

LUBYS INC
Form 10-Q
January 29, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
^x 1934

For the quarterly period ended December 20, 2017

or

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

For the Transition Period From to
Commission file number: 001-08308

Luby's, Inc.
(Exact name of registrant as specified in its charter)

Delaware 74-1335253
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

13111 Northwest Freeway, Suite 600 77040
Houston, Texas
(Address of principal executive offices) (Zip Code)

(713) 329-6800
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes 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
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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 January 23, 2018, there were 29,343,840 shares of the registrant's common stock outstanding.

1

Luby's, Inc.
 Form 10-Q
 Quarter ended December 20, 2017
 Table of Contents

	Page
<u>Part I—Financial Information</u>	
<u>Item 1 Financial Statements</u>	<u>3</u>
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	<u>42</u>
<u>Item 4 Controls and Procedures</u>	<u>42</u>
<u>Part II—Other Information</u>	
<u>Item 1 Legal Proceedings</u>	<u>43</u>
<u>Item 1A Risk Factors</u>	<u>43</u>
<u>Item 6 Exhibits</u>	<u>43</u>
<u>Signatures</u>	<u>44</u>

Additional Information

We file reports with the Securities and Exchange Commission (the "SEC"), 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.lubysinc.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.

Part I—FINANCIAL INFORMATION

Item 1. Financial Statements

Luby's, Inc.

Consolidated Balance Sheets

(In thousands, except share data)

	December 20, 2017	August 30, 2017
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 812	\$ 1,096
Trade accounts and other receivables, net	8,954	8,011
Food and supply inventories	4,743	4,453
Prepaid expenses	3,030	3,431
Total current assets	17,539	16,991
Property held for sale	3,231	3,372
Assets related to discontinued operations	2,371	2,755
Property and equipment, net	171,426	172,814
Intangible assets, net	19,164	19,640
Goodwill	1,068	1,068
Deferred income taxes	7,348	7,254
Other assets	2,505	2,563
Total assets	\$ 224,652	\$ 226,457
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 15,866	\$ 15,937
Liabilities related to discontinued operations	20	367
Current portion of credit facility debt	295	—
Accrued expenses and other liabilities	31,070	28,076
Total current liabilities	47,251	44,380
Credit facility debt, less current portion	30,525	30,698
Liabilities related to discontinued operations	16	16
Other liabilities	6,843	7,311
Total liabilities	84,635	82,405
Commitments and Contingencies		
SHAREHOLDERS' EQUITY		
Common stock, \$0.32 par value; 100,000,000 shares authorized; shares issued were 29,816,771 and 29,624,083, respectively; shares outstanding were 29,316,771 and 29,124,083, respectively	9,542	9,480
Paid-in capital	32,655	31,850
Retained earnings	102,595	107,497
Less cost of treasury stock, 500,000 shares	(4,775)	(4,775)
Total shareholders' equity	140,017	144,052
Total liabilities and shareholders' equity	\$ 224,652	\$ 226,457

The accompanying notes are an integral part of these Consolidated Financial Statements.

Luby's, Inc.

Consolidated Statements of Operations (unaudited)

(In thousands, except per share data)

	Quarter Ended	
	December 2017	December 21, 2016
	(16 weeks)	(16 weeks)
SALES:		
Restaurant sales	\$104,583	\$ 108,082
Culinary contract services	7,519	4,297
Franchise revenue	1,887	1,871
Vending revenue	143	159
TOTAL SALES	114,132	114,409
COSTS AND EXPENSES:		
Cost of food	29,754	30,850
Payroll and related costs	38,126	38,673
Other operating expenses	19,499	19,648
Occupancy costs	6,261	6,475
Opening costs	75	165
Cost of culinary contract services	6,332	3,811
Cost of franchise operations	488	580
Depreciation and amortization	5,353	6,550
Selling, general and administrative expenses	11,525	13,759
Provision for asset impairments and restaurant closings	845	287
Net loss on disposition of property and equipment	222	85
Total costs and expenses	118,480	120,883
LOSS FROM OPERATIONS	(4,348)	(6,474)
Interest income	6	1
Interest expense	(649)	(602)
Other income, net	115	103
Loss before income taxes and discontinued operations	(4,876)	(6,972)
Benefit for income taxes	(9)	(1,458)
Loss from continuing operations	(4,867)	(5,514)
Loss from discontinued operations, net of income taxes	(35)	(72)
NET LOSS	\$(4,902)	\$(5,586)
Loss per share from continuing operations:		
Basic	\$(0.17)	\$(0.19)
Assuming dilution	\$(0.17)	\$(0.19)
Loss per share from discontinued operations:		
Basic	\$(0.00)	\$(0.00)
Assuming dilution	\$(0.00)	\$(0.00)
Net loss per share:		
Basic	\$(0.17)	\$(0.19)
Assuming dilution	\$(0.17)	\$(0.19)
Weighted average shares outstanding:		
Basic	29,691	29,339
Assuming dilution	29,691	29,339

The accompanying notes are an integral part of these Consolidated Financial Statements.

4

Luby's, Inc.

Consolidated Statement of Shareholders' Equity (unaudited)

(In thousands)

	Common Stock				Paid-In Capital	Retained Earnings	Total Shareholders' Equity
	Issued Shares	Amount	Treasury Shares	Amount			
Balance at August 30, 2017	29,624	\$ 9,480	(500)	\$(4,775)	\$31,850	\$ 107,497	\$ 144,052
Net loss	—	—	—	—	—	(4,902)	(4,902)
Share-based compensation expense	30	10	—	—	857	—	867
Common stock issued under employee benefit plans	163	52	—	—	(52)	—	—
Balance at December 20, 2017	29,817	\$ 9,542	(500)	\$(4,775)	\$32,655	\$ 102,595	\$ 140,017

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	Quarter Ended	
	December 20,	December 21,
	2017	2016
	(16	(16 weeks)
	weeks)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(4,902)	\$ (5,586)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for asset impairments and net (gains) on property sales	1,067	372
Depreciation and amortization	5,353	6,550
Amortization of debt issuance cost	40	67
Share-based compensation expense	867	433
Deferred tax provision (benefit)	16	(1,466)
Cash provided by operating activities before changes in operating assets and liabilities	2,441	370
Changes in operating assets and liabilities:		
Decrease (Increase) in trade accounts and other receivables	(1,287)	254
Decrease in insurance receivables	344	—
Increase in food and supply inventories	(290)	(440)
Decrease (Increase) in prepaid expenses and other assets	441	(59)
Insurance proceeds	276	—
Increase in accounts payable, accrued expenses and other liabilities	1,557	3,116
Net cash provided by operating activities	3,482	3,241
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from disposal of assets and property held for sale	185	38
Insurance proceeds	344	—
Purchases of property and equipment	(4,325)	(4,980)
Net cash used in investing activities	(3,796)	(4,942)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Revolver borrowings	22,900	45,700
Revolver repayments	(22,800)	(78,300)
Proceeds from term loan	—	35,000
Debt issuance costs	—	(625)
Taxes paid for shares withheld	(70)	—
Net cash provided by financing activities	30	1,775
Net (decrease) increase in cash and cash equivalents	(284)	74
Cash and cash equivalents at beginning of period	1,096	1,339
Cash and cash equivalents at end of period	\$812	\$ 1,413
Cash paid for:		
Income taxes	\$—	\$ —
Interest	515	478

The accompanying notes are an integral part of these Consolidated Financial Statements.

Luby's, Inc.

Notes to Consolidated Financial Statements (unaudited)

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 quarter ended December 20, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending August 29, 2018.

The Consolidated Balance Sheet dated August 30, 2017, included in this Quarterly Report on Form 10-Q (this "Form 10-Q"), has been derived from the audited Consolidated Financial Statements as of that date. However, this Form 10-Q does not include all of the information and footnotes required by GAAP for audited, year-end 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 30, 2017.

Recently Adopted Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No 2014-15. The amendments in ASU 2014-15 are intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The pronouncement is effective for fiscal years and interim periods within those fiscal years, after December 31, 2016, which required us to adopt these provisions in the first quarter of fiscal 2018. We adopted this pronouncement effective August 31, 2017 and the adoption did not have impact to our consolidated financial statements or disclosures to our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory (Topic 330). This update requires inventory within the scope of the standard to be measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This update is effective for annual and interim periods beginning after December 15, 2016, which required us to adopt these provisions in the first quarter of fiscal 2018. We adopted this pronouncement in the first quarter of fiscal 2018 and the adoption did not have impact to our consolidated financial statements or disclosures to our consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes (Topic 740). This update requires that deferred tax liabilities and assets be classified as noncurrent in a classified balance sheet. This update is effective for annual and interim periods beginning after December 15, 2016, which required us to adopt these provisions in the first quarter of fiscal 2018. The interim period adoption of this guidance had an immaterial

impact on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718). This update was issued as part of the FASB's simplification initiative and affects all entities that issue share-based payment awards to their employees. The amendments in this update cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. This update is effective for annual and interim periods for fiscal years beginning after December 15, 2016, which required us to adopt these provisions in the first quarter of fiscal 2018. The impact on the Company's consolidated financial statements from interim period adoption of ASU 2016-09 was immaterial. The Company maintains its accounting policy for forfeitures and continues to estimate the total number of awards for which the requisite service period will not be rendered for book expense purposes.

New Accounting Pronouncements - "to be Adopted"

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This update provides a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. The guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. This update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, which will require us to adopt these provisions in the first quarter of fiscal 2019. Early application is not permitted. This update permits the use of either the retrospective or cumulative effect transition method. Further, in March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the guidance in ASU No. 2014-09 for evaluating when another party, along with the entity, is involved in providing a good or service to a customer. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing," which clarifies the guidance in ASU No. 2014-09 regarding assessing whether promises to transfer goods or services are distinct, and whether an entity's promise to grant a license provides a customer with a right to use or right to access the entity's intellectual property. The Company plans to adopt the standard in the first quarter of fiscal 2019, which is the first fiscal quarter of the annual reporting period beginning after December 15, 2017. We have not yet decided on a method of transition upon adoption. The Company expects the pronouncement may impact the recognition of the initial franchise fee, which is currently recognized upon the opening of a franchise restaurant. We are further evaluating the effect this guidance will have on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update requires a lessee to recognize on the balance sheet a liability to make lease payments and a corresponding right-of-use asset. The update also requires additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This update is effective for annual and interim periods beginning after December 15, 2018, which will require us to adopt these provisions in the first quarter of fiscal 2020. This standard requires adoption based upon a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with optional practical expedients. Based on a preliminary assessment, the Company expects that most of its operating lease commitments will be subject to the new guidance and recognized as operating lease liabilities and right-of-use assets upon adoption, resulting in a significant increase in the assets and liabilities on our consolidated balance sheet. The Company is continuing its assessment, which may identify additional impacts this standard will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities – Extinguishment of Liabilities: Recognition of Breakage for Certain Prepaid Stored-Value Products," which is intended to eliminate current and future diversity in practice related to derecognition of prepaid stored-value product liability in a way that aligns with the new revenue recognition guidance. The update is effective for fiscal years beginning after December 15, 2017; however, early application is permitted. We are evaluating the impact on the Company's consolidated financial statements and do not expect the adoption to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). This update provides clarification regarding how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This update is effective for annual and interim periods beginning after December 15, 2017, which will require us to adopt these provisions in the first quarter of fiscal 2019 using a retrospective approach. Early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Subsequent Events

On December 22, 2017, the Tax Cuts and Jobs Act (“H.R. 1”), the tax reform bill (“the Act”), was signed into law. The Act includes numerous changes to the Internal Revenue Code, including a permanent reduction in the statutory corporate income tax rate from 35% to 21%. Deferred tax assets and liabilities are measured using enacted statutory income tax rates expected to apply to taxable income in the years in which the deferred timing differences are expected to be recovered or settled. The Act’s statutory income rate reduction takes effect on January 1, 2018 and is anticipated to impact significantly the Company’s income tax provision for continuing operations and deferred tax balances in the Company’s financial statements, including for fiscal year 2018 and the interim periods beginning in the second quarter of this fiscal year. As a result of the statutory corporate income tax rate reduction, the Company will remeasure all deferred tax assets and liabilities upon enactment of the Act, as of December 22, 2017. The estimated impact of deferred tax remeasurement will be recorded in the Company’s interim period financial statements for the second quarter in fiscal 2018. The Company is currently analyzing the impact of the Act, including not only deferred tax remeasurement, which is not yet complete. However, based on currently available information, the Company anticipates recording an additional income tax provision of approximately \$3.1 million in the second quarter of fiscal 2018 regarding remeasurement of deferred tax balances. The Company’s analysis of the Act’s impact is subject to further clarification and resulting change that cannot be estimated at this time. The actual impact concerning deferred tax remeasurement may vary from the estimated amount due to such analysis and change, including uncertainties in our preliminary analysis.

Note 2. Accounting Periods

The Company’s fiscal year ends on the last Wednesday in August. Accordingly, each fiscal year normally consists of 13 four-week periods, or accounting periods, accounting for 364 days in the aggregate. However, every fifth or sixth year, we have a fiscal year that consists of 53 weeks, accounting for 371 days in the aggregate; fiscal year 2016 was such a year. The first fiscal quarter consists of four four-week periods, or 16 weeks, and the remaining three quarters typically include three four-week periods, or 12 weeks, in length. The fourth fiscal quarter includes 13 weeks in certain fiscal years to adjust for our standard 52 week, or 364 day, fiscal year compared to the 365 day calendar year.

Note 3. Hurricane Harvey

Hurricane Harvey struck the Texas Gulf Coast on August 26, 2017. It meandered along the upper Texas coast for several days bringing unprecedented rain fall resulting in torrential flooding throughout the Greater Houston area. Over 55 Luby’s and Fuddrucker’s locations in the Texas Gulf Coast region were temporarily closed over varying lengths of time due to the storm. Restaurant sales were negatively impacted by approximately 200 operating days in the aggregate. Two Fuddrucker’s locations, in the Houston region, were closed on a more than temporary basis, due to extensive flooding which requires reconstruction and renovation. The Company estimates that it incurred over \$2.0 million in lost sales from the store closures in fiscal 2017. The Company estimates that Loss before income taxes and discontinued operations was negatively impact by an estimated \$1.5 million in fiscal 2017 due to the reduced sales and increased costs incurred as a result of the hurricane. During the quarter ended December 20, 2017, the Company incurred an additional \$0.6 million in direct costs for repairs and other costs related to the hurricane. The Company has open insurance claims related to hurricane damages and losses. As of December 20, 2017, the Company has recovered \$0.6 million in insurance proceeds, of which \$0.3 million was recognized as a reduction to Other operating expenses as reimbursement of certain direct expenses incurred due to the storm, as an advance against total claims for estimated damages and losses related to the hurricane.

Note 4. Reportable Segments

The Company has three reportable segments: Company-owned restaurants, Culinary Contract Services (“CCS”), and Franchise Operations.

Company-owned restaurants

Company-owned restaurants consists of several brands which are aggregated into one reportable segment because the nature of the products and services, the production processes, the customers, the methods used to distribute the products and services, the nature of the regulatory environment, and store level profit margin are similar. The chief operating decision maker analyzes Company-owned restaurants at store level profit which is revenue less cost of food, payroll and related costs, other operating expenses, and occupancy costs. The primary brands are Luby's Cafeterias, Fuddruckers - World's Greatest Hamburger® and Cheeseburger in Paradise. All company-owned restaurants are casual dining restaurants. Each restaurant is an operating segment because operating results and cash flow can be determined for each restaurant.

The total number of Company-owned restaurants was 163 at December 20, 2017 and 167 at August 30, 2017.

Culinary Contract Services

CCS, branded as Luby's Culinary Contract Services, consists of a business line servicing healthcare, sport stadiums, corporate dining clients, and sales through retail grocery stores. The healthcare accounts are full service and typically include in-room delivery, catering, vending, coffee service, and retail dining. CCS has contracts with long-term acute care hospitals, acute care medical centers, ambulatory surgical centers, behavioral hospitals, a sports stadium, and business and industry clients. CCS has the unique ability to deliver quality services that include facility design and procurement as well as nutrition and branded food services to our clients. The cost of Culinary Contract Services on the Consolidated Statements of Operations include all food, payroll and related costs, other operating expenses, and other direct general and administrative expenses related to CCS sales.

CCS began selling Luby's Famous Fried Fish and Macaroni & Cheese in February 2017 and December 2016, respectively, in the freezer section of H-E-B stores, a Texas-born retailer. H-E-B stores now stock the family-sized versions (approximately five servings) of Luby's Classic Macaroni and Cheese and Luby's Jalapeño Macaroni and Cheese varieties and Luby's Fried Fish (two regular size fillets that provide four LuAnn-sized portions).

The total number of CCS locations was 22 at December 20, 2017 and 25 at August 30, 2017.

Franchise Operations

We only offer franchises for the Fuddruckers brand. Franchises are sold in markets where expansion is deemed advantageous to the development of the Fuddruckers concept and system of restaurants. Initial franchise agreements have a term of 20 years. Franchise agreements typically grant franchisees an exclusive territorial license to operate a single restaurant within a specified area, usually a four-mile radius surrounding the franchised restaurant.

Franchisees bear all direct costs involved in the development, construction, and operation of their restaurants. In exchange for a franchise fee, the Company provides assistance to franchisees in the following areas: site selection, prototypical architectural plans, interior and exterior design and layout, training, marketing and sales techniques, assistance by a Fuddruckers "opening team" at the time a franchised restaurant opens, and operations, and accounting guidelines set forth in various policies and procedures manuals.

All franchisees are required to operate their restaurants in accordance with Fuddruckers' standards and specifications, including controls over menu items, food quality, and preparation. The Company requires the successful completion of its training program by a minimum of three managers for each franchised restaurant. In addition, franchised restaurants are evaluated regularly by the Company for compliance with franchise agreements, including standards and specifications through the use of periodic, unannounced, on-site inspections, and standard evaluation reports.

The number of franchised restaurants was 111 at December 20, 2017 and 113 at August 30, 2017.

Licensee

In November 1997, a prior owner of the Fuddruckers – World's Greatest Hamburgers® brand granted to a licensee the exclusive right to use the Fuddruckers proprietary marks, trade dress and system to develop Fuddruckers restaurants in a territory consisting of certain countries in Africa, the Middle East and parts of Asia. As of July 2017, this licensee operated 34 restaurants that are licensed to use the Fuddruckers Proprietary Marks in Saudi Arabia, Egypt, United Arab Emirates, Qatar, Jordan, Bahrain, and Kuwait. The Company does not receive revenue or royalties from these

restaurants.

Segment Table

The table on the following page shows segment financial information. The table also lists total assets for each reportable segment. Corporate assets include cash and cash equivalents, property and equipment, assets related to discontinued operations, property held for sale, deferred tax assets, and prepaid expenses.

10

Edgar Filing: LUBYS INC - Form 10-Q

	Quarter Ended	
	December 20, 2017	December 21, 2016
	(16 weeks)	(16 weeks)
	(In thousands)	
Sales:		
Company-owned restaurants ⁽¹⁾	\$104,726	\$ 108,241
Culinary contract services	7,519	4,297
Franchise operations	1,887	1,871
Total	\$114,132	\$ 114,409
Segment level profit:		
Company-owned restaurants	\$11,086	\$ 12,595
Culinary contract services	1,187	486
Franchise operations	1,399	1,291
Total	\$13,672	\$ 14,372
Depreciation and amortization:		
Company-owned restaurants	\$4,451	\$ 5,454
Culinary contract services	19	22
Franchise operations	237	237
Corporate	646	837
Total	\$5,353	\$ 6,550
Capital expenditures:		
Company-owned restaurants	\$3,424	\$ 4,550
Culinary contract services	107	—
Franchise operations	—	—
Corporate	794	430
Total	\$4,325	\$ 4,980
Loss before income taxes and discontinued operations:		
Segment level profit	\$13,672	\$ 14,372
Opening costs	(75)	(165)
Depreciation and amortization	(5,353)	(6,550)
Selling, general and administrative expenses	(11,525)	(13,759)
Provision for asset impairments and restaurant closings	(845)	(287)
Net loss on disposition of property and equipment	(222)	(85)
Interest income	6	1
Interest expense	(649)	(602)
Other income, net	115	103
Loss before income taxes and discontinued operations	\$(4,876)	\$(6,972)

	December 20, 2017	August 30, 2017
Total assets:		
Company-owned restaurants ⁽²⁾	\$ 185,946	\$ 189,990
Culinary contract services	5,700	3,342
Franchise operations ⁽³⁾	11,606	11,325
Corporate	21,400	21,800

Edgar Filing: LUBYS INC - Form 10-Q

Total \$ 224,652 \$ 226,457

- (1) Includes vending revenue of \$143 thousand and \$159 thousand for the quarters ended December 20, 2017 and December 21, 2016, respectively.
- (2) Company-owned restaurants segment includes \$8.9 million of Fuddruckers trade name, Cheeseburger in Paradise liquor licenses, and Jimmy Buffett intangibles.
- (3) Franchise operations segment includes approximately \$10.4 million in royalty intangibles.

11

Note 5. Derivative Financial Instruments

The Company enters into derivative instruments, from time to time, to manage its exposure to changes in interest rates on a percentage of its long-term variable rate debt. On December 14, 2016, the Company entered into an interest rate swap, pay fixed - receive floating, with a constant notional amount of \$17.5 million. The fixed swap rate we pay is 1.965%, plus an applicable margin. The variable rate we receive is one-month LIBOR, plus an applicable margin. The term of the interest rate swap is 5 years. The Company does not apply hedge accounting treatment to this derivative, therefore, changes in fair value of the instrument are recognized in Other income (expense), net. The changes in the interest rate swap fair value resulted in a credit to expense of approximately \$173 thousand during the quarter ended December 20, 2017 and an expense of approximately \$91 thousand in the quarter ended December 21, 2016.

The Company does not hold or use derivative instruments for trading purposes.

Note 6. 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 assets 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.

Recurring fair value measurements related to liabilities are presented below:

	Fair Value Measurement Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Method
December 20, 2017				
Recurring Fair Value - Liabilities				(In thousands)

Continuing Operations:

TSR Performance Based Incentive Plan ⁽¹⁾	\$ 452	\$ —	\$ 452	\$	— Monte Carlo Simulation
Derivative - Interest Rate Swap ⁽²⁾	93	—	93	—	Discounted Cash Flow
Total liabilities at Fair Value	\$ 545	\$ —	\$ 545	\$	—

(1) The fair value of the Company's 2016 and 2017 Performance Based Incentive Plan liabilities were approximately \$369 thousand and \$83 thousand, respectively, and is recorded in Other liabilities on the Company's Consolidated Balance Sheet. See Note 12 to the Company's consolidated financial statements in this Form 10-Q for further discussion of Performance Based Incentive Plan.

(2) The fair value of the interest rate swap is recorded in Other liabilities on the Company's Consolidated Balance Sheet.

	Fair Value Measurement Using Quoted Prices in Significant Active Markets for Identical Assets (Level 1)				Significant Unobservable Inputs (Level 3)		Valuation Method
Recurring Fair Value - Liabilities							
(In thousands)							
Continuing Operations:							
TSR Performance Based Incentive Plan ⁽¹⁾	\$ 1,129	\$—	\$ 1,129	\$			—Monte Carlo Simulation
Derivative - Interest Rate Swap ⁽²⁾	\$ 91	\$—	\$ 91	\$			—Discounted Cash Flow
Total liabilities at Fair Value	\$ 1,220	\$—	\$ 1,220	\$			—

(1) The fair value of the Company's 2015, 2016 and 2017 Performance Based Incentive Plan liabilities were approximately \$491 thousand, \$526 thousand, and \$112 thousand, respectively, and is recorded in Other liabilities on the Company's Consolidated Balance Sheet.

(2) The fair value of the interest rate swap is recorded in Other liabilities on the Company's Consolidated Balance Sheet.

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

	Fair Value Measurement Using Quoted Prices in Significant Active Markets for Identical Assets (Level 1)				Significant Unobservable Inputs (Level 3)		Total Impairments ⁽³⁾
Nonrecurring Fair Value Measurements							
(In thousands)							
Continuing Operations							
Property held for sale ⁽¹⁾	\$ 1,626	\$—	\$—	\$ 1,626	\$		\$ (153)
Property and equipment related to company-owned restaurants ⁽²⁾	236	—	—	236			(547)
Total Nonrecurring Fair Value Measurements	\$ 1,862	\$—	\$—	\$ 1,862	\$		\$ (700)

(1) In accordance with Subtopic 360-10, long-lived assets held for sale with a carrying value of approximately \$1.8 million were written down to their fair value, less costs to sell, of approximately \$1.6 million, resulting in an impairment charge of approximately \$0.2 million.

(2) In accordance with Subtopic 360-10, long-lived assets held and used with a carrying amount of approximately \$0.8 million were written down to their fair value of approximately \$0.2 million, resulting in an impairment charge of approximately \$0.6 million.

(3) Total impairments are included in Provision for asset impairments and restaurant closings in the Company's Consolidated Statement of Operations for the quarter ended December 20, 2017.

	Fair Value Measurement Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
December 21, 2016						Impairments
Nonrecurring Fair Value Measurements Continuing Operations						
Property held for sale ⁽¹⁾	\$ 3,330	\$-			—\$ 3,330	\$ (287)

(1) In accordance with Subtopic 360-10, long-lived assets held for sale with a carrying value of approximately \$3.6 million were written down to their fair value, less costs to sell, of approximately \$3.3 million, resulting in an impairment charge of approximately \$0.3 million, which was included in Provision for asset impairments in the quarter ended December 21, 2016.

Note 7. Income Taxes

No cash payments of estimated federal income taxes were made during the quarters ended December 20, 2017 and December 21, 2016, respectively.

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 evidence and information raises doubt regarding the realization of the deferred tax assets, on a more likely than not basis, a valuation allowance is necessary. In evaluating our ability to realize our deferred tax assets, we considered available positive and negative evidence, including scheduled reversals of deferred tax liabilities, tax-planning strategies, and results of recent operations. As of December 20, 2017, management's valuation allowance for its deferred tax assets considered more likely than not to expire before being realized was approximately \$18.4 million.

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.

Note 8. Property and Equipment, Intangible Assets and Goodwill

The costs, net of impairment, and accumulated depreciation of property and equipment at December 20, 2017 and August 30, 2017, together with the related estimated useful lives used in computing depreciation and amortization, were as follows:

	December 20, 2017	August 30, 2017	Estimated Useful Lives (years)
	(In thousands)		
Land	\$60,414	\$60,414	—
Restaurant equipment and furnishings	76,133	73,411	3 to 15
Buildings	153,379	153,041	20 to 33
			Lesser of lease term or estimated useful life
Leasehold and leasehold improvements	26,090	26,953	
Office furniture and equipment	3,797	3,684	3 to 10
Construction in progress	35	35	—
	319,848	317,538	
Less accumulated depreciation and amortization	(148,422)	(144,724)	
Property and equipment, net	\$171,426	\$172,814	
Intangible assets, net	\$19,164	\$19,640	15 to 21

Intangible assets, net, consist of the Fuddruckers trade name and franchise agreements and are amortized. The Company believes the Fuddruckers brand name has an expected accounting life of 21 years from the date of acquisition, July 26, 2010, based on the expected use of its assets and the restaurant environment in which it is being used. The trade name represents a respected brand with customer loyalty and 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 from the date of acquisition and will be amortized over this period of time.

Intangible assets, net, also includes the license agreement and trade name related to Cheeseburger in Paradise and the value of the acquired licenses and permits allowing the sales of beverages with alcohol. These assets have an expected useful life of 15 years from the date of acquisition, December 6, 2012.

The aggregate amortization expense related to intangible assets subject to amortization was approximately \$0.4 million for the quarters ended December 20, 2017 and December 21, 2016, respectively. The aggregate amortization expense related to intangible assets subject to amortization is expected to be approximately \$1.4 million in each of the next five successive fiscal years.

Edgar Filing: LUBYS INC - Form 10-Q

The following table presents intangible assets as of December 20, 2017 and August 30, 2017:

	December 20, 2017 (In thousands)			August 30, 2017 (In thousands)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible Assets Subject to Amortization:						
Fuddruckers trade name and franchise agreements	\$29,486	\$ (10,376)	\$ 19,110	\$29,486	\$ (9,943)	\$ 19,543
Cheeseburger in Paradise trade name and license agreements	\$421	\$ (367)	\$ 54	\$421	\$ (324)	\$ 97
Intangible assets, net	\$29,907	\$ (10,743)	\$ 19,164	\$29,907	\$ (10,267)	\$ 19,640

In fiscal 2010, the Company recorded an intangible asset for goodwill in the amount of approximately \$0.2 million related to the acquisition of substantially all of the assets of Fuddruckers. The Company also recorded, in fiscal 2013, an intangible asset for goodwill in the amount of approximately \$2.0 million related to the acquisition of Cheeseburger in Paradise. Goodwill is considered to have an indefinite useful life and is not amortized. Management performs its formal annual assessment as of the second quarter each fiscal year. The individual restaurant level is the level at which goodwill is assessed for impairment under ASC 350. In accordance with our understanding of ASC 350, we have allocated the goodwill value to each reporting unit in proportion to each location's fair value at the date of acquisition. The result of these second quarter fiscal 2017 and 2016 assessments was impairment of goodwill of approximately \$537 thousand and \$38 thousand, respectively. The Company performs assessments on an interim basis if an event occurs or circumstances exist that indicate that it is more likely than not that a goodwill impairment exists. As of December 20, 2017, of the 23 Cheeseburger in Paradise locations that were acquired, seven locations remain operating as Cheeseburger in Paradise restaurants and of the restaurants closed for conversion to Fuddruckers, three locations remain operating as a Fuddruckers restaurant. Five locations were removed due to their lease term expiring, four locations were subleased to franchisees, and the remaining four were closed and held for future use.

Goodwill, net of accumulated impairments of approximately \$1.1 million, was approximately \$1.1 million as of December 20, 2017 and as of August 30, 2017, respectively, and relates to our Company-owned restaurants reportable segment.

Note 9. Impairment of Long-Lived Assets, Discontinued Operations, Property Held for Sale and Store Closings

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.

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 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.

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

	Quarter Ended	
	December 20, 2017	December 21, 2016
	(16 weeks)	(16 weeks)
	(In thousands, except per share data)	
Provision for asset impairments and restaurant closings	\$845	\$ 287
Net loss on disposition of property and equipment	222	85
	\$1,067	\$ 372
Effect on EPS:		
Basic	\$(0.04)	\$ (0.01)
Assuming dilution	\$(0.04)	\$ (0.01)

The approximate \$0.8 million impairment charge for the quarter ended December 20, 2017 is primarily related to assets at three property locations, two properties held for sale written down to their fair value and approximately \$0.1 million in net lease termination costs at four property locations.

The approximate \$0.3 million impairment charge for the quarter ended December 21, 2016 is related to three properties held for sale written down to their fair value.

The approximate \$0.2 million net loss for the quarter ended December 20, 2017 is primarily related to asset retirements at two property location closures and other routine asset retirements.

The approximate \$0.1 million net loss for the quarter ended December 21, 2016 is related to the sale of properties and equipment.

Discontinued Operations

On March 21, 2014, the Board of Directors of the Company (the "Board") approved a plan focused on improving cash flow from the acquired Cheeseburger in Paradise leasehold locations. This underperforming Cheeseburger in Paradise leasehold disposal plan called for certain Cheeseburger in Paradise restaurants closure or conversion to Fuddrucker's restaurants. As of December 20, 2017, no locations remain classified as discontinued operations in this plan.

As a result of the first quarter fiscal 2010 adoption of the Company's Cash Flow Improvement and Capital Redeployment Plan, the Company reclassified 24 Luby's Cafeterias to discontinued operations. As of December 20, 2017, one location remains held for sale.

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

	December 20, 2017	August 30, 2017
	(In thousands)	
Prepaid expenses	\$—	\$—
Assets related to discontinued operations—current	\$—	\$—
Property and equipment	\$1,872	\$1,872
Deferred tax assets	499	883
Assets related to discontinued operations—non-current	\$2,371	\$2,755
Deferred income taxes	\$—	\$354
Accrued expenses and other liabilities	20	13
Liabilities related to discontinued operations—current	\$20	\$367
Other liabilities	\$16	\$16
Liabilities related to discontinued operations—non-current	\$16	\$16

As of December 20, 2017, under both closure plans, the Company had one property classified as discontinued operations. The asset carrying value of the owned property was approximately \$1.9 million and is included in assets related to discontinued operations. The Company is actively marketing this property for sale and has one property with a ground lease previously impaired to zero.

The following table sets forth the sales and pretax losses reported from discontinued operations:

	Quarter Ended December 20, 2017	Quarter Ended December 21, 2016
	(16 weeks) (16 weeks)	
	(In thousands, except discontinued locations)	
Sales	\$—	\$—
Pretax loss	(2)	(7)
Income tax expense from discontinued operations	(33)	(65)
Loss from discontinued operations, net of income taxes	\$(35)	\$(72)
Discontinued locations closed during the period	—	—

The following table summarizes discontinued operations for the first quarters of fiscal 2018 and 2017:

	Quarter Ended December 20, 2017	Quarter Ended December 21, 2016
	(16 weeks) (16 weeks)	
	(In thousands, except per share data)	
Discontinued operating loss	\$(2)	\$(7)
Pretax loss	\$(2)	\$(7)
Income tax expense from discontinued operations	(33)	(65)

Edgar Filing: LUBYS INC - Form 10-Q

Loss from discontinued operations, net of income taxes	\$(35)	\$ (72)
Effect on EPS from discontinued operations—basic	\$(0.00)	\$ (0.00)

18

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, actively marketed and recorded at fair value less transaction costs. 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 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 December 20, 2017, the Company had four owned properties recorded at approximately \$3.2 million in property held for sale.

At August 30, 2017, the Company had four owned properties recorded at approximately \$3.4 million in property held for sale.

The Company is actively marketing the locations currently classified as property held for sale.

Abandoned Leased Facilities - Reserve for Store Closing

As of December 20, 2017, the Company classified six restaurant leased locations in Arkansas, Illinois, Indiana, Maryland, New York, and Virginia as abandoned. Although the Company remains obligated under the terms of the leases for the rent and other costs that may be associated with the leases, the Company decided to cease operations and has no foreseeable plans to occupy the spaces as a company restaurant in the future. During the quarter ended December 20, 2017, the Company recorded an increase to the liability for lease termination expense and charged to earnings, in Provision for asset impairments and restaurant closings of approximately \$243 thousand. The liability is equal to the total amount of rent and other direct costs for the remaining period of time the properties will be unoccupied plus the present value of the amount by which the rent paid by the Company to the landlord exceeds any rent paid to the Company by a tenant under a sublease over the remaining period of the lease terms. Accrued lease termination expense was approximately \$625 thousand and \$540 thousand as of December 20, 2017 and August 30, 2017, respectively.

Note 10. Commitments and Contingencies

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements, except for operating leases.

Pending Claims

From time to time, the Company is subject to various 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 fiscal 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 this industry, 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, and contract termination expenses. The Company had one non-cancelable contract with an approximate \$331 thousand commitment as of December 20, 2017.

Cheeseburger in Paradise, Royalty Commitment

The license agreement and trade name relates to a perpetual license to use intangible assets including trademarks, service marks and publicity rights related to Cheeseburger in Paradise owned by Jimmy Buffett and affiliated entities. In return, the Company pays a royalty fee of 2.5% of gross sales, less discounts, at the Company's operating Cheeseburger in Paradise locations to an entity owned or controlled by Jimmy Buffett. The trade name represents a respected brand with positive customer loyalty, and the Company intends to cultivate and protect the use of the trade name.

Note 11. 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 Amended and Restated Master Sales Agreement dated August 2, 2017 among the Company and the Pappas entities.

Under the terms of the Amended and Restated 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. There were no costs incurred under the Amended and Restated Master Sales Agreement for custom-fabricated and refurbished equipment in the quarters ended December 20, 2017 and December 21, 2016, respectively. Services provided under this agreement are subject to review and approval by the Finance and Audit Committee of the Board.

Operating Leases

In the third quarter of fiscal 2004, Messrs. Pappas became partners in a limited partnership which purchased a retail strip center in Houston, Texas. Messrs. Pappas collectively own a 50% limited partnership interest and a 50% general partnership interest in the limited partnership. A third party company manages the center. One of the Company's restaurants has rented approximately 7% of the space in that center since July 1969. No changes were made to the Company's lease terms as a result of the transfer of ownership of the center to the new partnership.

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 12 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 paid rent of \$22.00 per square foot plus maintenance, taxes, and insurance during the remaining primary term of the lease. Thereafter, the lease provides for increases in rent at set intervals. The Company made payments of approximately \$110 thousand and approximately \$103 thousand in the quarters ended December 20, 2017 and December 21, 2016, respectively. The new lease agreement was approved by the Finance and Audit Committee.

In the third quarter of fiscal 2014, on March 12, 2014, the Company executed a new lease agreement for one of the Company's Houston Fuddrucker's locations with Pappas Restaurants, Inc. The lease provides for a primary term of approximately six years with two subsequent five-year options. Pursuant to the lease agreement, the Company paid \$27.56 per square foot plus maintenance, taxes, and insurance from March 12, 2014 until November 30, 2016. Currently, the lease agreement provides for increases in rent at set intervals. The Company made payments of approximately \$44 thousand and \$41 thousand in the quarters ended December 20, 2017 and December 21, 2016,

respectively.

20

	Quarter Ended	
	December 2017	December 21, 2016
	(16 weeks)	(16 weeks)
	(In thousands, except percentages)	
Affiliated costs incurred:		
Other operating expenses, occupancy costs and opening costs, including property leases	154	144
Total	\$154	\$ 144
Relative total Company costs:		
Selling, general and administrative expenses	\$11,525	\$ 13,759
Capital expenditures	4,325	4,980
Other operating expenses, occupancy costs and opening costs	25,835	26,288
Total	\$41,685	\$ 45,027
Affiliated costs incurred as a percentage of relative total Company costs	0.37	% 0.32
		%

Board of Directors

Christopher J. Pappas is a member of the Advisory Board of Amegy Bank, a Division of ZB, N.A. (formerly, Amegy Bank, N.A.), which was a lender and syndication agent under the 2013 Credit Facility (as defined herein).

Key Management Personnel

The Company entered into a new employment agreement with Christopher Pappas on December 11, 2017. The new employment agreement contains a termination date of August 28, 2019. Mr. Pappas continues to devote his primary time and business efforts to the Company while maintaining his role at Pappas Restaurants, Inc.

Peter Tropoli, a director of the Company and the Company's Chief Operating Officer, and formerly the Company's Senior Vice President, Administration, General Counsel and Secretary, is an attorney and 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.

Note 12. Share-Based Compensation

We have two active share based stock plans, the Luby's Incentive Stock Plan, as amended and restated effective December 5, 2015 (the "Employee Stock Plan") and the Nonemployee Director Stock Plan. Both plans authorize the granting of stock options, restricted stock, and other types of awards consistent with the purpose of the plans.

Of the 1.1 million shares approved for issuance under the Nonemployee Director Stock Plan, 1.2 million options, restricted stock units and restricted stock awards were granted, and 0.1 million options were canceled or expired and added back into the plan, since the plan's inception. Approximately 0.1 million shares remain available for future issuance as of December 20, 2017. Compensation cost for share-based payment arrangements under the Nonemployee Director Stock Plan, recognized in selling, general and administrative expenses for the quarters ended December 20, 2017 and December 21, 2016 were approximately \$152 thousand and \$192 thousand, respectively.

Of the aggregate 4.1 million shares approved for issuance under the Employee Stock Plan (which amount includes shares authorized under the original plan and shares authorized pursuant to the amended and restated plan effective as of December 5, 2015), 6.9 million options and restricted stock units were granted, and 3.7 million options and restricted stock units were canceled or expired and added back into the plan, since the plan's inception in 2005. Approximately 0.9 million shares remain available for future issuance as of December 20, 2017. Compensation cost for share-based payment arrangements under the Employee Stock Plan, recognized in selling, general and administrative expenses for the quarters ended December 20, 2017 and December 21, 2016 were approximately \$289 thousand and \$241 thousand, respectively.

The Company previously approved a Total Shareholder Return ("TSR") Performance Based Incentive Plan which provides for a right to receive an unspecified number of shares of common stock under the Employee Stock Plan based on the total shareholder return ranking compared to a selection of peer companies over a three-year cycle, for each plan year. The award value varies from 0% to 200% of a base amount, as a result of the Company's TSR performance in comparison to its peers over the measurement period. The number of shares at the end of the three-year measurement period will be determined as the award value divided by the closing stock price on the last day of each fiscal year accordingly. Each three-year measurement period is designated a plan year name based on year one of the measurement period. Since the plans provide for an undeterminable number of awards, the plans are accounted for as liability based plans. The liability valuation estimate for each plan year has been determined based on a Monte Carlo simulation model. Based on this estimate, management accrues expense ratably over the three-year service periods. A valuation estimate of the future liability associated with each fiscal year's performance award plan is performed periodically with adjustments made to the outstanding liability at each reporting period to properly state the outstanding liability for all plan years in the aggregate as of the respective balance sheet date. As of December 20, 2017, the valuation estimate which represents the fair value of the performance awards liability for all plan years 2016 and 2017, resulted in an approximate \$117 thousand increase in the aggregate liability. Non-cash compensation expense related to the Company's TSR Performance Based Incentive Plans was approximately \$117 thousand and \$336 thousand in the quarters ended December 20, 2017 and December 21, 2016, respectively, and are recorded in Selling, general and administrative expenses. The 2015 TSR Performance Based Incentive Plan vested for each active participant on August 30, 2017. The fair value of the 2015 plan's liability in the amount of \$496 thousand was converted to equity and the number of shares awarded for the 2015 TSR Performance Based Incentive Plan was based on the Company's stock price at closing on the last day of fiscal 2017. The number of shares at the end of each plan's three-year periods will be determined as the award value divided by the Company's closing stock price on the last day of the plan's fiscal year.

Stock Options

Stock options granted under either the Employee Stock Plan or the Nonemployee Director Stock Plan have exercise prices equal to the market price of the Company's common stock at the date of the grant.

Option awards under the Nonemployee Director Stock Plan generally vest 100% on the first anniversary of the grant date and expire ten years from the grant date. No options were granted under the Nonemployee Director Stock Plan in the quarter ended December 20, 2017. No options to purchase shares were outstanding under this plan as of December 20, 2017.

Options granted under the Employee Stock Plan generally vest 50% on the first anniversary date of the grant date, 25% on the second anniversary of the grant date and 25% on the third anniversary of the grant date, with all options expiring ten years from the grant date. All options granted in the quarter ended December 20, 2017 were granted under the Employee Stock Plan. Options to purchase 1,750,525 shares at option prices of \$2.82 to \$5.95 per share remain outstanding as of December 20, 2017.

A summary of the Company's stock option activity for the quarter ended December 20, 2017 is presented in the following table:

Shares Under Fixed Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value
----------------------------	---------------------------------	--	---------------------------

Edgar Filing: LUBYS INC - Form 10-Q

		(Per share)		(In thousands)
Outstanding at August 30, 2017	1,345,916	\$ 4.64	6.4	\$ —
Granted	449,410	2.82	—	—
Expired	(44,801)	7.89	—	—
Outstanding at December 20, 2017	1,750,525	\$ 4.09	7.3	\$ —
Exercisable at December 20, 2017	1,018,289	\$ 4.55	5.9	\$ —

The intrinsic value for stock options is defined as the difference between the current market value, or closing price on December 20, 2017, and the grant price on the measurement dates in the table above.

At December 20, 2017, there was approximately \$0.6 million of total unrecognized compensation cost related to unvested options that are expected to be recognized over a weighted-average period of 2.0 years.

Restricted Stock Units

Grants of restricted stock units consist of the Company's common stock and generally vest after three years. All restricted stock units are cliff-vested. Restricted stock units are valued at the closing market price of the Company's common stock at the date of grant.

A summary of the Company's restricted stock unit activity during the quarter ended December 20, 2017 is presented in the following table:

	Restricted Stock Units	Weighted Average Fair Value (Per share)	Weighted- Average Remaining Contractual Term (In years)
Unvested at August 30, 2017	404,364	\$ 4.54	1.8
Granted	170,868	2.81	—
Vested	(4,000)	5.15	—
Unvested at December 20, 2017	571,232	\$ 4.02	2.1

At December 20, 2017, there was approximately \$1.1 million of total unrecognized compensation cost related to unvested restricted stock units that is expected to be recognized over a weighted-average period of 2.1 years.

Restricted Stock Awards

Under the Nonemployee Director Stock Plan, directors are granted restricted stock in lieu of cash payments, for all or a portion of their compensation as directors. Directors may receive a 20% premium of additional restricted stock by opting to receive stock over a minimum required amount of stock, in lieu of cash. The number of shares granted is valued at the average of the high and low price of the Company's stock at the date of the grant. Restricted stock awards vest when granted because they are granted in lieu of a cash payment. However, directors are restricted from selling their shares until after the third anniversary of the date of the grant.

Note 13. 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 excluded from the computation of net income per share for the quarter ended December 20, 2017 include 1,750,525 shares with exercise prices exceeding market prices and no shares whose inclusion would also be anti-dilutive.

Edgar Filing: LUBYS INC - Form 10-Q

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

	Quarter Ended	
	December 16, 2017	December 21, 2016
	(16 weeks)	(16 weeks)
	(In thousands, except per share data)	
Numerator:		
Loss from continuing operations	\$ (4,867)	\$ (5,514)
Loss from discontinued operations, net of income taxes	(35)	(72)
NET LOSS	\$ (4,902)	\$ (5,586)
Denominator:		
Denominator for basic earnings per share—weighted-average shares	29,691	29,339
Effect of potentially dilutive securities:		
Employee and non-employee stock options	—	—
Denominator for earnings per share assuming dilution	29,691	29,339
Loss per share from continuing operations:		
Basic	\$ (0.17)	\$ (0.19)
Assuming dilution	\$ (0.17)	\$ (0.19)
Loss per share from discontinued operations:		
Basic	\$ (0.00)	\$ (0.00)
Assuming dilution	\$ (0.00)	\$ (0.00)
Net loss per share:		
Basic	\$ (0.17)	\$ (0.19)
Assuming dilution	\$ (0.17)	\$ (0.19)

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 quarter ended December 20, 2017 included in Item 1 of Part I of this Quarterly Report on Form 10 (this "Form 10-Q"), and the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended August 30, 2017.

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.

Edgar Filing: LUBYS INC - Form 10-Q

The following table sets forth selected operating data as a percentage of total sales (unless otherwise noted) for the periods indicated. All information is derived from the accompanying consolidated statements of income.

Percentages may not total due to rounding.

	Quarter Ended			
	December 20, 2017		December 21, 2016	
	(16 weeks)	(16 weeks)	(16 weeks)	(16 weeks)
Restaurant sales	91.6 %	94.5 %		
Culinary contract services	6.6 %	3.8 %		
Franchise revenue	1.7 %	1.6 %		
Vending revenue	0.1 %	0.1 %		
TOTAL SALES	100.0 %	100.0 %		

STORE COSTS AND EXPENSES:

(As a percentage of restaurant sales)

Cost of food	28.5 %	28.5 %		
Payroll and related costs	36.5 %	35.8 %		
Other operating expenses	18.6 %	18.2 %		
Occupancy costs	6.0 %	6.0 %		
Vending revenue	(0.1)%	(0.1)%		
Store level profit	10.6 %	11.7 %		

COMPANY COSTS AND EXPENSES:

(As a percentage of total sales)

Opening costs	0.1 %	0.1 %		
Depreciation and amortization	4.7 %	5.7 %		
Selling, general and administrative expenses	10.1 %	12.0 %		
Net loss on disposition of property and equipment	0.2 %	0.1 %		

Culinary Contract Services Costs

(As a percentage of Culinary Contract Services sales)

Cost of culinary contract services	84.2 %	88.7 %		
Culinary segment profit	15.8 %	11.3 %		

Franchise Operations Costs

(As a percentage of Franchise revenue)

Cost of franchise operations	25.9 %	31.0 %		
Franchise segment profit	74.1 %	69.0 %		

(As a percentage of total sales)

LOSS FROM OPERATIONS	(3.8)%	(5.7)%		
Interest income	0.0 %	0.0 %		
Interest expense	(0.6)%	(0.5)%		

Edgar Filing: LUBYS INC - Form 10-Q

Other income, net	0.1	%	0.1	%
Loss before income taxes and discontinued operations	(4.3)%	(6.1)%
Benefit for income taxes	0.0	%	(1.3)%
Loss from continuing operations	(4.3)%	(4.8)%
Loss from discontinued operations, net of income taxes	(0.0)%	(0.1)%
NET LOSS	(4.3)%	(4.9)%

26

Although store level profit, defined as restaurant sales less cost of food, payroll and related costs, other operating expenses, and occupancy costs is a non-GAAP measure, we believe its presentation is useful because it explicitly shows the results of our most significant reportable segment. The following table reconciles between store level profit, a non-GAAP, measure to loss from continuing operations, a GAAP measure:

	Quarter Ended	
	December 20, 2017	December 21, 2016
	(16 weeks)	(16 weeks)
	(In thousands)	
Store level profit	\$11,086	\$ 12,595
Plus:		
Sales from culinary contract services	7,519	4,297
Sales from franchise operations	1,887	1,871
Less:		
Opening costs	75	165
Cost of culinary contract services	6,332	3,811
Cost of franchise operations	488	580
Depreciation and amortization	5,353	6,550
Selling, general and administrative expenses	11,525	13,759
Provision for asset impairments and restaurant closings	845	287
Net loss on disposition of property and equipment	222	85
Interest income	(6)	(1)
Interest expense	649	602
Other income, net	(115)	(103)
Benefit for income taxes	(9)	(1,458)
Loss from continuing operations	\$(4,867)	\$ (5,514)

The following table shows our restaurant unit count as of August 30, 2017 and December 20, 2017.

Restaurant Counts:

	August 30, 2017	FY18 Q1 Openings	FY18 Q1 Closings	December 20, 2017
Luby's Cafeterias	88	—	—	88
Fuddrucker's Restaurants	71	—	(3)	68
Cheeseburger in Paradise	8	—	(1)	7
Total	167	—	(4)	163

Overview

Luby's, Inc. ("Luby's" or "Company") is a multi-branded company operating in the restaurant industry and in the contract food services industry. Our primary brands include Luby's Cafeteria, Fuddruckers - World's Greatest Hamburgers®, Luby's Culinary Contract Services and Cheeseburger in Paradise.

Our Company's vision is that our guests, employees and shareholders stay loyal to our restaurant brands and value them as a significant part of their lives. We want our company's performance to make it a leader in our industry.

We are headquartered in Houston, Texas. Our corporate headquarters is located at 13111 Northwest Freeway, Suite 600, Houston, Texas 77040, and our telephone number at that address is (713) 329-6800. Our website is www.lubysinc.com. The information on our website is not, and shall not be deemed to be, a part of this Form 10-Q or incorporated by reference into any of our other filings with the SEC.

As of December 20, 2017, we owned and operated 163 restaurants, of which 88 are traditional cafeterias, 68 are gourmet hamburger restaurants, and seven are casual dining restaurants and bars. These establishments are located in close proximity to retail centers, business developments and residential areas mostly throughout the United States. Included in the 163 restaurants that we own and operate are 12 restaurants located at six property locations where we operate a side-by-side Luby's Cafeteria and Fuddruckers on the same property. We refer to these locations as "Combo locations."

As of December 20, 2017, we operated 22 Culinary Contract Services locations. We operated 15 of these locations in the Houston, Texas area, two in San Antonio, Texas, two in the Texas Lower Rio Grande Valley, and one in Dallas, Texas. Outside of Texas we operated one location in Oklahoma and one location in North Carolina. Luby's Culinary Contract Services currently provides food service management to healthcare and corporate dining facilities.

As of December 20, 2017, we had 47 franchisees operating 111 Fuddruckers restaurants. Our largest five franchise owners own five to twelve restaurants each. Sixteen franchise owners each own two to four restaurants. The 26 remaining franchise owners each own one restaurant.

Accounting Periods

The Company's fiscal year ends on the last Wednesday in August. Accordingly, each fiscal year normally consists of 13 four-week periods, or accounting periods, accounting for 364 days in the aggregate. However, every fifth or sixth year, we have a fiscal year that consists of 53 weeks, accounting for 371 days in the aggregate; fiscal 2016 was such a year. The first fiscal quarter consists of four four-week periods, or 16 weeks, and the remaining three quarters typically includes three four-week periods, or 12 weeks, in length. The fourth fiscal quarter includes 13 weeks in certain fiscal years to adjust for our standard 52 week, or 364 day, fiscal year compared to the 365 day calendar year. Comparability between quarters may be affected by the 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. A restaurant's sales results are included in the same-store sales calculation in the quarter after a store has been open for six consecutive fiscal quarters. Stores that close on a permanent basis (or on a temporary basis for remodeling) are removed from the group in the quarter when operations cease at the restaurant, but remain in the same-store group for previously reported 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

Quarter Ended December 20, 2017 Compared to Quarter Ended December 21, 2016

Comparability between quarters is affected by the varying lengths of the quarters and quarters ending at different points in the calendar year when seasonal patterns for sales are different. Both the quarter ended December 20, 2017 and the quarter ended December 21, 2016 consisted of 16 weeks.

Sales

(\$000s)	Quarter	Quarter	Increase/	
	Ended	Ended	(Decrease)	
	December 20,	December 21,	(16 weeks vs 16	
	2017	2016	weeks)	
	(16 weeks)	(16 weeks)		
Restaurant sales	\$ 104,583	\$ 108,082	\$(3,499)	(3.2)%
Culinary contract services	7,519	4,297	3,222	75.0 %
Franchise revenue	1,887	1,871	16	0.9 %
Vending revenue	143	159	(16)	(10.1)%
TOTAL SALES	\$ 114,132	\$ 114,409	\$(277)	(0.2)%

Total sales decreased approximately \$0.3 million, or 0.2%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016, consisting primarily of an approximate \$3.5 million decrease in restaurant sales partially offset by an approximate \$3.2 million increase in Culinary Contract Services sales. The other component of total sales are franchise revenue and vending revenue, which increased \$16 thousand and decreased \$16 thousand, respectively, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016.

The Company has three reportable segments: Company-owned restaurants, franchise operations, and culinary contract services.

Company-Owned Restaurants

Restaurant Sales

(\$000s)	Quarter	Quarter	Increase/(Decrease)	
	Ended	Ended	Amount Change	
Restaurant Brand	December 20,	December 21,	(16 weeks vs 16	
	2017	2016	weeks)	
	(16 weeks)	(16 weeks)		
Luby's Cafeterias	\$ 67,430	\$ 68,339	\$(909)	(1.3)%
Fuddruckers	26,914	28,748	(1,834)	(6.4)%
Combo locations	6,712	6,626	86	1.3 %
Cheeseburger in Paradise	3,527	4,369	(842)	(19.3)%
Restaurant Sales	\$ 104,583	\$ 108,082	\$(3,499)	(3.2)%

Restaurant sales decreased approximately \$3.5 million in the quarter ended December 20, 2017, compared to the quarter ended December 21, 2016. Sales at stand-alone Luby's Cafeteria restaurants decreased approximately \$0.9

million to approximately \$67.4 million; sales from stand-alone Fuddruckers locations decreased approximately \$1.8 million to approximately \$26.9 million; sales at Combo locations increased approximately \$0.1 million to approximately \$6.7 million; and sales at Cheeseburger in Paradise restaurants decreased by approximately \$0.8 million to approximately \$3.5 million.

The approximate \$0.9 million sales decrease in stand-alone Luby's Cafeteria restaurants was the result of the closure of four locations over the prior year partially offset by a 1.5% increase in same-store sales. The 1.5% Luby's Cafeteria same-store sales increase was the result of a 4.8% increase in average spend per guest partially offset by a 3.3% decrease in guest traffic.

The approximate \$1.8 million sales decrease at stand-alone Fuddruckers restaurants was the result of seven permanent restaurant closings and two temporary closures for renovation over the prior year offset by a 0.6% increase in same-store sales. The 0.6% increase in same-store sales was the result of a 4.5% increase in average spend per guest, partially offset by a 3.9% decrease in guest traffic. All six Combo location stores are included in our same-store grouping and sales at this group of restaurants increased 1.3%. All seven stores that we operate as Cheeseburger in Paradise are included in our same-store grouping and sales at this group of restaurants decreased 10.5% in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016.

Cost of Food

(\$000s)	Quarter	Quarter	Increase/ (Decrease) (16 weeks vs 16 weeks)
	Ended December 20, 2017 (16 weeks)	Ended December 21, 2016 (16 weeks)	
Cost of food	\$ 29,754	\$ 30,850	\$(1,096) (3.6)%
As a percentage of restaurant sales	28.5 %	28.5 %	0.0 %

Cost of food decreased approximately \$1.1 million, or 3.6%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016 with lower guest traffic levels and operations at twelve fewer locations. As a percentage of restaurant sales, cost of food was 28.5% in the quarter ended December 20, 2017 and in the quarter ended December 21, 2016 due to higher average menu pricing offset by higher average food commodity prices.

Payroll and Related Costs

(\$000s)	Quarter	Quarter	Increase/ (Decrease) (16 weeks vs 16 weeks)
	Ended December 20, 2017 (16 weeks)	Ended December 21, 2016 (16 weeks)	
Payroll and related costs	\$ 38,126	\$ 38,673	\$(547) (1.4)%
As a percentage of restaurant sales	36.5 %	35.8 %	0.7 %

Payroll and related costs decreased approximately \$0.5 million in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The decrease reflects operating twelve fewer restaurants and lower associate hours scheduled and deployed on the decreased level of guest traffic, partially offset by comparison to the quarter ended December 21, 2016 which included an approximate \$0.5 million reduction to workers' compensation expense. As a percentage of restaurant sales, payroll and related costs increased 0.7% to 36.5% in the quarter ended December 20, 2017 compared to 35.8% in the quarter ended December 21, 2016 due to higher workers' compensation expense, higher average wage rates, and greater overtime hour deployment. Payroll and related costs increased 0.2% to 36.5% in the quarter ended December 20, 2017 compared to 36.3% in the quarter ended December 20, 2017, excluding the reduction in workers' compensation expense of approximately \$0.5 million, or 0.5% of restaurant sales.

Other Operating Expenses

Quarter	Quarter
Ended	Ended

Edgar Filing: LUBYS INC - Form 10-Q

(\$000s)	December 20,	December 21,	Increase/
	2017	2016	(Decrease)
	(16 weeks)	(16 weeks)	(16 weeks vs 16 weeks)
Other operating expenses	\$ 19,499	\$ 19,648	\$(149) (0.8)%
As a percentage of restaurant sales	18.6 %	18.2 %	0.4 %

30

Other operating expenses primarily include restaurant-related expenses for utilities, repairs and maintenance, local store advertising, property and liability insurance losses above insurance deductibles, services and supplies. Other operating expenses decreased approximately \$0.1 million, or 0.8%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016, due primarily to (1) an approximate \$0.3 million decrease in repairs and maintenance; (2) an approximate \$0.2 million decrease in utilities expense with the operation of fewer restaurants; (3) an approximate \$0.1 million decrease in credit card processing fees with the operation of fewer restaurants; partially offset by (4) an approximate \$0.3 million expense related to net uninsured losses; and (5) an approximate \$0.2 million increase in fees to third party delivery services associated with higher sales through this channel. As a percentage of restaurant sales, other operating expenses increased 0.4%, to 18.6%, in the quarter ended December 20, 2017, compared to 18.2% in the the quarter ended December 21, 2016 due to an approximate \$0.3 million expense related to losses above insurance deductibles and higher average restaurant supplies and services costs per store, partially offset by lower average repairs and maintenance expense per store.

Occupancy Costs

(\$000s)	Quarter	Quarter	Increase/ (Decrease)
	Ended December 20, 2017 (16 weeks)	Ended December 21, 2016 (16 weeks)	
Occupancy costs	\$ 6,261	\$ 6,475	\$(214) (3.3)%
As a percentage of restaurant sales	6.0 %	6.0 %	— %

Occupancy costs include property lease expense, property taxes, common area maintenance charges, and property insurance expense. Occupancy costs decreased approximately \$0.2 million to approximately \$6.3 million in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The decrease was primarily due to a decrease in rent and property taxes associated with fewer restaurants in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. As a percentage of restaurant sales, other occupancy costs were 6.0% in the quarter ended December 20, 2017 and in the quarter ended December 21, 2016.

Franchise Operations

We only offer franchises for the Fuddruckers brand. Franchises are sold in markets where expansion is deemed advantageous to the development of the Fuddruckers concept and system of restaurants. Franchise revenue includes (1) royalties paid to us as the franchisor for the Fuddruckers brand and (2) franchise fees paid to us when franchise units are opened for business or transferred to new owners and when franchise agreements are renewed. Cost of franchise operations includes the direct costs associated with supporting franchisees with opening new Fuddruckers franchised restaurants and the corporate overhead expenses associated with generating franchise revenue. These corporate expenses primarily include the salaries and benefits, travel and related expenses, and other expenses for employees whose primary job function involves supporting our franchise owners and the development of new franchise locations.

(\$000s)	Quarter	Quarter	Increase/ (Decrease)
	Ended December 20, 2017 (16 weeks)	Ended December 21, 2016 (16 weeks)	

Edgar Filing: LUBYS INC - Form 10-Q

				(16 weeks vs 16 weeks)
Franchise revenue	\$ 1,887	\$ 1,871	\$16	0.9 %
Cost of franchise operations	488	580	(92)	(15.9)%
Franchise profit	\$ 1,399	\$ 1,291	\$108	8.4 %
Franchise profit as a percentage of franchise revenue	74.1	% 69.0	%	5.1 %

31

Franchise revenue increased \$16 thousand in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The \$16 thousand increase in franchise revenue includes an approximate \$10 thousand increase in franchise royalties and an approximate \$6 thousand increase in non-royalty related fee income in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The increase in franchise royalties is due in part to the timing of franchise location openings and closings partially offset by same-store sales declines at franchise locations.

Cost of Franchise Operations

Cost of franchise operations includes the direct costs associated with supporting franchisees with opening new Fuddrucker's franchised restaurants and the corporate overhead expenses associated with generating franchise revenue. These corporate expenses primarily include the salaries and benefits, travel and related expenses, and other expenses for employees whose primary job function involves supporting our franchise owners and the development of new franchise locations. Cost of franchise operations decreased \$92 thousand in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. Franchise segment profit, defined as Franchise revenue less Cost of franchise operations, increased approximately \$0.1 million in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016 due primarily to the lower franchise operations costs as result of lower franchise support headcount and reduced travel costs. Franchisees opened three locations (one international location in Mexico, and two domestic locations, one in each of Florida and Pennsylvania) and closed five locations (one international location in Italy and four domestic locations, one in each of Tennessee, North Carolina, South Dakota, and North Dakota) in the quarter ended December 20, 2017.

Culinary Contract Services

Culinary Contract Services is a business line servicing healthcare, sport stadiums, corporate dining clients, and sales through retail grocery stores. The healthcare accounts are full service and typically include in-room delivery, catering, vending, coffee service, and retail dining. Culinary Contract Services has contracts with long-term acute care hospitals, acute care medical centers, ambulatory surgical centers, behavioral hospitals, a sports stadium, and business and industry clients. Culinary Contract Services has the unique ability to deliver quality services that include facility design and procurement as well as nutrition and branded food services to our clients. We operated 22 Culinary Contract Services locations at the end of the quarter ended December 20, 2017 and 23 at the end of the quarter ended December 21, 2016. We focus on clients who are able to enter into agreements in which all operating costs are reimbursed to us and we generally charge a fixed fee. These agreements typically present lower financial risk to the company.

(\$000s)	Quarter	Quarter	Increase/	
	Ended	Ended	(Decrease)	
	December 20,	December 21,	(16 weeks vs 16	
	2017	2016	weeks)	
	(16 weeks)	(16 weeks)		
Culinary contract services sales	\$ 7,519	\$ 4,297	\$3,222	75.0 %
Cost of culinary contract services	6,332	3,811	2,521	66.2 %
Culinary contract profit	\$ 1,187	\$ 486	\$701	144.2 %
Culinary contract services profit as a percentage of Culinary contract services sales	15.8	% 11.3	%	4.5 %

Culinary contract services sales increased approximately \$3.2 million, or 75.0%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The increase in Culinary contract services revenue was primarily the result of a change in the mix of our Culinary agreements with clients and the addition of retail sales of our Luby's Fried Fish and Luby's Macaroni and Cheese in the frozen section of retail grocery stores. New locations and retail sales combined contributed approximately \$4.3 million in revenue which was partially offset by a \$0.8 million decrease in revenue from locations that ceased operations and an approximate \$0.3 million decrease in revenue at locations continually operated over the prior full year.

Cost of culinary contract services includes the food, payroll and related costs, other direct operating expenses, and corporate overhead expenses associated with generating Culinary Contract Services sales. Cost of Culinary Contract Services increased approximately \$2.5 million, or 66.2%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. Culinary Contract Services segment profit, defined as Culinary Contract Services sales less Cost of Culinary Contract Services, increased to 15.8% in the quarter ended December 20, 2017 from 11.3% in the the quarter ended December 21, 2016 due to the change in the mix of our Culinary agreements with clients, including newer higher sales volume and higher profit margin locations replacing lower profit margin locations.

Company-wide 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 \$0.1 million in the quarter ended December 20, 2017 compared to approximately \$0.2 million in the quarter ended December 21, 2016. The approximate \$0.1 million in opening costs for the quarter ended December 20, 2017 reflects the carrying costs for one location where we previously operated a Cheeseburger in Paradise restaurant and one location that we lease for a potential future Fuddruckers opening. The approximate \$0.2 million in opening costs in the quarter ended December 21, 2016 included the carrying costs for two locations where we previously operated as Cheeseburger in Paradise restaurants.

Depreciation and Amortization Expense

	Quarter Ended December 20, 2017 (16 weeks)	Quarter Ended December 21, 2016 (16 weeks)	Increase/ (Decrease) (16 weeks vs 16 weeks)
(\$000s)			
Depreciation and amortization	\$ 5,353	\$ 6,550	\$(1,197) (18.3)%
As a percentage of total sales	4.7 %	5.7 %	(1.0)%

Depreciation and amortization expense decreased by approximately \$1.2 million, or 18.3%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016 due primarily to reduced capital investment, certain assets reaching the end of their depreciable lives, change in estimated useful lives of certain assets, and the removal of certain assets upon sale. As a percentage of total revenue, depreciation and amortization expense decreased to 4.7% in the quarter ended December 20, 2017, compared to 5.7% in the the quarter ended December 21, 2016.

Selling, General and Administrative Expenses

	Quarter Ended December 20, 2017 (16 weeks)	Quarter Ended December 21, 2016 (16 weeks)	Increase/ (Decrease) (16 weeks vs 16 weeks)
(\$000s)			
General and administrative expenses	\$ 10,093	\$ 11,433	\$(1,340) (11.7)%
Marketing and advertising expenses	1,432	2,326	(894) (38.4)%

Edgar Filing: LUBYS INC - Form 10-Q

Selling, general and administrative expenses	\$ 11,525		\$ 13,759		\$(2,234)	(16.2)%
As a percentage of total sales	10.1	%	12.0	%		(1.9)%

33

Selling, general and administrative expenses include corporate salaries and benefits-related costs, including restaurant area leaders, share-based compensation, marketing and advertising expenses, professional fees, travel and recruiting expenses and other office expenses. Selling, general and administrative expenses decreased approximately \$2.2 million, or 16.2%, in the quarter ended December 20, 2017 compared to the quarter ended December 21, 2016. The decrease in Selling, general and administrative expenses includes (1) an approximate \$0.9 million decrease in marketing and advertising expense due to re-directing marketing investment away from more costly broad channels, such as television advertising, toward more focused and economical channels for our brands, such as digital media, as well as changes in the timing of marketing spend through the fiscal year; (2) an approximate \$0.4 million reduction in corporate travel expense; (3) and approximate \$0.6 million reduction in compensation, benefits, and general liability insurance expense; and a (4) a net \$0.3 million reduction in other corporate overhead costs.

As a percentage of total revenue, Selling, general and administrative expenses decreased to 10.1% in the quarter ended December 20, 2017, compared to 12.0% in the the quarter ended December 21, 2016.

Provision for Asset Impairments and Restaurant Closings

The approximate \$0.8 million provision for asset impairments and restaurant closings, net, for the quarter ended December 20, 2017, was the result of an impairment charge for five property locations (two of which are included in property held for sale) each written down to its fair value as well as net lease termination costs of approximately \$0.1 million, in the aggregate, at four property locations. The approximate \$0.3 million impairment charge for the quarter ended December 21, 2016 related to property held for sale written down to its fair value.

Net Loss (Gain) on Disposition of Property and Equipment

Loss on disposition of property and equipment was approximately \$0.2 million in the quarter ended December 20, 2017 and primarily reflects normal asset retirement activity. The loss on disposition of property and equipment was approximately \$85 thousand in the quarter ended December 21, 2016 and primarily reflects normal asset retirement activity.

Interest Income

Interest income was \$6 thousand in the quarter ended December 20, 2017 and \$1 thousand in the quarter ended December 21, 2016.

Interest Expense

Interest expense was approximately \$0.6 million in the quarter ended December 20, 2017 and in the quarter ended December 21, 2016. The expense associated with higher average interest rates was offset by a lower average outstanding debt balance.

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; oil and gas royalty income; and changes in the fair value of our interest rate swap agreement. Other income, net, was approximately \$0.1 million in the quarter ended December 20, 2017 and in the quarter ended December 21, 2016. Increase in the fair value of our interest rate swap was offset by greater gift card related expense and lower net rental income.

Taxes

For the quarter ended December 20, 2017, the income taxes related to continuing operations resulted in a tax benefit of approximately \$9 thousand compared to a tax benefit of approximately \$1.5 million for the quarter ended December 21, 2016.

The effective tax rate (ETR) from continuing operations was a positive 0.2% and a positive 20.9% for the quarters ended December 20, 2017 and December 21, 2016, respectively. The ETR for the quarter ended December 20, 2017 differs from the

federal statutory rate of 34% due to management's valuation allowance conclusions, anticipated federal jobs credits, state income taxes, and other discrete items.

Discontinued Operations

Discontinued operations resulted in a loss of \$35 thousand in the quarter ended December 20, 2017 compared to a loss of \$72 thousand in the quarter ended December 21, 2016. The loss from discontinued operations of approximately \$35 thousand in the quarter ended December 20, 2017 was related to \$2 thousand in carrying costs associated with assets related to discontinued operations. Loss from discontinued operations of \$72 thousand in the quarter ended December 21, 2016 consisted of (1) \$7 thousand in carrying costs associated with assets related to discontinued operations and (2) a tax provision of \$65 thousand.

LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents

General. Our primary sources of short-term and long-term liquidity are cash flows from operations, our Revolver (as defined below), and our Term Loan (as defined below). During the quarter ended December 20, 2017, cash provided by operating activities of approximately \$3.5 million and cash provided by financing activities of approximately \$30 thousand was offset by cash used in investing activities of approximately \$3.8 million. Cash and cash equivalents decreased \$0.3 million in the quarter ended December 20, 2017 compared to an approximate \$0.1 million increase in the quarter ended December 21, 2016. 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:

- capital expenditures for recurring maintenance of our restaurant property and equipment, restaurant renovations and upgrades, new construction, information technology and culinary contract services development; and
- payments to reduce our debt; and
- working capital primarily for our Company-owned restaurants and obligations under our Culinary Contract Services agreements.

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, higher levels of accounts receivable are typical for culinary contract services and franchises. We also continually invest in our business through the addition of new units and refurbishment of existing units, which are reflected as long-term assets.

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

	Quarters Ended	
	December 20,	December 21,
	2017	2016
	(16	(16
	weeks)	weeks)
	(In thousands)	
Total cash provided by (used in):		
Operating activities	\$3,482	\$ 3,241
Investing activities	(3,796)	(4,942)
Financing activities	30	1,775

Net (decrease) increase in cash and cash equivalents \$(284) \$ 74

Operating Activities. Cash provided by operating activities was approximately \$3.5 million in the quarter ended December 20, 2017, an approximate \$0.2 million increase from the quarter ended December 21, 2016. The approximate \$0.2 million increase in cash provided by operating activities is due to an approximate \$2.1 million increase in cash provided by operations before changes in operating assets and liabilities partially offset by an approximate \$1.8 million decrease in cash provided by changes in operating assets and liabilities for the quarter ended December 20, 2017.

Cash provided by operating activities before changes in operating assets and liabilities was approximately \$2.4 million in the quarter ended December 20, 2017, an approximate \$2.1 million increase compared to the quarter ended December 21, 2016. The \$2.1 million increase in cash provided by operating activities before changes in operating assets and liabilities was primarily due to increased store-level profit from our Company-owned restaurants.

Changes in operating assets and liabilities was an approximate \$1.0 million source of cash in the quarter ended December 20, 2017 and an approximate \$2.9 million source of cash in the quarter ended December 21, 2016. The approximate \$1.8 million increase in the source of cash was due to differences in the change in asset and liability balances between the quarter ended December 20, 2017 and the quarter ended December 21, 2016. Increases in current asset accounts are a use of cash while decreases in current asset accounts are a source of cash. During the quarter ended December 20, 2017, the change in trade accounts and other receivables was an approximate \$1.3 million use of cash which was an approximate \$1.5 million decrease from the source of cash in the quarter ended December 21, 2016. The change in insurance receivables was an approximate \$0.3 million source of cash which was an approximate \$0.3 million increase from the quarter ended December 21, 2016. The change in food and supplies inventory during the quarter ended December 20, 2017 was an approximate \$0.3 million use of cash which was an approximate \$0.2 million decrease from the use of cash in the quarter ended December 21, 2016. The change in prepaid expenses and other assets was an approximate \$0.4 million source of cash during the quarter ended December 20, 2017, which was an approximate \$0.5 million increase from the use of cash in the quarter ended December 21, 2016.

Increase in current liability accounts are a source of cash, while decreases in current liability accounts are a use of cash. During the quarter ended December 20, 2017, changes in the balances of accounts payable, accrued expenses and other liabilities was an approximate \$1.6 million source of cash, compared to a source of cash of approximately \$3.1 million during the quarter ended December 21, 2016.

Investing Activities. We generally reinvest available cash flows from operations to develop new restaurants, maintain and enhance existing restaurants and support Culinary Contract Services. Cash used in investing activities was approximately \$3.8 million in the quarter ended December 20, 2017 and approximately \$4.9 million in the quarter ended December 21, 2016. Capital expenditures were approximately \$4.3 million in the quarter ended December 20, 2017 and approximately \$5.0 million in the quarter ended December 21, 2016. Proceeds from the disposal of assets were approximately \$0.2 million in the quarter ended December 20, 2017 and approximately \$38 thousand in the quarter ended December 21, 2016. Insurance proceeds received as a result of claims made from property damage caused by Hurricane Harvey were approximately \$0.3 million in the quarter ended December 20, 2017.

Financing Activities. Cash provided by financing activities was approximately \$30 thousand in the quarter ended December 20, 2017 compared to an approximate \$1.8 million source of cash during the quarter ended December 21, 2016. Cash flows from financing activities was primarily the result of borrowings and repayments related to the 2016 Credit Facility; our Revolver and our Term Loan. During the quarter ended December 20, 2017, cash provided by Revolver borrowings was approximately \$0.1 million, we had no required Term Loan payments, due to Term Loan prepayments made in fiscal 2017, and cash used for equity shares withheld to cover taxes was approximately \$0.1 million. During the quarter ended December 21, 2016, borrowings on our Term Loan and Revolver exceeded repayments of the 2013 Credit Facility and Revolver by approximately \$2.4 million and cash used for debt issuance costs was approximately \$0.6 million.

Status of Long-Term Investments and Liquidity

At December 20, 2017, we did not hold any long-term investments.

Status of Trade Accounts and Other Receivables, Net

We monitor the aging of our receivables, including Fuddruckers franchising related receivables, and record provisions for uncollectable accounts, as appropriate. Credit terms of accounts receivable associated with our CCS business vary from 30 to 45 days based on contract terms.

Working Capital

Current assets increased approximately \$0.5 million in the quarter ended December 20, 2017 compared to an increase of approximately \$0.3 million in the quarter ended December 21, 2016. In the quarter ended December 20, 2017, trade accounts and other receivables, net increased approximately \$1.2 million, food and supplies inventory increased approximately \$0.3 million; partially offset by decreases in prepaid expenses of approximately \$0.4 million and insurance receivables of approximately \$0.3 million and cash and cash equivalents of approximately \$0.3 million. In the quarter ended December 21, 2016, food and supplies inventory increased approximately \$0.4 million, prepaid expenses increased approximately \$0.1

million, and cash and cash equivalents increased approximately \$0.1 million; partially offset by an approximate \$0.3 million decrease in trade accounts and other receivables, net.

Current liabilities increased approximately \$2.9 million in the quarter ended December 20, 2017 compared to an increase of approximately \$5.4 million in the quarter ended December 21, 2016. In the quarter ended December 20, 2017, unredeemed gift cards increased approximately \$1.7 million, accrued taxes other than income taxes increased approximately \$1.0 million, current portion of credit facility debt increased approximately \$0.3 million, salaries and incentives increased approximately \$0.2 million, and accrued professional fees and accrued claims combined increased approximately \$0.2 million; partially offset by decreases in deferred income taxes of approximately \$0.3 million, accounts payable of approximately \$0.1 million, and accrued operating expenses of approximately \$0.1 million. In the quarter ended December 21, 2016, current portion of credit facility debt increased approximately \$2.5 million, unredeemed gift cards increased approximately \$1.5 million, salaries and incentives increased approximately \$1.0 million, accrued taxes other than income taxes increased approximately \$0.9 million and accrued professional fees increased approximately \$0.5 million; partially offset by decreases in accounts payable of approximately \$0.7 million, operating expenses of approximately \$0.2 million and accrued claims and insurance of approximately \$0.1 million.

Capital Expenditures

Capital expenditures consist of purchases of real estate for future restaurant sites, Culinary Contract Services investments, new unit construction, purchases of new and replacement restaurant furniture and equipment, and ongoing remodeling programs. Capital expenditures for the quarter ended December 20, 2017 were approximately \$4.3 million and related to recurring maintenance of our existing units, existing restaurant remodels and rollout of new point of sale and network equipment, improvement of our culinary contract services business and the development of future restaurant sites. We expect to be able to fund all capital expenditures in fiscal 2018 using proceeds from the sale of assets, cash flows from operations and our 2016 Credit Agreement. We expect to spend less than \$14.0 million on capital expenditures in fiscal 2018.

DEBT

The following table summarizes credit facility debt, less current portion at December 20, 2017 and August 30, 2017:

	December 20, 2017	August 30, 2017
	(In thousands)	
2016 Credit Agreement - Revolver	4,500	4,400
2016 Credit Agreement - Term Loan	26,585	26,585
Total credit facility debt	31,085	30,985
Less unamortized debt issue costs	(265)	(287)
Total credit facility debt, less unamortized debt issuance costs	30,820	30,698
Current portion of credit facility debt	(295)	—
Total	\$30,525	\$ 30,698

On November 8, 2016, we refinanced our 2013 Credit Facility (as defined below) with a new \$65.0 million Senior Secured Credit Agreement. The debt issue costs we incurred on the new 2016 Credit Agreement (as defined below) financing amounted to \$0.6 million of which \$0.3 million was applicable to the Term Loan and was setup on a pro-rata basis as a liability, which is included in credit facility debt, less current portion.

Senior Secured Credit Agreement

Edgar Filing: LUBYS INC - Form 10-Q

On November 8, 2016, we entered into a \$65.0 million Senior Secured Credit Facility with Wells Fargo Bank, National Association, as Administrative Agent and Cadence Bank, NA and Texas Capital Bank, NA, as lenders (“2016 Credit Agreement”). The 2016 Credit Agreement, as amended, is comprised of a \$30.0 million 5-year Revolver (the “Revolver”) and a \$35.0 million 5-year Term Loan (the “Term Loan”). The maturity date of the 2016 Credit Agreement is November 8, 2021. For this section of this Form 10-Q, capitalized terms that are used but not otherwise defined shall have the meanings given to such terms in the 2016 Credit Agreement.

The Term Loan and/or Revolver commitments may be increased by up to an additional \$10.0 million in the aggregate.

The 2016 Credit Agreement also provides for the issuance of letters of credit in an aggregate amount equal to the lesser of \$5.0 million and the Revolving Credit Commitment, which was \$30.0 million as of December 20, 2017. The 2016 Credit Agreement is guaranteed by all of the Company's present subsidiaries and will be guaranteed by our future subsidiaries.

At any time throughout the term of the 2016 Credit Agreement, we have the option to elect one of two bases of interest rates. One interest rate option is the highest of (a) the Prime Rate, (b) the Federal Funds Rate plus 0.50% and (c) 30-day LIBOR plus 1%, plus, in each case, the Applicable Margin, which ranges from 1.50% to 2.50% per annum. The other interest rate option is the LIBOR plus the Applicable Margin, which ranges from 2.50% to 3.50% per annum. The Applicable Margin under each option is dependent upon our Consolidated Total Lease Adjusted Leverage Ratio ("CTLAL") at the most recent quarterly determination date.

The Term Loan amortizes 7.0% per year (35.0% in 5 years) which includes the quarterly payment of principal. As of December 20, 2017, we have prepaid the required principal payments through the second calendar quarter of 2018. On December 14, 2016, we entered into an interest rate swap with a notional amount of \$17.5 million, representing 50% of the initial outstanding Term Loan.

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 0.35% per annum depending on the CTLAL at the most recent quarterly determination date.

The proceeds of the 2016 Credit Agreement are available for us to (i) pay in full all indebtedness outstanding under the 2013 Credit Agreement as of November 8, 2016, (ii) pay fees, commissions, and expenses in connection with our repayment of the 2013 Credit Agreement, initial extensions of credit under the 2016 Credit Agreement, and (iii) for working capital and general corporate purposes of the Company.

The 2016 Credit Agreement, as amended, contains the following covenants among others:

- CTLAL of not more than (i) 5.00 to 1.00, at the end of each fiscal quarter, through and including the third fiscal quarter of the Borrower's fiscal year 2018, and (ii) 4.75 to 1.00 thereafter,
- Consolidated Fixed Charge Coverage Ratio of not less than 1.25 to 1.00, at the end of each fiscal quarter,
- Limit on Growth Capital Expenditures so long as the CTLAL is at least 0.25x less than the then-applicable permitted maximum CTLAL,
- restrictions on mergers, acquisitions, consolidations, and asset sales,
- restrictions on the payment of dividends, redemption of stock, and other distributions,
- 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, and
- restrictions on certain acquisitions of all or a substantial portion of the assets, property and/or equity interests of any person, including share repurchases and dividends.

The 2016 Credit Agreement is secured by an all asset lien on all of our real property and also includes customary events of default. If a default occurs and is continuing, the lenders' commitments under the 2016 Credit Agreement may be immediately terminated, and, or we may be required to repay all amounts outstanding under the 2016 Credit Agreement.

As of December 20, 2017, we had \$31.1 million in total outstanding loans and approximately \$1.3 million committed under letters of credit, which we use as security for the payment of insurance obligations, and approximately \$0.2 million in other indebtedness.

We were in compliance with the covenants contained in the 2016 Credit Agreement as of December 20, 2017. At any determination date, if certain leverage and fixed charge ratios exceed the maximum permitted under our 2016 Credit Agreement, we would be considered in default under the terms of the agreement. Due to negative results in the first quarter of fiscal 2018, continued under performance in the current fiscal year could cause our financial ratios to

exceed the permitted limits under the terms of the 2016 Credit Agreement.

38

2013 Credit Facility

In August 2013, we entered into a \$70.0 million revolving credit facility with Wells Fargo Bank, National Association, as Administrative Agent, and ZB, N.A. dba Amegy Bank (formerly Amegy Bank, N.A.), as Syndication Agent. Pursuant to the October 2, 2015 amendment, the total aggregate amount of the lenders' commitments was lowered to \$60.0 million from \$70.0 million. The following description summarizes the material terms of the revolving credit facility, as subsequently amended on March 21, 2014, November 7, 2014 and October 2, 2015, (the revolving credit facility is referred to as the "2013 Credit Facility"). The 2013 Credit Facility is governed by the credit agreement dated as of August 14, 2013 (the "2013 Credit Agreement") among us, the lenders from time to time party thereto, Wells Fargo Bank, National Association, as Administrative Agent, and ZB, N.A. dba Amegy Bank (formerly Amegy Bank, N.A.), as Syndication Agent. The maturity date of the 2013 Credit Facility was September 1, 2017.

The 2013 Credit Facility also provided for the issuance of letters of credit in a maximum aggregate amount of \$5.0 million outstanding as of August 14, 2013 and \$15.0 million outstanding at any one time with prior written consent of the Administrative Agent and the Issuing Bank.

At any time throughout the term of the 2013 Credit 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 ranged from 0.75% to 2.25% per annum. The other interest rate option is the London InterBank Offered Rate plus a spread that ranged from 2.50% to 4.00% per annum. The applicable spread under each option is dependent upon the ratio of our debt to EBITDA at the most recent determination date.

We were 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 0.40% per annum depending on the Total Leverage Ratio at the most recent determination date.

The proceeds of the 2013 Credit Facility were available for our general corporate purposes, general working capital purposes and capital expenditures.

The 2013 Credit Agreement, as amended, contained the following covenants among others:

- Debt Service Coverage Ratio of not less than (i) 1.10 to 1.00 at all times during the first, second and third fiscal quarters of the Borrower's fiscal year 2015, (ii) 1.25 to 1.00 at all times during the fourth fiscal quarter of the Borrower's fiscal year 2015, and (iii) 1.50 to 1.00 at all times thereafter,
- Lease Adjusted Leverage Ratio of not more than (i) 5.75 to 1.00 at all times during the first, second and third fiscal quarters of the Borrower's fiscal year 2015, (ii) 5.50 to 1.00 at all times during the fourth fiscal quarter of the Borrower's fiscal year 2015, (iii) 5.25 to 1.00 at all times during the first fiscal quarter of the Borrower's fiscal year 2016, (iv) 5.00 to 1.00 at all times during the second fiscal quarter of the Borrower's fiscal year 2016, and (v) 4.75 to 1.00 at all times thereafter,
- capital expenditures limited to \$25.0 million per year,
- 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, and
- restrictions on certain acquisitions of all or a substantial portion of the assets, property and/or equity interests of any person, including share repurchases and dividends.

The 2013 Credit Agreement also included customary events of default.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Consolidated Financial Statements included in Item 1 of Part 1 of this Form 10-Q were prepared in conformity with GAAP. 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. Management believes the following are critical accounting policies used in the preparation of these financial statements. Actual results may differ from these estimates, including our estimates of future cash flows, which are subject to the current economic environment and changes in estimates. We had no changes in our critical accounting policies and estimates which were disclosed in our Annual Report on Form 10-K for the fiscal year ended August 30, 2017.

NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This update provides a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. The guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. This update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, which will require us to adopt these provisions in the first quarter of fiscal 2019. Early application is not permitted. This update permits the use of either the retrospective or cumulative effect transition method. Further, in March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the guidance in ASU No. 2014-09 for evaluating when another party, along with the entity, is involved in providing a good or service to a customer. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing," which clarifies the guidance in ASU No. 2014-09 regarding assessing whether promises to transfer goods or services are distinct, and whether an entity's promise to grant a license provides a customer with a right to use or right to access the entity's intellectual property. The Company plans to adopt the standard in the first quarter of fiscal 2019, which is the first fiscal quarter of the annual reporting period beginning after December 15, 2017. We have not yet decided on a method of transition upon adoption. The Company expects the pronouncement may impact the recognition of the initial franchise fee, which is currently recognized upon the opening of a franchise restaurant. We are further evaluating the effect this guidance will have on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This update requires a lessee to recognize on the balance sheet a liability to make lease payments and a corresponding right-of-use asset. The update also requires additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. This update is effective for annual and interim periods beginning after December 15, 2018, which will require us to adopt these provisions in the first quarter of fiscal 2020. This standard requires adoption based upon a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with optional practical expedients. Based on a preliminary assessment, the Company expects that most of its operating lease commitments will be subject to the new guidance and recognized as operating lease liabilities and right-of-use assets upon adoption, resulting in a significant increase in the assets and liabilities on our consolidated balance sheet. The Company is continuing its assessment, which may identify additional impacts this standard will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities – Extinguishment of Liabilities: Recognition of Breakage for Certain Prepaid Stored-Value Products," which is intended to eliminate current and future diversity in

practice related to derecognition of prepaid stored-value product liability in a way that aligns with the new revenue recognition guidance. The update is effective for fiscal years beginning after December 15, 2017; however, early application is permitted. We are evaluating the impact on the Company's consolidated financial statements and do not expect the adoption to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230). This update provides clarification regarding how certain cash receipts and cash payment are presented and classified in the statement of cash flows. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This update is effective for annual and interim periods beginning after December 15, 2017, which will require us to adopt these provisions in the first quarter of fiscal 2019 using a retrospective approach. Early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

INFLATION

It is generally our policy 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.

FORWARD-LOOKING STATEMENTS

This 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 (the “Exchange Act”). 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 and expected sources of funds for capital expenditures,
- future debt, including liquidity and the sources and availability of funds related to debt, and expected repayment of debt, as well as our 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,
- 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 2016 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 its experience and perception of historical trends, current conditions, expected future developments and other factors it believes are relevant. Although management believes that its assumptions are reasonable based on information currently available, those assumptions are subject to significant risks and uncertainties, many of which are outside of its 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 31, 2016 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:

- 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 customer 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,
- effectiveness of the Cheeseburger in Paradise conversions to Fuddruckers restaurants,
- the effectiveness of our credit card controls and PCI compliance,
- 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to interest rate risk due to changes in interest rates affecting our variable-rate debt, Term Loan and borrowings under our 2016 Revolver. As of December 20, 2017, the total amount of debt subject to interest rate fluctuations outstanding under our Revolver and Term Loan was \$13.6 million. Assuming an average debt balance with interest rate exposure of \$13.6 million, a 100 basis point increase in prevailing interest rates would increase our annual interest expense by \$0.1 million. The interest rate on our remaining \$17.5 million in outstanding debt is fixed plus an applicable margin based on our CTLAL at each determination date, beginning December 14, 2016, under the terms of our interest rate swap agreement. Under the terms of our 2016 Credit Agreement, we are required to manage interest rate risk, utilizing interest rate swaps, on at least 50% of our 2016 Credit Agreement variable rate debt (Term Loan). Prior to November 8, 2016, we did not utilize any interest rate swaps to manage interest rate risk on our variable rate 2013 Credit Facility debt.

We have exposure to various foreign currency exchange rate fluctuations for revenues generated by our operations outside of the United States, which can adversely impact our net income and cash flows. Sales to customers and royalties from franchisees outside the contiguous United States as a percentage of our total revenues was approximately 0.10% and 0.08% in the quarter ended December 20, 2017 and December 21, 2016.

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 defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act), as of December 20, 2017. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 20, 2017, 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 December 20, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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 30, 2017.

Item 1A. Risk Factors

There have been no material changes during the quarter ended December 20, 2017 to the Risk Factors discussed in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended August 30, 2017.

Item 6. Exhibits

- 10.1 Employment Amendment dated December 11, 2017, between Luby’s, Inc. and Christopher J. Pappas (incorporated by reference to exhibit 10.1 to the Company’s form 8-K filed with the Securities and Exchange Commission on December 12, 2017).
- 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.

101.INS XBRL Instance Document

101.SCH XBRL Schema Document

101.CAL XBRL Calculation Linkbase Document

101.DEF XBRL Definition Linkbase Document

101.LAB XBRL Label Linkbase Document

101.PRE XBRL Presentation Linkbase Document

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: 1/29/2018 By: /s/ Christopher J. Pappas
Christopher J. Pappas
President and Chief Executive Officer
(Principal Executive Officer)

Date: 1/29/2018 By: /s/ K. Scott Gray
K. Scott Gray
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)