

LUBYS INC
Form 10-Q
December 22, 2009
Table of Contents

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 November 18, 2009

or

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _____ to _____

Commission file number 001-08308

Luby s, Inc.

(Exact name of registrant as specified in its charter)

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

74-1335253
*(IRS Employer
Identification Number)*

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 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 December 10, 2009, there were 28,023,986 shares of the registrant's common stock outstanding.

Table of Contents

Luby's, Inc.

Form 10-Q

Quarter ended November 18, 2009

Table of Contents

	Page
<u>Part I - Financial Information</u>	
Item 1 <u>Financial Statements</u>	3
Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3 <u>Quantitative and Qualitative Disclosures about Market Risk</u>	25
Item 4 <u>Controls and Procedures</u>	25
<u>Part II - Other Information</u>	
Item 1 <u>Legal Proceedings</u>	26
Item 6 <u>Exhibits</u>	26
<u>Signatures</u>	27
<u>Additional Information</u>	

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****Lubys, Inc.****Consolidated Balance Sheets***(In thousands, except share data)*

	November 18, 2009 <i>(Unaudited)</i>	August 26, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 980	\$ 882
Trade accounts and other receivables, net	1,534	1,463
Food and supply inventories	3,492	2,801
Prepaid expenses	793	655
Assets related to discontinued operations	158	391
Deferred income taxes	269	192
Total current assets	7,226	6,384
Property and equipment, net	143,353	146,250
Long-term investments	5,080	6,903
Deferred incomes taxes	6,467	5,082
Property held for sale	3,858	3,858
Assets related to discontinued operations	24,252	25,794
Other assets	173	241
Total assets	\$ 190,409	\$ 194,512
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 9,563	\$ 11,541
Liabilities related to discontinued operations	1,452	1,888
Accrued expenses and other liabilities	15,057	14,045
Total current liabilities	26,072	27,474
Credit facility debt	600	
Liabilities related to discontinued operations	456	382
Other liabilities	3,561	3,524
Total liabilities	30,689	31,380
Commitments and Contingencies		
SHAREHOLDERS' EQUITY		
Common stock, \$0.32 par value; 100,000,000 shares authorized; shares issued were 28,523,151 and 28,494,511, respectively; shares outstanding were 28,023,151 and 27,994,511, respectively	9,129	9,118
Paid-in capital	22,283	21,989
Retained earnings	133,083	136,800
Less cost of treasury stock, 500,000 shares	(4,775)	(4,775)

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Total shareholders' equity	159,720	163,132
Total liabilities and shareholders' equity	\$ 190,409	\$ 194,512

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 per share data)*

	Quarter Ended	
	November 18, 2009 <i>(12 weeks)</i>	November 19, 2008 <i>(12 weeks)</i>
SALES:		
Restaurant sales	\$ 48,426	\$ 57,006
Culinary contract services	3,292	3,002
TOTAL SALES	51,718	60,008
COSTS AND EXPENSES:		
Cost of food	12,983	15,614
Payroll and related costs	18,454	20,812
Other operating expenses	11,853	13,575
Opening costs	39	61
Cost of culinary contract services	2,927	2,660
Depreciation and amortization	3,522	3,647
General and administrative expenses	5,482	6,110
Net loss (gain) on disposition of property and equipment	311	(212)
Total costs and expenses	55,571	62,267
LOSS FROM OPERATIONS	(3,853)	(2,259)
Interest income	9	119
Interest expense	(128)	(86)
Impairment charge for decrease in fair value of investments	(459)	
Other income, net	198	259
Loss before income taxes and discontinued operations	(4,233)	(1,967)
Benefit for income taxes	(1,367)	(666)
Loss from continuing operations	(2,866)	(1,301)
Loss from discontinued operations, net of income taxes	(851)	(891)
NET LOSS	\$ (3,717)	\$ (2,192)
Loss per share from continuing operations:		
Basic	\$ (0.10)	\$ (0.05)
Assuming dilution	(0.10)	(0.05)
Loss per share from discontinued operations:		
Basic	\$ (0.03)	\$ (0.03)
Assuming dilution	(0.03)	(0.03)
Net loss per share:		
Basic	\$ (0.13)	\$ (0.08)
Assuming dilution	(0.13)	(0.08)

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Weighted average shares outstanding:

Basic	28,111	28,068
Assuming dilution	28,111	28,068

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

Note: The Company's Cash Flow Improvement and Capital Redeployment Plan (the Plan) was approved in the first quarter of fiscal year 2010. As a result, the Company reclassified 24 stores to discontinued operations for current and prior fiscal years.

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

	Common Stock Issued		Treasury		Paid-In Capital	Retained Earnings	Total Shareholders Equity
	Shares	Amount	Shares	Amount			
BALANCE AT AUGUST 26, 2009	28,494	\$ 9,118	(500)	\$ (4,775)	\$ 21,989	\$ 136,800	\$ 163,132
Net loss						(3,717)	(3,717)
Common stock issued under nonemployee director benefit plans	12	4			59		63
Common stock issued under employee benefit plans	17	7			235		242
BALANCE AT NOVEMBER 18, 2009	28,523	\$ 9,129	(500)	\$ (4,775)	\$ 22,283	\$ 133,083	\$ 159,720

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

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

	Quarter ended	
	November 18, 2009 <i>(12 weeks)</i>	November 19, 2008 <i>(12 weeks)</i>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (3,717)	\$ (2,192)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for asset impairments, net of gains and losses on property sales	(862)	(210)
Depreciation and amortization	3,799	4,365
Impairment charge for decrease in fair value of investments	459	
Amortization of debt issuance cost	67	20
Non-cash compensation expense	63	68
Share-based compensation expense	242	283
Deferred tax benefit	(1,899)	(1,264)
Cash provided by (used in) operating activities before changes in operating assets and liabilities	(1,848)	1,070
Changes in operating assets and liabilities:		
Increase in trade accounts and other receivables, net	(64)	(572)
Increase in food and supply inventories	(461)	(945)
Increase in prepaid expenses and other assets	(142)	(1,046)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(1,434)	3,146
Net cash provided by (used in) operating activities	(3,949)	1,653
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from redemption of long-term investments	1,364	500
Proceeds from disposal of assets and property held for sale	3,016	1,111
Purchases of property and equipment	(933)	(5,477)
Net cash provided by (used in) investing activities	3,447	(3,866)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Credit facility borrowings	16,400	5,000
Credit facility repayments	(15,800)	(5,000)
Net cash provided by financing activities	600	
Net decrease in cash and cash equivalents	98	(2,213)
Cash and cash equivalents at beginning of period	882	4,566
Cash and cash equivalents at end of period	\$ 980	\$ 2,353
Cash paid for:		
Income taxes	\$	\$
Interest	34	67

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

Table of Contents

Luby s, Inc.

Notes to Consolidated Financial Statements (unaudited)

November 18, 2009

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Luby s, Inc. (the Company or Luby s) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements that are prepared for the Company s Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the period ended November 18, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending August 25, 2010.

The balance sheet dated August 26, 2009, included in this Form 10-Q, has been derived from the audited financial statements at that date. However, this Form 10-Q does not include all of the information and footnotes required by GAAP for an annual filing of complete financial statements. Therefore, these financial statements should be read in conjunction with the consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the fiscal year ended August 26, 2009.

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

Events subsequent to the Company s fiscal quarter ended November 18, 2009 through the date of issuance, December 22, 2009, are evaluated to determine if the nature and significance of the event warrant inclusion in the Company s quarterly report. The Company determined there were no subsequent events warranting inclusion.

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. Fair Value Measurement

The Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements* (ASC 820), which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. ASC 820 applies whenever other statements require or permit asset or liabilities to be measured at fair value. The Company adopted the provisions of ASC 820 at the beginning of the first quarter of fiscal year 2009.

ASC 820 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.

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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.

Table of Contents

As of November 18, 2009, the Company held auction rate securities, which are classified as available-for-sale investments under long-term investments on the balance sheet and are required to be measured at fair value on a recurring basis. As discussed in Note 4 below, the continued illiquidity in the auction rate market has affected the fair market value of the Company's auction rate securities because the auctions continue to fail. Therefore, in the absence of an active market, the Company estimated the fair value of these investments using price submissions from traders specializing in the securities. These traders considered, among other things, the collateralization underlying the security, the creditworthiness of the counterparty, the timing of the expected future cash flows, the interest rate of the Company's investments compared to similar investments, the current illiquidity of the investments, and the estimated next successful auction of the security.

Management believes the Company will more likely than not sell its auction rate securities prior to maturity or prior to the time when the securities can be sold for par value. The market for the Company's auction rate securities has not been liquid for an extended time and the credit risk of the security issuers and related insurers is uncertain. Therefore, the Company considers the impairment of its auction rate securities to be other-than-temporary.

As a result of the other-than-temporary decline in the fair value of the Company's auction rate securities investments, the Company recorded a realized holding loss of approximately \$0.5 million during the quarter ended November 18, 2009 and zero during the quarter ended November 19, 2008. Any recoveries of previous recognized losses will not be recognized until the security is sold. Any future decrease in fair value related to these investments will increase the Company's recognized loss in these securities.

The assets measured at fair value on a recurring basis were as follows:

	Fair Value Measurement at November 18, 2009 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) <i>(In thousands)</i>	Significant Unobservable Inputs (Level 3)
Balance at August 27, 2008	\$	\$	\$ 8,525
Purchase of long-term investments			
Sale of long-term investments			(625)
Total gains or losses (realized and unrealized):			
Included in net income (loss)			(997)
Balance at August 26, 2009			6,903
Purchase of long-term investments			
Sale of long-term investments			(1,364)
Total gains or losses (realized and unrealized):			
Included in net income (loss)			(459)
Balance at November 18, 2009	\$	\$	\$ 5,080

The carrying value of cash and cash equivalents, trade accounts and other receivable, accounts payable and accrued expenses approximate fair value based on the short term nature of these accounts. The carrying value of credit facility debt approximates fair value based on the recent renegotiated terms of our credit facility.

Table of Contents**Note 4. Investments**

Investments include available-for-sale securities which are reported at fair value with unrealized gains and losses excluded from earnings and reported in shareholders' equity unless such losses are considered other-than-temporary. The Company recorded \$7.2 million par value (\$5.1 million fair value) and \$8.7 million par value (\$6.9 million fair value) as of November 18, 2009 and August 26, 2009, respectively, in auction rate municipal bonds as long-term investments. Adjustments to fair value were recorded in fiscal years 2008 and 2009 and the first quarter of fiscal year 2010 based on the continued illiquidity of the auction rate securities market and a valuation of the securities. The Company recognized cumulative unrealized losses of \$2.1 million and \$1.8 million losses as of November 18, 2009 and August 26, 2009, respectively, including a \$0.5 million loss recognized in the quarter ended November 18, 2009, which were considered other-than-temporary and are recorded as a charge to earnings.

Currently, there are no active markets for the Company's auction rate securities. Therefore, the Company estimated the fair value using valuation models and methodologies. Based on these valuation models and methodologies and on the possible long-term illiquidity of the markets, the Company recognized an other-than-temporary impairment. See Note 3, Fair Value Measurement, above.

The auction rate municipal securities are long-term debt obligations that are secured by certain revenue streams (airport, sewer, hospital, etc.). These auction rate securities have insurance policies guaranteeing, with respect to each bond, the payment of principal and accrued interest, as scheduled, if the issuer is unable to service the debt and have been issued ratings ranging from A1 Aaa (Moody's) and AA AAA (Standard and Poor's). The bonds have experienced this disparity in credit ratings because of the insurance company's revised credit ratings issued by Moody's and Standard and Poor's. If these securities continue to fail at auction, interest income will continue to accrue at a designated benchmark rate plus a premium; otherwise, they will be sold. At each of the resets between February 12, 2008 and November 18, 2009, the Company received all accrued interest due.

When normal trading on the auction rate securities market halted in February 2008, the Company had sell orders on all of its holdings. The Company received par and book value of \$0.625 million plus accrued interest on the bonds in fiscal year 2009. During the first quarter ended November 18, 2009, the Company sold one auction rate municipal bond with a par value of \$1.6 million (\$1.3 million book value) at a 12% discount and received \$1.4 million including accrued interest.

These municipal bonds have underlying maturity dates ranging from June 1, 2019 through February 1, 2042 offering rates tied to benchmarks plus a premium. Historically, the auction process allowed investors to obtain immediate liquidity by selling the securities at their face amounts. Liquidity for these securities was historically provided by entering sales orders through a Dutch-auction process that resets interest rates on these investments every 7, 28 or 35 days. However, the disruptions in the credit markets have continued to adversely affect the auction market for these types of securities.

Note 5. Income Taxes

For the quarter ended November 18, 2009, including both continuing and discontinued operations, the Company generated a gross taxable loss of approximately \$4.3 million. No cash payments of estimated income taxes were made during the quarter ended November 18, 2009.

Deferred tax assets and liabilities are recorded based on differences between the financial reporting basis and the tax basis of assets and liabilities using currently enacted rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are recognized to the extent future taxable income is expected to be sufficient to utilize those assets prior to their expiration. If current available information raises doubt about the realization of the deferred tax assets, a valuation allowance would be necessary. A valuation allowance for deferred tax assets may be required if recovery of prior taxes by carrying back current losses to prior years is not available, if the Company projects lower levels of future taxable income, or if the Company recently experienced consecutive pretax losses. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect the Company's reported operating results. Management concluded that for the quarter ended November 18, 2009 an increase in the valuation allowance of approximately \$69,000 was necessary. The valuation allowance partially offsets the Company's operating loss (NOL) carryovers to future years and its carryover of general business 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.

Table of Contents**Note 6. Property and Equipment**

The cost and accumulated depreciation of property and equipment at November 18, 2009 and August 26, 2009, together with the related estimated useful lives used in computing depreciation and amortization, were as follows:

	November 18, 2009	August 26, 2009	Estimated Useful Lives
	<i>(In thousands)</i>		
Land	\$ 40,540	\$ 40,540	
Restaurant equipment and furnishings	92,254	92,153	3 to 15 years
Buildings	148,108	148,003	20 to 33 years
Leasehold and leasehold improvements	22,844	22,722	Lesser of lease term or estimated useful life
Office furniture and equipment	6,292	6,280	3 to 10 years
Construction in progress	473	544	
	310,511	310,242	
Less accumulated depreciation and amortization	(167,158)	(163,992)	
Property and equipment, net	\$ 143,353	\$ 146,250	

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

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 24 operating stores to discontinued operations. The results of operations, assets and liabilities for all units included in the disposal 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 sales and pretax losses reported for all discontinued locations:

	Quarter ended	
	November 18, 2009 <i>(12 weeks)</i>	November 19, 2008 <i>(12 weeks)</i>

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*(In thousands, except discontinued locations
and per share data)*

Sales	\$	3,747	\$	8,939
Pretax losses		(1,285)		(1,360)
Income tax benefit on discontinued operations		434		469
Net loss on discontinued operations		(851)		(891)
Effect on EPS from pretax losses:				
Basic		(0.05)		(0.05)
Discontinued locations closed during the period		23		

Table of Contents

When the Company formally settles lease terminations or reaches definitive agreements to terminate leases in communication with the Plan, the related charges will be recorded. For the periods presented, no lease exit costs associated with the business plan met these criteria and are not accrued as of that date. Furthermore, the Company did not accrue future rental costs in instances where locations closed; since management has the ability to sublease at amounts equal to or greater than the rental costs. The Company incurred \$0.7 million and zero in employee settlement costs in the quarters ended November 18, 2009 and November 19, 2008, respectively.

The following table summarizes discontinued operations for the periods presented:

	Quarter ended	
	November 18, 2009 (12 weeks) (In thousands, except per share data)	November 19, 2008 (12 weeks) (In thousands, except per share data)
Impairments	\$	\$
Gains (Losses)	1,172	(2)
Net impairments	1,172	(2)
Other	(2,023)	(889)
Discontinued operations	(851)	(891)
Effect on EPS from net impairments - decrease - basic	\$ 0.04	\$
Effect on EPS from discontinued operations - decrease - basic	\$ (0.03)	\$ (0.03)

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

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 August 26, 2009, the Company had a total of four owned properties and four ground leases recorded at approximately \$3.9 million in property held for sale.

As discussed above under *Discontinued Operations*, in the first quarter of fiscal year 2010, the Company adopted the Plan, which included closing 23 underperforming stores. The closed stores consisted of 21 owned properties and two in-line leases in strip malls that the Company will attempt to sublease or settle. In addition, the Company decided to market for sale three unimproved properties, two of which are ground leases and one which is owned. The Plan assets also include a ground lease location that was closed in fiscal year 2009 and not previously in property held for sale.

In conjunction with the Plan adoption, the Company recorded in the fourth quarter of fiscal year 2009 a non-cash, pre-tax \$19.0 million impairment charge. Of the total impairment charge, \$13.1 million related to the newly closed locations, \$4.4 million related to stores that have not been closed, \$0.9 million related to stores previously closed, and \$0.6 million related to unimproved properties that will be sold.

During the first quarter of fiscal year 2010, two of the recently closed stores were sold.

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As of November 18, 2009, the Company had 24 owned properties held for sale with a carrying value of approximately \$3.9 million as properties held for sale and \$23.0 million included in assets related to discontinued operations in the consolidated balance sheet. There are a total of seven ground leases for sale; five include restaurant buildings and two do not. All of the ground leased assets have zero carrying value on the Company's balance sheet. The two in-line leased properties also have a carrying value of zero. The Company is actively marketing the locations currently classified as property held for sale.

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

Table of Contents

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 seeks penalties and attorney's fees and was conditionally certified as a collective action in October 2008. The Company intends to vigorously defend its position. It is not possible at this time to reasonably estimate the possible loss or range of loss, if any.

From time to time, the Company is subject to various other private lawsuits, administrative proceedings and claims that arise in the ordinary course of its business. A number of these lawsuits, proceedings and claims may exist at any given time. These matters typically involve claims from guests, employees and others related to issues common to the restaurant industry. The Company currently believes that the final disposition of these types of lawsuits, proceedings and claims will not have a material adverse effect on its 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 November 18, 2009.

Note 9. Related Parties

Affiliate Services

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

Under the terms of the Master Sales Agreement, the Pappas entities may provide specialized (customized) equipment fabrication and basic equipment maintenance, including stainless steel stoves, shelving, rolling carts, and chef tables. The total costs under the Master Sales Agreement of custom-fabricated and refurbished equipment in the quarters ended November 18, 2009 and November 19, 2008 were \$26,000 and \$150,000, respectively. Services provided under this agreement are subject to review and approval by the Finance and Audit Committee.

Operating Leases

The Company previously leased from the Pappas entities property that was used to accommodate the Company's in-house repair and fabrication center, which was referred to as the Houston Service Center. The Company terminated this lease in August 2008. The Company paid zero dollars pursuant to the terms of this lease in the quarters ended November 18, 2009 and November 19, 2008. The Company leases from an unrelated third party a new property that combines both the offices of the Company's Facility Services and Warehouse Operations. The property is approximately 60,000 square feet.

The Company also previously leased from the Pappas entities approximately 27,000 square feet of warehouse space to complement the Houston Service Center at a monthly rate of approximately \$0.21 per square foot. The Company paid zero dollars pursuant to the terms of this lease in the quarters ended November 18, 2009 and November 19, 2008. On February 29, 2008, the Company terminated this lease.

In the third quarter of fiscal year 2004, Messrs. Pappas became partners in a limited partnership which purchased a retail strip center in Houston, Texas. Messrs. Pappas collectively own a 50% limited partnership interest and a 50% general partnership interest in the limited partnership. A third party company manages the center. One of the Company's restaurants has rented approximately 7% of the space in that center since July

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1969. No changes were made to the Company's lease terms as a result of the transfer of ownership of the center to the new partnership. The Company made payments of \$57,000 and \$46,300 in the quarter ended November 18, 2009 and November 19, 2008, respectively, under the lease agreement that currently includes an annual base rate of \$14.64 per square foot.

Table of Contents

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

Affiliated rents paid for the Houston Service Center, the separate storage facility and the Houston property leases combined represented 5.4% and 4.0% of total rents for continuing operations for the quarter ended November 18, 2009 and November 19, 2008, respectively.

	Quarter ended	
	November 18, 2009 (12 weeks) (In thousands, except percentages)	November 19, 2008 (12 weeks)
AFFILIATED COSTS INCURRED:		
General and administrative expenses – professional and other costs	\$ 13	\$ 50
Capital expenditures – custom-fabricated and refurbished equipment and furnishings	26	150
Other operating expenses and opening costs, including property leases	57	50
Total	\$ 96	\$ 250
RELATIVE TOTAL COMPANY COSTS:		
General and administrative expenses	\$ 5,482	\$ 6,110
Capital expenditures	868	4,742
Other operating expenses and opening costs	11,892	13,636
Total	\$ 18,242	\$ 24,488
AFFILIATED COSTS INCURRED AS A PERCENTAGE OF RELATIVE TOTAL COMPANY COSTS	0.53%	1.02%

Board of Directors

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

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

Christopher J. Pappas is a member of the advisory board of Amegy Bank, National Association, which is a lender and syndication agent under the Company's 2009 amended and restated revolving credit facility (New Credit Facility).

Key Management Personnel

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

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On April 20, 2009, 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 expires on January 31, 2010. Mr. Pekmezaris is also the Treasurer of Pappas Restaurants, Inc. Compensation for the services provided by Mr. Pekmezaris to Pappas Restaurants, Inc. is paid entirely by that entity.

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

Table of Contents

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

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

The Company has an Incentive Stock Plan for officers and employees together (Employee Stock Plans) and a Non-employee Director Stock Option Plan for non-employee directors. These plans authorize the granting of stock options, restricted stock and other types of awards consistent with the purpose of the plans. Approximately 2.8 million shares are authorized for issuance under the Company's plans as of November 18, 2009, of which approximately 1.3 million shares are available for future issuance. Stock options granted under the Incentive Stock Plan and the Non-employee Director Stock Option Plan have an exercise price equal to the market price of the Company's common stock at the date of grant. Option awards under the Employee Stock Plans generally vest 25% each year on the anniversary of the grant date and expire six to ten years from the grant date. Option awards under the Non-employee Director Stock Option Plan generally vest 100% on the first anniversary of the grant date and expire ten years from the grant date.

A summary of the Company's stock option activity for the quarter ended November 18, 2009 is presented below:

	Shares Under Fixed Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at August 26, 2009	1,025,451	\$ 8.77	4.58	\$ 43
Granted				
Exercised				
Forfeited or Expired				
Outstanding at November 18, 2009	1,025,451	8.77	4.35	
Exercisable at November 18, 2009	551,657	\$ 10.68	2.74	\$ 24

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.

A summary of the Company's restricted stock activity during the quarter ended November 18, 2009 is presented in the following table:

	Restricted Stock Units	Weighted-Average Fair Value (Per share)	Weighted-Average Remaining Contractual Term (Years)
Unvested at August 26, 2009	80,155	\$ 9.62	1.06
Granted			
Vested	20,969	10.28	
Forfeited	10	10.28	
Unvested at November 18, 2009	59,176	\$ 9.37	1.15

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 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 computation of net income per share amounted to approximately 1,010,000 shares and 653,000 shares for the quarter ended November 18, 2009 and November 19, 2008, respectively.

Table of Contents

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

	Quarter ended	
	November 18, 2009 (12 weeks)	November 19, 2008 (12 weeks)
Numerator:		
Loss from continuing operations	(2,866)	(1,301)
Loss from discontinued operations	\$ (851)	\$ (891)
Net loss	\$ (3,717)	\$ (2,192)
Denominator:		
Denominator for basic earnings per share weighted-average shares	28,111	28,068
Effect of potentially dilutive securities:		
Employee and non-employee stock options		
Denominator for earnings per share assuming dilution	28,111	28,068
Loss per share from continuing operations:		
Basic	\$ (0.10)	\$ (0.05)
Assuming dilution	\$ (0.10)	\$ (0.05)
Loss per share from discontinued operations:		
Basic	\$ (0.03)	\$ (0.03)
Assuming dilution	\$ (0.03)	\$ (0.03)
Net loss per share:		
Basic	\$ (0.13)	\$ (0.08)
Assuming dilution	\$ (0.13)	\$ (0.08)

Note 12. New Accounting Pronouncements

On August 27, 2009, the Company adopted the FASB Accounting Standards Codification (ASC) Topic 105, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162 (ASC 105). ASC 105 provides for the FASB Accounting Standards Codification (the Codification) to become the single source of authoritative, nongovernmental U.S. GAAP. The Codification did not change or alter GAAP but reorganizes the literature and changes the referencing of financial standards. The Codification is effective for interim and annual periods ending after September 15, 2009.

On August 27, 2009, the Company adopted ASC subtopic 260-10, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends that are paid or unpaid are participating securities and shall be included in the computation of earnings per share based on the two-class method. The two-class method is an earnings allocation method for computing earnings per share when an entity's capital structure includes either two or more classes of common stock or common stock and participating securities. The adoption did not have a material impact on the financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), which replaces SFAS No. 141. The Codification replaces SFAS 141(R) and SFAS 141 with ASC 805. ASC 805 requires assets and liabilities acquired in a business combination, contingent consideration, and certain acquired contingencies to be measured at their fair values as of the date of acquisition. ASC 805 also requires that acquisition-related costs and restructuring costs be recognized separately from the business combination. ASC 805 is effective for fiscal years beginning after December 15, 2008 and is effective for business combinations entered into beginning in fiscal year 2010. The adoption did not have any affect on the financial statements.

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In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination (FSP FAS 141(R)-1). The Codification replaces FAS 141(R)-1 with ASC subtopic 805-10(ASC 805-10). ASC 805-10, which became effective for business combinations having an acquisition date on or after January 1, 2009, requires an asset or liability arising from a contingency in a business combination to be recognized at fair value if fair value can be reasonably determined. If it cannot, the asset or liability must be recognized in accordance with FASB Statement No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of the Loss*. The implementation of this guidance will affect the Company's consolidated financial statements only to the extent the Company completes business combinations in the future.

Table of Contents

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51* (SFAS 160). The Codification replaces SFAS 160 with ASC 810. ASC 810 clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. ASC 810 is effective for fiscal years beginning after December 15, 2008. The Company does not have any non-controlling interests.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). The Codification replaces SFAS 161 with ASC 815. ASC 815 requires entities to provide enhanced disclosures about derivative instruments and hedging activities. ASC 815 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not currently have any derivative instruments or hedging activities.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 eliminates FIN 46(R) s 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. SFAS 167 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 in applying FIN 46(R) s provisions. 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. SFAS 167 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact of SFAS 167 on its 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 consolidated financial statements and footnotes for the period ended November 18, 2009 included in Item 1 of Part I of this Quarterly Report on Form 10-Q, and the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended August 26, 2009.

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

As of November 18, 2009, we operated 96 restaurants, of which 95 are traditional cafeterias and one primarily serves seafood. These establishments are located in close proximity to retail centers, business developments and residential areas in four states. Of the 96 restaurants, 68 are located on property that we own and 28 are on leased premises.

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. 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.

Table of Contents**RESULTS OF OPERATIONS*****For the First Quarter Fiscal year 2010 versus the First Quarter Fiscal Year 2009******Sales***

Total sales decreased approximately \$8.3 million, or 13.8%, in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008, consisting of an \$8.6 million decrease in restaurant sales and a \$0.3 million increase in culinary contract services revenue due to increases in the number of facilities operated. The \$8.6 million decline in restaurant sales included a \$1.0 million reduction in sales related to restaurants closed prior to the approval of (and not included in) the Cash Flow Improvement and Capital Redeployment Plan (the Plan). On a same-store basis, sales decreased approximately \$7.4 million, or 13.3%, due primarily to declines in guest traffic and overall lower menu prices. Excluding the lost sales from Hurricane Ike, we estimate same-store sales were down 13.5%. Sales from stores open fewer than 18 periods, and therefore not included in our same-store sales measure, contributed approximately \$0.3 million less to restaurant sales for the quarter ended November 18, 2009 than the quarter ended November 19, 2008. We closed 23 restaurants during the quarter ended November 18, 2009 and three restaurants during the quarter ended November 19, 2008.

Cost of Food

Food costs decreased approximately \$2.6 million, or 16.8%, in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008 due to lower sales volumes and lower beef and certain seafood commodity costs. As a percentage of restaurant sales, food costs decreased 0.6%, to 26.8% in the quarter ended November 18, 2009 compared to 27.4% in the quarter ended November 19, 2008, primarily due to lower commodity prices and operational improvements in food production and menu management.

Payroll and Related Costs

Payroll and related costs decreased approximately \$2.4 million in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008. Payroll and related expenses decreased primarily due to increased efficiencies in crew scheduling, lower crew overtime, and lower management costs partially offset by higher average wages paid to our crew employees. As a percentage of restaurant sales, these costs increased 1.6%, to 38.1%, in the quarter ended November 18, 2009 compared to 36.5% in the quarter ended November 19, 2008, due to reduced restaurant sales.

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 decreased by approximately \$1.7 million, or 12.7 %, in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008. Other operating expenses decreased primarily due to 1) an approximate \$0.4 million reduction in repairs and maintenance expense related to improvements in cost controls, 2) an approximate \$0.4 million reduction in utility expense; 3) a decrease of \$0.5 million in Hurricane Ike-related expenses that occurred in the quarter ended November 19, 2008 and did not recur in the quarter ended November 18, 2009 and 4) a decrease of \$1.0 million in supplies and other operating expenses. These savings were partially offset by approximately \$0.6 million higher marketing and advertising expense. As a percentage of restaurant sales, other operating expenses increased 0.7%, to 24.5%, in the quarter ended November 18, 2009 compared to 23.8% in the quarter ended November 19, 2008.

Opening Costs

Opening costs include labor, supplies, occupancy, and other costs necessary to support the restaurant through its opening period. Opening costs were approximately \$39,000 in the quarter ended November 18, 2009 compared to approximately \$61,000 in the quarter ended November 19, 2008. The quarter ended November 18, 2009 and the quarter ended November 19, 2008 included carrying costs of locations which are to be developed for future restaurant openings.

Cost of Culinary Contract Services

Cost of culinary contract services increased by approximately \$0.3 million in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008. Cost of culinary contract services includes the food, labor, and other direct operating expenses associated with culinary contract services. Substantially all of these costs are reimbursable costs incurred within the contract terms. During the quarter ended November 18, 2009, culinary services operated fifteen facilities compared to eleven for the quarter ended November 19, 2008.

Depreciation and Amortization

Depreciation and amortization expense decreased by approximately \$0.1 million, or 3.4%, in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008 due to a slightly lower depreciable asset base reflecting reduced capital spending, and certain assets reaching the end of their depreciable lives.

Table of Contents

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 decreased by approximately \$0.6 million, or 10.3%, in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008. The decrease was due to 1) a \$0.5 million decrease in corporate salary and benefit expense as a result of reductions in corporate support headcount, net of \$0.3 million severance payments incurred and 2) other smaller reductions in travel, supplies expense, and other net general and administrative expenses. As a percentage of total sales, general and administrative expenses increased to 10.6% in the quarter ended November 18, 2009 compared to 10.2% in the quarter ended November 19, 2008.

Net (Gain) Loss on Disposition of Property and Equipment

The net loss on disposition of property and equipment was approximately \$0.3 million in the quarter ended November 18, 2009. The net loss reflects asset retirements at one culinary unit of \$0.1 million and \$0.2 million of asset retirement activity at our cafeteria units. The net gain on disposition of property and equipment was approximately \$0.2 million in the quarter ended November 19, 2008 from the sale of one restaurant unit offset by asset retirement activity.

Interest Income

Interest income decreased by approximately \$0.1 million in the quarter ended November 18, 2009 compared to the quarter ended November 19, 2008, primarily related to lower cash and cash equivalents and lower interest rates.

Interest Expense

Interest expense in the quarter ended November 18, 2009 increased approximately \$42,000 compared to the interest expense in the quarter and quarter ended November 19, 2008 primarily due to write off of deferred financing fees related to the credit facility during the quarter ended November 18, 2009.

Impairment of Fair Market Value of Investment

The provision for impairment charges for the quarter ended November 18, 2009 was \$0.5 million. There was no such impairment charge in the quarter ended November 19, 2008. The impairment charge recorded in the quarter ended November 18, 2009 was due to the continued illiquidity of the auction rate securities markets. The reduction in fair value of the investments was derived through valuation and is considered other-than-temporary. See Liquidity and Capital Resources Status of Long-Term Investments and Liquidity below for additional information regarding these investments.

Other Income, Net

Other income, net in the quarter ended November 18, 2009 decreased \$61,000 compared to the quarter ended November 19, 2008. 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; oil and gas royalty income; and de-recognition of gift certificate liability resulting from the expiration of state statutes of limitation on gift certificate amounts.

Taxes

The income tax benefit for the quarter ended November 18, 2009 increased \$0.7 million compared to the quarter ended November 19, 2008.

The income tax benefit for the quarter ended November 18, 2009 reflects an effective tax rate of 33.4% of the pre-tax loss from continuing operations offset by a valuation allowance increase of \$69,000 recorded during the quarter.

The income tax benefit recorded for the quarter ended November 19, 2008 reflects an effective tax rate of 33.9% of the results of continuing operations. There was no valuation allowance at the end of the quarter ended November 19, 2008.

Discontinued Operations

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The loss from discontinued operations was \$0.9 million in the quarter ended November 18, 2009 compared to a \$0.9 million loss in the quarter ended November 19, 2008. The loss in the quarter ended November 18, 2009 includes a \$1.2 million gain related to the sale of closed properties.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES*****Cash and Cash Equivalents***

General. Our primary sources of short-term and long-term liquidity are cash flows from operations and our revolving credit facility. The current macroeconomic conditions have adversely affected our cash flows from operations. We have reduced our discretionary capital expenditures but 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:

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.

The continued decline in our cash flow from operations in fiscal year 2009 required us to utilize our 2007 Revolving Credit Facility, as amended; as of November 18, 2009, we had \$0.6 million in loans outstanding under this facility. Proceeds from the sale of assets contributed capital for debt repayments. Under the current terms of our New Credit Facility, capital expenditures are limited to a maximum amount in fiscal 2010 and to an amount based on our EBITDA, as defined in the credit agreement, in subsequent years. The amount of borrowings are also limited based on our EBITDA. Based upon our level of past and projected capital requirements, we expect that proceeds from the sale of assets and cash flows from operations, combined with other financing alternatives in place or available, will be sufficient to meet our capital expenditures and working capital requirements during the next twelve months.

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 increased to \$1.0 million from \$0.9 million at the beginning of the quarter. This increase is primarily due to an increase in cash provided by investing and financing activities. 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:

	Quarter ended November 18, 2009 (12 weeks)	November 19, 2008 (12 weeks)
	<i>(In thousands)</i>	
Total cash provided by (used in):		
Operating activities	\$ (3,949)	\$ 1,653
Investing activities	3,447	(3,866)
Financing activities	600	
Increase (decrease) in cash and cash equivalents	\$ 98	\$ (2,213)

Operating Activities. In the quarter ended November 18, 2009, operating cash flow decreased \$5.6 million compared to the quarter ended November 19, 2008, primarily due to a decline in restaurant sales and increased expenses related to the 2010 Business Plan.

Investing Activities. Cash flows provided by investing activities were \$3.4 million in the quarter ended November 18, 2009 compared to negative \$3.9 million in the quarter ended November 19, 2008, primarily due to proceeds received on the sale of properties and long term investments as

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well as decreased purchases of property and equipment. Our capital expenditure program includes, among other things, restaurant remodeling, information technology enhancements and Culinary Contract Service locations. We used \$0.9 million for purchases of property and equipment in the quarter ended November 18, 2009 compared to \$5.5 million in the quarter ended November 19, 2008. We expect to spend approximately \$4.5 million to \$10.0 million on capital expenditures in fiscal year 2010.

Financing Activities. Cash provided by financing activities increased \$0.6 million compared to the quarter ended November 19, 2008, due primarily to borrowings under our Amended Facility (as described below under Debt First Amendment to 2007 Revolving Credit Facility) and our New Credit Facility that replaced the Amended Facility. Net borrowings under our Amended Facility and New Credit Facility during the quarter ended November 18, 2009 were \$0.6 million.

Table of Contents

Status of Long-Term Investments and Liquidity

At November 18, 2009, we held \$7.2 million, par value (\$5.1 million, net book value) in auction rate municipal bonds as long-term investments. These securities are long-term bonds with underlying maturities in years 2019 through 2042 but have historically had short-term features intended for the investor's liquidity. Prior to the collapse of the auction rate securities market in February 2008, these bonds were purchased or sold through a Dutch-auction process in short-term intervals of 7, 28 or 35 days, whereby the interest rate on the security is reset. The prevailing market auction failures resulted in the long-term investments classification and an other-than-temporary impairment loss of \$1.0 million in fiscal year 2009 and \$0.5 million in the quarter ended November 18, 2009. For additional information, see Note 4, Investments, to our Consolidated Financial Statements included in Item 1 of Part I of this report.

Given our current cash position, expected future cash flow from operations and our available borrowing capacity under our revolving credit facility, we believe the current and near term illiquidity of the auction rate municipal bonds will not adversely affect management's ability to achieve its operating goals.

Status of Trade Accounts and Other Receivables, Net

We monitor our receivables aging 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 \$18.9 million as of November 18, 2009, compared to a working capital deficit of \$21.1 million as of August 26, 2009, primarily due to a \$3.9 million decrease in cash from operating activities partially offset by sales of long term investments of \$1.4 million and properties held for sale of \$3.0 million. We expect to meet our working capital requirements through cash flows from operations and availability under our New 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 quarter ended November 18, 2009 were approximately \$0.9 million, and related to maintaining our investment in existing operating units. We expect to be able to fund all capital expenditures in fiscal year 2010 using cash flows from operations and our available credit. We expect to spend approximately \$4.5 million to \$10.0 million on capital expenditures in fiscal year 2010.

DEBT

Amended and Restated 2007 Revolving Credit Facility

On November 9, 2009, we entered into a revolving credit facility (the New Credit Facility), which amends and restates the 2007 Revolving Credit Facility, as amended, and reflects the following changes to the Amended Facility:

Reduced the aggregate amount of the lenders' commitments from \$30.0 million to \$20.0 million. The amounts available under the New Credit Facility may still be increased by up to \$10.0 million, subject to certain terms and conditions, for a maximum total facility size of \$30.0 million.

Changed the maturity date to June 30, 2011.

Required security interest in selected real estate and other Company assets.

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Increased interest rate margins from a range of 1.75% to 2.50%, subject to an interest rate floor of 3.50%, to a range of 2.75% to 3.50%, subject to a 4.00% interest rate floor. The applicable spread continues to be dependent upon the ratio of the Company's debt to EBITDA at the most recent determination date, as defined in the credit agreement, as amended.

Modified certain financial covenants for the fiscal year 2010, including the addition of minimum fiscal year 2010 quarterly EBITDA requirements, and reduced restaurant capital expenditures in fiscal year 2010, as defined.

Management estimates approximately \$0.3 million to \$0.5 million in related fees and expenses to be incurred associated with the closing of the New Credit Facility. Management recognized \$54,000 in unamortized pre-paid financing fees outstanding in fiscal year 2010 as a result of the reduction in the facility size and maturity.

The New Credit Facility contains customary covenants and restrictions on our ability to engage in certain activities, asset sales, letters of credit, and acquisitions, and contains customary events of default. As of November 18, 2009, we were in compliance with all covenants.

Table of Contents

As of November 18, 2009, we had \$0.6 million outstanding in loans and \$1.6 million committed under letters of credit, which were issued as security for the payment of insurance obligations.

At November 18, 2009 \$17.8 million was available under the New Credit Facility.

First Amendment to 2007 Revolving Credit Facility

On March 18, 2009, we entered into Amendment No. 1 to the 2007 Revolving Credit Facility (the Amended Facility), which amended the 2007 Revolving Credit Facility as follows:

Reduced the aggregate amount of the lenders' commitments from \$50.0 million to \$30.0 million. The amounts available under the Amended Facility, may still be increased by up to \$70.0 million, subject to certain terms and conditions, for a maximum total facility size of \$100 million.

Modified the restriction on capital expenditures in fiscal years 2009 through June 30, 2012. In the original 2007 Revolving Credit Facility, capital expenditures were limited to the extent of our annual four-quarter rolling EBITDA plus 75% of the unused availability for capital expenditures from the immediately preceding fiscal year. We revised the level of spending allowed for capital expenditures by creating a floor of \$20.0 million. The amount of agreed capital expenditures was the greater of (1) \$20.0 million in each fiscal year, or (2) the amount of 100% of the preceding fiscal year's EBITDA; plus, in either case, all of the unused availability for capital expenditures from the immediately preceding fiscal year.

Modified the interest rate margins to a range of 1.75% to 2.50% per annum. The applicable spread under each option continues to be dependent upon the ratio of our debt to EBITDA at the most recent determination date.

Amended the quarterly commitment fee, which is dependent upon the ratio of our debt to EBITDA, to a range of 0.30% to 0.45% per annum. We will also continue to pay quarterly fees with respect to any letters of credit issued and outstanding. In addition, we were obligated to pay the lenders a one-time fee in connection with the closing of the Amended Facility.

In the original 2007 Revolving Credit Facility, we were permitted to invest in any auction rate securities rated Aaa by Moody's or AAA by S&P. Because the ratings of our auction rate securities have dropped below these thresholds, the Amended Facility limited these types of investments to a specific list of auction rate securities which we hold.

Modified certain financial covenants, including: (1) the Interest Coverage Ratio from not less than 2.50 to not less than 2.00, (2) the debt-to-EBITDA ratio from not greater than 3.00 to not greater than 2.75. The Amended Facility also amends the Interest Coverage Ratio calculation to include one-fifth of the principal balance of the loans in the denominator.

2007 Revolving Credit Facility

On July 13, 2007, we entered into a \$50.0 million unsecured Revolving Credit Facility (the 2007 Revolving Credit Facility) with Wells Fargo Bank, National Association, as Administrative Agent, and Amegy Bank, National Association, as Syndication Agent. The 2007 Revolving Credit Facility may, subject to certain terms and conditions, be increased once by an amount up to \$50.0 million for a maximum total facility size of \$100.0 million. The 2007 Revolving Credit Facility allowed for up to \$15.0 million of the available credit to be extended in the form of letters of credit. All amounts owed by us under the 2007 Revolving Credit Facility were guaranteed by our subsidiaries and must be repaid in full upon the maturity date on June 30, 2012. We amended the 2007 Revolving Credit Facility on March 18, 2009, as described above under First Amendment to 2007 Revolving Credit Facility.

At any time throughout the term of the facility, we had the option to elect one of two bases of interest rates. One interest rate option was 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 zero to

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0.50% per annum. The other interest rate option was the London InterBank Offered Rate plus a spread that ranges from 0.75% to 2.00% per annum. The applicable spread under each option was dependent upon the ratio of our debt to EBITDA at the most recent determination date.

Table of Contents

We paid a quarterly commitment fee based on the unused available balance of the 2007 Revolving Credit Facility, which was also dependent upon the ratio of our debt to EBITDA, ranging from 0.20% to 0.30% per annum. We also paid quarterly fees with respect to any letters of credit issued and outstanding. In addition, we paid the lenders a one-time fee in connection with the closing of the 2007 Revolving Credit Facility.

Interest Expense

Total interest expense incurred for fiscal quarters ended November 18, 2009 and November 19, 2008 was approximately \$0.1 million. Interest paid was approximately \$34,000 and \$67,000 in quarters ended November 18, 2009 and November 19, 2008, respectively. No interest expense was allocated to discontinued operations in fiscal years 2009, 2008 or 2007. No interest was capitalized on properties in fiscal years 2009, 2008 or 2007.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Consolidated Financial Statements included in Item 1 of Part 1 of this report are 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 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

We account for income taxes in accordance with ASC 740, *Income Taxes*. We record 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. We periodically review the recoverability of tax assets recorded on the balance sheet and provide valuation allowances as management deems necessary.

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. In addition, 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 years. We regularly assess the potential outcomes of examinations in determining the adequacy of our provision for income taxes and our income tax liabilities. We believe that we have adequately provided for any reasonable and foreseeable outcome related to uncertain tax matters.

Impairment of Long-Lived Assets

We periodically evaluate long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We estimate future cash flows expected to result from the use and possible disposition of the asset and will recognize an impairment loss when the sum of the undiscounted estimated future cash flows is less than the carrying amounts of such assets. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. The span of time for which future cash flows are estimated is often lengthy, which increases the sensitivity to assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. 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 either discounted cash flows or appraisals.

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

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We also periodically review long-lived assets against our plans to retain or ultimately dispose of properties. Property is moved into property held for sale when the restaurant is closed and the property held for sale is 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 routinely monitor the estimated value of property held for sale and record adjustments to these values as required. We periodically measure and analyze our estimates against third-party appraisals.

Table of Contents

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. The third party actuary utilizes methods and assumptions that are in accordance with generally accepted actuarial practices and we believe the conclusions reached are reasonable.

Actual workers' compensation, employee injury and general liability 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 estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using the Black Scholes model which requires the use of certain assumptions. The assumptions include the risk-free interest rate based on the United States Treasury yield curve at the time of the grant, expected dividend yield, expected volatility, expected forfeitures and expected life of the award.

INFLATION

Our policy is to maintain stable menu prices without regard to seasonal variations in food costs. General increases in cost 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.

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;

projections regarding the financial performance of our new prototype restaurants;

plans for expansion of our business;

plans for expansion of our culinary contract services 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 sale;

plans relating to our short-term and long-term investments; and

continued compliance with the terms of our existing revolving credit facility.

Table of Contents

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 their 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 our Annual Report on Form 10-K for the fiscal year ended August 26, 2009 and any other cautionary language in this Quarterly Report on 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:

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 successfully increase sales of existing restaurants to achieve profitability;

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;

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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.

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.

Table of Contents

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 November 18, 2009, the total amount of debt subject to interest rate fluctuations outstanding under our New Credit Facility was \$0.6 million. Assuming an average debt balance of \$5.0 million, a 1.0% increase in prevailing interest rates above our 4.0% interest rate floor per our Amended and Restated Credit Facility, effective November 9, 2009, would increase our annual interest expense by \$50,000.

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 November 18, 2009. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of November 18, 2009, 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 November 18, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

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 26, 2009.

Item 6. Exhibits

- 4.1 Credit Agreement dated as of November 9, 2009 among Luby's, Inc., the lenders from time to time party thereto, Wells Fargo Bank, National Association, as Administrative Agent, and Amegy Bank National Association, as Syndication Agent (incorporated by reference to Exhibit 4 (I) to the Company's Annual Report on Form 10-K for the fiscal year ended August 26, 2009 filed with the SEC on November 9, 2009).
- 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 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 Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

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: December 22, 2009

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

Date: December 22, 2009

By: /s/ K. Scott Gray
K. Scott Gray
Senior Vice President and Chief Financial Officer

Table of Contents

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