of Directors, guaranteed the payment of up to \$13.0 million of our indebtedness under the 2009 Credit Facility. The maximum amount of this guaranty was reduced to \$9.5 million on February 28, 2011 and further reduced to \$6.0 million on May 31, 2011.

The 2009 Credit Facility expires on September 1, 2011 and all amounts owed by us under the 2009 Credit Facility must be repaid in full upon the maturity date of September 1, 2011.

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At any time throughout the term of the 2009 Credit Facility, we have the option to elect one of two bases of interest rates. One interest rate option is the greater of (a) the Federal Funds Effective Rate plus 0.50%, or (b) prime, plus, in either case, an applicable spread that ranges from 1.00% to 2.75% per annum, subject to an interest rate floor of 4.00%. The other interest rate option is the London InterBank Offered Rate plus a spread that ranges from 2.75% to 4.50% per annum, subject to an interest rate floor of 4.00%. The applicable spread under each option is dependent upon the Total Leverage Ratio (as defined below) at the most recent determination date.



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We are obligated to pay to the Administrative Agent for the account of each lender a quarterly commitment fee based on the average daily unused amount of the commitment of such lender, ranging from 0.30% to 0.45% per annum depending on the Total Leverage Ratio at the most recent determination date.

The proceeds of the 2009 Credit Facility may be used for our general corporate purposes and general working capital purposes.

Borrowings under the 2009 Credit Facility are subject to mandatory repayment with the proceeds of sales of certain of our real property, subject to certain exceptions.

The 2009 Credit Facility is secured by a perfected first priority lien on certain of our real property and all of the material personal property owned by us or any of our subsidiaries, other than certain excluded assets (as defined in the agreement governing the 2009 Credit Facility (as amended, the Credit Agreement )).

The Credit Agreement contains covenants that include, among others

the maintenance of a ratio of indebtedness (as defined in the Credit Agreement) to EBITDA (as defined in the Credit Agreement) of no greater than 2.75 to 1.00 at any time (the Total Leverage Ratio ),

the maintenance of a ratio of EBITDA to the sum of (1) interest expense (as defined in the Credit Agreement) plus (2) the outstanding balance of the loans divided by seven (the Interest Coverage Ratio ) of at least 2.00 to 1.00 as of the end of each fiscal quarter,

the maintenance of EBTIDA of not less than (1) \$4,500,000 for the fiscal quarter ended August 25, 2010, (2) \$2,500,000 for the fiscal quarter ended November 17, 2010, (3) \$3,500,000 for the fiscal quarter ended February 9, 2011, (4) \$7,000,000 for the fiscal quarter ended May 4, 2011 and (5) \$6,500,000 for the fiscal quarter ending August 31, 2011,

restrictions on incurring indebtedness, including certain guarantees and capital lease obligations,

restrictions on incurring liens on certain of our property and the property of our subsidiaries,

restrictions on transactions with affiliates and materially changing our business,

restrictions on making certain investments, loans, advances and guarantees,

restrictions on selling assets outside the ordinary course of business,

prohibitions on entering into sale and leaseback transactions,

limiting Capital Expenditures (as defined in the Credit Agreement) to \$10.0 million for the fiscal year ended August 25, 2010 and to \$15.0 million for any subsequent fiscal year; and

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restrictions on certain acquisitions of all or a substantial portion of the assets, property and/or equity interests of any person. We are in compliance with the covenants contained in the Credit Agreement. To comply with our quarterly minimum EBITDA covenant for the fiscal quarter ended November 17, 2010, however, we requested and received approval from the lenders to add to EBITDA non-recurring expenses, as defined, related to our acquisition of substantially all of the assets of Fuddruckers. The definition of EBITDA in the Credit Agreement permits us to make adjustments to EBITDA for certain non-recurring expenses, as defined, or income items, among others, subject to the approval of the Administrative Agent. If we had not received approval to adjust our EBITDA, we would not have been in compliance with the minimum EBITDA covenant as of the end of the first quarter of fiscal 2011. Although we expect to meet the requirements of the minimum EBITDA covenant in the future, noncompliance could have a material adverse affect on our financial condition and would represent an event of default under the Credit Agreement.

The Credit Agreement also includes customary events of default. If a default occurs and is continuing, the lenders' commitments under the 2009 Credit Facility may be immediately terminated and/or we may be required to repay all amounts outstanding under the 2009 Credit Facility.

As of May 4, 2011, we had \$31.0 million in outstanding loans and \$1.2 million committed under letters of credit, which were issued as security for the payment of insurance obligations.

At May 4, 2011, \$16.6 million was available under the 2009 Credit Facility.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The Consolidated Financial Statements included in Item 1 of Part 1 of this report were prepared in conformity with U.S. generally accepted accounting principles. Preparation of the financial statements requires us to make judgments, estimates and assumptions that affect the amounts of assets and liabilities in the financial statements and revenues and expenses during the reporting periods. Due to the significant, subjective and complex judgments and estimates used when preparing our consolidated

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financial statements, management regularly reviews these assumptions and estimates with the Finance and Audit Committee of our Board of Directors. Management believes the following are critical accounting policies used in the preparation of these financial statements.

### ***Income Taxes***

The estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in the accompanying consolidated balance sheets, as well as operating loss and tax credit carrybacks and carryforwards are recorded. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities (temporary differences) and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. We periodically review the recoverability of tax assets recorded on the balance sheet and provide valuation allowances as management deems necessary.

If the future consequences of differences between financial reporting bases and tax bases of our assets and liabilities result in a net deferred tax asset, management will evaluate the probability of our ability to realize the future benefits of such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that all or some portion of the deferred tax asset will not be realized. The realization of such net deferred tax will generally depend on whether we will have sufficient taxable income of an appropriate character within the carryforward period permitted by the tax law.

Management evaluates both positive and negative evidence, including its forecasts of our future taxable income adjusted by varying probability factors, in making a determination as to whether it is more likely than not that all or some portion of the deferred tax asset will be realized. Based on its analysis, management concluded that a valuation allowance was necessary.

The valuation allowance partially offsets our operating loss ( NOL ) carryovers to future years and our carryover of general business tax credits. Both of these items may be carried over up to twenty years in the future for possible utilization in the future. The carryover of the NOLs began in fiscal year 2008 and will begin to expire at the end of fiscal year 2028 through the end of fiscal year 2031 if not utilized by then. The carryover of the general business credits began in fiscal year 2006 and will begin to expire at the end of fiscal year 2026 through the end of fiscal year 2031 if not utilized by then.

Management makes judgments regarding the interpretation of tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. We operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions as well as by the Internal Revenue Service. In management's opinion, adequate provisions for income taxes have been made for all open tax years. The potential outcomes of examinations are regularly assessed in determining the adequacy of the provision for income taxes and income tax liabilities. Management believes that adequate provisions have been made for reasonable and foreseeable outcomes related to uncertain tax matters. Management has recently been notified that the IRS will review the income tax return for fiscal year 2008. The details and scope of the planned review are not known at this time. There are no other audits or reviews at this time.

### ***Impairment of Long-Lived Assets***

We periodically evaluate long-lived assets held for use and held for sale, whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. We analyze historical cash flows of operating locations and compare results of poorer performing locations to more profitable locations. We also analyze lease terms, condition of the assets and related need for capital expenditures or repairs, construction activity in the surrounding area as well as the economic and market conditions in the surrounding area.

For assets held for use, we estimate future cash flows using assumptions based on possible outcomes of the areas analyzed. If the undiscounted future cash flows are less than the carrying value of our location's assets, we record an impairment based on an estimate of discounted cash flows. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. Assumptions and estimates used include operating results, changes in working capital, discount rate, growth rate, anticipated net proceeds from disposition of the property and if applicable, lease terms. The span of time for which future cash flows are estimated is often lengthy, increasing the sensitivity to assumptions made. The time span is longer and could be 20 to 25 years for newer properties, but only 5 to 10 years for older properties. 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. We consider 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 discounted cash flows. We operated 155 restaurants as of May 4, 2011 and periodically experience unanticipated changes in our assumptions and estimates. Those changes could have a significant impact on discounted cash flow models with a corresponding significant impact on the measurement of an impairment. We believe we have 5 locations with an aggregate net carrying value of assets held for use of \$1.5 million where it is possible that an impairment charge could be taken over the next 12 months. Gains are not recognized until the assets are disposed.



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We evaluate the useful lives of our intangible assets, primarily the Fuddruckers trade name and franchise agreements to determine if they are definite or indefinite-lived. Reaching a determination of useful life requires significant judgments and assumptions regarding the future effects of obsolescence, contract term, demand, competition, other economic factors (such as the stability of the industry, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels), the level of required maintenance expenditures, and the expected lives of other related groups of assets.

### ***Investments***

Investments include available-for-sale securities, classified as long-term and reported at fair value. Securities available-for-sale consist of auction rate securities. Declines in fair value of available-for-sale securities are analyzed to determine if the decline is temporary or other-than-temporary. Temporary unrealized gains and losses on available-for-sale securities are excluded from earnings and reported in shareholders' equity. Other-than-temporary declines reduce earnings. Any increases in other-than-temporary declines in fair value will not be realized until the securities are sold.

### ***Property Held for Sale***

We periodically review long-lived assets against our plans to retain or ultimately dispose of properties. If we decide to dispose of a property, it will be moved to property held for sale and actively marketed. Property held for sale is recorded at amounts not in excess of what management currently expects to receive upon sale, less costs of disposal. We analyze market conditions each reporting period and record additional impairments due to declines in market values of like assets. The fair value of the property is determined by observable inputs such as appraisals and prices of comparable properties in active markets for assets like ours. Gains are not recognized until the properties are sold.

### ***Insurance and Claims***

We self-insure a significant portion of risks and associated liabilities under our employee injury, workers' compensation and general liability programs. We maintain insurance coverage with third party carriers to limit our per-occurrence claim exposure. We have recorded accrued liabilities for self-insurance based upon analysis of historical data and actuarial estimates, and we review these amounts on a quarterly basis to ensure that the liability is appropriate.

The significant assumptions made by the actuary to estimate self-insurance reserves, including incurred but not reported claims, are as follows: (1) historical patterns of loss development will continue in the future as they have in the past (Loss Development Method), (2) historical trend patterns and loss cost levels will continue in the future as they have in the past (Bornhuetter-Ferguson Method), and (3) historical claim counts and exposures are used to calculate historical frequency rates and average claim costs are analyzed to get a projected severity (Frequency and Severity Method). The results of these methods are blended by the actuary to provide the reserves estimates.

Actual workers' compensation and employee injury claims expense may differ from estimated loss provisions. The ultimate level of claims under the in-house safety program are not known, and declines in incidence of claims as well as claims costs experiences or reductions in reserve requirements under the program may not continue in future periods.

### ***Share-Based Compensation***

Share-based compensation is recognized as compensation expense in the income statement utilizing the fair value on the date of the grant. The fair value of restricted stock units is valued at the closing market price of the Company's common stock at the date of grant. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. Assumptions for volatility, expected option life, risk free interest rate and dividend yield are used in the model.

## **NEW ACCOUNTING PRONOUNCEMENTS**

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820) which amends the fair value measurement and disclosure requirements. The amendment is effective during interim and annual reporting periods beginning after December 15, 2011. We are currently evaluating the impact on our consolidated financial statements.

## **INFLATION**

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It is generally our policy is to maintain stable menu prices without regard to seasonal variations in food costs. Certain increases in costs of food, wages, supplies, transportation and services may require us to increase our menu prices from time to time. To the extent prevailing market conditions allow, we intend to adjust menu prices to maintain profit margins.

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**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains statements that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements contained in this Form 10-Q, other than statements of historical facts, are forward-looking statements for purposes of these provisions, including any statements regarding

future operating results,

future capital expenditures, including expected reductions in capital expenditures,

future debt, including liquidity and the sources and availability of funds related to debt, and expected repayment of debt, ability to refinance the existing credit facility or enter into a new credit facility on a timely basis,

expected sources of funds for working capital requirements,

plans for our new prototype restaurants,

plans for expansion of our business,

scheduled openings of new units,

closing existing units,

effectiveness of management's Cash Flow Improvement and Capital Redeployment Plan,

future sales of assets and the gains or losses that may be recognized as a result of any such sales, and

continued compliance with the terms of our 2009 Credit Facility.

In some cases, investors can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, outlook, may, should, will, and would or similar words. Forward-looking statements are based on certain assumptions and analyses made by management in light of their experience and perception of historical trends, current conditions, expected future developments and other factors we believe are relevant. Although management believes that our assumptions are reasonable based on information currently available, those assumptions are subject to significant risks and uncertainties, many of which are outside of our control. The following factors, as well as the factors set forth in Item 1A of this Form 10-Q and any other cautionary language in this Form 10-Q, provide examples of risks, uncertainties, and events that may cause our financial and operational results to differ materially from the expectations described in our forward-looking statements

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general business and economic conditions,

the impact of competition,

our operating initiatives, changes in promotional, couponing and advertising strategies and the success of management's business plans,

fluctuations in the costs of commodities, including beef, poultry, seafood, dairy, cheese, oils and produce,

ability to raise menu prices and customers acceptance of changes in menu items,

increases in utility costs, including the costs of natural gas and other energy supplies,

changes in the availability and cost of labor, including the ability to attract qualified managers and team members,

the seasonality of the business,

collectability of accounts receivable,

changes in governmental regulations, including changes in minimum wages and health care benefit regulation,

the effects of inflation and changes in our customers' disposable income, spending trends and habits,

the ability to realize property values,

the availability and cost of credit,

weather conditions in the regions in which our restaurants operate,

costs relating to legal proceedings,

impact of adoption of new accounting standards,

effects of actual or threatened future terrorist attacks in the United States,

unfavorable publicity relating to operations, including publicity concerning food quality, illness or other health concerns or labor relations, and



the continued service of key management personnel.

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Each forward-looking statement speaks only as of the date of this Form 10-Q, and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Investors should be aware that the occurrence of the events described above and elsewhere in this Form 10-Q could have material adverse effect on our business, results of operations, cash flows and financial condition.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in interest rates affecting our variable-rate debt. During the quarter ended May 4, 2011, the total amount of debt subject to interest rate fluctuations outstanding under our 2009 Credit Facility was \$31.0 million. Assuming an average debt balance of \$31.0 million, a 1.0% increase in prevailing interest rates above our 4.00% interest rate to a 5.00% interest rate per our 2009 Credit Facility would increase our annual interest expense by \$0.3 million.

Although we are not currently using interest rate swaps, we have previously used and may in the future use these instruments to manage cash flow risk on a portion of our variable-rate debt.

Many ingredients in the products sold in our restaurants are commodities, subject to unpredictable price fluctuations. We attempt to minimize price volatility by negotiating fixed price contracts for the supply of key ingredients and in some cases by passing increased commodity costs through to the customer by adjusting menu prices or menu offerings. Our ingredients are available from multiple suppliers so we are not dependent on a single vendor for our ingredients.

### **Item 4. Controls and Procedures**

#### ***Evaluation of Disclosure Controls and Procedures***

Management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of May 4, 2011. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of May 4, 2011, our disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

#### ***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting during the quarter ended May 4, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Part II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

There have been no material changes to our legal proceedings as disclosed in Legal Proceedings in Item 3 of Part I of our Annual Report on Form 10-K for the fiscal year ended August 25, 2010.

**Item 6. Exhibits**

- 10.1 Amendment No. 6 dated as of April 20, 2011 to Employment Agreement dated as of November 9, 2005, as amended on October 29, 2007, November 19, 2008, November 19, 2009, April 15, 2010 and September 2, 2010, between Luby s, Inc. and Christopher J. Pappas (incorporated by reference to Exhibit 10.1 to the Company s current report on Form 8-K filed on April 26, 2011).
- 31.1 Rule 13a-14(a)/15d-14(a) certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Rule 13a-14(a)/15d-14(a) certification of the Principal Financial and Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Section 1350 certification of the Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Section 1350 certification of the Principal Financial and Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**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.

LUBY S, INC.

(Registrant)

Date: June 10, 2011

By: /s/ Christopher J. Pappas  
Christopher J. Pappas  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: June 10, 2011

By: /s/ K. Scott Gray  
K. Scott Gray  
Senior Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

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