

A photograph of a woman and a young boy sitting at a table, smiling and eating. The woman is on the left, wearing a red vest over a white collared shirt. The boy is on the right, wearing a blue shirt and a dark vest. They are both looking at each other. On the table in front of them are two Luby's cups with straws, a glass of iced tea, and plates of food including a sandwich, a fried item, and a salad. The background is a warm, orange-toned wall.

Luby's<sup>®</sup>

2003 Annual Report

*Tastes like Texas,  
Feels like Home*

# Dear Shareholders:

**W**hen the new management arrived in March of 2001, the long-term goal was to return Luby's to the status of a strong, healthy organization. Everyone involved understood it would likely be a long process, marked by incremental improvements in the restaurants. During 2003, we made a number of such improvements as part of our business plan – launching exciting, new marketing initiatives, continuing our efforts to embrace high food quality, reducing our combined food and labor costs, and paying down a substantial amount of our bank debt. We are proud to report on those efforts and provide you with our outlook for 2004.

## Getting the Word Out

In 2002, the focus was on the fundamentals: putting systems in place to bring food quality up to a consistently high level, using marquees outside of our restaurants to communicate to customers and potential customers close to those locations, and exploring opportunities – including breakfast, all-you-can-eat buffets, and other test restaurants – to bring in customers. As a result of these efforts, food quality has improved, the marquees are in place and working, and we continue to use breakfast, all-you-can-eat and the test restaurants on a limited basis as a complement to the traditional cafeteria.

In 2003, we turned our attention to more of the details of how we target our key customers and talk to them about Luby's. Families, especially young families, have always been an essential part of the Luby's customer base. In February we launched our new Kids Program, which targets these young families with special kid-sized meal options. Also as part of this program we introduced certain times during the week (Wednesday night and Saturday) when children eat free with the purchase of an adult meal. The Kids Program has been successful, for example, helping move Wednesday from one of the lowest performing days of the week to one of the highest.

With our restaurants poised to deliver consistent, fresh, high quality food to our customers, Luby's went up on the airwaves once again this year to get the word out. Our new bilingual advertising campaign, with the tagline, "Luby's: Tastes Like Texas, Feels Like Home," features testimonials

from customers, footage of typical Texas scenes, and a catchy jingle.

We are also using the advertising campaign to feature our new combo meals. Displayed on menus above the cafeteria line with big, color pictures and an easy-to-understand numbering system, our combo meals make ordering easier for our customers. We have expanded the combo meal approach to include large entrée salads as well. Luby's has always attracted health-conscious consumers because of our fresh-cooked vegetables and other healthy meal choices – these additional entrée salads have increased the number of healthy offerings.

## Behind the Cafeteria Line

Aside from the new marketing and product initiatives, much of the work that was done this year may have gone unnoticed by the customers coming in to dine with us every day. That's because these changes focused on the details of our business – how we manage our labor and food costs. And while these changes may not have been noticed by our customers, they are important to you, our shareholders. To help control labor cost, we have launched a number of programs to better track and manage our valuable employee resources. Learning how to control food cost while maintaining the high standards of quality our customers have come to expect is also very important, so we have implemented tools to help our managers better plan their food purchases each week.

We are happy to report that our combined food and labor cost dropped as a percent of sales from 57.5% in fiscal 2002 to 56.3% in fiscal 2003. To be competitive in the restaurant industry, a successful company must constantly review and analyze how it runs its business at the individual restaurant level. We will continue to explore opportunities to better control and plan for both of these costs.

Our successes to date are based in large part on the incredible efforts of our employees, who work hard every day and are the key to our future. Those individuals at the helm of each store, our managers, are especially key to our success. These are the men and women who are charged with implementing our new initiatives, and we are constantly working with them to develop the tools they need to run their stores better. Continuing education has

become a key component of the Luby's management experience, and our managers are constantly learning the new best practices in the industry. Our goal is to make the Luby's manager program one of the most highly sought after opportunities in the food service industry.

### **Streamlined and Positioned for the Future**

Along with the operational and marketing initiatives discussed above, the Company's business plan involves closing approximately 50 underperforming locations and returning to a focus on our core Texas markets. We have had to make difficult choices, but we believe closing these stores was the best decision for the future of the Company. The Company is currently selling these closed restaurant properties, with the proceeds going to reduce our bank debt. As part of this effort, Luby's paid down almost \$27 million in debt during fiscal 2003, with more than \$14 million of that coming during the fourth quarter.

During the upcoming year, Luby's will continue to implement initiatives begun during 2003. It is our belief that many of the changes we have introduced over the past year need a chance to take hold in the restaurants. This means giving our customers a chance to come in and see the improved offerings, which hopefully will encourage them to dine with us more often. It also means giving employees time to become more efficient working with our new systems.

Luby's position in the marketplace has shifted during the Company's life, from Luby's being a dominant player in our markets to being only one of many. Today, we have embraced the challenge of regaining our competitive foothold. In 2004, we will implement more new initiatives, including programs in the restaurants reinforcing the importance of customer service and guest interaction. We also will continue to work to improve the perception of the Luby's experience in the eyes of our customers.

Like many of our customers, Luby's was born and raised in Texas. By returning to our roots and focusing on the fundamentals, we believe Luby's, in the long-term, will be a company that employees, customers, and shareholders can be proud of. We will be working hard over the next year toward this goal.

Sincerely,



Gasper Mir, III  
*Chairman of the Board*



Christopher J. Pappas  
*President and Chief Executive Officer*



Harris J. Pappas  
*Chief Operating Officer*





Salad \$2.99  
Casserole \$3.99

Beef Fajita Salad \$5.99

Chicken Casserole \$5.99

Spring Casserole \$4.99

Stuffed Cornish \$3.99



## Combo Meals Make Ordering as Easy as 1-2-3...

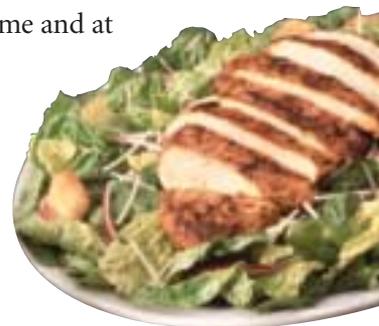


*Enchilada Platter*

We are always listening to our customers, so when they told us they wanted an easier way to order their favorite

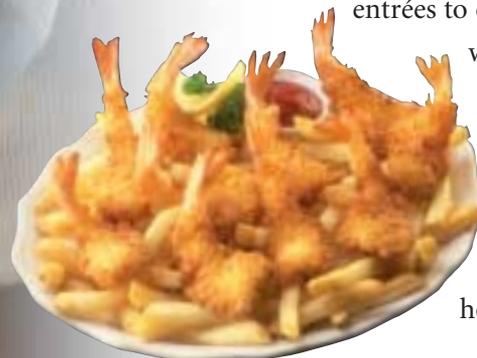
Luby's meal, we came up with a solution that is as easy as 1-2-3. Our new combo meal menus feature big, color pictures and numbers, giving our customers a chance to order their favorite full-sized entrée, two sides, and bread at one time and at one great price.

## ...So We've Given Our Customers a Perfect 10!



*Grilled Chicken Caesar Salad*

Our customers responded so positively when we launched the new combo meals in the spring that we continued the program in the summer, adding four entrée salad choices. In the fall, we expanded the offering even more, from eight entrée combos to ten, giving our customers an even greater choice. We also are using the combo meals to introduce new entrées to our customers that



*Fried Shrimp and French Fries*

we are sure will become new favorites. Stay tuned for more new choices at your neighborhood Luby's soon!

## Financial Highlights

(Thousands of dollars except per share data)

|  | 2003       | 2002      | 2001       |
|--|------------|-----------|------------|
| Sales .....  | \$ 318,521 | \$334,473 | \$ 385,416 |
| Provision for asset impairments and restaurant closings.....                                   | 2,060      | 271       | 30,402     |
| Income (loss) from operations .....  | (2,141)    | 1,442     | (33,543)   |
| Income (loss) before discontinued operations .....   | (2,534)    | (2,828)   | (25,857)   |
| Discontinued operations, net of taxes .....  | (30,560)   | (6,825)   | (6,024)    |
| Net income (loss) .....  | (33,094)   | (9,653)   | (31,881)   |
| Income (loss) per share — before discontinued operations —<br>basic and assuming dilution..... | (0.11)     | (0.13)    | (1.15)     |
| Income (loss) per share — from discontinued operations —<br>basic and assuming dilution.....   | (1.36)     | (0.30)    | (0.27)     |
| Net income (loss) per share — basic and assuming dilution .....                                | (1.47)     | (0.43)    | (1.42)     |
| EBITDA .....   | 19,333     | 21,145    | 17,453     |
| EBITDA per share .....   | 0.86       | 0.94      | 0.78       |
| Cash and short-term investments.....   | 21,369     | 25,706    | 24,083     |
| Property held for sale.....  | 32,946     | 8,144     | 3,048      |
| Total assets.....  | 279,881    | 342,479   | 353,864    |
| Total debt, net .....  | 98,532     | 124,331   | 127,401    |
| Capital expenditures .....   | 9,057      | 13,097    | 17,630     |
| Number of restaurants .....  | 148        | 196       | 213        |

See Notes to Five-Year Summary of Operations on page 6 of the Form 10-K.

## Corporate Information

Founded in 1947 in San Antonio, Texas, where the corporate headquarters remains today, Luby's prides itself on providing its customers with fresh, delicious, home-style meals and value pricing at its restaurants throughout Texas (133) and in a number of surrounding states (15). The Company has approximately 7,500 employees who work hard every day to provide our guests with outstanding customer service when they visit Luby's restaurants.

The Luby's dining experience appeals to a broad range of consumers who want quick, healthy meals, including families with children, shoppers, seniors, and business people. Generally located in close proximity to retail centers, business developments, and residential areas, the restaurants are open seven days a week for lunch and dinner in most markets. For those customers who want to take their Luby's meal home or back to the office, the restaurants also offer take-out service.

### Company Headquarters

Luby's, Inc.  
2211 Northeast Loop 410  
P. O. Box 33069  
San Antonio, TX 78265-3069  
210/654-9000

### Company Website

www.lubys.com

### Registrar and Stock Transfer Agent

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10007  
800/937-5449  
www.amstock.com

### Corporate Counsel

Hornberger Sheehan Fuller & Beiter Incorporated  
700 North St. Mary's Street, Suite 600  
San Antonio, TX 78205

### Independent Auditor

Ernst & Young LLP  
P. O. Box 2938  
San Antonio, TX 78299

### Annual Report

The 2003 Luby's, Inc. Annual Report is available online at [www.lubys.com](http://www.lubys.com) or additional copies may be obtained by contacting:

Luby's, Inc.  
Shareholder Relations  
2211 Northeast Loop 410  
P. O. Box 33069  
San Antonio, TX 78265-3069  
210/654-9000

### NYSE Stock Symbol

LUB

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

Form 10-K/A

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

For the Fiscal Year Ended August 27, 2003

- 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 1-8308

**Luby's, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State of incorporation)

74-1335253  
(IRS Employer Identification Number)

2211 Northeast Loop 410  
San Antonio, Texas 78217  
(Address of principal executive offices, including zip code)

(210) 654-9000                      www.lubys.com  
(Registrant's telephone number, including area code, and Website)

**Securities registered pursuant to Section 12(b) of the Act:**

| <u>Title of Class</u>                    | <u>Name of Exchange on which registered</u> |
|--|---|
| Common Stock Par Value (\$.32 par value) | New York Stock Exchange                     |
| Common Stock Purchase Rights             | New York Stock Exchange                     |

Securities registered pursuant to Section 12(g) of the Act: **None**

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 and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the shares of Common Stock of the registrant held by nonaffiliates of the registrant as of November 3, 2003, was approximately \$55,022,819 (based upon the assumption that directors and executive officers are the only affiliates).

The aggregate market value of the shares of Common Stock of the registrant held by nonaffiliates of the registrant as of February 12, 2003, was approximately \$26,545,468 (based upon the assumption that directors and executive officers are the only affiliates).

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of November 3, 2003, there were 22,470,004 shares of the registrant's Common Stock outstanding, which does not include 4,933,063 treasury shares.

**EXPLANATORY NOTE:** The registrant is hereby amending its Form 10-K for the fiscal year ended August 27, 2003 (SEC File Number 1-8308) to add the information required by Part III Items 10 through 14. The remaining Items contained within this Amendment No. 1 to Annual Report on Form 10-K/A consist of all other Items originally contained in the registrant's Annual Report on Form 10-K for the fiscal year ended August 27, 2003. This Form 10-K/A does not reflect events occurring after the filing of the original Form 10-K, nor modify or update those disclosures in any way other than to add the information required by Part III Items 10 through 14.

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**LUBY’S, INC.**  
**FORM 10-K**  
**Year ended August 27, 2003**

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**Additional Information**

The Company’s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports are available free of charge via hyperlink on its website at [www.lubys.com](http://www.lubys.com). The Company makes these reports available as soon as reasonably practicable upon filing with the SEC. Information on the Company’s website is not incorporated into this report.

## PART I

### Item 1. Business

#### Overview

Luby's, Inc. (formerly, Luby's Cafeterias, Inc.) was originally incorporated in Texas in 1959 and was reincorporated in Delaware on December 31, 1991. The Company's administrative offices are at 2211 Northeast Loop 410, P.O. Box 33069, San Antonio, Texas 78265-3069.

Luby's, Inc. was restructured into a holding company on February 1, 1997, at which time all of the operating assets were transferred to Luby's Restaurants Limited Partnership, a Texas limited partnership composed of two wholly owned, indirect corporate subsidiaries of the Company. All restaurant operations are conducted by the partnership. Unless the context indicates otherwise, the word "Company" as used herein includes the partnership and the consolidated corporate subsidiaries of Luby's, Inc.

As of November 3, 2003, the Company operated 144 restaurants under the name "Luby's." These establishments are located in close proximity to retail centers, business developments, and residential areas throughout seven states (listed under Item 2). Of the 144 restaurants, 97 are at locations owned by the Company and 47 are on leased premises. Two of the restaurants primarily serve seafood, one is a steak buffet, four are full-time buffets, 22 are cafeteria-style restaurants with all-you-can-eat options, and 115 are traditional cafeterias.

#### Operations

The Company's operations provide guests with a wide variety of delicious, home-style food, with the majority of locations serving cafeteria-style. Daily, each restaurant offers 12 to 14 entrees, 12 to 14 vegetable dishes, 12 to 16 salads, and 15 to 18 varieties of desserts. Food is prepared in small quantities throughout serving hours, and frequent quality checks are conducted.

The Company's historical marketing research has shown that its products appeal to a broad range of value-oriented consumers with particular success among families with children, seniors, shoppers, travelers, and business people looking for a quick, homestyle meal at a reasonable price. During fiscal 2003, the Company spent approximately 0.6% of its sales on traditional marketing venues, including newsprint, radio, point-of-purchase, and local-store marketing. Also in fiscal 2003, the Company continued to invest in distinctive store marquees to enhance guest awareness of specific store promotions. The total number of operating locations with marquees as of the end of fiscal 2003 was 103.

Luby's restaurants are generally open for lunch and dinner seven days a week. All of the restaurants sell take-out orders, and many of them have separate food-to-go entrances, which provide guests the option of enjoying complete and flavorful meals at the office or at home. Take-out orders accounted for 12.9% of sales in fiscal 2003. Breakfast is served on weekends in 38 of its restaurants, accounting for 0.9% of sales. Those locations offer a wide array of popular breakfast foods served buffet style. They also have made-to-order omelette, pancake, and waffle stations.

Each restaurant is operated as a separate unit under the control of a general manager who has responsibility for day-to-day operations, including food production and personnel employment and supervision. The Company's philosophy is to grant broad authority to its restaurant managers to direct the daily operations of their stores and, in turn, to compensate them on the basis of their performance, believing this strategy to be a significant factor in restaurant profitability. Of the total number of general managers employed by the Company, 106 have been employed for more than ten years. Typically, an individual is employed for a period of four to seven years before he or she is considered qualified to become a general manager.

The Company operates from a centralized purchasing arrangement to obtain the economic benefit of bulk purchasing and lower prices for most of its food products. The arrangement involves a competitively selected prime vendor for each of its three major purchasing regions.

Foods are prepared fresh daily at the Company's restaurants. Menus are reviewed periodically by a committee of managers and chefs. The committee introduces newly developed recipes to ensure offerings are varied and that seasonal food preferences are incorporated.

Quality control teams also help to maintain uniform standards of food preparation. The teams visit each restaurant as necessary and work with the staff to check adherence to Company recipes, train personnel in new techniques, and implement systems and procedures used universally throughout the Company.

During the fiscal year ended August 27, 2003, the Company closed approximately 50 underperforming units, of which approximately 40 were closed in accordance with its new business plan. Since August 27, 2003, the Company has closed four other underperforming restaurants.

Of the 144 restaurants currently in operation, two were opened during the year under different concepts, including the second of the Company's seafood concept and its first Steak Buffet. In addition to changing the concepts in some locations based upon their surrounding demographics, the Company believes one of its primary opportunities for growth centers around improving same-store sales at existing locations.

As of the fiscal year-end, the Company had a workforce of approximately 7,550, consisting of 7,000 nonmanagement restaurant workers; 400 restaurant managers, associate managers, and assistant managers; and 150 clerical, administrative, and executive employees. Employee relations are considered to be good. The Company has never had a strike or work stoppage and is not subject to collective bargaining agreements.

### **Service Marks**

The Company uses several service marks, including "Luby's," and believes that such marks are of material importance to its business. The Company has federal registrations for its service marks as deemed appropriate.

The Company is not the sole user of the name Luby's in the cafeteria business. A cafeteria using the name Luby's is being operated in Texas by an unaffiliated company. The Company's legal counsel is of the opinion that the Company has the paramount right to use the name Luby's as a service mark in the United States and that the other user could be precluded from expanding its use of the name as a service mark.

### **Competition and Other Factors**

The foodservice business is highly competitive, and there are numerous restaurants and other foodservice operations in each of the markets where the Company operates. The quality of food served, in relation to price and public reputation, is an important factor in foodservice competition. Neither the Company nor any of its competitors has a significant share of the total market in any area in which the Company competes. The Company believes that its principal competitors include family-style and fast-casual restaurants, buffets, and quick-service establishments in the home-meal-replacement category.

The Company's facilities and food products are subject to state and local health and sanitation laws. In addition, the Company's operations are subject to federal, state, and local regulations with respect to environmental and safety matters, including regulations concerning air and water pollution and regulations under the Americans with Disabilities Act and the federal Occupational Safety and Health Act. Over the years, such laws and regulations have resulted in increased costs that have been absorbed by the Company, in turn, improving its compliance.

### **Item 2. Properties**

The Company's restaurants constructed prior to 1999 typically contain 9,000 to 10,500 square feet of floor space and can seat 250 to 300 guests simultaneously. In more recent years, the Company built several more-contemporary units. They contain 6,000 to 8,600 square feet of floor space and can seat 170 to 214 guests simultaneously.

Luby's restaurants are well maintained and in good condition. The Company refurbishes and updates restaurants and equipment as necessary to maintain their appearance and utility.

As of November 3, 2003, the Company's restaurants are regionally located as follows: two in Arizona, two in Arkansas, two in Louisiana, one in Missouri, three in Oklahoma, one in Tennessee, and 133 in Texas.

The Company owns the underlying land and buildings in which 97 of its restaurants are located. Several of these restaurant properties contain excess building space, which is rented to tenants unaffiliated with the Company.

In addition to the owned locations, 47 other restaurants are held under leases, including 22 in regional shopping malls. Most of the leases provide for a combination of fixed-dollar and percentage rentals. Many require the Company to pay additional amounts related to property taxes, hazard insurance, and maintenance of common areas. See Note 9 of the Notes to Consolidated Financial Statements for information concerning the Company's lease rental expenses and lease commitments. Of the 47 restaurant leases, the current terms of 27 expire before 2009, ten from 2009 to 2013, and ten thereafter. Forty-three of the leases can be extended beyond their current terms at the Company's option.

In addition to the properties currently in operation, the Company also has 34 locations on the market for sale.

The Company's primary administrative offices are located in a building owned by the Company containing approximately 40,000 square feet of useable office space.

The Company maintains public liability insurance and property damage insurance on its properties in amounts which management believes to be adequate.

**Item 3. Legal Proceedings**

The Company is from time to time subject to pending claims and lawsuits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of such claims and lawsuits will not have a material adverse effect on the Company's operations or consolidated financial position. There are no material legal proceedings to which any director, officer, or affiliate of the Company, or any associate of any such director or officer, is a party, or has a material interest, adverse to the Company.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted during the fourth quarter of the fiscal year ended August 27, 2003, to a vote of security holders of the Company.

**Item 4A. Executive Officers of the Registrant**

Certain information is set forth below concerning the executive officers of the Company, each of whom has been elected to serve until his successor is duly elected and qualified:

| <u>Name</u>           | <u>Served as Officer Since</u> | <u>Positions with Company and Principal Occupation Last Five Years</u>                                 | <u>Age</u> |
|-----------------------|--------------------------------|--|------------|
| Christopher J. Pappas | 2001                           | President and CEO (since March 2001), CEO of Pappas Restaurants, Inc.                                  | 56         |
| Harris J. Pappas      | 2001                           | Chief Operating Officer (since March 2001), President of Pappas Restaurants, Inc.                      | 59         |
| Ernest Pekmezaris     | 2001                           | Senior Vice President and CFO (since March 2001), Treasurer and former CFO of Pappas Restaurants, Inc. | 59         |
| Peter Tropoli         | 2001                           | Senior Vice President-Administration (since March 2001), attorney in private practice.                 | 31         |

## PART II

### Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

#### Stock Prices and Dividends

The Company's common stock is traded on the New York Stock Exchange under the symbol LUB. The following table sets forth, for the last two fiscal years, the high and low sales prices on the New York Stock Exchange from the consolidated transaction reporting system and the per share cash dividends declared on the common stock.

| <u>Fiscal Quarter Ended</u> | <u>High</u> | <u>Low</u> | <u>Quarterly<br/>Cash<br/>Dividend</u> |
|-----------------------------|-------------|------------|--|
| November 21, 2001           | \$9.49      | \$5.90     | \$0.00                                 |
| February 13, 2002           | 7.80        | 5.50       | 0.00                                   |
| May 8, 2002                 | 7.33        | 6.00       | 0.00                                   |
| August 28, 2002             | 7.05        | 5.00       | 0.00                                   |
| November 20, 2002           | 5.53        | 3.55       | 0.00                                   |
| February 12, 2003           | 4.50        | 1.10       | 0.00                                   |
| May 7, 2003                 | 2.80        | .95        | 0.00                                   |
| August 27, 2003             | 2.98        | 1.75       | 0.00                                   |

There were no sales of unregistered securities in fiscal 2003. As of November 3, 2003, there were approximately 3,777 record holders of the Company's common stock.

## Item 6. Selected Financial Data

### Five-Year Summary of Operations

|   | Year Ended                       |  |                                  |                                  |                                  |
|---|----------------------------------|--|----------------------------------|----------------------------------|----------------------------------|
|   | August 27,<br>2003<br>(364 days) | August 28,<br>2002<br>(362 days)<br>(In thousands except per share data) | August 31,<br>2001<br>(365 days) | August 31,<br>2000<br>(366 days) | August 31,<br>1999<br>(365 days) |
| Sales   | \$318,521                        | \$334,473  | \$385,416                        | \$403,608                        | \$411,474                        |
| Costs and Expenses:   |                                  |  |                                  |                                  |                                  |
| Cost of food  | 87,048                           | 85,275   | 95,835                           | 100,952                          | 99,308                           |
| Payroll and related costs   | 92,416                           | 106,969  | 134,886                          | 124,231                          | 124,438                          |
| Occupancy and other operating expenses  | 97,708                           | 101,178  | 113,901                          | 108,179                          | 108,935                          |
| Depreciation and amortization   | 18,104                           | 18,122   | 18,652                           | 18,050                           | 15,806                           |
| General and administrative expenses   | 23,326                           | 21,216   | 25,283                           | 20,983                           | 22,010                           |
| Provision for asset impairments and restaurant closings                           | 2,060                            | 271  | 30,402                           | 11,577                           | —                                |
|   | <u>320,662</u>                   | <u>333,031</u>   | <u>418,959</u>                   | <u>383,972</u>                   | <u>370,497</u>                   |
| Income (loss) from operations   | (2,141)                          | 1,442  | (33,543)                         | 19,636                           | 40,977                           |
| Interest expense  | (7,610)                          | (7,676)  | (8,135)                          | (3,529)                          | (3,891)                          |
| Other income, net   | 7,217                            | 2,374  | 2,167                            | 2,207                            | 1,853                            |
| Income (loss) before income taxes   | (2,534)                          | (3,860)  | (39,511)                         | 18,314                           | 38,939                           |
| Provision (benefit) for income taxes  | —                                | (1,032)  | (13,654)                         | 6,008                            | 13,280                           |
| Income (loss) from continuing operations  | (2,534)                          | (2,828)  | (25,857)                         | 12,306                           | 25,659                           |
| Discontinued operations, net of taxes   | (30,560)                         | (6,825)  | (6,024)                          | (3,181)                          | 2,954                            |
| Net income (loss)   | <u>\$ (33,094)</u>               | <u>\$ (9,653)</u>  | <u>\$ (31,881)</u>               | <u>\$ 9,125</u>                  | <u>\$ 28,613</u>                 |
| Income (loss) per common share before discontinued operations — basic             | \$ (0.11)                        | \$ (0.13)  | \$ (1.15)                        | \$ 0.55                          | \$ 1.14                          |
| Income (loss) per common share from discontinued operations — basic               | \$ (1.36)                        | \$ (0.30)  | \$ (0.27)                        | \$ (0.14)                        | \$ 0.13                          |
| Net income (loss) per common share — basic  | <u>\$ (1.47)</u>                 | <u>\$ (0.43)</u>   | <u>\$ (1.42)</u>                 | <u>\$ 0.41</u>                   | <u>\$ 1.27</u>                   |
| Income (loss) per common share before discontinued operations — assuming dilution | \$ (0.11)                        | \$ (0.13)  | \$ (1.15)                        | \$ 0.55                          | \$ 1.13                          |
| Income (loss) per common share from discontinued operations — assuming dilution   | \$ (1.36)                        | \$ (0.30)  | \$ (0.27)                        | \$ (0.14)                        | \$ 0.13                          |
| Net income (loss) per common share — assuming dilution                            | <u>\$ (1.47)</u>                 | <u>\$ (0.43)</u>   | <u>\$ (1.42)</u>                 | <u>\$ 0.41</u>                   | <u>\$ 1.26</u>                   |
| Cash dividend declared per common share   | <u>\$ 0.00</u>                   | <u>\$ 0.00</u>   | <u>\$ 0.00</u>                   | <u>\$ 0.70</u>                   | <u>\$ 0.80</u>                   |
| At year-end:  |                                  |  |                                  |                                  |                                  |
| Total assets  | <u>\$279,881</u>                 | <u>\$342,479</u>   | <u>\$353,864</u>                 | <u>\$370,843</u>                 | <u>\$346,025</u>                 |
| Long-term debt (including net convertible subordinated debt) <sup>(a)</sup>       | <u>\$ —</u>                      | <u>\$ 5,883</u>  | <u>\$127,401</u>                 | <u>\$116,000</u>                 | <u>\$ 78,000</u>                 |
| Total debt  | <u>\$ 98,532</u>                 | <u>\$124,331</u>   | <u>\$127,401</u>                 | <u>\$116,000</u>                 | <u>\$ 78,000</u>                 |
| Number of restaurants   | 148                              | 196  | 213                              | 231                              | 223                              |

<sup>(a)</sup> See *New Business Plan* under the Debt section and Note 6 of the Notes to Consolidated Financial Statements.

**Note:** In fiscal year 2002, the Company moved from 12 calendar months to 13 four-week periods. The first period of fiscal year 2002 began September 1, 2001, and covered 26 days. All subsequent periods covered 28 days. Fiscal year 2002, the Company's conversion year from months to periods, was 362 days in length. Fiscal 2003 and most years hereafter are 364 days in length.

**Note:** The Company's new business plan, as approved in fiscal 2003, called for the closure of approximately 50 locations. In accordance with the plan, the entire fiscal activity of the applicable stores closed through the end of the 2003 fiscal year were reclassified to discontinued operations. For comparison purposes, in prior fiscal years the entire activity for the same locations closed in fiscal 2003 have also been reclassified to discontinued operations.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Results of Operations**

#### ***Fiscal 2003 Compared to Fiscal 2002***

Sales decreased \$16.0 million, or 4.8%, in fiscal 2003 compared to fiscal 2002. Of the total decline, \$12.2 million was due to the closure of 20 restaurants since August 31, 2001, that were not included in the new business plan, and \$8.7 million was due to a 2.7% decrease in same-store sales. These decreases were offset by the positive impact of two additional days of sales of \$2.2 million and the opening of three restaurants since August 28, 2002, that accounted for \$2.7 million in sales.

The cost of food increased \$1.8 million, or 2.1%, and as a percentage of sales increased from 25.5% to 27.3% in fiscal 2003 compared to fiscal 2002. Early in the fiscal year, the increase in food cost was related primarily to efforts to implement value offerings for the Company's guests. Those offerings were a planned part of the Company's strategy aimed at increasing value while maintaining quality. Also in the beginning of the year, fresh produce pricing was negatively impacted by increased transportation costs due to the higher cost of diesel fuel. Toward the end of the year, upward pressure on beef pricing due to lower availability, reduced cattle weights, and an overall higher demand negatively impacted food cost. These increases completely offset reductions due to store closures. Even so, the increases were partially mitigated in the later part of the year by targeted cost control programs.

Payroll and related costs decreased \$14.6 million, or 13.6%, and as a percentage of sales decreased from 32.0% to 29.0%. The decrease was due primarily to the Company's continued operational focus on labor efficiencies coupled with lower workers' compensation expense in fiscal 2003. Of the total reduction, \$7.5 million was due to improved labor deployments and efficiencies resulting from various Company initiatives to reduce labor costs. An additional \$1.9 million of the total decline was due to lower workers' compensation costs resulting from the Company's in-house training and safety programs. The remainder related to stores closed prior to the adoption of the new business plan.

Occupancy and other operating expenses decreased \$3.5 million, or 3.4%. Several factors contributed to this fluctuation. Net repairs and maintenance costs decreased primarily due to increased efficiencies from the Company's in-house repair program as provided by its in-house service center. Food-to-go packaging costs further declined due to less expensive packaging. These decreases were partially offset by property/employee insurance, which increased principally due to premium increases for owned properties coupled with pass-through insurance adjustments from landlords of leased properties, as well as premium increases for directors' and officers' liability.

Depreciation and amortization expense was approximately equal to the prior fiscal year, with a slight decrease of \$18,000.

General and administrative expenses increased \$2.1 million, or 9.9%. Several factors contributed to this increase. Professional fees increased principally due to a fixed-asset, cost segregation study on tax depreciation. Consulting costs increased principally due to fees paid to outside firms relating to the Company's bank group. Excluding those items, the Company showed higher year-over-year general and administrative expenses because of the increased investment in support personnel to improve its focus on operational efficiencies and facilities maintenance.

The provision for asset impairments and restaurant closings charged to continuing operations increased by \$1.8 million due to impairments on various locations that were either not yet closed per the new business plan or were a part of prior impairment and disposal plans.

Interest expense was approximately equal to the prior fiscal year, with only a slight decrease of \$66,000. The payoff of loans on officers' life insurance policies, which were surrendered during the prior year, in addition to amortization of the loss on interest rate swaps and principal reductions on the outstanding bank debt, contributed to this decrease. These decreases were partially offset by an increase in the effective interest rate on outstanding debt coupled with an increase in the amortization of the discount on the subordinated notes. Approximately \$2.7 million and \$2.6 million were reclassified from interest expense to discontinued operations in fiscal 2003 and 2002, respectively. These reclassifications related to the launch of the Company's new business plan whereby the proceeds from certain properties closed and sold are committed to paying down debt.

Other income increased \$4.8 million primarily due to gains on the sales of assets, which reflect the sale of nine previously closed stores. These gains were partially offset by a loan commitment fee expensed in fiscal 2003.

The income tax benefit decreased by \$1.0 million. No benefit was recorded in fiscal 2003 because the realization of loss carryforward utilization is uncertain.

The loss from discontinued operations increased by \$23.7 million principally due to approximately \$19.2 million in noncash impairments, with the remainder in carrying costs, allocated bank debt interest, and certain settlement fees incurred on various locations closed as part of the Company's new business plan. The impairment charges included reductions in the fourth quarter of 2003 from gains on the disposal of properties previously held for sale. Also see the discussion below entitled *Debt/The New Business Plan*.

Relative to prior closure plans, the Company had a reserve for restaurant closings of approximately \$1.7 million and \$3.1 million at August 27, 2003, and August 28, 2002, respectively. Excluding certain lease termination settlements, all material cash outlays required for the store closings originally planned as of August 31, 2001, were made prior to August 27, 2003. See further discussion in Note 7 of the Notes to Consolidated Financial Statements.

### ***Fiscal 2002 Compared to Fiscal 2001***

Sales decreased \$50.9 million, or 13.2%, in fiscal 2002 compared to fiscal 2001. Of the total decline, \$32.0 million was due to an 8.8% decrease in same-store sales, while \$16.7 million was due to the closure of 27 restaurants since August 31, 2000. In addition, there were three fewer days during fiscal 2002, accounting for approximately \$2.9 million of the total sales decline. The decreases were partially offset by the opening of one new restaurant, which accounted for \$723,000 in additional sales.

Cost of food decreased \$10.6 million, or 11.0%, due primarily to fewer restaurants and the decline in same-store sales. Food cost as a percentage of sales increased from 24.9% to 25.5% in fiscal 2002 in comparison with fiscal 2001. Various "manager's special" promotions coupled with new "all-you-can-eat" offerings at selected locations contributed to higher food costs as a percent of sales.

Payroll and related costs decreased \$27.9 million, or 20.7%, due primarily to restaurant closures unrelated to the new business plan, lower workers' compensation expense, and three fewer days in fiscal 2002. Of the total reduction, \$16.3 million was due to lower wages and associated payroll taxes resulting from numerous store closures and \$11.6 million was due to lower workers' compensation costs. Relative to the latter, in fiscal 2001, there was a large increase for estimated claims expense under the Company's historical third-party program. The Company initiated a safety training and accident prevention program in October 2001 that substantially lowered fiscal 2002 costs.

Occupancy and other operating expenses decreased \$12.7 million, or 11.2%. Although the dollar decrease was primarily due to store closures, other factors contributed to the fluctuation. Utility expenses decreased due to lower energy commodity costs coupled with moderate temperatures and conservation. Advertising costs declined due to a reduced emphasis on television media spending. Food-to-go packaging costs further declined due to the intentional redirection at many locations to inside dining coupled with less expensive packaging.

Depreciation and amortization expense decreased \$530,000, or 2.8%, due to fewer depreciable properties resulting from previous impairments and property sales.

General and administrative expenses decreased \$4.1 million, or 16.1%. Several factors contributed to the decline. Officers' compensation decreased principally due to a reduction in relative headcount coupled with accelerated vesting of noncash option compensation in fiscal 2001. Charges related to the proxy and restructuring advice contributed to higher professional costs in fiscal 2001. Consulting fees were less principally due to a preliminary search for new senior management in fiscal 2001.

The provision for asset impairments and restaurant closings decreased by \$30.1 million due to numerous impairments and provisions for impairments recorded in the prior year. Charges of \$271,000 were recorded in fiscal 2002 principally to account for labor termination costs and an additional store closing, net of unrelated lease settlements that were more favorable than anticipated.

Interest expense decreased \$459,000, or 5.6%, due primarily to lower effective interest rates on outstanding bank debt, the payoff of the loans on surrendered officers' life insurance policies, and principal reductions in the

outstanding bank debt. These factors were offset by interest on the \$10 million in subordinated debt, amortization of the loss on interest rate Swaps, and the amortization of amendment fees for the credit facility. Approximately \$2.6 million and \$3.5 million were reclassified from interest expense to discontinued operations in fiscal 2002 and 2001, respectively. This was done for comparability to fiscal 2003, which includes the launch of the Company's new business plan whereby the proceeds of properties closed and sold are being used to pay down debt.

The income tax benefit decreased by \$12.6 million, or 92.4%, primarily due to a significantly lower incurred loss in fiscal 2002 versus fiscal 2001.

The loss from discontinued operations increased by \$801,000, or 13.3%. This was due primarily to increased operating losses on properties later associated with the Company's new business plan.

### ***EBITDA***

The Company's operating performance is evaluated using several measures. One of those measures, EBITDA, is derived from the Income (Loss) From Operations GAAP measurement. EBITDA has historically been used by the Company's credit-facility lenders to measure compliance with certain financial debt covenants. The Company's credit-facility debt agreement defines EBITDA as the sum of operating income, plus nonrecurring, noncash charges which decrease operating income, plus depreciation and amortization, minus nonrecurring credits which are included in operating income. The agreement further specifies that EBITDA shall exclude the noncash portion of the CEO's and the COO's stock option compensation, cost of stock options with employees, accounting requirements for future store closings required by GAAP, and costs of closing a store location.

EBITDA decreased by \$1.8 million from fiscal 2002 to 2003 compared to an increase of \$3.7 million from fiscal 2001 to 2002. These net changes were due to various applicable reasons noted in the Results of Operations section above. Prior year amounts have been reclassified to conform to the current year presentation.

|   | <b>Year Ended</b>                        |  |  |
|---|--|--|--|
|   | <u>August 27,<br/>2003</u><br>(364 days) | <u>August 28,<br/>2002</u><br>(362 days) | <u>August 31,<br/>2001</u><br>(365 days) |
|   | <b>(In thousands)</b>                    |  |  |
| Income (loss) from operations                           | \$ (2,141)                               | \$ 1,442                                 | \$(33,543)                               |
| Less excluded items:                                    |  |  |  |
| Provision for asset impairments and restaurant closings | 2,060                                    | 271                                      | 30,402                                   |
| Depreciation and amortization                           | 18,104                                   | 18,122                                   | 18,652                                   |
| Noncash executive compensation expense                  | <u>1,310</u>                             | <u>1,310</u>                             | <u>1,942</u>                             |
| EBITDA  | <u>\$19,333</u>                          | <u>\$21,145</u>                          | <u>\$ 17,453</u>                         |

While the Company and many in the financial community consider EBITDA to be an important measure of operating performance, it should be considered in addition to, but not as a substitute for or superior to, other measures of financial performance prepared in accordance with accounting principles generally accepted in the United States, such as operating income and net income. In addition, the Company's definition of EBITDA is not necessarily comparable to similarly titled measures reported by other companies.

### **Liquidity and Capital Resources**

#### ***Cash and Working Capital***

Cash decreased by \$713,000 from the end of the preceding fiscal year to August 27, 2003, primarily due to capital purchases and certain initial store-closure costs, which were offset by reductions in short-term investments and a large tax refund.

The \$7.2 million income tax receivable balance as of the prior fiscal year-end related to 2002 tax benefits. The Company received a comprehensive refund of \$13.4 million in the third quarter of fiscal 2003 that resulted from changes in tax legislation that extended carrybacks of net operating losses. The refund was higher than the original fiscal 2002 estimate primarily due to increases in tax depreciation relative to an updated cost-segregation study.

After taking into account the current classification of its senior and subordinated debt, the Company had a working capital deficit of \$103.3 million as of August 27, 2003, compared to \$119.5 million as of August 28, 2002. The improvement was primarily attributable to paydowns on the Company's senior credit facility. Excluding the reclassification of the credit-facility balance and subordinated notes explained in the *Debt* section below, the Company's working capital deficit increased \$3.7 million. That increase in the deficit was primarily attributable to continued requirements to internally fund cash needs, including capital acquisitions. The increase was partially offset by the collection of the income tax receivable explained above.

As of August 27, 2003, the Company owned 34 properties held for sale, including three undeveloped land sites.

Capital expenditures for the fiscal year ended August 27, 2003, were \$9.1 million. Consistent with prior fiscal years, the Company used most of its capital funds to maintain its investment in existing operating units. Based on the business plan for fiscal 2004, the Company again intends to fund all capital expenditures from cash flows from operations and expects them to be no more than \$11.5 million for that fiscal year.

## **Debt**

### ***New Business Plan***

During the mid-1990's, the Company entered into a revolving line of credit with a bank group. It was primarily used for financing long-term objectives, including capital acquisitions and a stock repurchase program. Capacity under that credit facility was fully exhausted in fiscal 2001, at which time the Company was unable to draw further advances under the agreement. Since then, existing management has financed its capital acquisitions and working capital needs through careful cash management and the provision of an additional \$10 million in financing in fiscal 2001 from the Company's CEO and the COO.

Current management recognized the need to arrange financing that would better match long-term assets with the existing debt. Accordingly, early in the second quarter of fiscal 2003, the Company executed a commitment letter with a third-party lender for an \$80 million loan to replace that amount of debt in the existing credit facility. Simultaneously, when the current bank group provided a waiver and amendment, it also added a stipulation that required the new \$80 million financing be completed and funded by January 31, 2003. However, the Company was unable to finalize the new financing arrangement because of changes in the proposed agreement terms that the Company believed were not in its best interest. This led to a default under the credit facility that the Company is currently focused on rectifying. Even though the lack of replacement financing caused a default, the Company was in compliance with its financial performance covenants at the end of the second quarter and no default in interest payments has occurred as of the date this SEC report was filed. Also as of that date, the existing bank group has taken no legal action related to the default other than to notify the Company that it reserves all of its rights and remedies.

Management has actively communicated with the credit-facility bank group, while working on its new business plan that is focused on returning the Company to profitability. The Company also engaged the financial advisory firms of Morgan Joseph & Co. and ING Capital LLC ("Morgan-ING") to review the new plan.

After thorough review of several strategic alternatives — including the new business plan — and after consultation with the Morgan-ING advisors, the Company's Board of Directors approved the plan on March 29, 2003. Subsequent to Board approval, management initiated immediate implementation of the plan, which calls for closure of approximately 50 of the Company's operating stores. In cases where those properties are owned by the Company, the proceeds from the sale of the properties are being used to pay down bank debt under the existing agreement. The first 43 of those 50 restaurants were closed by the end of fiscal 2003. Most of the remaining locations are leased units that will close as soon as commercially feasible after negotiations with landlords or at the end of lease terms that expire in the near future.

With the assistance of Morgan-ING, the Company continues to have constructive discussions with its credit-facility lenders. In the meantime, the Company is focused on day-to-day operations and the implementation of its new strategic plan. Initially, cash resources have been reduced pursuant to the new plan, especially relative to lease settlements and termination costs. The Company used part of its fiscal 2002 federal income tax refund of \$13.4 million to support cash needs during the initial stages of the plan.

Over a time span starting in the third quarter of fiscal 2003 through the fourth quarter of fiscal 2004, the Company expects to report net losses from discontinued operations, including charges for impairments and store closures due to its decision to close the locations specified in the new business plan. To date through the 2003 fiscal year-end, \$30.6 million has been incurred. In fiscal year 2004, the Company expects more carrying and settlement costs; however, it also expects that these amounts will ultimately be offset by certain property gains through the next fiscal year.

Through the end of fiscal 2003, the Company recorded noncash impairment charges of approximately \$19.2 million, which were included in discontinued operations. The assets of these individual operating units have been written down to their net realizable values and are being actively marketed for sale. The impairment charges were reduced by \$2.1 million in gains on the sale of certain properties held for sale as part of the new business plan. The Company also recorded the related fiscal year-to-date net operating results, employee terminations, lease settlements, and basic carrying costs of the closed units in discontinued operations.

The Company also incurred approximately \$2.3 million in impairment costs that were charged to continuing operations. The impairments in this category were slightly offset by \$223,000 in gains on the sale of other properties held for sale. The net amount primarily reflects either impairments on properties designated for closure under the new business plan but not yet closed or impairments on properties included in prior disposal plans. Relative to the latter, most properties designated for closure prior to the new business plan were primarily lease locations. Those impairments were computed with the aid of discounted cash flow models that were consistent with prior years.

The reserve for store closures balance as of August 27, 2003, related to the 2001 asset disposal plan.

#### ***Credit-Facility Debt***

At August 28, 2002, the Company had a credit-facility balance of \$118.4 million with the bank group (a syndicate of four banks). In accordance with provisions of that credit facility, the Company paid the outstanding balance down by \$26.9 million during fiscal 2003 primarily from proceeds received from the sale of real and personal property. As a result, the balance was lowered to \$91.6 million at the end of fiscal 2003. The interest rate was prime plus 4.0% and prime plus 1.5% at August 27, 2003, and August 28, 2002, respectively. The Company is current on all interest payments due under the credit facility.

As of August 27, 2003, \$219.1 million of the Company's total book value, or 78.3% of its total assets, including the Company's owned real estate, improvements, equipment, and fixtures, was pledged as collateral under the credit facility. Although the current lenders have reserved all of their rights and remedies as a result of the January 31, 2003, default — including the right to demand immediate repayment of the entire outstanding balance or the right to pursue foreclosure on the assets pledged as collateral — they have not announced any intention to take such action.

#### ***Subordinated Debt***

On March 9, 2001, the Company's CEO and COO, Christopher J. Pappas and Harris J. Pappas, respectively, committed to lending the Company a total of \$10 million in exchange for convertible subordinated notes that were funded in the fourth quarter of fiscal 2001. The notes, as formally executed, bore interest at LIBOR plus 2%, payable quarterly.

The subordinated notes include a cross-default provision that is tied to the Company's credit facility. The Company was notified of the declared default by the note holders just after the end of the third quarter of fiscal 2003. Also pursuant to the terms of the note, it was determined that the quarterly interest payment made effective March 1, 2003, could not be retained by the note holders, who in turn forwarded the payment of approximately \$84,000 to the bank group. That amount was applied to the principal of the credit facility after the end of the third quarter. Furthermore, no principal or interest payments may be made to the subordinated note holders while the credit-facility debt is in default. This restriction in turn caused a second default. The note holders waived all defaults through May 19, 2003, yet they have reserved all of their rights and remedies associated with the debt. Effective May 20, 2003, the notes bear interest at 10% per year. Even if the Company's performance covenants are cured under the senior credit facility, continuation of the default with respect to the subordinated notes will continue to result in a default on the senior indebtedness under existing cross-default provisions.

Notwithstanding any accrued interest that may also be converted to stock, the notes are convertible into the Company's common stock at \$5.00 per share for 2.0 million shares at the option of the holders at any time after January 2, 2003, and prior to the stated redemption date. The per share market price of the Company's stock on the commitment date (as determined by the closing price on the New York Stock Exchange on the date of issue) was \$7.34. The difference between the market price and strike price of \$5.00, or \$2.34 per share, multiplied by the 2.0 million convertible shares equaled approximately \$4.7 million. Under the Company's adopted intrinsic value method, applicable accounting principles require that this amount, which represents the beneficial conversion feature, be recorded as both a component of paid-in capital and a discount from the \$10 million.

Initially, the conversion feature was amortized over the ten-year term of the notes. The subordinated note defaults triggered an acceleration of the discount amortization over the remaining term of the senior debt, which is currently set to mature in October 2004. That shorter amortization time frame was determined to be appropriate as the notes are subordinate to the credit facility and, accordingly, no payoff of those notes could occur before the debt of the senior creditors is addressed.

The carrying value of the notes at August 27, 2003, net of the unamortized discount, was approximately \$7.0 million. The comparative carrying value of the notes at August 28, 2002, was approximately \$5.9 million.

### **Commitments and Contingencies**

In fiscal 1999, the Company guaranteed loans of approximately \$1.9 million relating to purchases of Luby's stock by various officers of the Company pursuant to the terms of a shareholder-approved plan. Under the officer loan program, shares were purchased and funding was obtained from JPMorgan Chase Bank, one of the four members of the bank group that participate in the Company's credit facility. Per the original terms of the agreements, these instruments only required annual interest to be paid by the individual debtors, with the entire principal balances due upon their respective maturity dates, which occur during the period from January through March of 2004, unless extended by the note holders.

At both August 27, 2003, and August 28, 2002, the notes had a combined outstanding balance of approximately \$1.6 million. The underlying guarantee on these loans includes a cross-default provision. The Company received notice from JPMorgan Chase Bank that the default in the Company's credit facility led to a default in the officer loans. JPMorgan Chase Bank initially requested that the Company repurchase the notes; however, such action cannot be completed without comprehensive resolution with the entire bank group. On July 10, 2003, JPMorgan Chase Bank notified the Company that although it continues to reserve all rights and remedies, it has not elected to pursue those rights and remedies in order to allow further discussions among the bank group. This notice did not constitute a waiver. The Company is therefore working constructively with all members of the bank group in an effort to cure all defaults and satisfactorily meet each lender's expectations.

In the event of individual debtor default, the Company could be required to purchase the loans from JPMorgan Chase Bank, become holder of the notes, record the receivables, and pursue collection. The purchased Company stock has been and can be used by borrowers to satisfy a portion of their loan obligation. As of August 27, 2003, based on the market price on that day, approximately \$213,000, or 13.2% of the note balances, could have been covered by stock, while approximately \$1.4 million, or 86.8%, would have remained outstanding.

### **Off-Balance-Sheet Arrangements**

The Company has no off-balance-sheet structured financing arrangements. The shareholder-approved guaranteed loans, as described above, were intended to encourage officer stock ownership. Under the terms of applicable SEC rules, the Company's obligation to repurchase the loans could be deemed a guarantee contract, which the SEC considers an off-balance-sheet arrangement. If the Company is required to purchase the loans, it would have to expend approximately \$1.6 million to do so. The Company expects that the borrowers will fully repay the obligations. However, since management is currently unable to determine the individual ability of each borrower to pay the underlying debt in full, it is difficult to assess the potential effect on liquidity.

### **Affiliate Services**

The Company entered into an Affiliate Services Agreement effective August 31, 2001, with two companies, Pappas Partners, L.P. and Pappas Restaurants, Inc., which are restaurant entities owned by Christopher J. Pappas

and Harris J. Pappas. That agreement, as amended on July 23, 2002, limited the scope of expenditures therein to professional and consulting services. The Company completed this amendment due to a significant decline in the use of professional and consulting services from Pappas entities.

Additionally, on July 23, 2002, the Company entered into a Master Sales Agreement with the same Pappas entities. Through this agreement, the Company contractually separated the design and fabrication of equipment and furnishings from the Affiliate Services Agreement. The Master Sales Agreement covers the costs incurred for modifications to existing equipment, as well as custom fabrication, including stainless steel stoves, shelving, rolling carts, and chef tables. These items are custom-designed and built to fit the designated kitchens and are also engineered to give a longer service life than comparably manufactured equipment.

The pricing of equipment, repair, and maintenance is set and evaluated periodically and is considered by management to be primarily at or below market for comparable goods and services. To assist in periodically monitoring pricing of the transactions associated with the Master Sales Agreement and the Affiliate Services Agreement, the Finance and Audit Committee of the Company's Board of Directors has periodically in the past used independent valuation consultants.

As part of the affiliation with the Pappas entities, the Company leases a facility, the Houston Service Center, in which Luby's has installed a centralized restaurant service center to support field operations. The building at this location has 22,253 square feet of warehouse space and 5,664 square feet of office space. It is leased from the Pappas entities by the Company at an approximate monthly rate of \$0.24 per square foot. From this center, Luby's repair and service teams are dispatched to the Company's restaurants when facility or equipment maintenance and servicing are needed. The facility is also used for repair and storage of new and used equipment.

The Company previously leased a location from an unrelated third party. That location is used to house increased equipment inventories due to store closures under the business plan. The Company considered it more prudent to lease this location rather than to pursue purchasing a storage facility, as its strategy is to focus its capital expenditures on its operating restaurants. In a separate transaction, the third-party property owner sold the location to the Pappas entities during the fourth quarter of fiscal 2003, with the Pappas entities becoming the Company's landlord for that location. The storage site complements the Houston Service Center with approximately 27,000 square feet of warehouse space at an approximate monthly rate of \$0.21 per square foot.

In another separate contract, pursuant to the terms of a ground lease dated March 25, 1994, the Company paid rent to PHCG Investments for a Luby's restaurant the Company operated in Dallas, Texas, until that location was closed early in the third quarter of fiscal 2003. Christopher J. Pappas and Harris J. Pappas are general partners of PHCG Investments. Preceding the store's closure, the Company entered into a lease termination agreement with a third party unaffiliated with the Pappas entities. That agreement severed the Company's interest in the PHCG property in exchange for a payment of cash to the Company. The Company also obtained the right to remove fixtures and equipment from the premises, and it was released from any future obligations under the lease agreement. The closing of the transaction was completed during the third quarter of fiscal 2003, resulting in a gain of \$735,000, and the gross proceeds were used to pay down debt. The amount paid by the Company pursuant to the terms of this lease before its termination was approximately \$42,000 and \$85,000 for the years ended August 27, 2003, and August 28, 2002, respectively.

Affiliated rents paid for the Houston Service Center, the separate storage facility, and the Dallas property leases combined represented 2.4% and 2.9% of total rents for continuing operations for fiscal 2003 and fiscal 2002, respectively.

The following compares current and prior fiscal year charges incurred under the Master Sales Agreement, the Affiliate Services Agreement, and affiliated property leases to the Company's total general and administrative expenses, capital expenditures, and occupancy and other operating expenses included in continuing operations:

|  | <u>Year Ended</u>          |                            |
|--|----------------------------|----------------------------|
|  | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> |
|  | <u>(364 days)</u>          | <u>(362 days)</u>          |
| (In thousands)   |                            |                            |
| Affiliate Services and Sales — Incurred Costs:                                       |                            |                            |
| General and administrative expenses — professional services                          | \$ —                       | \$ 8                       |
| Capital expenditures — custom-fabricated and refurbished equipment                   | 174                        | 506                        |
| Occupancy and other operating expenses, including property leases                    | 136                        | 130                        |
| Less pass-through amounts to third parties   | <u>—</u>                   | <u>(154)</u>               |
| Total  | <u>\$ 310</u>              | <u>\$ 490</u>              |
| Applicable Total Company Costs:  |                            |                            |
| General and administrative expenses  | \$ 23,326                  | \$ 21,216                  |
| Capital expenditures   | 9,057                      | 13,097                     |
| Occupancy and other operating expenses   | <u>97,708</u>              | <u>101,178</u>             |
| Total  | <u>\$130,091</u>           | <u>\$135,491</u>           |
| Affiliate Services Incurred Costs As a Percentage of Applicable Total Company Costs: |                            |                            |
| Year to date   | <u>0.24%</u>               | <u>0.36%</u>               |
| Inception to date  | <u>0.23%</u>               |                            |

## Trends and Uncertainties

### Same-Store Sales

The restaurant business is highly competitive with respect to food quality, concept, location, price, and service. The Company has experienced declining same-store sales since 1996 as a result of previous execution strategies, as well as increased industry-wide competition. The Company competes with a large number of other restaurants, many of which have greater financial resources. Management believes the Company's success will depend largely on its ability to execute its new strategies, optimize its financial resources, and respond to changes in consumer preferences, as well as to general economic conditions.

The following shows the quarterly comparative change in same-store sales:

|             | <u>Q4</u>    | <u>Q3</u>    | <u>Q2</u>    | <u>Q1</u>    |
|-------------|--------------|--------------|--------------|--------------|
| Fiscal 2001 | 1.9%         | (0.4)%       | (5.3)%*      | (6.8)%       |
| Fiscal 2002 | (13.0)       | (13.2)       | (8.6)        | (2.7)        |
| Fiscal 2003 | <u>(2.4)</u> | <u>(3.2)</u> | <u>(0.6)</u> | <u>(5.1)</u> |
| Average     | <u>(4.5)</u> | <u>(5.6)</u> | <u>(4.8)</u> | <u>(4.9)</u> |

\* Adjusted for leap year.

The Company enacted price increases in the third and fourth quarters of fiscal 2001. The first quarter of fiscal 2002 includes September 11, 2001. In the third and fourth quarters of fiscal 2002, the Company was able to maintain its comparative cash flow level with declining sales by lowering operating costs. Even with national economic issues, such as continued concerns about domestic terrorism and a military offensive overseas, there was less quarterly same-store sales variability in fiscal 2003 than in the prior fiscal year.

The Company may find additional opportunities to lower costs; however, continued declines in net same-store sales could reduce operating cash flow. If severe declines in cash flow were to develop without offsetting reductions in uses of cash, such as capital expenditures, the Company's liquidity, the current status of the

Company's credit facility, and the ability of the Company to refinance its indebtedness could be further impacted. As a possible result, the current lenders may choose to terminate the credit facility, accelerate the maturity of any outstanding obligation under that facility, and pursue foreclosure on assets pledged as collateral.

### ***New Programs***

In addition to those described earlier, the Company has initiated a number of programs since March 2001. These programs, as listed below, are intended to address the decline in total and same-store sales, while prudently managing costs and increasing overall profitability:

- Food excellence;
- Service excellence;
- Emphasis on value, including all-you-can-eat promotions;
- Increased emphasis on employee training and development;
- Targeted marketing, especially directed at families;
- Closure of certain underperforming restaurants;
- New concept conversions; and
- Continued emphasis on in-house safety training, accident prevention, and claims management.

### ***Impairment***

Statement of Financial Accounting Standards (SFAS) 144 requires the Company to review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company considers a history of operating losses or negative cash flows and unfavorable changes in market conditions to be its main indicators of potential impairment. Assets are generally evaluated for impairment at the restaurant level. If a restaurant does not meet its financial investment objectives or continues to incur negative cash flows or operating losses, an impairment charge may be recognized in future periods.

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

Workers' compensation and employee injury claims expense decreased in comparison with the prior fiscal year due to improved cost control, safety training and accident prevention efforts, as well as the management of new claims in-house. Actual claims settlements and expenses may differ from estimated loss provisions. The Company cannot make any assurances as to the ultimate level of claims under the in-house safety program or whether declines in incidence of claims as well as claims costs experienced under the program will continue in future periods.

The Company may be the subject of claims or litigation from guests and employees alleging injuries as a result of its operations. In addition, unfavorable publicity from such allegations could have an adverse impact on financial results, regardless of their validity or ultimate outcome.

### ***Minimum Wage and Labor Costs***

From time to time, the U.S. Congress considers an increase in the federal minimum wage. The restaurant industry is intensely competitive, and in such case, the Company may not be able to transfer all of the resulting increases in operating costs to its guests in the form of price increases. In addition, since the Company's business is labor-intensive, shortages in the labor pool or other inflationary pressure could increase labor costs.

### ***Reserve for Restaurant Closings***

The Company's reserve for restaurant closings is associated with prior disposal plans. The reserve declined from \$3.1 million at August 28, 2002, to \$1.7 million at August 27, 2003, primarily due to the payment of and reductions in certain accrued lease settlement costs of approximately \$1.3 million. (See Note 7 of the Notes to Consolidated Financial Statements.)

## **Critical Accounting Policies**

The Company has identified the following policies as critical to its business and the understanding of its results of operations. The Company believes it is improbable that materially different amounts would be reported relating to the accounting policies described below if other acceptable approaches were adopted. However, the application of these accounting policies, as described below, involve the exercise of judgment and use of assumptions as to future uncertainties; therefore, actual results could differ from estimates generated from their use.

### ***Income Taxes***

The Company records the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in the accompanying consolidated balance sheets, as well as operating loss and tax credit carrybacks and carryforwards. The Company periodically reviews the recoverability of tax assets recorded on the balance sheet and provides valuation allowances as management deems necessary. Management makes judgments as to the interpretation of the tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. In addition, the Company operates within multiple taxing jurisdictions and is subject to audit in these jurisdictions. In management's opinion, adequate provisions for income taxes have been made for all years. Historically, the Company has been periodically reviewed by the Internal Revenue Service. The Company is currently under review for the 2002, 2001, and 2000 fiscal years.

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

The Company periodically evaluates long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing impairment reviews of such restaurants, the Company estimates future cash flows expected to result from the use of the asset and the possible residual value associated with its eventual disposition. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. The time periods for estimating future cash flows is often lengthy, which increases the sensitivity to assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. The Company considers the likelihood of possible outcomes in determining the best estimate of future cash flows.

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

The Company also periodically reviews long-lived assets against its plans to retain or ultimately dispose of properties. If the Company decides to dispose of a property, it will be moved to property held for sale and actively marketed. Property held for sale is stated at the lower of cost or estimated net realizable value. The net realizable value is generally estimated by management based upon the specific circumstance of each location. The Company will periodically measure and analyze its estimates against third-party appraisals.

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

The Company periodically reviews its workers' compensation and general liability reserves to ensure reasonableness. In fiscal 2001, the Company initiated an in-house safety and claims program focused on safety training and rigorous scrutiny of new claims, which has reduced costs significantly. Consistent with the prior year, the Company's liability is based upon estimates obtained from both an actuarial firm and internal risk management staff. Assumptions and judgments are used in evaluating these costs. The possibility exists that future claims-related liabilities could increase due to unforeseen circumstances.

### ***Stock-Based Compensation***

The Company accounts for its employee stock compensation plans using the intrinsic value method of accounting set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and the related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

## **New Accounting Pronouncements**

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 (“SFAS 144”) “Accounting for the Impairment or Disposal of Long-Lived Assets.” The Company was required to adopt SFAS 144 as of August 29, 2002. The adoption of SFAS 144 extended the reporting of discontinued operations to all components of an entity from a segment of an entity. In the current year, all qualifying disposal plans were reported as discontinued operations, and operations related to those disposals in prior years were reclassified as required. The results of disposal plans prior to the adoption were included in continuing operations for all periods presented.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (“SFAS 146”), “Accounting for Costs Associated with Exit or Disposal Activities,” which nullifies EITF Issue No. 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).” SFAS 146 requires that costs associated with an exit or disposal activity be recognized only when the liability is incurred (that is, when it meets the definition of a liability in the FASB’s conceptual framework). SFAS 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company adopted SFAS in the first quarter of fiscal 2003.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.” For certain guarantees issued after December 31, 2002, FIN 45 requires a guarantor to recognize, upon issuance of a guarantee, a liability for the fair value of the obligations it assumes under the guarantee. Guarantees issued prior to January 1, 2003, are not subject to liability recognition, but are subject to expanded disclosure requirements. The Company does not believe that the adoption of this Interpretation has had a material effect on its consolidated financial position or statement of operations.

In January 2003, FASB issued Interpretation No. 46 (FIN 46), an interpretation of Accounting Research Bulletin No. 51, which requires the Company to consolidate variable interest entities for which it is deemed to be the primary beneficiary and disclose information about variable interest entities in which it has a significant variable interest. FIN 46 became effective immediately for variable interest entities formed after January 31, 2003, and effective for periods ending after December 15, 2003, for any variable interest entities formed prior to February 1, 2003. The Company does not believe that this Interpretation will have a material impact on its consolidated financial statements.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145 (“SFAS 145”), “Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections,” which requires that the extinguishment of debt not be considered an extraordinary item under APB Opinion No. 30 (“APB 30”), “Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,” unless the debt extinguishment meets the “unusual in nature and infrequent of occurrence” criteria in APB 30. SFAS 145 is effective for fiscal years beginning after May 15, 2002, and, upon adoption, companies must reclassify prior period items that do not meet the extraordinary item classification criteria in APB 30. The Company adopted SFAS 145 and related rules as of August 29, 2002. The adoption of SFAS 145 had no effect on the Company’s financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 (“SFAS 150”), “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.” This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The provisions of this Statement are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement did not have an impact on the Company’s financial results of operations and financial position.

In April 2003, the FASB issued SFAS No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities,” which amends and clarifies financial accounting and reporting derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.” This statement is effective for

contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of this statement did not have a impact on the Company's operating results or financial position.

In August 2001, the FASB issued Statement of Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations." SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company adopted SFAS 143 as of August 29, 2002. The adoption of SFAS 143 had no effect on the Company's financial position or results of operations.

### **Inflation**

The Company's policy is to maintain stable menu prices without regard to seasonal variations in food costs. General increases in costs of food, wages, supplies, and services make it necessary for the Company to increase its menu prices from time to time. To the extent prevailing market conditions allow, the Company intends to adjust menu prices to maintain profit margins.

### **Forward-Looking Statements**

The Company wishes to caution readers that various factors could cause its actual financial and operational results to differ materially from those indicated by forward-looking statements made from time to time in news releases, reports, proxy statements, registration statements, and other written communications (including the preceding sections of this Management's Discussion and Analysis), as well as oral statements made from time to time by representatives of the Company. Except for historical information, matters discussed in such oral and written communications are forward-looking statements that involve risks and uncertainties, including but not limited to general business conditions, the impact of competition, the success of operating initiatives, changes in the cost and supply of food and labor, the seasonality of the Company's business, taxes, inflation, governmental regulations, and the availability of credit, as well as other risks and uncertainties disclosed in periodic reports on Form 10-K and Form 10-Q.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The Company is exposed to market risk from changes in interest rates affecting its variable-rate debt. As of August 27, 2003, \$91.6 million was outstanding under its credit facility at prime plus 4.0%. Additionally, the Company has \$10 million in notes which bore interest at LIBOR plus 2% through the third quarter of fiscal 2003. The total amount of debt subject to interest rate fluctuations was \$101.6 million. Assuming a consistent level of debt, a 1% change in interest rates effective from the beginning of the year would result in an increase or decrease in annual interest expense of \$1.0 million. Although the Company is not currently using interest rate swaps, it has previously used and may in the future use these instruments to manage cash flow risk on a portion of its variable-rate debt.

Relative to subordinated debt, the interest rate was increased early in the fourth quarter of 2003 by the note holders to a default rate of 10%. The rise in the rate resulted in an increase in interest costs of \$187,000 for the fourth quarter of fiscal 2003.

**Item 8. Financial Statements and Supplementary Data**

**LUBY'S, INC.**

**FINANCIAL STATEMENTS**

**Years Ended August 27, 2003, August 28, 2002, and August 31, 2001  
with Report of Independent Auditors**

Report of Independent Auditors

The Board of Directors and Shareholders of Luby's, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Luby's, Inc. and Subsidiaries at August 27, 2003, and August 28, 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended August 27, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Luby's, Inc. and Subsidiaries at August 27, 2003, and August 28, 2002, and the results of their operations and their cash flows for each of the three years in the period ended August 27, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, in 2003 the Company was required to change its method of accounting for discontinued operations.

The accompanying consolidated financial statements have been prepared assuming that Luby's, Inc. and Subsidiaries will continue as a going concern. As more fully described in Note 6, there are no assurances that the Company will be able to obtain financing necessary to satisfy payments required by the Company's amended bank facility. This condition raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 6. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/ ERNST & YOUNG LLP

San Antonio, Texas  
November 14, 2003

**LUBY'S, INC.**  
**CONSOLIDATED BALANCE SHEETS**

|  | August 27,<br>2003 | August 28,<br>2002 |
|--|--------------------|--------------------|
|  | (In thousands)     |                    |
| <b>ASSETS</b>  |                    |                    |
| Current Assets:  |                    |                    |
| Cash   | \$ 871             | \$ 1,584           |
| Short-term investments (see Note 2)  | 20,498             | 24,122             |
| Trade accounts and other receivables   | 283                | 185                |
| Food and supply inventories  | 1,798              | 2,197              |
| Prepaid expenses   | 3,485              | 1,667              |
| Income tax receivable  | —                  | 7,245              |
| Deferred income taxes (see Note 3)   | 1,777              | 2,726              |
| Total current assets   | 28,712             | 39,726             |
| Property held for sale   | 32,946             | 8,144              |
| Investments and other assets   | 547                | 4,642              |
| Property, plant, and equipment — at cost, net (see Note 4)   | 217,676            | 289,967            |
| Total assets   | \$ 279,881         | \$ 342,479         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                    |                    |
| Current Liabilities:   |                    |                    |
| Accounts payable   | \$ 12,488          | \$ 19,077          |
| Accrued expenses and other liabilities (see Note 5)  | 20,978             | 21,735             |
| Convertible subordinated notes, net — related party (see Note 6)   | 6,973              | —                  |
| Credit-facility debt (see Note 6)  | 91,559             | 118,448            |
| Total current liabilities  | 131,998            | 159,260            |
| Convertible subordinated notes, net — related party (see Note 6)   | —                  | 5,883              |
| Accrued claims and insurance   | 3,729              | 5,142              |
| Deferred income taxes and other credits (see Note 3)   | 10,579             | 5,460              |
| Reserve for restaurant closings (see Note 7)   | 1,663              | 3,114              |
| Commitments and contingencies (see Note 8)   |                    |                    |
| Total liabilities  | 147,969            | 178,859            |
| Shareholders' Equity   |                    |                    |
| Common stock, \$.32 par value; authorized 100,000,000 shares, issued<br>27,403,067 shares in 2003 and 2002 | 8,769              | 8,769              |
| Paid-in capital  | 36,916             | 37,335             |
| Deferred compensation  | (679)              | (1,989)            |
| Retained earnings  | 191,968            | 225,062            |
| Less cost of treasury stock, 4,946,771 and 4,970,024 shares in 2003 and 2002,<br>respectively              | (105,062)          | (105,557)          |
| Total shareholders' equity   | 131,912            | 163,620            |
| Total liabilities and shareholders' equity   | \$ 279,881         | \$ 342,479         |

See accompanying notes.

**LUBY'S, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | <u>Year Ended</u>                           |                            |                            |
|--|---|----------------------------|----------------------------|
|  | <u>August 27,<br/>2003</u>                  | <u>August 28,<br/>2002</u> | <u>August 31,<br/>2001</u> |
|  | <u>(In thousands except per share data)</u> |                            |                            |
| Sales  | \$318,521                                   | \$334,473                  | \$385,416                  |
| Costs and expenses:  |   |                            |                            |
| Cost of food   | 87,048                                      | 85,275                     | 95,835                     |
| Payroll and related costs  | 92,416                                      | 106,969                    | 134,886                    |
| Occupancy and other operating expenses   | 97,708                                      | 101,178                    | 113,901                    |
| Depreciation and amortization  | 18,104                                      | 18,122                     | 18,652                     |
| General and administrative expenses  | 23,326                                      | 21,216                     | 25,283                     |
| Provision for asset impairments and restaurant closings (see Note 7)                               | <u>2,060</u>                                | <u>271</u>                 | <u>30,402</u>              |
|  | <u>320,662</u>                              | <u>333,031</u>             | <u>418,959</u>             |
| Income (loss) from operations  | (2,141)                                     | 1,442                      | (33,543)                   |
| Interest expense   | (7,610)                                     | (7,676)                    | (8,135)                    |
| Other income, net  | <u>7,217</u>                                | <u>2,374</u>               | <u>2,167</u>               |
| Income (loss) before income taxes  | (2,534)                                     | (3,860)                    | (39,511)                   |
| Provision (benefit) for income taxes (see Note 3):   |   |                            |                            |
| Current  | —   | (1,719)                    | (5,071)                    |
| Deferred   | <u>—</u>                                    | <u>687</u>                 | <u>(8,583)</u>             |
|  | <u>—</u>                                    | <u>(1,032)</u>             | <u>(13,654)</u>            |
| Income (loss) from continuing operations   | (2,534)                                     | (2,828)                    | (25,857)                   |
| Discontinued operations, net of taxes (see Note 7)   | <u>(30,560)</u>                             | <u>(6,825)</u>             | <u>(6,024)</u>             |
| Net income (loss)  | <u>\$ (33,094)</u>                          | <u>\$ (9,653)</u>          | <u>\$ (31,881)</u>         |
| Income (loss) per share — before discontinued operations basic and assuming dilution (see Note 15) | (0.11)                                      | (0.13)                     | (1.15)                     |
| Income (loss) per share — from discontinued operations basic and assuming dilution (see Note 15)   | <u>(1.36)</u>                               | <u>(0.30)</u>              | <u>(0.27)</u>              |
| Net income (loss) per share — basic and assuming dilution (see Note 15)                            | <u>\$ (1.47)</u>                            | <u>\$ (0.43)</u>           | <u>\$ (1.42)</u>           |

See accompanying notes.

LUBY'S, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(In thousands)

|  | Common Stock  |                 |                 | Paid-In Capital | Deferred Compensation | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|--|---------------|-----------------|-----------------|-----------------|-----------------------|-------------------|---|----------------------------|
|  | Issued Shares | Treasury Shares | Treasury Amount |                 |                       |                   |   |                            |
| Balance at August 31, 2000   | 27,403        | —               | \$8,769         | (4,983)         | \$(105,826)           | \$27,202          | \$ —  | \$196,741                  |
| Net income (loss) for the year   | —             | —               | —               | —               | —                     | (31,881)          | —   | (31,881)                   |
| Other comprehensive income (loss), net of taxes:   |               |                 |                 |                 |                       |                   |   |                            |
| Cumulative effect of a change in accounting for derivative financial instruments upon adoption of SFAS 133, net of taxes of \$61 | —             | —               | —               | —               | —                     | —                 | 114   | 114                        |
| Net derivative loss, net of taxes of \$514   | —             | —               | —               | —               | —                     | —                 | (958)   | (958)                      |
| Reclassification adjustment for loss included in net income (loss), net of taxes of \$71   | —             | —               | —               | —               | —                     | —                 | 133   | 133                        |
| Reclassification adjustment for loss recognized on termination of interest rate swaps, net of taxes of \$64                      | —             | —               | —               | —               | —                     | —                 | 119   | 119                        |
| Common stock issued under nonemployee director benefit plans   | —             | 3               | 55              | 58              | —                     | —                 | —   | 113                        |
| Deferred Compensation/Options  | —             | —               | —               | 5,241           | (5,241)               | —                 | —   | —                          |
| Noncash stock compensation expense   | —             | —               | —               | —               | 1,942                 | —                 | —   | 1,942                      |
| Intrinsic value of beneficial conversion feature on convertible subordinated notes   | —             | —               | —               | 4,680           | —                     | —                 | —   | 4,680                      |
| Balance at August 31, 2001   | 27,403        | (4,980)         | \$8,769         | \$(105,771)     | \$37,181              | \$234,715         | \$(592)                                       | \$171,003                  |
| Net income (loss) for the year   | —             | —               | —               | —               | —                     | (9,653)           | —   | (9,653)                    |
| Reclassification adjustment for loss recognized on termination of interest rate swaps, net of taxes of \$318                     | —             | —               | —               | —               | —                     | —                 | 592   | 592                        |
| Noncash stock compensation expense   | —             | —               | —               | —               | 1,310                 | —                 | —   | 1,310                      |
| Common stock issued under nonemployee director benefit plans   | —             | 10              | 214             | 154             | —                     | —                 | —   | 368                        |
| Balance at August 28, 2002   | 27,403        | (4,970)         | \$8,769         | \$(105,557)     | \$37,335              | \$225,062         | \$ —  | \$163,620                  |
| Net income (loss) for the year   | —             | —               | —               | —               | —                     | (33,094)          | —   | (33,094)                   |
| Noncash stock compensation expense   | —             | —               | —               | —               | 1,310                 | —                 | —   | 1,310                      |
| Common stock issued under nonemployee director benefit plans   | —             | 23              | 495             | (419)           | —                     | —                 | —   | 76                         |
| Balance at August 27, 2003   | 27,403        | (4,947)         | \$8,769         | \$(105,062)     | \$36,916              | \$191,968         | \$ —  | \$131,912                  |

See accompanying notes.

**LUBY'S, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | Year Ended         |                    |                    |
|--|--------------------|--------------------|--------------------|
|  | August 27,<br>2003 | August 28,<br>2002 | August 31,<br>2001 |
|  | (In thousands)     |                    |                    |
| <b>Cash flows from operating activities:</b>   |                    |                    |                    |
| Net income (loss)  | \$(33,094)         | \$(9,653)          | \$(31,881)         |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: |                    |                    |                    |
| Provision for (reversal of) asset impairments — discontinued operations                            | 17,053             | 43                 | —                  |
| Provision for (reversal of) asset impairments and restaurant closings                              | 2,060              | 271                | 30,402             |
| Depreciation and amortization — continuing operations  | 18,104             | 18,122             | 18,652             |
| Depreciation and amortization — discontinued operations  | 1,979              | 3,520              | 4,413              |
| Amortization of deferred loss on interest rate swaps   | —                  | 910                | 183                |
| Amortization of discount on convertible subordinated notes   | 1,090              | 482                | 81                 |
| (Gain) loss on disposal of property held for sale  | (3,222)            | (1,330)            | (1,741)            |
| (Gain) loss on disposal of property, plant, and equipment  | (3,364)            | 270                | 547                |
| Noncash nonemployee directors' fees  | 76                 | 313                | 112                |
| Noncash executive compensation expense   | 1,310              | 1,310              | 1,942              |
| Cash (used in) provided by operating activities before changes in operating assets and liabilities | 1,992              | 14,258             | 22,710             |
| Changes in operating assets and liabilities:   |                    |                    |                    |
| (Increase) decrease in trade accounts and other receivables  | (98)               | 173                | 45                 |
| (Increase) decrease in food and supply inventories   | 399                | 504                | 1,152              |
| (Increase) decrease in income tax receivable   | 7,245              | (637)              | (2,859)            |
| (Increase) decrease in prepaid expenses  | (1,818)            | 1,098              | 1,716              |
| (Increase) decrease in other assets  | (201)              | 251                | (117)              |
| Increase (decrease) in accounts payable  | (6,589)            | 5,381              | (6,147)            |
| Increase (decrease) in accrued claims and insurance, accrued expenses, and other liabilities       | (2,170)            | (7,708)            | 10,545             |
| Increase (decrease) in deferred income taxes and other credits                                     | 6,068              | 2,939              | (8,824)            |
| Increase (decrease) in reserve for restaurant closings   | (210)              | (1,651)            | (1,301)            |
| Net cash (used in) provided by operating activities  | 4,618              | 14,608             | 16,920             |
| <b>Cash flows from investing activities:</b>   |                    |                    |                    |
| (Increase) decrease in short-term investments  | 3,624              | (4,138)            | (19,984)           |
| Proceeds from disposal of property held for sale   | 19,178             | 3,609              | 7,825              |
| Proceeds from disposal of property, plant, and equipment   | 7,813              | —                  | —                  |
| Purchases of property, plant, and equipment  | (9,057)            | (13,097)           | (17,630)           |
| Net cash (used in) provided by investing activities  | 21,558             | (13,626)           | (29,789)           |
| <b>Cash flows from financing activities:</b>   |                    |                    |                    |
| Proceeds from convertible subordinated notes   | —                  | —                  | 10,000             |
| Issuance (repayment) of debt, net  | (26,889)           | (3,552)            | 6,000              |
| Cash paid upon termination of interest rate swaps  | —                  | —                  | (1,092)            |
| Proceeds from (payments on) borrowing against cash surrender value of officers' life insurance     | —                  | —                  | 3,623              |
| Proceeds received on the exercise of employee stock options  | —                  | 55                 | —                  |
| Dividends paid   | —                  | —                  | (2,242)            |
| Net cash (used in) provided by financing activities  | (26,889)           | (3,497)            | 16,289             |
| Net increase (decrease) in cash  | (713)              | (2,515)            | 3,420              |
| Cash at beginning of year  | 1,584              | 4,099              | 679                |
| Cash at end of year  | \$ 871             | \$ 1,584           | \$ 4,099           |

See accompanying notes.

**LUBY'S, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Fiscal Years 2003, 2002, and 2001**

**Note 1. Nature of Operations and Significant Accounting Policies**

***Nature of Operations***

Luby's, Inc. and Subsidiaries (the Company), is based in San Antonio, Texas. As of August 27, 2003, the Company owned and operated 148 restaurants, with 133 in Texas and the remainder in six other states. The Company's restaurants are located convenient to shopping and business developments as well as to residential areas. Accordingly, the restaurants appeal primarily to shoppers, travelers, store and office personnel at lunch, and to families at dinner.

***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of Luby's, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

***Inventories***

The food and supply inventories are stated at the lower of cost (first-in, first-out) or market.

***Property Held for Sale***

Property held for sale is stated at the lower of cost or estimated net realizable value.

***Depreciation and Amortization***

The Company depreciates the cost of plant and equipment over their estimated useful lives using the straight-line method. Leasehold improvements are amortized over the related lease lives, which are in some cases shorter than the estimated useful lives of the improvements.

***Long-Lived Assets***

Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount. The Company evaluates impairments on a restaurant-by-restaurant basis and uses three or more years of negative cash flows and other market conditions as indicators of impairment.

***Fiscal Year***

In fiscal year 2002, the Company changed its reporting-period measurement to 13 four-week periods from 12 calendar months. The first period of fiscal year 2002 began September 1, 2001, and covered 26 days, and all subsequent periods covered 28 days. Fiscal year 2002 ended on August 28, 2002, and contained 362 days, compared to 364 days in fiscal 2003.

***Advertising Expenses***

Advertising costs are expensed as incurred. Total advertising expense was \$1.1 million, \$889,000, and \$7.5 million in fiscal 2003, 2002, and 2001, respectively, of which \$80,000, \$0, and \$1.5 million in fiscal 2003, 2002, and 2001, respectively, related to stores included in discontinued operations and was reclassified accordingly.

***Income Taxes***

Deferred income taxes are computed using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

(temporary differences) and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

***Financial Instruments***

The estimated fair value of financial instruments held by the Company approximates the carrying value.

***Stock-Based Compensation***

The Company accounts for its employee stock compensation plans using the intrinsic value method of accounting set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and the related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

The following table illustrates the effect on net income and earnings per share if the Company had converted to the fair-value method of expensing stock options, as alternatively allowed under FAS 123:

|  | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> | <u>August 31,<br/>2001</u> |
|--|----------------------------|----------------------------|----------------------------|
|  | (In thousands)             |                            |                            |
| Net (loss), as reported  | \$(33,094)                 | \$ (9,653)                 | \$(31,881)                 |
| Add: Stock-based employee compensation expense included in reported net (loss), net of related tax effects <sup>(a)</sup>                                  | 1,310                      | 852                        | 1,262                      |
| Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects <sup>(a)</sup> | <u>(1,325)</u>             | <u>(1,645)</u>             | <u>(945)</u>               |
| Pro forma net (loss)   | <u><u>\$(33,109)</u></u>   | <u><u>\$(10,446)</u></u>   | <u><u>\$(31,564)</u></u>   |
| Earnings per share:  |                            |                            |                            |
| Basic and assuming dilution — as reported <sup>(b)</sup>   | <u><u>\$ (1.47)</u></u>    | <u><u>\$ (0.43)</u></u>    | <u><u>\$ (1.42)</u></u>    |
| Basic and assuming dilution — pro forma <sup>(b)</sup>   | <u><u>\$ (1.47)</u></u>    | <u><u>\$ (0.47)</u></u>    | <u><u>\$ (1.41)</u></u>    |

<sup>(a)</sup> Income taxes have been offset by a valuation allowance in 2003. See Note 3 of the Notes to Consolidated Financial Statements.

<sup>(b)</sup> As the Company had net losses for the years ended August 27, 2003, August 28, 2002, and August 31, 2001, earnings per share assuming dilution equals basic earnings per share since potentially dilutive securities are antidilutive in loss periods.

***Comprehensive Income***

Comprehensive income (loss) includes adjustments for certain revenues, expenses, gains, and losses that are excluded from net income in accordance with accounting principles generally accepted in the United States, such as adjustments to the interest rate swaps.

***Earnings Per Share***

The Company presents basic income (loss) per common share and diluted loss per common share in accordance with SFAS 128, "Earnings Per Share." Basic income (loss) per share is computed by dividing net income (loss) by the weighted-average number of shares outstanding during each period presented. In fiscal years 2003, 2002, and 2001, basic and diluted loss per share were the same due to the antidilutive effect of options in loss periods.

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### *Derivative Financial Instruments*

The Company adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," and its amendments, Statements No. 137 and 138, on September 1, 2000. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at fair value.

#### *Use of Estimates*

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### *New Accounting Pronouncements*

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS 144") "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company was required to adopt SFAS 144 as of August 29, 2002. The adoption of SFAS 144 extended the reporting of discontinued operations to all components of an entity from a segment of an entity. In the current year, all qualifying disposal plans were reported as discontinued operations, and operations related to those disposals in prior years were reclassified as required. The results of disposal plans prior to the adoption were included in continuing operations for all periods presented.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 ("SFAS 146"), "Accounting for Costs Associated with Exit or Disposal Activities," which nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 requires that costs associated with an exit or disposal activity be recognized only when the liability is incurred (that is, when it meets the definition of a liability in the FASB's conceptual framework). SFAS 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company adopted SFAS in the first quarter of fiscal 2003.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." For certain guarantees issued after December 31, 2002, FIN 45 requires a guarantor to recognize, upon issuance of a guarantee, a liability for the fair value of the obligations it assumes under the guarantee. Guarantees issued prior to January 1, 2003, are not subject to liability recognition, but are subject to expanded disclosure requirements. The Company does not believe that the adoption of this Interpretation has had a material effect on its consolidated financial position or statement of operations.

In January 2003, FASB issued Interpretation No. 46 (FIN 46), an interpretation of Accounting Research Bulletin No. 51, which requires the Company to consolidate variable interest entities for which it is deemed to be the primary beneficiary and disclose information about variable interest entities in which it has a significant variable interest. FIN 46 became effective immediately for variable interest entities formed after January 31, 2003, and effective for periods ending after December 15, 2003, for any variable interest entities formed prior to February 1, 2003. The Company does not believe that this Interpretation will have a material impact on its consolidated financial statements.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145 ("SFAS 145"), "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," which requires that the extinguishment of debt not be considered an extraordinary item under APB Opinion No. 30 ("APB 30"), "Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," unless the debt extinguishment meets the "unusual in nature and infrequent of occurrence" criteria in APB 30. SFAS 145 is effective for fiscal years beginning after May 15, 2002, and, upon adoption, companies must reclassify prior period items that do not meet the extraordinary item classification criteria in APB 30. The

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Company adopted SFAS 145 and related rules as of August 29, 2002. The adoption of SFAS 145 had no effect on the Company's financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 ("SFAS 150"), "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The provisions of this Statement are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement did not have an impact on the Company's financial results of operations and financial position.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies financial accounting and reporting derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of this statement did not have a impact on the Company's operating results or financial position.

In August 2001, the FASB issued Statement of Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations." SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company adopted SFAS 143 as of August 29, 2002. The adoption of SFAS 143 had no effect on the Company's financial position or results of operations.

#### ***Reclassifications***

Certain prior year amounts have been reclassified to conform to the current year presentation. Further, the Company's new business plan, as approved in fiscal 2003, called for the closure of approximately 50 locations. In accordance with SFAS 144, the entire fiscal activity of the applicable closures completed through the end of the 2003 fiscal year were recorded to discontinued operations. For comparison purposes, the net activity for the same locations closed in fiscal 2003 have also been reclassified to discontinued operations in prior fiscal years.

#### **Note 2. Short-Term Investments**

The Company maintained a balance of \$20.5 million and \$24.1 million in short-term investments as of August 27, 2003, and August 28, 2002, respectively. Cash resources were invested in money-market funds and time deposits. As of August 27, 2003, approximately \$2.3 million of the Company's short-term investments was also pledged as collateral for four separate letters of credit. There have been no draws upon these letters of credit.

#### **Note 3. Income Taxes**

The following is a summarization of deferred income tax assets and liabilities as of the current and prior fiscal year-end:

|   | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> |
|---|----------------------------|----------------------------|
|   | (In thousands)             |                            |
| Net deferred long-term income tax liability and other credits | \$(10,579)                 | \$(5,460)                  |
| Other credits   | <u>1,523</u>               | <u>1,653</u>               |
| Net deferred long-term income tax liability                   | (9,056)                    | (3,807)                    |
| Net deferred short-term income tax asset                      | <u>1,777</u>               | <u>2,726</u>               |
| Net deferred income tax liability                             | <u><u>\$ (7,279)</u></u>   | <u><u>\$(1,081)</u></u>    |

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The tax effect of temporary differences results in the following deferred income tax assets and liabilities as of the current and prior fiscal year-end:

|  | August 27,<br>2003 | August 28,<br>2002 |
|--|--------------------|--------------------|
|  | (In thousands)     |                    |
| Deferred income tax assets:  |                    |                    |
| Workers' compensation, employee injury, and general liability claims | \$ 2,429           | \$ 3,501           |
| Deferred compensation  | 2,283              | 1,806              |
| Asset impairments and restaurant closure reserves                    | 20,224             | 19,243             |
| Net operating losses   | 11,086             | —                  |
| Subtotal   | 36,022             | 24,550             |
| Valuation allowance  | (11,113)           | —                  |
| Total deferred income tax assets                                     | 24,909             | 24,550             |
| Deferred income tax liabilities:                                     |                    |                    |
| Depreciation and amortization  | 29,390             | 23,650             |
| Other  | 2,798              | 1,981              |
| Total deferred income tax liabilities                                | 32,188             | 25,631             |
| Net deferred income tax liability                                    | \$ (7,279)         | \$ (1,081)         |

The reconciliation of the benefit for income taxes to the expected income tax benefit from continuing operations computed using the statutory tax rate was as follows:

|                                      | 2003   |         | 2002      |         | 2001       |         |
|--------------------------------------|--|---------|-----------|---------|------------|---------|
|                                      | Amount   | %       | Amount    | %       | Amount     | %       |
|                                      | (In thousands and as a percent of pretax income) |         |           |         |            |         |
| Normally expected income tax benefit | \$(887)  | (35.0)% | \$(1,351) | (35.0)% | \$(13,829) | (35.0)% |
| State income taxes                   | —  | —       | —         | —       | 125        | 0.3     |
| Jobs tax credits                     | (218)  | (8.6)   | (218)     | (5.6)   | (381)      | (1.0)   |
| Other differences                    | 254  | 10.0    | 537       | 13.9    | 431        | 1.1     |
| Valuation allowance                  | 851  | 33.6    | —         | —       | —          | —       |
|                                      | \$ —   | —%      | \$(1,032) | (26.7)% | \$(13,654) | (34.6)% |

The income tax benefit in fiscal 2003 from continuing operations and discontinued operations is entirely offset by the valuation allowance. Approximately \$3.7 million and \$3.2 million in income tax benefit is included in discontinued operations for the 2002 and 2001 fiscal years, respectively.

Due to the Company's loss position, no federal income taxes have been paid in fiscal 2003, 2002, or 2001. The Company generated a tax operating loss carryforward of approximately \$31.7 million for the fiscal year ended August 27, 2003, which would expire in 2023 if not utilized. The tax benefit for book purposes of \$11.1 million was netted against a valuation allowance because loss carrybacks were exhausted with the fiscal 2002 tax filing, making the realization of loss carryforward utilization uncertain.

Historically, the Company has been periodically reviewed by the Internal Revenue Service. The Company is currently under review for the 2002, 2001, and 2000 fiscal years. Management believes that adequate provisions for income taxes have been reflected in the financial statements and is not aware of any significant exposure items.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**Note 4. Property, Plant, and Equipment**

The cost and accumulated depreciation of property, plant, and equipment at August 27, 2003, and August 28, 2002, together with the related estimated useful lives used in computing depreciation and amortization, were as follows:

|  | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> | <u>Estimated<br/>Useful Lives</u> |
|--|----------------------------|----------------------------|-----------------------------------|
|  | (In thousands)             |                            |                                   |
| Land   | \$ 55,259                  | \$ 73,664                  | —                                 |
| Restaurant equipment and furnishings           | 108,183                    | 138,846                    | 3 to 15 years                     |
| Buildings                                      | 191,521                    | 236,806                    | 20 to 40 years                    |
| Leasehold and leasehold improvements           | 21,989                     | 33,107                     | Term of leases                    |
| Office furniture and equipment                 | 11,710                     | 12,330                     | 5 to 10 years                     |
| Transportation equipment                       | <u>574</u>                 | <u>811</u>                 | 5 years                           |
|  | 389,236                    | 495,564                    |                                   |
| Less accumulated depreciation and amortization | <u>(171,560)</u>           | <u>(205,597)</u>           |                                   |
|  | <u>\$ 217,676</u>          | <u>\$ 289,967</u>          |                                   |

**Note 5. Current Accrued Expenses and Other Liabilities**

Current accrued expenses and other liabilities as of the current and prior fiscal year-end consist of:

|   | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> |
|---|----------------------------|----------------------------|
|   | (In thousands)             |                            |
| Salaries, compensated absences, incentives, and bonuses | \$ 5,476                   | \$ 4,986                   |
| Taxes, other than income                                | 6,951                      | 6,833                      |
| Accrued claims and insurance                            | 5,584                      | 7,888                      |
| Rent, legal, and other                                  | <u>2,967</u>               | <u>2,028</u>               |
|   | <u>\$20,978</u>            | <u>\$21,735</u>            |

**Note 6. Debt**

***Debt/New Business Plan***

During the mid-1990's, the Company entered into a revolving line of credit with a bank group. It was primarily used for financing long-term objectives, including capital acquisitions and a stock repurchase program. Capacity under that credit facility was fully exhausted in fiscal 2001, at which time the Company was unable to draw further advances under the agreement. Since then, existing management has financed its capital acquisitions and working capital needs through careful cash management and the provision of an additional \$10 million in financing in fiscal 2001 from the Company's CEO and the COO.

Current management recognized the need to arrange financing that would better match long-term assets with the existing debt. Accordingly, early in the second quarter of fiscal 2003, the Company executed a commitment letter with a third-party lender for an \$80 million loan to replace that amount of debt in the existing credit facility. Simultaneously, when the current bank group provided a waiver and amendment, it also added a stipulation that required the new \$80 million financing be completed and funded by January 31, 2003. However, the Company was unable to finalize the new financing arrangement because of changes in the proposed agreement terms that the Company believed were not in its best interest. This led to a default under the credit facility that the Company is currently focused on rectifying. Even though the lack of replacement financing caused a default, the Company was in compliance with its financial performance covenants at the end of the quarter and no default in interest

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

payments has occurred as of the date this SEC report was filed. Also as of that date, the existing bank group has taken no formal action other than to notify the Company that it reserves all of its rights and remedies.

Management has actively communicated with the credit-facility bank group, while working on its new business plan that is focused on returning the Company to profitability. The Company also engaged the financial advisory firms of Morgan Joseph & Co. and ING Capital LLC ("Morgan-ING") to review the new plan.

After thorough review of several strategic alternatives — including the new business plan — and after consultation with the Morgan-ING advisors, the Company's Board of Directors approved the plan on March 29, 2003. Subsequent to Board approval, management initiated immediate implementation of the plan, which calls for closure of approximately 50 of the Company's operating stores. In cases where those properties are owned by the Company, the proceeds from the sale of the properties are being used to pay down bank debt under the existing agreement. The first 43 of those 50 restaurants were closed by the end of fiscal 2003. Most of the remaining locations are leased units that will close as soon as commercially feasible after negotiations with landlords or at the end of lease terms that expire in the near future.

With the assistance of Morgan-ING, the Company continues to have constructive discussions with its credit-facility lenders. In the meantime, the Company is focused on day-to-day operations and the implementation of its new strategic plan. Initially, cash resources have been reduced pursuant to the new plan, especially relative to lease settlements and termination costs. The Company used part of its fiscal 2002 federal income tax refund of \$13.4 million to support cash needs during the initial stages of the plan.

Over a time span starting in the third quarter of fiscal 2003 through the fourth quarter of fiscal 2004, the Company expects to report net losses from discontinued operations, including charges for impairment and store closures due to its decision to close the locations specified in the new business plan. To date through the 2003 fiscal year-end, \$30.6 million has been incurred. In fiscal year 2004, the Company expects more carrying and settlement costs; however, it also expects that these amounts will ultimately be offset by certain property gains through the next fiscal year. As explained in Note 1 above, the Company adjusts its property held for sale to the lower of cost or net realizable value. Relative to that process, while the Company had net book values that had to be written down, it also had net book values that could not be written up before the actual sale. The anticipated gains relate to those assets that could not be written up.

Through the end of fiscal 2003, the Company recorded noncash impairment charges of approximately \$19.2 million, which were included in discontinued operations. The assets of these individual operating units have been written down to their net realizable values and are being actively marketed for sale. The impairment charges were reduced by \$2.1 million in gains on the sale of certain properties held for sale as part of the new business plan. The Company also recorded the related fiscal year-to-date net operating results, employee terminations, lease settlements, and basic carrying costs of the closed units in discontinued operations.

The Company also incurred approximately \$2.3 million in impairment costs that were charged to continuing operations. The impairments in this category were slightly offset by \$223,000 in gains on the sale of other properties held for sale. The net amount primarily reflects impairments on properties designated for closure under the new business plan but not yet closed. Most properties designated for closure prior to the new business plan were primarily lease locations. The impairments were computed with the aid of discounted cash flow models that are consistent with those used in prior years.

The reserve for store closures balance as of August 27, 2003, related to the 2001 asset disposal plan.

#### ***Credit-Facility Debt***

At August 28, 2002, the Company had a credit-facility balance of \$118.4 million with the bank group (a syndicate of four banks). In accordance with provisions of that credit facility, the Company paid the outstanding balance down by \$26.9 million during fiscal 2003 primarily from proceeds received from the sale of real and personal property. As a result, the balance was lowered to \$91.6 million at the end of fiscal 2003. The interest rate was prime plus 4.0% and prime plus 1.5% at August 27, 2003, and August 28, 2002, respectively. The Company is current on all interest payments due under the credit facility.

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of August 27, 2003, \$219.1 million of the Company's total book value, or 78.3% of its total assets, including the Company's owned real estate, improvements, equipment, and fixtures, was pledged as collateral under the credit facility. Although the current lenders have reserved all of their rights and remedies as a result of the January 31, 2003, default — including the right to demand immediate repayment of the entire outstanding balance or the right to pursue foreclosure on the assets pledged as collateral — they have not announced any intention to take such action.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. There can be no assurances that the Company's credit defaults will be resolved in the near future. However, it is focused on constructive discussion with all of its lenders to do so.

#### *Subordinated Debt*

On March 9, 2001, the Company's CEO and COO, Christopher J. Pappas and Harris J. Pappas, respectively, committed to lending the Company a total of \$10 million in exchange for convertible subordinated notes that were funded in the fourth quarter of fiscal 2001. The notes, as formally executed, bore interest at LIBOR plus 2%, payable quarterly.

The subordinated notes include a cross-default provision that is tied to the Company's credit facility. The Company was notified of the declared default by the note holders just after the end of the third quarter of fiscal 2003. Also pursuant to the terms of the note, it was determined that the quarterly interest payment made effective March 1, 2003, could not be retained by the note holders, who in turn forwarded the payment of approximately \$84,000 to the bank group. That amount was applied to the principal of the credit facility after the end of the third quarter. Furthermore, no principal or interest payments may be made to the subordinated note holders while the credit-facility debt is in default. This restriction in turn caused a second default. The note holders waived all defaults through May 19, 2003, yet they have reserved all of their rights and remedies associated with the debt. Effective May 20, 2003, the notes bear interest at 10% per year. Even if the Company's performance covenants are cured under the senior credit facility, continuation of the default with respect to the subordinated notes will continue to result in a default on the senior indebtedness under existing cross-default provisions.

Notwithstanding any accrued interest that may also be converted to stock, the notes are convertible into the Company's common stock at \$5.00 per share for 2.0 million shares at the option of the holders at any time after January 2, 2003, and prior to the stated redemption date. The per share market price of the Company's stock on the commitment date (as determined by the closing price on the New York Stock Exchange on the date of issue) was \$7.34. The difference between the market price and strike price of \$5.00, or \$2.34 per share, multiplied by the 2.0 million convertible shares equaled approximately \$4.7 million. Under the Company's adopted intrinsic value method, applicable accounting principles require that this amount, which represents the beneficial conversion feature, be recorded as both a component of paid-in capital and a discount from the \$10 million.

Initially, the conversion feature was amortized over the ten-year term of the notes. The subordinated note defaults triggered an acceleration of the discount amortization over the remaining term of the senior debt, which is currently set to mature in October 2004. That shorter amortization time frame was determined to be appropriate as the notes are subordinate to the credit facility and, accordingly, no payoff of those notes could occur before the debt of the senior creditors is addressed.

The carrying value of the notes at August 27, 2003, net of the unamortized discount, was approximately \$7.0 million. The comparative carrying value of the notes at August 28, 2002, was approximately \$5.9 million.

#### *Interest Expense*

Total interest expense incurred for 2003, 2002, and 2001 was \$10.3 million, \$10.3 million, and \$12.0 million, respectively. Excluding the deferred interest payments and the debt discount amortization on the Company's subordinated notes described above, interest paid approximated \$8.8 million, \$9.8 million, and \$11.9 million in fiscal 2003, 2002, and 2001, respectively.

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Interest expense of approximately \$2.7 million, \$2.6 million, and \$3.5 million, in fiscal years 2003, 2002, and 2001, respectively, has been allocated to discontinued operations based upon the debt that is required to be repaid as a result of the disposal transactions.

The amount of interest cost capitalized on qualifying properties in 2001 was \$336,000. No amounts were capitalized on qualifying properties in 2003 or 2002.

#### **Note 7. Impairment of Long-Lived Assets and Store Closings**

In accordance with Company guidelines, management periodically reviews the financial performance of each store for indicators of impairment or indicators that closure would be appropriate. Where indicators are present, such as three full fiscal years of negative cash flows or other unfavorable market conditions, the carrying values of assets are written down to the estimated future discounted cash flows or fully written off in the case of negative cash flows anticipated in the future. Estimated future cash flows are based upon regression analyses generated from similar Company restaurants, discounted at the Company's weighted-average cost of capital.

In fiscal 2003, 2002, and 2001, the Company recorded charges to continuing operations of \$2.1 million, \$271,000, and \$30.4 million, respectively, for asset impairment and store-closure costs. Relative to fiscal 2003, the Company incurred impairment charges of approximately \$2.3 million, offset by the gains on the sale of other properties of approximately \$223,000. These charges related primarily to leased properties designated for closure under the new business plan that did not meet the property held for sale criteria under SFAS 144, as the units are currently in operation and will remain open during initial lease negotiations.

No restaurants were impaired during fiscal 2002. The Company closed one restaurant not previously designated for closure. The net provision for asset impairment and restaurant closings included the labor termination costs and the loss associated with closing the restaurant, which were both offset by the charge reversals for two lease settlements that were slightly more favorable than originally anticipated.

#### ***Fiscal 2003 Restaurant Impairments and Closings***

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations for a Disposal of a Segment of a Business." SFAS 144 establishes a single accounting model for long-lived assets to be disposed of by sales and broadens the presentation of discontinued operations to include more disposal transactions. The Company adopted SFAS 144 in the first quarter of fiscal 2003, as required.

In the third quarter of fiscal 2003, the Company finalized and began implementing a business plan, which calls for the closure of approximately 50 of the Company's operating stores. In cases where those properties are owned by the Company, the proceeds from the sale of the properties are being used to pay down bank debt under the existing agreement. In cases where the properties are leased, the Company has settled leases, is pursuing lease settlement negotiations, or will allow lease terms to expire in the near future. Most lease settlement negotiations are expected to be completed by the end of the 2004 fiscal year.

Of the approximately 50 stores identified in the new business plan, 43 have been closed as of August 27, 2003. In accordance with the plan, the entire fiscal activity of the applicable stores closed through the end of the 2003 fiscal year were reclassified to discontinued operations. For comparison purposes, in prior fiscal years the entire activity for the same locations closed in fiscal 2003 have also been reclassified to discontinued operations.

The operating results of 43 closed stores for all periods presented have been reclassified and reported as discontinued operations. Total charges to discontinued operations were \$30.6 million, \$6.8 million, and \$6.0 million in fiscal 2003, 2002, and 2001, respectively. Included in discontinued operations, primarily charged within the third quarter of fiscal 2003, were noncash impairment charges of approximately \$19.2 million, offset by gains on the sale of properties of \$2.1 million, for a net impairment charge of \$17.1 million.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

After the original designation of stores, two were removed from the list and replaced by two other locations. Specifically, one in Bossier City, Louisiana, and one in Houston, Texas, were neutrally exchanged for one location in San Antonio, Texas, and one in Lufkin, Texas.

The following are the sales and pretax losses reported in discontinued operations for the 43 closed stores:

|   | Quarter Ended                   |                                 | Year Ended                       |                                  |
|---|---------------------------------|---------------------------------|----------------------------------|----------------------------------|
|   | August 27,<br>2003<br>(84 days) | August 28,<br>2002<br>(84 days) | August 27,<br>2003<br>(364 days) | August 28,<br>2002<br>(362 days) |
|   | (In thousands)                  |                                 |                                  |                                  |
| Sales   | \$2,496                         | \$18,887                        | \$40,950                         | \$64,592                         |
| Pretax losses — including noncash impairments | (3,249)                         | (3,302)                         | (30,560)                         | (10,500)                         |

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

Pursuant to the new business plan and expectations of its bank group, the Company is committed to applying the proceeds from the sales of closed restaurants to pay down its credit-facility debt. Of the total paid down in the fourth quarter of fiscal 2003, \$10.6 million resulted from sales proceeds for which their financial results were charged to discontinued operations.

As of August 27, 2003, the Company also had \$29.5 million of its property held for sale related to closed stores, with results included in discontinued operations. Management therefore estimated the total proceeds related to the business plan disposals and to the discontinued operations was the combined amount of \$40.1 million.

In accordance with Emerging Issues Task Force (EITF) 87-24, "Allocation of Interest to Discontinued Operations," interest on debt that is required to be repaid as a result of a disposal transaction should be allocated to discontinued operations. Accordingly, the Company has reclassified approximately \$2.7 million, \$2.6 million, and \$3.5 million in interest expense to that category in fiscal 2003, 2002, and 2001, respectively. The basis of the reclassifications was an application of the credit facility's historical effective interest rates to a portion of the estimated total debt to be paid down with property proceeds from the sale of locations included in discontinued operations.

The Company does not accrue employee settlement costs; these charges are expensed as incurred.

As the Company has formally settled lease terminations or has reached definitive terms to terminate leases, the related charges have been recorded. As of August 27, 2003, the Company had accrued approximately \$1.5 million in lease settlement costs. The Company did not accrue future rental costs in instances where locations closed, yet management has the ability to sublease.

***Fiscal 2002 Property Held for Sale***

At August 28, 2002, the Company had \$8.1 million in property held for sale. This included nine closed restaurants and six undeveloped land sites that related to prior disposal plans. The results of those locations are included in continuing operations. Of this amount, six properties, or \$3.5 million, remained unsold as of August 27, 2003. The Company remains committed to selling these properties by the end of 2004 and using the proceeds to pay down debt.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

***Reserve for Restaurant Closings***

At August 27, 2003, and August 28, 2002, the Company had a reserve for restaurant closings of \$1.7 million and \$3.1 million, respectively. The reserve balances as of both fiscal year-ends related to the 2001 asset disposal plan. All material cash outlays associated with earlier disposal plans were completed in the 2001 fiscal year.

The remaining balance as of fiscal 2003 related to pending lease negotiations from the 2001 plan. The following is a summary of the types and amounts recognized as accrued expenses or accrual reductions together with cash payments made against such accruals for the three years ended August 27, 2003:

|                        | <b>Reserve Balance</b>                |  |                                |                             |                          |
|------------------------|---------------------------------------|--|--------------------------------|-----------------------------|--------------------------|
|                        | <b>Lease<br/>Settlement<br/>Costs</b> | <b>Legal and<br/>Professional<br/>Fees</b> | <b>Workforce<br/>Severance</b> | <b>Other<br/>Exit Costs</b> | <b>Total<br/>Reserve</b> |
|                        | (In thousands)                        |  |                                |                             |                          |
| As of August 31, 2000  | \$ 765                                | \$ 375                                     | \$ 375                         | \$ 300                      | \$ 1,815                 |
| Additions (reductions) | 4,196                                 | (375)                                      | (59)                           | 693                         | 4,455                    |
| Cash payments          | <u>(755)</u>                          | <u>—</u>                                   | <u>(316)</u>                   | <u>(693)</u>                | <u>(1,764)</u>           |
| As of August 31, 2001  | 4,206                                 | —  | —                              | 300                         | 4,506                    |
| Additions (reductions) | (373)                                 | —  | —                              | —                           | (373)                    |
| Cash payments          | <u>(856)</u>                          | <u>—</u>                                   | <u>—</u>                       | <u>(163)</u>                | <u>(1,019)</u>           |
| As of August 28, 2002  | 2,977                                 | —  | —                              | 137                         | 3,114                    |
| Additions (reductions) | (1,163)                               | —  | —                              | (78)                        | (1,241)                  |
| Cash payments          | <u>(151)</u>                          | <u>—</u>                                   | <u>—</u>                       | <u>(59)</u>                 | <u>(210)</u>             |
| As of August 27, 2003  | <u>\$ 1,663</u>                       | <u>\$ —</u>                                | <u>\$ —</u>                    | <u>\$ —</u>                 | <u>\$ 1,663</u>          |

**Note 8. Commitments and Contingencies**

***Officer Loans***

In fiscal 1999, the Company guaranteed loans of approximately \$1.9 million relating to purchases of Luby's stock by various officers of the Company pursuant to the terms of a shareholder-approved plan. Under the officer loan program, shares were purchased and funding was obtained from JPMorgan Chase Bank, one of the four members of the bank group that participate in the Company's credit facility. Per the original terms of the agreements, these instruments only required annual interest to be paid by the individual debtors, with the entire principal balances due upon their respective maturity dates, which occur during the period from January through March of 2004, unless extended by the note holders.

At both August 27, 2003, and August 28, 2002, the notes had a combined outstanding balance of approximately \$1.6 million. The underlying guarantee on these loans includes a cross-default provision. The Company received notice from JPMorgan Chase Bank that the default in the Company's credit facility led to a default in the officer loans. JPMorgan Chase Bank initially requested that the Company repurchase the notes; however, such action cannot be completed without comprehensive resolution with the entire bank group. On July 10, 2003, JPMorgan Chase Bank notified the Company that although it continues to reserve all rights and remedies, it has not elected to pursue those rights and remedies in order to allow further discussions among the bank group. This notice did not constitute a waiver. The Company is therefore working constructively with all members of the bank group in an effort to cure all defaults and satisfactorily meet each lender's expectations.

In the event of individual debtor default, the Company could be required to purchase the loans from JPMorgan Chase Bank, become holder of the notes, record the receivables, and pursue collection. The purchased Company stock has been and can be used by borrowers to satisfy a portion of their loan obligation. As of August 27, 2003, based on the market price on that day, approximately \$213,000, or 13.2% of the note balances, could have been covered by stock, while approximately \$1.4 million, or 86.8%, would have remained outstanding.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

***Pending Claims***

The Company is presently, and from time to time, subject to pending claims and lawsuits arising in the ordinary course of business. In the opinion of management, the resolution of any pending legal proceedings will not have a material adverse effect on the Company's operations or consolidated financial position.

***Surety Bonds***

At August 27, 2003, surety bonds in the amount of \$6.0 million have been issued as security for the payment of insurance obligations classified as accrued expenses on the balance sheet.

**Note 9. Leases**

The Company conducts part of its operations from facilities that are leased under noncancelable lease agreements. Approximately 90.8% of the leases contain renewal options ranging from five to thirty years.

Most leases include periodic escalation clauses. In accordance with those clauses, the Company records increases in rent expense as they become applicable. Accordingly, the Company does not follow the straight-line rent method as prescribed by SFAS 13 under generally accepted accounting principles; however, management does not believe the variation from the straight-line method is material to the Company's results of operations and financial position.

Annual future minimum lease payments under noncancelable operating leases as of August 27, 2003, are as follows:

| <u>Year Ending:</u>          | <u>(In thousands)</u> |
|------------------------------|-----------------------|
| August 25, 2004              | \$ 5,098              |
| August 31, 2005              | 4,719                 |
| August 30, 2006              | 4,250                 |
| August 29, 2007              | 3,763                 |
| August 27, 2008              | 3,478                 |
| Thereafter                   | <u>16,484</u>         |
| Total minimum lease payments | <u>\$37,792</u>       |

Most of the leases are for periods of ten to twenty-five years and provide for contingent rentals based on sales in excess of a base amount. Total rent expense for operating leases for the last three fiscal years was as follows:

|                    | <u>Year Ended</u>          |                            |                            |
|--------------------|----------------------------|----------------------------|----------------------------|
|                    | <u>August 27,<br/>2003</u> | <u>August 28,<br/>2002</u> | <u>August 31,<br/>2001</u> |
|                    | <u>(In thousands)</u>      |                            |                            |
| Minimum rentals    | \$6,112                    | \$6,512                    | \$6,914                    |
| Contingent rentals | <u>507</u>                 | <u>770</u>                 | <u>437</u>                 |
|                    | <u>\$6,619</u>             | <u>\$7,282</u>             | <u>\$7,351</u>             |
| Percent of sales   | <u>2.1%</u>                | <u>2.2%</u>                | <u>1.9%</u>                |

See Note 13 for lease payments associated with related parties.

**Note 10. Employee Benefit Plans and Agreements**

***Executive Stock Options***

In connection with their employment agreements effective March 9, 2001, the CEO and the COO were granted approximately 2.2 million stock options at a strike price of \$5.00 per share, which was below the quoted

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

market price on the date of grant. From that date through fiscal 2004, the Company will recognize a total of \$5.2 million in noncash compensation expense associated with these options. Totals of \$1.3 million were recognized for both fiscal 2003 and 2002, respectively. Of the \$5.2 million to be recognized, \$4.6 million has been recognized to date, while \$679,000 remains to be amortized.

***All Stock Options***

The Company has an incentive stock plan to provide for market-based incentive awards, including stock options, stock appreciation rights, and restricted stock. Under this plan, stock options may be granted at prices not less than 100% of fair market value on the date of grant. Options granted to the participants of the plan are exercisable over staggered periods and expire, depending upon the type of grant, in five to ten years. The plan provides for various vesting methods, depending upon the category of personnel.

During 1999, the Company authorized 2.0 million shares of the Company's common stock for a new plan. Under its terms, including the 1999 authorization, nonqualified stock options, incentive stock options, and other types of awards for not more than 4.9 million shares of the Company's common stock may be granted to eligible employees of the Company. As previously stated, the Company also granted 2.2 million options to the CEO and the COO in conjunction with their employment agreements. Neither individual has exercised any of those options.

The following is a summary of activity in the Company's incentive stock plan and the executive stock options for the three years ended August 27, 2003, August 28, 2002, and August 31, 2001:

|                            | <b>Weighted-Average<br/>Exercise Price Per<br/>Share — Options<br/>Outstanding</b> | <b>Options<br/>Outstanding</b> |
|----------------------------|--|--------------------------------|
| Balances — August 31, 2000 | \$15.30  | 2,295,541                      |
| Granted                    | 5.26   | 2,958,000                      |
| Cancelled or expired       | 13.95  | (747,300)                      |
| Exercised                  | —  | —                              |
| Balances — August 31, 2001 | 8.93   | 4,506,241                      |
| Granted                    | 6.21   | 133,500                        |
| Cancelled or expired       | 14.10  | (435,306)                      |
| Exercised                  | 5.44   | (10,100)                       |
| Balances — August 28, 2002 | 8.31   | 4,194,335                      |
| Granted                    | 1.98   | 28,000                         |
| Cancelled or expired       | 12.49  | (302,737)                      |
| Balances — August 27, 2003 | \$ 7.96  | <u>3,919,598</u>               |

**Balances of Exercisable Options as of:**

|                 |           |
|-----------------|-----------|
| August 31, 2001 | 1,441,490 |
| August 28, 2002 | 2,242,095 |
| August 27, 2003 | 3,029,098 |

Exercise prices for options outstanding as of August 27, 2003, range from \$1.98 to \$22.75 per share. The weighted-average remaining contractual life of these options is 5.35 years. Excluding 1,680,000 executive stock options with an exercise price of \$5.00 per share, the exercisable options as of August 27, 2003, have a weighted-average exercise price of \$13.09 per share.

LUBY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Options Outstanding and Exercisable by Price Range  
As of August 27, 2003

| Range of Exercise Prices | Options Outstanding              |   |                                 | Options Exercisable              |                                 |
|--------------------------|----------------------------------|---|---------------------------------|----------------------------------|---------------------------------|
|                          | Number Outstanding As of 8/27/03 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable As of 8/27/03 | Weighted Average Exercise Price |
| \$ 1.9800 - \$ 1.9800    | 28,000                           | 9.43  | \$1.9800                        | 0                                | \$ 0                            |
| 5.0000 - 5.0000          | 2,240,000                        | 7.53  | 5.0000                          | 1,680,000                        | 5.0000                          |
| 5.4375 - 6.6500          | 395,150                          | 3.57  | 5.5576                          | 211,275                          | 5.5326                          |
| 6.7000 - 12.0625         | 395,750                          | 3.22  | 10.2761                         | 292,125                          | 10.4491                         |
| 13.9375 - 15.4375        | 677,887                          | 1.44  | 15.1130                         | 662,887                          | 15.1056                         |
| 15.9375 - 18.0625        | 49,979                           | 1.82  | 16.5710                         | 49,979                           | 16.5710                         |
| 19.1250 - 19.1250        | 109,500                          | 0.28  | 19.1250                         | 109,500                          | 19.1250                         |
| 20.2500 - 20.2500        | 10,000                           | 3.38  | 20.2500                         | 10,000                           | 20.2500                         |
| 21.6250 - 21.6250        | 5,000                            | 2.38  | 21.6250                         | 5,000                            | 22.6250                         |
| 22.7500 - 22.7500        | <u>8,332</u>                     | <u>0.13</u>                                 | <u>22.7500</u>                  | <u>8,332</u>                     | <u>22.7500</u>                  |
| \$ 1.9800 - \$22.7500    | <u><u>3,919,598</u></u>          | <u><u>5.35</u></u>                          | <u><u>\$7.9564</u></u>          | <u><u>3,029,098</u></u>          | <u><u>\$ 8.6023</u></u>         |

At August 27, 2003, and August 28, 2002, the number of incentive stock option shares available to be granted under the plans was 935,966 and 653,561 shares, respectively.

The weighted-average fair value of the individual options granted during 2003, 2002, and 2001 was estimated at \$0.94, \$3.38, and \$3.16, respectively, on the date of grant. The fair values were determined using a Black-Scholes option pricing model with the following assumptions:

|                         | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|-------------------------|-------------|-------------|-------------|
| Dividend yield          | —%          | —%          | —%          |
| Volatility              | 0.51        | 0.35        | 0.41        |
| Risk-free interest rate | 3.02%       | 3.56%       | 4.44%       |
| Expected life           | 5.00        | 6.18        | 8.65        |

**Supplemental Executive Retirement Plan**

The Company has a Supplemental Executive Retirement Plan (SERP) for key executives and officers. The SERP is a “target” benefit plan, with the annual lifetime benefit based upon a percentage of average salary during the final five years of service at age 65, offset by several sources of income including benefits payable under deferred compensation agreements, if applicable, the profit sharing plan, and Social Security. SERP benefits will be paid from the Company’s assets. The net expense incurred for this plan for the years ended August 27, 2003, August 28, 2002, and August 31, 2001, was \$67,000, \$64,000, and \$296,000, respectively, and the unfunded accrued pension liability as of August 27, 2003, August 28, 2002, and August 31, 2001, was approximately \$709,000, \$665,000, and \$622,000, respectively.

**401(k) Plan**

The Company also has a voluntary 401(k) employee savings plan to provide substantially all employees of the Company an opportunity to accumulate personal funds for their retirement. These contributions may be made on a pre-tax basis to the plan, and the Company matches 25% of participants’ contributions of up to 4% of their salary. The net expense recognized in connection with the employer match feature of the voluntary 401(k) employee savings plan for the years ended August 27, 2003, August 28, 2002, and August 31, 2001, was \$252,000, \$311,000, and \$270,000, respectively.

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### *Deferred Compensation Plan*

During 1999, the Company established a nonqualified deferred compensation plan for highly compensated executives allowing deferral of a portion of their annual salary and up to 100% of bonuses before taxes. The Company does not match any deferral amounts and retains ownership of all assets until distributed. The liability under this deferred compensation plan at August 27, 2003, August 28, 2002, and August 31, 2001, was approximately \$57,000, \$54,000, and \$70,000, respectively. The Company terminated the plan after the end of fiscal 2003, and the funds will be distributed in fiscal 2004.

#### *Profit Sharing Plan*

After the end of fiscal 2003, the Company initiated steps to terminate the Company's profit sharing and retirement plan (the Plan). The Company intends to complete the termination process, including distributions to all Plan participants in fiscal 2004. Through fiscal 2003, the Plan covered substantially all employees who had attained the age of 21 years and had completed one year of continuous service. It was administered by a corporate trustee, was a "qualified plan" under Section 401(a) of the Internal Revenue Code, and provided for the payment of the employee's vested portion of the Plan upon retirement, termination, disability, or death. The Plan had been funded by contributions of a portion of the net earnings of the Company and was amended effective August 31, 2001, to make all contributions discretionary. No annual contributions to the Plan were made in fiscal 2003, 2002 or 2001.

#### **Note 11. Derivative Financial Instruments**

The Company adopted Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities," and its amendments, Statement Nos. 137 and 138, on September 1, 2000. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at fair value. Pursuant to this Standard, the Company designated its Interest Rate Protection Agreements (Swaps) as cash flow hedge instruments. Swaps were used to manage exposure to interest rate movement by effectively changing the variable rate to a fixed rate. The critical terms of the Swaps and the interest-bearing debt associated with the Swaps were the same; therefore, the Company concluded that there was no ineffectiveness in the hedge relationship. Due to declining interest rates and in anticipation of additional future unfavorable interest rate changes, the Company terminated the Swaps on July 2, 2001, for a cash payment of \$1.3 million, including accrued interest of \$163,000. Changes in fair value of the Swaps were recognized in other comprehensive income (loss), net of tax effects, until the hedged items were recognized in earnings.

In accordance with SFAS 133, the loss of \$1.1 million was recognized as interest expense over the original term of the Swaps (through June 30, 2002). At August 28, 2002, there was no balance in accumulated other comprehensive loss.

#### **Note 12. Comprehensive Income (Loss)**

As noted above, due to the decline in interest rates and in anticipation of additional unfavorable interest rate changes, the Company terminated the Swaps on July 2, 2001. The loss associated with the termination was recognized as interest expense over the original term of the swaps, through June 30, 2002. At August 28, 2002, there was no balance in accumulated other comprehensive loss. The Company did not acquire any additional swaps in fiscal 2003.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The Company's comprehensive (loss) was comprised of net (loss) and adjustments to derivative financial instruments. The components of the comprehensive (loss) were as follows:

|  | <b>August 27,<br/>2003</b> | <b>August 28,<br/>2002</b> | <b>August 31,<br/>2001</b> |
|--|----------------------------|----------------------------|----------------------------|
|  | (In thousands)             |                            |                            |
| Net (loss)   | \$(33,094)                 | \$(9,653)                  | \$(31,881)                 |
| Other comprehensive (loss), net of taxes:  |                            |                            |                            |
| Cumulative effect of a change in accounting for derivative financial instruments upon adoption of SFAS 133, net of taxes of \$61 | —                          | —                          | 114                        |
| Net derivative loss, net of taxes of \$514   | —                          | —                          | (958)                      |
| Reclassification adjustment for loss included in net income (loss), net of taxes of \$71   | —                          | —                          | 133                        |
| Reclassification adjustment for loss recognized on termination of interest rate swaps, net of taxes of \$64                      | —                          | —                          | 119                        |
| Reclassification adjustment for loss recognized on termination of interest rate swaps, net of taxes of \$318                     | —                          | 592                        | —                          |
| Comprehensive income (loss)  | \$(33,094)                 | \$(9,061)                  | \$(32,473)                 |

**Note 13. Related Parties**

*Affiliate Services*

The CEO and COO of the Company, Christopher J. Pappas and Harris J. Pappas, respectively, own two restaurant entities that may provide services to Luby's, Inc. as detailed in the Affiliate Services Agreement and the Master Sales Agreement. Under the terms of the Affiliate Services Agreement, the Pappas entities may provide accounting, architectural, and general business services. In the current fiscal year, no costs were incurred under the Affiliate Services Agreement. Under the terms of the Master Sales Agreement, the Pappas entities may provide specialized (customized) equipment fabrication and basic equipment maintenance, including stainless steel stoves, shelving, rolling carts, and chef tables. The total cost under the Master Sales Agreement of custom-fabricated and refurbished equipment for fiscal 2003 and 2002 was approximately \$174,000 and \$506,000, respectively. As of this report date, all amounts charged under the agreements through August 27, 2003, have been paid.

*Operating Leases*

In a separate contract from the Affiliate Services Agreement and the Master Sales Agreement, the Company entered into a three-year lease which commenced on June 1, 2001, and ends May 31, 2004. The leased property, referred to as the Houston Service Center, is used to accommodate the Company's own in-house repair and fabrication center. The amount paid by the Company pursuant to the terms of this lease was approximately \$79,000 and \$78,000 for fiscal 2003 and 2002, respectively.

The Company previously leased a location from an unrelated third party. That location is used to house increased equipment inventories due to store closures under the business plan. The Company considered it more prudent to lease this location rather than to pursue purchasing a storage facility, as its strategy is to focus its capital expenditures on its operating restaurants. In a separate transaction, the third-party property owner sold the location to the Pappas entities during the fourth quarter of fiscal 2003, with the Pappas entities becoming the Company's landlord for that location. The storage site complements the Houston Service Center with approximately 27,000 square feet of warehouse space at an approximate monthly rate of \$0.21 per square foot.

In another separate contract, pursuant to the terms of a ground lease dated March 25, 1994, the Company paid rent to PHCG Investments for a Luby's restaurant the Company operated in Dallas, Texas, until that location was closed early in the third quarter of fiscal 2003. Christopher J. Pappas and Harris J. Pappas are general

## LUBY'S, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

partners of PHCG Investments. Preceding the store's closure, the Company entered into a lease termination agreement with a third party unaffiliated with the Pappas entities. That agreement severed the Company's interest in the PHCG property in exchange for a payment of cash. The Company also obtained the right to remove fixtures and equipment from the premises, and it was released from any future obligations under the lease agreement. The closing of the transaction was completed during the third quarter of fiscal 2003, resulting in a gain of \$735,000, and the gross proceeds were used to pay down debt. The amount paid by the Company pursuant to the terms of this lease before its termination was approximately \$42,000 and \$85,000 for the years ended August 27, 2003, and August 28, 2002, respectively.

Affiliated rents paid for the Houston Service Center, the separate storage facility, and the Dallas property leases combined represented 2.4% and 2.9% of total rents for continuing operations for fiscal 2003 and fiscal 2002, respectively.

#### *Subordinated Debt*

As described in Note 6 in the section entitled "Subordinated Debt," the CEO and the COO loaned the Company a total of \$10 million in the form of convertible subordinated notes to support the Company's future operating cash needs. The entire balance was outstanding as of August 27, 2003. The debt is reported net of a discount.

#### *Board of Directors*

Pursuant to the terms of a separate Purchase Agreement dated March 9, 2001, entered into by and among the Company, Christopher J. Pappas and Harris J. Pappas, the Company agreed to submit three persons designated by Christopher J. Pappas and Harris J. Pappas as nominees for election for directors. Messrs. Pappas designated themselves and Frank Markantonis as their nominees for directors, all of whom were subsequently elected. Christopher J. Pappas and Harris J. Pappas are brothers. As disclosed in the proxy statement for the January 31, 2003, annual meeting of shareholders, Frank Markantonis is an attorney whose principal client is Pappas Restaurants, Inc., an entity owned by Harris J. Pappas and Christopher J. Pappas.

#### *Key Management Personnel*

Ernest Pekmezaris, the Chief Financial Officer of the Company, is also the Treasurer of Pappas Restaurants, Inc. Compensation for the services provided by Mr. Pekmezaris to Pappas Restaurants, Inc. is paid entirely by that entity.

Peter Tropoli, the Senior Vice President-Administration of the Company, is an attorney who, from time to time, has provided litigation services to entities controlled by Christopher J. Pappas and Harris J. Pappas. Mr. Tropoli is the stepson of Frank Markantonis, who, as previously mentioned, is a director of the Company.

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

#### **Note 14. Common Stock**

In 1991, the Board of Directors adopted a Shareholder Rights Plan and declared a dividend of one common stock purchase right for each outstanding share of common stock. The rights are not initially exercisable. The Company amended the Shareholder Rights Plan effective March 8, 2001. The rights may become exercisable under circumstances described in the plan if any person or group becomes the beneficial owner of 15% or more of the common stock or announces a tender or exchange offer, the completion of which would result in the ownership by a person or group of 15% or more of the common stock (either, an Acquiring Person). Once the rights become exercisable, each right will be exercisable to purchase, for \$27.50 (the Purchase Price), one-half of one share of common stock, par value \$.32 per share, of the Company. If any person becomes an Acquiring Person, each right will entitle the holder, other than the Acquiring Person, to acquire for the Purchase Price a number of shares of the Company's common stock having a market value of four times the Purchase Price.

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

In connection with the employment of Christopher J. Pappas, the Company's President and Chief Executive Officer, and Harris J. Pappas, the Company's Chief Operating Officer, the Shareholder Rights Plan was amended to exempt from the operation of the plan Messrs. Pappas' ownership of the Company's common stock, which was acquired prior to March 8, 2001 (and certain additional shares permitted to be acquired) and certain shares of common stock which may be acquired in connection with options issued on the date of their employment and the convertible notes subsequently purchased from the Company.

In the past, the Board of Directors periodically authorized the purchase, in the open market, of shares of the Company's outstanding common stock. The most recent authorization was a purchase of 850,300 shares of the Company's common stock at a cost of \$12,919,000 in 1999, which are being held as treasury stock. There have been no treasury shares purchased since 1999.

The Company has approximately 3.9 million shares of common stock reserved for issuance upon the exercise of outstanding stock options and 2.0 million shares for issuance upon the conversion of subordinated notes.

**Note 15. Per Share Information**

A reconciliation of the numerators and denominators of basic earnings per share and earnings per share assuming dilution is shown in the table below:

|   | Year Ended         |                    |                    |
|---|--------------------|--------------------|--------------------|
|   | August 27,<br>2003 | August 28,<br>2002 | August 31,<br>2001 |
|   | (In thousands)     |                    |                    |
| Numerator:  |                    |                    |                    |
| Net income (loss)   | \$(33,094)         | \$(9,653)          | \$(31,881)         |
| Effect of potentially dilutive securities:  |                    |                    |                    |
| Interest on convertible subordinated notes  | <u>1,054</u>       | <u>585</u>         | <u>194</u>         |
| Numerator for net income (loss) per common share — diluted                                | <u>\$(32,040)</u>  | <u>\$(9,068)</u>   | <u>\$(31,687)</u>  |
| Denominator for basic earnings per share — weighted-average shares                        |                    |                    |                    |
|   | 22,451             | 22,428             | 22,422             |
| Effect of potentially dilutive securities:  |                    |                    |                    |
| Employee stock options  | 3                  | 165                | 96                 |
| Convertible subordinated notes  | <u>2,000</u>       | <u>2,000</u>       | <u>312</u>         |
| Denominator for earnings per share — assuming dilution — adjusted weighted-average shares | <u>24,454</u>      | <u>24,593</u>      | <u>22,830</u>      |
| Net income (loss) per share — basic   | <u>\$ (1.47)</u>   | <u>\$ (0.43)</u>   | <u>\$ (1.42)</u>   |
| Net income (loss) per share — assuming dilution <sup>(a)</sup>                            | <u>\$ (1.47)</u>   | <u>\$ (0.43)</u>   | <u>\$ (1.42)</u>   |

<sup>(a)</sup> As the Company had net losses for the years ended August 27, 2003, August 28, 2002, and August 31, 2001, earnings per share assuming dilution equals basic earnings per share since potentially dilutive securities are antidilutive in loss periods.

**Note 16. Quarterly Financial Information (Unaudited)**

The sales and gross profit components of the Company's quarterly financial statements have been affected by reclassifications to discontinued operations in accordance with the disposal of operating units under the Company's new business plan. Even so, the Company's net loss per share for each quarter is consistent with

**LUBY'S, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

previous quarterly filings. The following is a summary of quarterly unaudited financial information for 2003 and 2002, including those reclassifications:

|                             | <u>Quarter Ended</u>                 |                              |                                    |                                    |
|-----------------------------|--------------------------------------|------------------------------|------------------------------------|------------------------------------|
|                             | <u>August 27,</u><br><u>2003</u>     | <u>May 7,</u><br><u>2003</u> | <u>February 12,</u><br><u>2003</u> | <u>November 20,</u><br><u>2002</u> |
|                             | (112 days)                           | (84 days)                    | (84 days)                          | (84 days)                          |
|                             | (In thousands except per share data) |                              |                                    |                                    |
| Sales                       | \$96,743                             | \$ 74,208                    | \$73,899                           | \$73,671                           |
| Gross profit                | 43,644                               | 32,858                       | 31,722                             | 30,833                             |
| Discontinued operations     | (3,249)                              | (21,990)                     | (2,393)                            | (2,928)                            |
| Net income (loss)           | <u>(1,598)</u>                       | <u>(24,990)</u>              | <u>(3,405)</u>                     | <u>(3,101)</u>                     |
| Net income (loss) per share | <u>\$ (0.07)</u>                     | <u>\$ (1.11)</u>             | <u>\$ (0.15)</u>                   | <u>\$ (0.14)</u>                   |

|                             | <u>Quarter Ended</u>                 |                              |                                    |                                    |
|-----------------------------|--------------------------------------|------------------------------|------------------------------------|------------------------------------|
|                             | <u>August 28,</u><br><u>2002</u>     | <u>May 8,</u><br><u>2002</u> | <u>February 13,</u><br><u>2002</u> | <u>November 21,</u><br><u>2001</u> |
|                             | (112 days)                           | (84 days)                    | (84 days)                          | (82 days)                          |
|                             | (In thousands except per share data) |                              |                                    |                                    |
| Sales                       | \$100,657                            | \$78,311                     | \$76,391                           | \$79,114                           |
| Gross profit                | 42,503                               | 35,257                       | 33,199                             | 31,270                             |
| Discontinued operations     | (2,147)                              | (1,181)                      | (1,488)                            | (2,009)                            |
| Net income (loss)           | <u>(1,972)</u>                       | <u>(174)</u>                 | <u>(2,162)</u>                     | <u>(5,345)</u>                     |
| Net income (loss) per share | <u>\$ (0.09)</u>                     | <u>\$ (0.01)</u>             | <u>\$ (0.09)</u>                   | <u>\$ (0.24)</u>                   |

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

### **Item 9A. Controls and Procedures**

In fiscal 2003, the Company established an internal Disclosure Committee. The President and CEO, as well as the CFO, with the assistance of the committee, maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. This collective group accumulates and reviews this information, as appropriate, to allow timely decisions regarding required disclosure, applying its judgment in assessing the costs and benefits of such controls and procedures which, by their nature, can provide only reasonable assurance regarding management's control objectives.

Management has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. The Company's President and CEO and the CFO participated and provided input into this process. Based upon the foregoing, these senior officers concluded that as of August 27, 2003, the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company required to be disclosed.

There have been no significant changes in the Company's internal controls or in other factors which could significantly affect internal controls subsequent to the date the President and CEO and the CFO carried out their evaluation.

## **PART III**

### **Item 10. Directors and Executive Officers of the Registrant**

#### **Election of Directors**

The shareholders elect approximately one-third of the members of the Board of Directors annually. The Board is divided into three classes, as nearly equal in number as possible, with the members of each class serving three-year terms. Currently, the Board is comprised of twelve members, four whose terms expire in 2004, four whose terms expire in 2005, and four whose terms expire in 2006.

Robert T. Herres, whose term as director would have expired at the 2004 Annual Meeting of Shareholders, resigned his directorship, effective August 27, 2003. Immediately following his resignation, the class of directors whose terms expire at the 2004 Annual Meeting of Shareholders was comprised of three directors. Since the Bylaws of the Company state that the three classes of directors shall be as nearly equal in number as possible, and the class of directors whose terms expire in 2006 was then comprised of five directors, Jill Griffin resigned from her position in the class whose terms expire in 2006, was appointed by the Board to fill the vacancy in the class whose term expires at the 2004 Annual Meeting of Shareholders.

Pursuant to the terms of the Purchase Agreement dated March 9, 2001, entered into by and among the Company, Christopher J. Pappas and Harris J. Pappas, the Company agreed to submit three persons designated by Christopher J. Pappas and Harris J. Pappas as nominees for election as directors at the 2002 Annual Meeting of Shareholders. Messrs. Pappas designated themselves and Frank Markantonis as their nominees for directors at the 2002 Annual Meeting of Shareholders. The Company is not contractually obligated to nominate Christopher J. Pappas, Harris J. Pappas or Frank Markantonis for election as directors at the 2004 Annual Meeting of Shareholders. Christopher J. Pappas and Harris J. Pappas are brothers. Mr. Markantonis is an attorney whose principal client is Pappas Restaurants, Inc., an entity controlled by Harris J. Pappas and Christopher J. Pappas.

The following information is furnished with respect to each of the directors who currently serve on the Board of Directors. Such information includes all positions with the Company and principal occupations during the last five years.

#### ***Directors Whose Terms Expire in 2006***

J.S.B. JENKINS is President, Chief Executive Officer, and a director of Tandy Brands Accessories, Inc. (manufacturer and marketer of fashion accessories) and has served as such since the company's formation in

1990. He previously served as the Executive Vice President of the Bombay Company, Inc. He is also a member of the Texas A&M University College of Business Administration/Graduate School of Business Development Council, the Texas A&M University President's Council, the advisory board of directors for the Texas A&M University 12th Man Foundation, and the board of directors for the Cotton Bowl Athletic Association. He is 60 years of age and has been a director of the Company since January of 2003. He is Vice-Chairman of the Finance and Audit Committee.

JOE C. MCKINNEY is Vice-Chairman of Broadway National Bank (since October 1, 2002). He formerly served as Chairman of the Board and Chief Executive Officer of JPMorgan Chase Bank-San Antonio (commercial banking) until his retirement on March 31, 2002. He is 57 years of age and has been a director of the Company since January of 2003. He is a director of Tampa Equities REIT I (USAA), Washington Real Estate Equities REIT I (USAA), Houston Equities REIT I (USAA), and U.S. Industrial REIT (USAA). He is Chairman of the Finance and Audit Committee and a member of the Board Governance Committee and the Executive Committee.

HARRIS J. PAPPAS is Chief Operating Officer of the Company (since March 7, 2001). He is 59 and has been a director of the Company since March of 2001. He is also President of Pappas Restaurants, Inc. He is a director of Oceaneering International, Inc., Memorial Hermann Affiliated Services, Inc., and the YMCA of Greater Houston. He is also an advisory trustee of Schreiner's College and an advisory board member of Frost National Bank-Houston. He is a member of the Executive Committee and the Personnel and Administrative Policy Committee.

JOANNE WINIK is President, General Manager, and a director of KLRN-TV, San Antonio's Public Broadcasting Service affiliate. She is a director of PBS (Public Broadcasting System). She is 64 and has been a director of the Company since January of 1993. She is Vice-Chairman of the Personnel and Administrative Policy Committee and a member of the Executive Compensation Committee.

#### ***Directors Whose Terms Expire in 2005***

JUDITH B. CRAVEN is President of JAE & Associates US. She was President of United Way of the Texas Gulf Coast (from 1992 to 1998). She is 58 and has been a director of the Company since 1998. She is a director of A.H. Belo Corporation, Sysco Corporation, and Valic Corp. and serves on the Board of Regents of the University of Texas at Austin. She is Chairman of the Personnel and Administrative Policy Committee, Vice-Chairman of the Executive Compensation Committee, and a member of the Board Governance Committee and the Executive Committee.

ARTHUR R. EMERSON is Chairman/CEO of Groves Rojas Emerson, an advertising and public relations firm (since June 2000). Prior thereto he was Vice President and General Manager of the Texas Stations of the Telemundo television network. He is a director of USAA Federal Savings Bank and Chairman of its Trust Committee. He is 59 and has been a director of the Company since January of 1998. He is a member of the Finance and Audit Committee.

FRANK MARKANTONIS is an attorney licensed to practice in Texas since 1973. He has worked extensively in the real estate and corporate areas for over 30 years. He is a member of the State Bar of Texas and the District of Columbia Bar. His principal client is Pappas Restaurants, Inc. He is 55 years old and has been a director of the Company since January of 2002. He is a member of the Personnel and Administrative Policy Committee.

GASPER MIR, III is currently serving as Executive Advisor to the Superintendent of the Houston Independent School District. Mr. Mir is a principal owner and founder of the public accounting and professional services firm Mir•Fox & Rodriguez, P.C. (since 1988). He is currently on a leave of absence from the accounting firm. He is 57 and has been a director of the Company since January of 2002. He is a director of the Memorial Hermann Hospital System, Sam Houston Council of Boy Scouts, the American Leadership Foundation, the Houston Hispanic Chamber of Commerce, the Advisory Board of the University of Houston-Downtown School of Business, and the Houston Region Board of Directors of JPMorgan Chase Bank of Texas. He is Chairman of the Luby's Board, Chairman of the Executive Committee and the Board Governance Committee, and a member of the Finance and Audit Committee.

### ***Directors Whose Terms Expire in 2004***

JILL GRIFFIN is a business consultant, an internationally published author, and speaker. She is a principal of the Griffin Group (customer loyalty research, customer relationship program development, and management training), which she founded in 1988. In her early career, she served as senior brand manager for RJR/Nabisco's largest brand. She then joined AmeriSuites Hotels where she served as national director of sales and marketing. She has also served on the marketing faculty at the University of Texas at Austin. She is 48 years of age and has been a director of the Company since January of 2003. She is a member of the Personnel and Administrative Policy Committee and the Executive Compensation Committee.

ROGER R. HEMMINGHAUS is the retired Chairman of Ultramar Diamond Shamrock Corporation where he also served as Chief Executive Officer until 1999 and as President until 1996. He is 67 and has been a director of the Company since January of 1989. He is a director of Tandy Brands Accessories, Inc., CTS Corporation, Excel Energy, Inc., and Southwest Research Institute. He is Vice-Chairman of the Board, Chairman of the Executive Compensation Committee, Vice-Chairman of the Executive Committee, Vice-Chairman of the Board Governance Committee, and a member of the Personnel and Administrative Policy Committee.

CHRISTOPHER J. PAPPAS is President and Chief Executive Officer of the Company (since March 7, 2001). He is also Chief Executive Officer of Pappas Restaurants, Inc. He is 56 and has been a director of the Company since March of 2001. He is a director of the Sam Houston Council of Boy Scouts of America Board, the Southwest Bank of Texas Advisory Board, the University of Houston Conrad Hilton School of Hotel and Restaurant Management Dean's Advisory Board, and is a former director of the Greater Houston Partnership Board. He is a member of the Board Governance Committee and the Executive Committee.

JIM W. WOLIVER is a retired former officer of the Company. He was Senior Vice President-Operations from 1995 to 1997 and Vice President-Operations from 1984 to 1995. He is 66 and has been a director of the Company since January of 2001. He is a member of the Personnel and Administrative Policy Committee and Executive Compensation Committee.

### **Information Concerning the Finance and Audit Committee**

The members of the Finance and Audit Committee are:

Joe C. McKinney (Chair)  
J.S.B. Jenkins (Vice Chair)  
Arthur R. Emerson  
Gasper Mir, III

The Finance and Audit Committee is a standing audit committee established to oversee the Company's accounting and financial reporting processes and the audit of the Company's financial statements. Its primary functions are to monitor and evaluate corporate financial plans and performance and to assist the Board in monitoring (1) the integrity of the financial statements of the Company; (2) the compliance by the Company with legal and regulatory requirements; (3) the independent auditor's qualifications and independence; and (4) the performance of the Company's internal audit function and its independent auditors. The Finance and Audit Committee is also directly responsible for the appointment, compensation, retention and oversight of the work of the Company's independent auditor and the preparation of the Report of the Finance and Audit Committee.

All members of the Finance and Audit Committee are independent as that term is defined in the listing standards of the New York Stock Exchange, as amended by the new corporate governance listing standards approved by the Securities and Exchange Commission on November 4, 2003.

The Board determined that Gasper Mir, III and Joe C. McKinney are "audit committee financial experts" as defined in rules of the Securities and Exchange Commission recently adopted pursuant to the Sarbanes-Oxley Act of 2002. Messrs. Mir and McKinney are independent as that term is defined in the listing standards of the New York Stock Exchange, as such definition has been amended under the new corporate governance listing standards of the New York Stock Exchange.

At each meeting, Committee members have the opportunity to meet privately with representatives of the Company's independent auditors and with the Company's Director of Internal Audit. The Board of Directors has adopted a written charter for the Finance and Audit Committee. A copy of the Finance and Audit Committee

Charter, as amended effective June 26, 2003, will be available on the Company's website at [www.lubys.com](http://www.lubys.com) after January 31, 2004.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors, executive officers, and any persons beneficially owning more than ten percent of the Company's common stock to report their initial ownership of the Company's common stock and any subsequent changes in that ownership to the Securities and Exchange Commission and the New York Stock Exchange, and to provide copies of such reports to the Company. Based upon the Company's review of copies of such reports received by the Company and written representation of its directors and executive officers, the Company believes that during the year ended August 27, 2003, all Section 16(a) filing requirements were satisfied on a timely basis.

### **Corporate Governance**

During fiscal 2003, the Board adopted amendments to the Company's Policy Guide on Standards of Conduct and Ethics, which applies to all directors, officers, and employees of the Company. The Board also adopted Supplemental Standards of Conduct and Ethics that apply to the Company's Chief Executive Officer, Chief Financial Officer, Controller, and all senior financial officers. These documents are included as exhibits to this Annual Report on Form 10-K. After January 31, 2004, these documents can also be found on the Company's website at [www.lubys.com](http://www.lubys.com).

#### ***Code of Conduct and Ethics for All Directors, Officers, and Employees***

During fiscal 2003, the Board amended the existing Policy Guide on Standards of Conduct and Ethics, which is applicable to all directors, officers, and employees, to comply with the new corporate governance standards proposed by the New York Stock Exchange and approved by the Securities and Exchange Commission on November 4, 2003. It is the intent of the Policy Guide on Standards of Conduct and Ethics to promote observance of fundamental principles of honesty, loyalty, fairness and forthrightness and adherence to the letter and spirit of the law. There shall be no waiver of any part of the Policy Guide on Standards of Conduct and Ethics for any director or executive officer except by a vote of the Board or a designated Board committee that shall ascertain whether a waiver is appropriate under all the circumstances. The Company intends to disclose any waivers of the Policy Guide on Standards of Conduct and Ethics granted to directors and executive officers on the Company's website at [www.lubys.com](http://www.lubys.com).

#### ***Code of Ethics for the Chief Executive Officer and Senior Financial Officers***

During fiscal 2003, the Board also adopted Supplemental Standards of Conduct and Ethics that apply to the Company's Chief Executive Officer, Chief Financial Officer, Controller, and all senior financial officers ("Senior Officers' Code"). The Senior Officers' Code is designed to deter wrongdoing and to promote:

Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant;

Compliance with applicable governmental laws, rules and regulations;

The prompt internal reporting to an appropriate person or persons identified in the code of violations of the code; and

Accountability for adherence to the code.

Waivers of the Senior Officers' Code for the Chief Executive Officer, Chief Financial Officer, and the Controller are permitted only by a vote of the Board or a designated Board committee that shall ascertain whether a waiver is appropriate under all the circumstances.

A copy of the Senior Officers' Code is filed as an exhibit to this Annual Report on Form 10-K and will be available at the Company's website at [www.lubys.com](http://www.lubys.com) after January 31, 2004. The Company intends to satisfy the disclosure requirement under Item 10 of Form 8-K regarding amendments to or waivers of the Policy Guide

on Standards of Conduct and Ethics and the Senior Officers' code by posting such information on the Company's website at [www.lubys.com](http://www.lubys.com).

## **Item 11. Executive Compensation**

### **Compensation of Directors**

Each nonemployee director other than the Chairman of the Board is currently paid an annual retainer of \$25,000. The Chairman of the Board is currently paid an annual retainer of \$50,000. In addition to the base annual retainer of \$25,000, the Chairman of the Finance and Audit Committee is currently paid an additional annual retainer of \$3,000, and the Chairman of each other Board committee is currently paid an additional annual retainer of \$1,000. All nonemployee directors are also paid the following meeting fees for each meeting he or she attends: (i) \$1,500 per day for each meeting of the Board, including committee meetings attended on the same day as a meeting of the Board, so long as the total duration of the meeting(s) attended in that day exceeds four hours; (ii) \$750 per day for each meeting of the Board, including committee meetings attended on the same day as a meeting of the Board, if the meeting is conducted by telephone or its total duration is less than four hours; (iii) \$1,000 per day for each meeting of any Board committee held on a day other than a Board meeting day; and (iv) \$500 per day for each meeting of any Board committee conducted by telephone on a day other than a Board meeting day.

Under the Company's Nonemployee Director Stock Option Plan, as amended and restated (the "Option Plan"), nonemployee directors are periodically granted nonqualified options to purchase shares of the Company's common stock at an option price equal to 100% of fair market value on the date of grant. Each option terminates upon the expiration of ten years from the date of grant or one year after the optionee ceases to be a director, whichever first occurs. An option may not be exercised prior to the expiration of one year from the date of grant, subject to certain exceptions specified in the Option Plan.

Pursuant to the provisions of the Option Plan, options were granted on January 31, 2003, to Judith B. Craven, Arthur R. Emerson, Roger R. Hemminghaus, Robert T. Herres, Frank J. Markantonis, Gasper Mir, III, Joanne Winik, and Jim W. Woliver for 2,000 shares each, and to Jill Griffin, J.S.B. Jenkins and Joe C. McKinney for 4,000 shares each, at an option price of \$1.98 per share.

Under the Company's Nonemployee Director Phantom Stock Plan, as amended and restated (the "Phantom Stock Plan"), nonemployee directors were previously required and encouraged to defer their director retainer and meeting fees into a phantom share account which is credited with dollar amounts in the form of phantom shares priced at current market value of the Company's common stock. Nonemployee directors were required to defer at least 50% of their director retainer fees until they acquired at least \$100,000 of the Company's common stock based on its average closing price over the preceding 365-day period. In addition, nonemployee directors were encouraged to defer the balance of their director retainer fees and their meeting fees into their respective phantom share accounts by provisions of the Phantom Stock Plan which provides an additional credit to their account of 25% of any amounts voluntarily deferred. The phantom share accounts are also credited with dollar amounts equal to dividends, if any, paid on the common stock. When a participant ceases to be a director, the number of phantom shares in his or her account is converted into an equal number of shares of the Company's common stock.

The Company's Corporate Governance Guidelines have consistently required deferral of director retainer fees until the \$100,000 minimum market value threshold is met. Because the number of authorized shares under the Phantom Stock Plan has been fully depleted, directors may no longer defer payment into the Phantom Stock Plan of cash compensation which would otherwise be payable to nonemployee directors.

The Company's Nonemployee Director Deferred Compensation Plan permits nonemployee directors to defer all or a portion of their directors' fees in accordance with applicable regulations under the Internal Revenue Code. Deferred amounts bear interest at the average interest rate of U.S. Treasury ten-year obligations. The Company's obligation to pay deferred amounts is unfunded and is payable from general assets of the Company.

### **Employment Agreements**

The Company is a party to employment agreements with Christopher J. Pappas (President and Chief Executive Officer) and Harris J. Pappas (Chief Operating Officer). The employment agreements were filed with the Securities and Exchange Commission as exhibits to the Company's Current Report on Form 8-K, filed

March 15, 2001. Each agreement provides for a fixed base annual salary of \$100,000 during the term of the agreements, plus bonus compensation in the discretion of the Board or appropriate Board committee. Pursuant to the agreements, Messrs. Pappas each received a nonqualified stock option to purchase 1,120,000 shares of the Company's common stock at an exercise price per share equal to five dollars (\$5.00) per share. Each agreement provides that the employee will be entitled to receive all of his compensation and benefits under the contract until March 31, 2004, if his employment is terminated by the Company without cause (as therein defined) or if he terminates his employment for good reason (as therein defined). The employment agreements expire on March 31, 2004.

### **Executive Compensation Committee Report**

The Executive Compensation Committee of the Board presents the following report on executive compensation. The report describes the Company's executive compensation programs and the bases on which the Committee made recommendations for compensation decisions for fiscal 2003, with respect to the Company's executive officers, including those named in the compensation tables.

#### ***Compensation Objectives***

The Committee annually evaluates the effectiveness of the Company's executive compensation program in incentivizing and rewarding executive performance that leads to long-term enhancement of shareholder value and encouraging executives who deliver such performance to continue with the Company for the long-term. The Company's executive compensation program currently consists of the elements summarized below.

*Base Salary.* Base salaries that are fair and competitive consistent with the Company's position in the foodservice industry are used to compensate ongoing performance throughout the year. Base salaries are reviewed annually.

*Annual Bonus.* Annual bonuses are awarded to executives based on an evaluation of both corporate performance and the executive's individual contribution to the long-term interests of shareholders.

*Long-Term Incentives.* Long-term incentives, such as stock options, are used to (i) incentivize performance that leads to enhanced shareholder value and (ii) encourage retention.

*Stock Ownership.* Stock ownership guidelines are used to more closely align the interests of the Company's executives with the interests of shareholders.

The Company's executive compensation program is designed to enable the Company to attract, retain, and motivate the highest quality of management talent.

#### ***Annual Base Salaries***

The Committee annually advises the Board on the appropriateness and reasonableness of the base salaries to be paid to the Company's executive officers and approves base salaries and salary increases for executives. The Committee evaluates base salaries with reference to the Company's performance for the prior fiscal year and competitive compensation data, as well as a subjective evaluation of each executive's contribution to the Company's performance, each executive's experience, responsibilities, and management abilities. Company performance is measured by net income, total sales, comparable store sales, return on shareholders' equity, and other financial factors. Since compensation of the Chief Executive Officer and Chief Operating Officer is fixed by contract (See "Executive Compensation Committee Report – Compensation of Chief Executive Officer"), the Committee's responsibility in regard to their compensation has been limited. However, the employment contracts for the Chief Executive Officer and Chief Operating Officer currently in effect expire in March of 2004. The Committee is involved in advising the Board on the appropriateness and reasonableness of base salaries for the Chief Executive Officer and the Chief Operating Officer for service rendered to the Company after March of 2004.

#### ***Stock Options***

The Committee administers the Company's stock option, ownership and other equity-based compensation plans. The Committee considers generally on an annual basis the granting of incentive stock options annually to eligible executive officers and other key employees. The options, which are granted at 100% of market price on

the date of grant, are typically for six-year terms. The number of option shares granted each year is typically determined by a formula based on a dollar amount divided by the option's exercise price. The dollar amount is determined as a percentage of the executive's base salary, which percentage varies based upon the executive's responsibility level, the percentage of equity compensation paid at comparable companies, and the executive's individual performance. The more senior executives typically receive option grants equal to a larger percentage of their base salaries than less senior executives. The number of option shares held by an executive is not considered in determining stock option awards.

### ***Stock Ownership Guidelines***

The Board of Directors has adopted guidelines for ownership of the Company's common stock by executives and directors to help demonstrate alignment of the interests of the Company's executives and directors with the interests of its shareholders. The guidelines provide that executives and directors are expected to attain the following levels of stock ownership within five years of election to the specified director or officer position:

| <b><u>Position</u></b>              | <b><u>Share Ownership</u></b>                    |
|-------------------------------------|--|
| Chief Executive Officer             | 4 times annual base salary                       |
| President and Senior Vice President | 2 times annual base salary                       |
| Vice President                      | Equal to annual base salary                      |
| Nonemployee Director                | Shares with a market value of at least \$100,000 |

Phantom stock and stock equivalents in the nonemployee director deferred compensation plan are considered common stock for purposes of the guidelines since they are, in effect, awarded in lieu of cash compensation for board services.

### ***Stock Purchase Loans Made in 1999***

During January and February 1999, to facilitate the purchase of Luby's stock by certain Luby's officers pursuant to Luby's Incentive Stock Plan, the Company guaranteed loans of approximately \$1.9 million related to open-market purchases of Company stock by various officers of the Company pursuant to the terms of a shareholder-approved plan. Under the officer loan program, shares were purchased by certain Luby's officers with funding obtained from JPMorgan Chase Bank, one of the four members of the bank group that participates in the Company's credit facility. Per the original terms of the agreements, these instruments only required annual interest to be paid by the individual debtors, with the entire principal balances due upon their respective maturity dates, which occur during the first three months of calendar 2004. As of November 19, 2003, the notes had an aggregate outstanding balance of approximately \$1.6 million. None of the individual debtors are currently, and were not as of August 27, 2003, senior executives or directors of the Company.

As reported in the Company's Current Report on Form 8-K dated June 26, 2003, the Company previously received written notice from JPMorgan Chase Bank that the underlying guarantee on these loans includes a cross-default provision; consequently, in the opinion of JPMorgan Chase Bank, the January 31, 2003, default in the Company's senior credit facility led to a default in the officer loans. JPMorgan Chase Bank initially requested that the Company repurchase the notes; however, such action cannot be completed without comprehensive resolution with the entire bank group. On July 10, 2003, JPMorgan Chase Bank notified the Company that although it continues to reserve all rights and remedies, it has not elected to pursue those rights and remedies in order to allow further discussions among the bank group. This notice did not constitute a waiver. The Company is therefore working constructively with all members of the bank group in a effort to cure all defaults and satisfactorily meet each lender's expectations.

The Company has engaged legal counsel to advise it in responding to the demands by JPMorgan Chase Bank. The Company continues to work with the four members of its senior bank group (of which JPMorgan Chase Bank is a member) to resolve the defaults under all of the Company's indebtedness.

If the Company purchases the loans from JPMorgan Chase Bank, it would become the holder of the notes, record the receivables, and pursue the note holders for collection. The purchased Company stock has been and can be used by borrowers to satisfy a portion of their loan obligation. As of November 19, 2003, based on the market price on that day, approximately \$332,000, or 20.6% of the note balances, could have been covered by stock, while approximately \$1.3 million, or 79.4%, would remain outstanding.

### ***Change in Control Agreements***

The employment agreements of Christopher J. Pappas and Harris J. Pappas each provide that the employee will be entitled to receive all of his compensation and benefits under the contract until March 31, 2004, if his employment is terminated by the Company without cause (as therein defined) or if he terminates his employment for good reason (as therein defined).

### ***Salary Continuation Agreements***

The Company currently has no salary continuation agreement, or agreement having similar effect, in place with any employee of the Company.

### ***Deferred Compensation Plan***

Beginning June 1, 1999, the Company maintained a Deferred Compensation Plan for all highly compensated employees, including the president and all senior vice presidents. The plan permitted highly compensated employees to defer a portion of their annual compensation into unfunded accounts with the Company. The deferrals mirror the results of a phantom investment portfolio theoretically (but not actually) invested in funds selected by each participant, including a Luby's, Inc. stock fund. None of the Named Officers (as that term is defined below under the heading "Executive Compensation") currently participates in the Deferred Compensation Plan. The Company terminated the plan after the end of fiscal 2003, and the funds will be distributed in fiscal 2004.

### ***Compensation of Chief Executive Officer***

In fiscal 2003, the Company paid Christopher J. Pappas an annual base salary of \$100,000, which is the annual base salary that has been in effect since he initially took office as the President and Chief Executive Officer of the Company in March of 2001. The employment contract entered into with Mr. Pappas, which was approved by the Board in 2001, fixes Mr. Pappas' base salary at \$100,000 per year for the duration of the contract, which expires on March 31, 2004. Pursuant to the employment contract, he was granted stock options on March 9, 2001, for 1,120,000 shares of common stock at \$5.00 per share. See "Employment Agreement."

Members of the Committee:

Roger R. Hemminghaus (Chair)  
Judith B. Craven (Vice Chair)  
Jill Griffin  
Joanne Winik  
Jim W. Woliver

## Executive Compensation

The table below contains information concerning annual and long-term compensation of the current chief executive officer, all persons who served as chief executive officer of the Company during the last fiscal year, and the most highly compensated individuals who made in excess of \$100,000 and who served as executive officers during the last fiscal year (the “Named Officers”), for services rendered in all capacities for the fiscal years ended August 27, 2003, August 28, 2002 and August 31, 2001.

### Summary Compensation Table

| Name and Principal Position                       | Fiscal Year | Annual Compensation |       |                               | Long-Term Compensation  |  |              |                            |
|---|-------------|---------------------|-------|-------------------------------|-------------------------|--|--------------|----------------------------|
|   |             | Salary              | Bonus | Other Annual Compensation (1) | Awards                  |  | Payouts      |                            |
|   |             |                     |       |                               | Restricted Stock Awards | Securities Underlying Options/SARs (2) | LTIP Payouts | All Other Compensation (3) |
| Christopher J. Pappas                             | 2003        | \$100,000           | \$0   | \$ 0                          | \$0                     | \$ 0                                   | \$0          | \$0                        |
| President and Chief Executive Officer             | 2002        | 107,564             | 0     | 0                             | 0                       | 1,120,000                              | 0            | 0                          |
|   | 2001        | 45,161              | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |
| Harris J. Pappas                                  | 2003        | 100,000             | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |
| Chief Operating Officer                           | 2002        | 107,564             | 0     | 0                             | 0                       | 1,120,000                              | 0            | 0                          |
|   | 2001        | 45,161              | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |
| Ernest Pekmezaris                                 | 2003        | 200,000             | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |
| Senior Vice President and Chief Financial Officer | 2002        | 215,128             | 0     | 0                             | 0                       | 25,000                                 | 0            | 0                          |
|   | 2001        | 90,232              | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |
| Peter Tropoli                                     | 2003        | 150,000             | 0     | 24,662                        | 0                       | 0                                      | 0            | 0                          |
| Senior Vice President – Administration            | 2002        | 161,346             | 0     | 0                             | 0                       | 25,000                                 | 0            | 0                          |
|   | 2001        | 50,000              | 0     | 0                             | 0                       | 0                                      | 0            | 0                          |

- (1) Perquisites and other personal benefits that did not exceed the lesser of \$50,000 or 10% of the total amount of annual salary and bonus for any Named Officer have been excluded.
- (2) The Company has not issued any stock appreciation rights to the Named Officers.
- (3) Amounts are contributions under the Profit Sharing Plan.

The following table reports the grant of stock options and stock appreciation rights (“SARs”) to the Named Officers during fiscal 2003. The Company has not granted SARs to any of the Named Officers.

### Options/SAR Grants in Last Fiscal Year

| Name              | Number of Securities Underlying Options/SARs Granted | % of Total Options/SARs Granted to Employees in Fiscal Year | Exercise or Base Price (\$/sh) | Expiration Date | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation For Option Term |     |
|-------------------|--|---|--------------------------------|-----------------|--|-----|
|                   |  |   |                                |                 | 5%   | 10% |
|                   |  |   |                                |                 | Christopher J. Pappas  | 0   |
| Harris J. Pappas  | 0  | 0   | —                              | —               | —  | —   |
| Ernest Pekmezaris | 0  | 0   | —                              | —               | —  | —   |
| Peter Tropoli     | 0  | 0   | —                              | —               | —  | —   |

The table below reports exercises of stock options and SARs by the Named Officers during fiscal 2003 and the value of their unexercised stock options and SARs as of August 27, 2003. Except for the stock options granted to Messrs. Pappas, which were granted pursuant to their employment contracts with the Company, the stock options were granted under the Company's Incentive Stock Plans. The Company has not granted SARs to any of the Named Officers.

**Aggregated Options/SAR Exercises in Last Fiscal Year  
and FY-End Option/SAR Values**

| <u>Name</u>           | <u>Shares<br/>Acquired on<br/>Exercise</u> | <u>Value<br/>Realized</u> | <u>Number of<br/>Securities Underlying<br/>Unexercised<br/>Options/SARs at FY-End<br/>Exercisable/Unexercisable</u> | <u>Value of Unexercised<br/>In-the-Money<br/>Options/SARs at FY-End<br/>Exercisable/Unexercisable (1)</u> |
|-----------------------|--|---------------------------|---|---|
| Christopher J. Pappas | 0  | \$0                       | 840,000/280,000   | \$0/0   |
| Harris J. Pappas      | 0  | 0                         | 840,000/280,000   | 0/0   |
| Ernest Pekmezaris     | 0  | 0                         | 12,500/12,500   | 0/0   |
| Peter Tropoli         | 0  | 0                         | 12,500/12,500   | 0/0   |

(1) The value of unexercised options is based on a price of \$2.37 per common share at August 27, 2003.

**Deferred Compensation**

Beginning June 1, 1999, the Company maintained a Deferred Compensation Plan for all of its highly compensated employees, which permitted deferral of a portion of annual compensation. The plan was terminated in fiscal 2003 and funds will be distributed in fiscal 2004. See the discussion under the caption "Deferred Compensation Plan" in the Report of the Executive Compensation Committee.

The Company has a Supplemental Executive Retirement Plan which is designed to provide benefits for selected officers at normal retirement age with 25 years of service equal to 50% of their final average compensation offset by Social Security, profit sharing benefits, and deferred compensation. Some of the officers designated to participate in the plan have retired and are receiving benefits under the plan. Accrued benefits of all actively employed participants become fully vested upon termination of the plan or a change in control (as defined in the plan). The plan is unfunded, and the Company is obligated to make benefit payments solely on a current disbursement basis. None of the Named Officers is currently entitled to participate in the Supplemental Executive Retirement Plan.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The following table sets forth information concerning the beneficial ownership of the Company's common stock, as of December 5, 2003, for (a) each director currently serving on the Company's Board, (b) each nominee for election as a director at the 2004 Annual Meeting of Shareholders, (c) each of the officers named in the Summary Compensation Table (Named Officers) not listed as a director, and (d) directors and executive officers as a group. In general, "beneficial ownership" includes those shares a director or executive officer has the power to vote or transfer and shares that the director or executive officer has the right to acquire within 60 days after December 5, 2003.

| <u>Name(1)</u>   | <u>Shares<br/>Beneficially<br/>Owned</u> | <u>Percent of<br/>Common<br/>Stock</u> |
|--|--|--|
| Judith B. Craven (2)   | 27,634                                   | *                                      |
| Arthur R. Emerson (3)  | 29,728                                   | *                                      |
| Jill Griffin (4)   | 4,000                                    | *                                      |
| Roger R. Hemminghaus (5)   | 50,317                                   | *                                      |
| J.S.B. Jenkins (6)   | 4,000                                    | *                                      |
| Frank Markantonis (7)  | 9,978                                    | *                                      |
| Joe C. McKinney (8)  | 4,000                                    | *                                      |
| Gasper Mir, III (9)  | 8,452                                    | *                                      |
| Christopher J. Pappas (10)   | 2,511,900                                | 9.54%                                  |
| Harris J. Pappas (11)  | 2,511,900                                | 9.54%                                  |
| Ernest Pekmezaris (12)   | 15,510                                   | *                                      |
| Peter Tropoli (13)   | 12,500                                   | *                                      |
| Joanne Winik (14)  | 33,412                                   | *                                      |
| Jim W. Woliver (15)  | 28,416                                   | *                                      |
| All directors and executive officers of the Company, as a Group<br>(14 persons) (16) | 5,251,747                                | 19.95%                                 |

\* Represents beneficial ownership of less than one percent of the shares of the Company's common stock issued and outstanding on December 5, 2003.

- (1) Except as indicated in these notes and subject to applicable community property laws, each person named in the table owns directly the number of shares indicated and has the sole power to vote and to dispose of such shares. Shares of phantom stock held by a nonemployee director convert into an equivalent number of shares of the Company's common stock when the nonemployee director ceases to be a director of the Company on account of resignation, retirement, death, disability, removal or any other circumstance. The shares of common stock payable upon conversion of the phantom stock are included in this table because it is possible for the holder to acquire the common stock within 60 days if his or her directorship terminated.
- (2) The shares shown for Ms. Craven include 1,500 shares held for her benefit in a custodial account. The shares shown include 14,666 shares which she has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 11,468 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.
- (3) The shares shown for Mr. Emerson include 3,237 shares held jointly with his wife in a custodial account. The shares shown include 14,666 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 11,825 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.
- (4) The shares shown for Ms. Griffin include 4,000 shares which she has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan.
- (5) The shares shown for Mr. Hemminghaus include 14,300 shares held in a custodial account for the benefit of Mr. Hemminghaus and his wife. The shares shown include 19,666 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 16,351 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.

- (6) The shares shown for Mr. Jenkins include 4,000 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan.
- (7) The shares shown for Mr. Markantonis include 100 shares held for his benefit in a custodial account. The shares shown include 6,000 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 3,878 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.
- (8) The shares shown for Mr. McKinney include 4,000 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan.
- (9) The shares shown for Mr. Mir include 6,000 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 2,452 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.
- (10) The shares shown for Christopher J. Pappas include 671,900 shares held for his benefit in a custodial account. The shares shown include 840,000 shares which he has the right to acquire within 60 days pursuant to stock options granted in connection with his employment by the Company and 1,000,000 shares which he has the right to acquire within 60 days upon conversion of subordinated convertible notes issued in 2001, exclusive of accrued interest which also may be converted. (See “Certain Relationships & Related Transactions” section).
- (11) The shares shown for Harris J. Pappas include 671,900 shares held for his benefit in a custodial account. The shares shown include 840,000 shares which he has the right to acquire within 60 days pursuant to stock options granted in connection with his employment by the Company and 1,000,000 shares which he has the right to acquire within 60 days upon conversion of subordinated convertible notes issued in 2001, exclusive of accrued interest which also may be converted. (See “Certain Relationships & Related Transactions” section).
- (12) The shares shown for Mr. Pekmezaris include 3,010 shares held for his benefit in a custodial account. The shares shown include 12,500 shares which he has the right to acquire within 60 days under the Company’s stock option plans.
- (13) The shares shown for Mr. Tropoli include 12,500 shares which he has the right to acquire within 60 days under the Company’s stock option plans.
- (14) The shares shown for Ms. Winik include 2,578 shares held for her benefit in custodial accounts. The shares shown include 16,333 shares which she has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan and 14,501 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.
- (15) The shares shown for Mr. Woliver include 20,416 shares held in a custodial account for the benefit of Mr. Woliver and his wife. The shares shown include 8,000 shares which he has the right to acquire within 60 days under the Nonemployee Director Stock Option Plan.
- (16) The shares shown for all directors and executive officers as a group include 1,802,331 shares which they have the right to acquire within 60 days under the Company’s benefit plans, 2,000,000 shares which they have the right to acquire within 60 days upon conversion of convertible notes, and 60,475 shares of phantom stock held under the Nonemployee Director Phantom Stock Plan.

## Principal Shareholders

The following table sets forth information as to the beneficial ownership of the Company's common stock by each person or group known by the Company to own beneficially more than 5% of the outstanding shares of the Company's common stock as of September 30, 2003, and, unless otherwise indicated, is based on disclosures made by the beneficial owners in SEC filings under Section 13 of the Exchange Act:

| <u>Name and Address of Beneficial Owner (1)</u>  | <u>Shares Beneficially Owned</u> | <u>Percent of Common Stock</u> |
|--|----------------------------------|--------------------------------|
| Christopher J. Pappas (2)<br>642 Yale Street<br>Houston, Texas 77007                                   | 2,511,900                        | 9.54%                          |
| Harris J. Pappas (3)<br>642 Yale Street<br>Houston, Texas 77007  | 2,511,900                        | 9.54%                          |
| Berno, Gambal & Barbee, Inc. (4)<br>1100 North Glebe Road, Suite 1040<br>Arlington, Virginia 22201     | 2,244,200                        | 8.53%                          |
| Dimensional Fund Advisors, Inc. (5)<br>1299 Ocean Avenue, 11th Floor<br>Santa Monica, California 90401 | 1,493,900                        | 5.68%                          |

- (1) Except as indicated in these notes and subject to applicable community property laws, each person named in the table owns directly the number of shares indicated and has the sole power to vote and to dispose of such shares.
- (2) The shares shown for Christopher Pappas include 840,000 shares which he has the right to acquire within 60 days pursuant to stock options granted in connection with his employment by the Company and 1,000,000 shares which he has the right to acquire within 60 days upon conversion of subordinated convertible notes he purchased in 2001, exclusive of any accrued interest, which also may be converted. (See "Certain Relationships & Related Transactions" section).
- (3) The shares shown for Harris Pappas include 840,000 shares which he has the right to acquire within 60 days pursuant to stock options granted in connection with his employment by the Company and 1,000,000 shares which he has the right to acquire within 60 days upon conversion of subordinated convertible notes he purchased in 2001, exclusive of any accrued interest, which also may be converted. (See "Certain Relationships & Related Transactions" section).
- (4) The information pertaining to beneficial ownership by Berno, Gambal & Barbee, Inc. ("BGB") is based on information furnished to the Company by BGB. In a Schedule 13G filed with the Securities and Exchange Commission on February 14, 2003, BGB reported that, with respect to the Company's common stock, the shares shown in the table above were beneficially owned by BGB, William S. Berno, Paul Gambal and Scott L. Barbee. BGB filed a Schedule 13F-HR with the Securities and Exchange Commission on November 14, 2003, in which BGB reported that BGB has sole investment discretion as to all of the shares shown in the table and sole voting power as to 1,946,400 of the shares. In addition to the shares shown in the table, Mr. Barbee holds sole investment and voting power as to 9,000 shares of the Company's common stock.
- (5) Dimensional Fund Advisors, Inc. ("Dimensional"), an investment advisor registered under Section 203 of the Investment Advisors Act of 1940, furnishes investment advice to four investment companies registered under the Investment Company Act of 1940, and serves as investment manager to certain other investment vehicles, including commingled group trusts. (These investment companies and investment vehicles are the "Portfolios"). In its role as investment advisor and investment manager, Dimensional possessed both investment and voting power over 1,493,900 shares of Luby's, Inc. stock as of September 30, 2003. The Portfolios own all securities reported in this statement, and Dimensional disclaims beneficial ownership of such securities.

Securities authorized under equity compensation plans as of August 27, 2003, were as follows:

| <u>Plan Category</u>                                       | <u>(a)</u>   | <u>(b)</u>   | <u>(c)</u>   |
|--|--|--|--|
|  | <b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</b> | <b>Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b> | <b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</b> |
| Equity compensation plans approved by security holders     | 1,679,598  | \$11.90  | 935,966  |
| Equity compensation plans not approved by security holders | <u>2,314,185</u>   | <u>5.08</u>  | <u>—</u>   |
| Total  | <u>3,993,783</u>   | <u>\$ 7.95</u>   | <u>935,966</u>   |

### **Item 13. Certain Relationships and Related Transactions**

The Company obtains certain services from entities owned and controlled by Christopher J. Pappas, President and Chief Executive Officer of the Company, and Harris J. Pappas, Chief Operating Officer of the Company, pursuant to the terms of an Affiliate Services Agreement dated August 28, 2001, and then amended and restated as of July 23, 2002. The types of services currently provided to the Company by these entities are the supply of goods and other services necessary for the operation of the Company. When the Affiliate Services Agreement was amended, a Master Sales Agreement with such entities was entered into, on July 23, 2002, to more properly reflect the current relationship between the Company and those entities regarding the provisions of services and goods.

During the 2003 fiscal year, the entities owned or controlled by Harris and Christopher Pappas (the “Pappas Entities”) provided goods to the Company under the Master Sales Agreement in the amount of \$174,000. Conversely, no services were provided in fiscal 2003 relative to the Affiliate Services Agreement. Subsequent to August 27, 2003, and through November 19, 2003, the Company incurred no costs from the Pappas Entities under either the Master Sales Agreement or the Affiliate Services Agreement.

Consistent with past practices, the Finance and Audit Committee of the Board reviewed on a quarterly basis all applicable amounts related to either the Master Sales Agreement or the Affiliate Services Agreement. That Committee is composed entirely of nonemployee directors.

The Company anticipates payments to such entities under the Affiliate Services Agreement and the Master Sales Agreement during the current fiscal year will not exceed \$500,000. Such payments will be primarily for goods purchased pursuant to the terms of the Master Sales Agreement. In the opinion of the Finance and Audit Committee, the fees paid by the Company for such goods and/or services are primarily at or below the level which the Company would pay for comparable goods and/or services (if available) from a party unaffiliated with the Company.

The Company is obligated under a separate agreement dated September 28, 2001, for the lease of real property for the Company’s service center from entities owned or controlled by Harris J. Pappas and Christopher J. Pappas. This lease agreement was amended on May 20, 2003, to expand the space leased by the Company. The proposal to amend the lease was investigated by the Company’s Internal Audit department, evaluated by the Finance and Audit Committee of the Board, and evaluated and approved by the Board with Messrs. Pappas and Markantonis abstaining from such vote. The amount paid by the Company under this Lease Agreement was \$79,000 in fiscal 2003. Subsequent to August 27, 2003, and through November 19, 2003, the Company incurred lease costs for the service center in the amount of \$20,000. The Company has contracted to pay \$82,000 in rent pursuant to said Lease Agreement to such entities during the current fiscal year. The Company is obligated to pay all related repairs and maintenance, insurance, and pro-rata portion of utilities on said lease.

The Company previously leased a location from an unrelated third party. That location is used to house increased equipment inventories due to store closures under the business plan. The Company considered it more prudent to lease this location rather than to pursue purchasing a storage facility, as its strategy is to focus its capital expenditures on its operating restaurants. In a separate transaction, the third-party property owner sold the

location to the Pappas Entities during the fourth quarter of fiscal 2003, with the Pappas Entities becoming the Company's landlord for that location effective August 1, 2003. The amount paid to the Pappas Entities by the Company under this lease agreement was \$4,000 in fiscal 2003.

Before the end of the 2003 fiscal year, the Finance and Audit Committee of the Board approved a proposal to amend the lease for additional space. The amendment expanded the location's capacity to approximately 27,000 square feet of warehouse space. Subsequent to August 27, 2003, and through November 19, 2003, the Company incurred lease costs for the storage site of \$19,000. The Company has contracted to pay \$69,000 in rent pursuant to said lease agreement to the Pappas Entities during the current fiscal year. The Company is obligated to pay all related repairs and maintenance, insurance, and pro-rata portion of utilities on said lease.

In addition to the amounts paid to Christopher J. Pappas and Harris J. Pappas under the terms of said Affiliate Services Agreement, Master Sales Agreement and Lease Agreement, the Company paid rent to PHCG Investments for real property in Dallas, Texas, pursuant to the terms of a Ground Lease dated March 25, 1994. Christopher J. Pappas and Harris J. Pappas are general partners of PHCG Investments. The amount paid by the Company to PHCG Investments pursuant to the terms of said Ground Lease during the last fiscal year was \$42,000. During the third quarter of fiscal 2003, the Company terminated its leasehold interest in the property pursuant to a Lease Termination Agreement with a third party unaffiliated with the Company, PHCG, Harris J. Pappas, Christopher J. Pappas, or any of their respective affiliates pursuant to which the Company received, in exchange for termination of its leasehold interest, a payment in cash, the right to remove fixtures and equipment from the premises, and the release of any future obligations under the Ground Lease. Prior to approving the Lease Termination Agreement, the Board, meeting without Christopher J. Pappas, Harris J. Pappas and Frank Markantonis, reviewed such matters as it deemed necessary to make an informed decision on the transaction, including an M.A.I. appraisal of the fair market value of the leasehold estate.

The Company entered into a Purchase Agreement with Christopher J. Pappas and Harris J. Pappas on March 9, 2001 (the "Purchase Agreement"). Pursuant to the terms of the Purchase Agreement, Messrs. Pappas became obligated to purchase subordinated convertible promissory notes (the "Pappas Notes") from the Company in the aggregate amount of \$10 million upon satisfaction of certain conditions specified in the Purchase Agreement. Messrs. Pappas each purchased two convertible subordinated promissory notes dated June 29, 2001, from the Company in the face amounts of \$1.5 million and \$3.5 million each, resulting in the receipt of \$10 million in proceeds by the Company. The Pappas Notes are unsecured, and the rights of Messrs. Pappas to receive payments under the Pappas Notes are subordinate to the rights of the Company's senior secured creditors. Prior to the default described in the succeeding paragraphs, the Pappas Notes bore interest at a variable rate of interest equal to LIBOR plus two percent. Interest is due quarterly on June 1, September 1, December 1, and March 1, and the principal is due on March 1, 2011. Exclusive of any accrued interest that may also be converted, the notes are convertible into the Company's common stock at \$5.00 per share, or 2,000,000 shares, at the election of the holders at any time after January 2, 2003, and prior to the stated redemption date of March 1, 2011, or at any time that the Company tenders prepayment of such amount. The Company has the right to prepay the notes at any time without the payment of any premium or penalty.

As previously reported in the Company's Current Report on Form 8-K filed May 23, 2003, on account of the cross-default provisions in the Pappas Notes, the Company's default on its senior indebtedness constituted an event of default under the Pappas Notes. Under the terms of the Pappas Notes, the interest rate on the indebtedness represented by such notes increases to 10% per annum from the date of such default (such rate being the greater of Libor plus 2% or 10% per annum and being referred to as the "Default Rate"). The Company made the regular quarterly interest payment on the Pappas Notes on March 1, 2003, in the aggregate amount of approximately \$84,000; however, under the terms of the Pappas Notes and the subordination agreement entered into by Christopher and Harris Pappas, the Company, and the holders of the senior indebtedness in June 2001 (the "Subordination Agreement"), such amount should not have been paid to Christopher and Harris Pappas because of the existing default on the senior indebtedness. Christopher and Harris Pappas subsequently paid the March 1, 2003, interest payment to the holders of the senior indebtedness in accordance with the provisions of the Pappas Notes and the Subordination Agreement. The resulting failure of the Company to pay interest on the Pappas Notes to Christopher and Harris Pappas on March 1, 2003, and the scheduled payment dates thereafter constitute additional events of default on the Pappas Notes. Christopher and Harris Pappas worked with the Company to document a waiver of all defaults under the Pappas Notes through May 19, 2003. All rights to increased interest on the Pappas Notes through such date have also been waived. As a

result, interest accrued on the Pappas Notes through May 19, 2003, at Libor plus 2% for such period (the rate in effect absent a default).

Christopher and Harris Pappas have not waived defaults from and after May 19, 2003, and after such date the interest on the Pappas Notes accrues at the Default Rate. Under the Subordination Agreement, no payments may be made in respect of principal or interest on the Pappas Notes or otherwise with respect to such Notes unless and until all defaults with respect to senior indebtedness have been cured or waived. However, the subordination provisions do not impair the legal obligation of the Company with respect to the Pappas Notes, which must be paid in full with accrued interest at the applicable rates. In addition, Christopher and Harris Pappas have expressly reserved all their rights and remedies that arise by reason of the defaults, including the right to demand immediate repayment of the Pappas Notes. The Company's two-year business plan includes the sale of certain properties, the closing of certain unprofitable cafeterias and the repayment of indebtedness, all with the goal, among others, of securing a cure (by agreement with the holders of the Company's senior indebtedness) to existing defaults with respect to the senior indebtedness. As a result of the existing default on the Pappas Notes, it will also be necessary for the Company to attempt to cure defaults with respect to the Pappas Notes (by agreement with the holders thereof or repayment of the Pappas Notes) in conjunction with such two-year business plan. Otherwise, a continuation of the defaults with respect to the Pappas Notes will continue to result in a default on the Company's senior indebtedness under existing cross-default provisions thereof.

Pursuant to the terms of the Purchase Agreement, the Company agreed to submit three persons designated by Christopher J. Pappas and Harris J. Pappas as nominees for election as directors at the 2002 Annual Meeting of Shareholders. Messrs. Pappas designated themselves and Frank Markantonis as their nominees for directors. Christopher J. Pappas and Harris J. Pappas are brothers. Mr. Markantonis is an attorney whose principal client is Pappas Restaurants, Inc., an entity controlled by Harris J. Pappas and Christopher J. Pappas.

On July 23, 2002, the Company entered into an Indemnification Agreement with each member of the Board of Directors under which the Company obligated itself to indemnify each director to the fullest extent permitted by applicable law so that he or she will continue to serve the Company free from undue concern regarding liabilities. The Company has also entered into an Indemnification Agreement with each person becoming a member of the Board of Directors since July 23, 2002. The Board of Directors has determined that uncertainties relating to liability insurance and indemnification have made it advisable to provide directors with assurance that liability protection will be available in the future.

#### **Item 14. Principal Accountant Fees and Services**

Aggregate fees for professional services rendered for the Company by the independent auditor, Ernst & Young LLP, in each of the last two fiscal years in each of the following categories were:

|                    | <u>2003</u>    | <u>2002</u>  |
|--------------------|----------------|--------------|
|                    | (In thousands) |              |
| Audit Fees         | \$162          | \$158        |
| Audit-Related Fees | 3              | 14           |
| Tax Fees           | 17             | 68           |
| All Other Fees     | <u>9</u>       | <u>16</u>    |
| Total              | <u>\$191</u>   | <u>\$256</u> |

In prior years, fees were prepared on a paid basis. In 2003, fees were compiled on a billed basis. Accordingly, certain fees for fiscal year 2002 were reclassified to conform to the presentation of the current year fees.

The *Audit Fees* for the fiscal years ended August 27, 2003, and August 28, 2002, were for professional services in connection with the audits of the consolidated financial statements of the Company, review of Quarterly Reports on Form 10-Q, and consents and assistance with the review of documents filed with the SEC.

The *Audit-Related Fees* for the fiscal years ended August 27, 2003, and August 28, 2002, were mainly for assurance and related services for benefit plan audits.

*Tax Fees* for the fiscal years ended August 27, 2003, and August 28, 2002, were for services related to tax compliance (including the preparation of income tax returns) and claims for refund, tax planning, and tax advice (including federal and state audit assistance).

*All Other Fees* for the fiscal years ended August 27, 2003, and August 28, 2002, were for services rendered for certain limited scope agreed-upon procedures.

The de minimis exception was not used for any fees paid to Ernst & Young LLP.

The Finance and Audit Committee has considered whether the provision of the above services other than audit services is compatible with maintaining Ernst & Young LLP's independence.

## **PART IV**

### **Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

#### *(a) Documents*

##### **1. Financial Statements**

The following financial statements are filed as part of this Report:

Consolidated balance sheets at August 27, 2003, and August 28, 2002

Consolidated statements of operations for each of the three years in the period ended August 27, 2003

Consolidated statements of shareholders' equity for each of the three years in the period ended August 27, 2003

Consolidated statements of cash flows for each of the three years in the period ended August 27, 2003

Notes to consolidated financial statements

Report of independent auditors

##### **2. Financial Statement Schedules**

All schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule or because the information required is included in the financial statements and notes thereto.

### 3. Exhibits

The following exhibits are filed as a part of this Report:

- 3(a) Certificate of Incorporation of Luby's, Inc. as currently in effect (filed as Exhibit 3(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1999, and incorporated herein by reference).
- 3(b) Bylaws of Luby's, Inc. as currently in effect (filed as Exhibit 3(c) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998, and incorporated herein by reference).
- 4(a) Description of Common Stock Purchase Rights of Luby's Cafeterias, Inc., in Form 8-A (filed April 17, 1991, effective April 26, 1991, File No. 1-8308, and incorporated herein by reference).
- 4(b) Amendment No. 1 dated December 19, 1991, to Rights Agreement dated April 16, 1991 (filed as Exhibit 4(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 1991, and incorporated herein by reference).
- 4(c) Amendment No. 2 dated February 7, 1995, to Rights Agreement dated April 16, 1991 (filed as Exhibit 4(d) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1995, and incorporated herein by reference).
- 4(d) Amendment No. 3 dated May 29, 1995, to Rights Agreement dated April 16, 1991 (filed as Exhibit 4(d) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1995, and incorporated herein by reference).
- 4(e) Amendment No. 4 dated March 8, 2001, to Rights Agreement dated April 16, 1991 (filed as Exhibit 99.1 to the Company's Report on Form 8-A12B/A on March 22, 2001, and incorporated herein by reference).
- 4(f) Credit Agreement dated February 27, 1996, among Luby's Cafeterias, Inc., Certain Lenders, and NationsBank of Texas, N.A. (filed as Exhibit 4(e) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 1996, and incorporated herein by reference).
- 4(g) First Amendment to Credit Agreement dated January 24, 1997, among Luby's Cafeterias, Inc., Certain Lenders, and NationsBank of Texas, N.A. (filed as Exhibit 4(f) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).
- 4(h) Second Amendment to Credit Agreement dated July 3, 1997, among Luby's Cafeterias, Inc., Certain Lenders, and NationsBank of Texas, N.A. (filed as Exhibit 4(i) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1997, and incorporated herein by reference).
- 4(i) Third Amendment to Credit Agreement dated October 27, 2000, among Luby's, Inc., Certain Lenders, and Bank of America, N.A. (filed as Exhibit 4(j) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2000, and incorporated herein by reference).
- 4(j) Fourth Amendment to Credit Agreement dated July 9, 2001, among Luby's, Inc., Bank of America, N.A. and other creditors of its bank group (filed as Exhibit 4(l) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(k) Deed of Trust, Assignment, Security Agreement, and Financing Statement dated July 2001, executed as part of the Fourth Amended to Credit Agreement (filed as Exhibit 4(m) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(l) Subordination and Intercreditor Agreement dated June 29, 2001, between Harris J. Pappas and Christopher J. Pappas, Bank of America, N.A. Agreement [as the bank group agent], and Luby's, Inc. (filed as Exhibit 4(n) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(m) Convertible Subordinated Promissory Note dated June 29, 2001, between Christopher J. Pappas and Luby's, Inc. in the amount of \$1,500,000 (filed as Exhibit 4(o) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(n) Convertible Subordinated Promissory Note dated June 29, 2001, between Harris J. Pappas and Luby's, Inc. in the amount of \$1,500,000 (filed as Exhibit 4(p) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(o) Convertible Subordinated Promissory Note dated June 29, 2001, between Christopher J. Pappas and Luby's, Inc. in the amount of \$3,500,000 (filed as Exhibit 4(q) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(p) Convertible Subordinated Promissory Note dated June 29, 2001, between Harris J. Pappas and Luby's, Inc. in the amount of \$3,500,000 (filed as Exhibit 4(r) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).

- 4(q) Fifth Amendment to Credit Agreement dated December 5, 2001, among Luby's, Inc., Bank of America, N.A. and other creditors of its bank group (filed as Exhibit 4(s) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 4(r) Sixth Amendment to Credit Agreement dated November 25, 2002, by and among Luby's, Inc., Bank of America, N.A. and other creditors of its bank group (filed as Exhibit 4(t) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).
- 10(a) Management Incentive Stock Plan of Luby's Cafeterias, Inc. (filed as Exhibit 10(i) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1989, and incorporated herein by reference).\*
- 10(b) Amendment to Management Incentive Stock Plan of Luby's Cafeterias, Inc. adopted January 14, 1997 (filed as Exhibit 10(k) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(c) Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted October 27, 1994 (filed as Exhibit 10(g) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 1994, and incorporated herein by reference).\*
- 10(d) Amendment to Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted January 14, 1997 (filed as Exhibit 10(m) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(e) Amendment to Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted March 19, 1998 (filed as Exhibit 10(o) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998, and incorporated herein by reference).\*
- 10(f) Amended and Restated Nonemployee Director Stock Option Plan of Luby's, Inc. approved by the shareholders of Luby's, Inc. on January 14, 2000 (filed as Exhibit 10(j) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2000, and incorporated herein by reference).\*
- 10(g) Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan dated May 30, 1996 (filed as Exhibit 10(j) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1996, and incorporated herein by reference).\*
- 10(h) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted January 14, 1997 (filed as Exhibit 10(r) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(i) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted January 9, 1998 (filed as Exhibit 10(u) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998, and incorporated herein by reference).\*
- 10(j) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted May 21, 1999 (filed as Exhibit 10(q) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1999, and incorporated herein by reference).\*
- 10(k) Severance Agreement between Luby's, Inc. and Barry J.C. Parker dated December 19, 2000 (filed as Exhibit 10(r) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2000, and incorporated herein by reference).\*
- 10(l) Luby's Incentive Stock Plan adopted October 16, 1998 (filed as Exhibit 10(cc) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1998, and incorporated herein by reference).\*
- 10(m) Form of Change in Control Agreement entered into between Luby's, Inc. and each of its Senior Vice Presidents as of January 8, 1999 (filed as Exhibit 10(aa) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1999, and incorporated herein by reference).\*
- 10(n) Luby's, Inc. Deferred Compensation Plan effective June 1, 1999 (filed as Exhibit 10(cc) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1999, and incorporated herein by reference).\*
- 10(o) Registration Rights Agreement dated March 9, 2001, by and among Luby's, Inc., Christopher J. Pappas, and Harris J. Pappas (filed as Exhibit 10.4 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).

- 10(p) Purchase Agreement dated March 9, 2001, by and among Luby's, Inc. Harris J. Pappas, and Christopher J. Pappas (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).
- 10(q) Employment Agreement dated March 9, 2001, between Luby's, Inc. and Christopher J. Pappas (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).\*
- 10(r) Employment Agreement dated March 9, 2001, between Luby's, Inc. and Harris J. Pappas (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).\*
- 10(s) Luby's, Inc. Incentive Bonus Plan for Fiscal 2001 (filed as Exhibit 10(z) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2000, and incorporated herein by reference).\*
- 10(t) Luby's, Inc. Stock Option granted to Christopher J. Pappas on March 9, 2001 (filed as Exhibit 10(w) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).\*
- 10(u) Luby's, Inc. Stock Option granted to Harris J. Pappas on March 9, 2001 (filed as Exhibit 10(x) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).\*
- 10(v) Affiliate Services Agreement dated August 31, 2001, by and among Luby's, Inc., Christopher J. Pappas, Harris J. Pappas, Pappas Restaurants, L.P., and Pappas Restaurants, Inc. (filed as Exhibit 10(y) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, refiled as Exhibit 10(y) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2002, to include signature reference and an exhibit that were inadvertently omitted, and incorporated herein by reference).
- 10(w) Ground Lease for a cafeteria site dated March 25, 1994, by and between Luby's Cafeterias, Inc. and PHCG Investments, as amended by Lease Amendment dated July 6, 1994 (filed as Exhibit 10(z) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 10(x) Lease Agreement dated June 1, 2001, by and between Luby's, Inc. and Pappas Restaurants, Inc. (filed as Exhibit 10(aa) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 10(y) Final Severance Agreement and Release between Luby's, Inc. and Alan M. Davis dated July 20, 2001 (filed as Exhibit 10(bb) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference). While in search for new executive management, the Company entered into an employment agreement with Mr. Davis in January 2001. The value of that one-year contract was a year's salary upon termination. After new management was secured, the Company finalized the exhibited agreement that provides for the payment of monthly consulting fees to Mr. Davis until July 2002, but releases the Company from all prior employment commitments.\*
- 10(z) Consultant Agreement between Luby's Restaurants Limited Partnership and Alan M. Davis dated July 20, 2001 (filed as Exhibit 10(cc) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).\*
- 10(aa) Luby's, Inc. Amended and Restated Nonemployee Director Phantom Stock Plan effective September 28, 2001 (filed as Exhibit 10(dd) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2002, and incorporated herein by reference).\*
- 10(bb) Final Severance Agreement and Release between Luby's, Inc. and S. Darrell Wood effective July 28, 2002 (filed as Exhibit 10(ee) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).\*
- 10(cc) Consultant Agreement dated August 30, 2002, between Luby's Restaurants Limited Partnership and S. Darrell Wood (filed as Exhibit 10(ff) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).\*
- 10(dd) Form of Indemnification Agreement entered into between Luby's, Inc. and each member of its Board of Directors initially dated July 23, 2002 (filed as Exhibit 10(gg) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).

- 10(ee) Amended and Restated Affiliate Services Agreement dated July 23, 2002, by and among Luby's, Inc., Pappas Restaurants, L.P., and Pappas Restaurants, Inc. (filed as Exhibit 10(hh) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).
- 10(ff) Master Sales Agreement dated July 23, 2002, by and among Luby's, Inc., Pappas Restaurants, L.P., and Pappas Restaurants, Inc. and Procedure adopted by the Finance and Audit Committee of the Board of Directors on July 23, 2002, pursuant to Section 2.3 of the Master Sales Agreement (filed as Exhibit 10(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).
- 10(gg) Lease Agreement dated October 15, 2002, by and between Luby's, Inc. and Rush Truck Centers of Texas, L.P. and Amendment dated August 1, 2003, by and between Luby's, Inc. and Pappas Restaurants, Inc.
- 11 Weighted-average shares used in the recomputation of per share earnings in Note 15 of the Consolidated Notes to Financial Statements.
- 14(a) Policy Guide on Standards of Conduct and Ethics applicable to all employees, as well as the board of directors.
- 14(b) Supplemental Standards of Conduct and Ethics for the CEO, CFO, Controller, and all senior financial officers.
- 21 Subsidiaries of Luby's, Inc. (filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 31 Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99(a) Corporate Governance Guidelines of Luby's, Inc., as amended March 5, 2003 (filed as Exhibit 99(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2003, and incorporated herein by reference).
- 99(b) Consent of Ernst & Young LLP.

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\*Denotes management contract or compensatory plan or arrangement.

(b) *Reports on Form 8-K.*

Form 8-K dated May 23, 2003 — press release announcing notification of default under its subordinated debt.

Form 8-K dated June 17, 2003 — press release announcing third quarter fiscal 2003 earnings.

Form 8-K dated June 26, 2003 — press release announcing the formal written demand made by JPMorgan Chase Bank for the Company to purchase the officer notes for approximately \$1.6 million.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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)

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

November 21, 2003  
Date

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u>                                   | <u>Title</u>   | <u>Date</u>       |
|--|--|-------------------|
| /s/ GASPER MIR, III<br>Gasper Mir, III             | Director and Chairman of the Board                   | November 21, 2003 |
| /s/ CHRISTOPHER J. PAPPAS<br>Christopher J. Pappas | Director, President and Chief<br>Executive Officer   | November 21, 2003 |
| /s/ HARRIS J. PAPPAS<br>Harris J. Pappas           | Director, Chief Operating Officer                    | November 21, 2003 |
| /s/ ERNEST PEKMEZARIS<br>Ernest Pekmezaris         | Senior Vice President and Chief<br>Financial Officer | November 21, 2003 |
| /s/ JUDITH B. CRAVEN<br>Judith B. Craven           | Director   | November 21, 2003 |
| /s/ ARTHUR R. EMERSON<br>Arthur R. Emerson         | Director   | November 21, 2003 |
| /s/ JILL GRIFFIN<br>Jill Griffin                   | Director   | November 21, 2003 |
| /s/ ROGER R. HEMMINGHAUS<br>Roger R. Hemminghaus   | Director   | November 21, 2003 |
| /s/ J.S.B. JENKINS<br>J.S.B. Jenkins               | Director   | November 21, 2003 |
| /s/ FRANK MARKANTONIS<br>Frank Markantonis         | Director   | November 21, 2003 |
| /s/ JOE C. MCKINNEY<br>Joe C. McKinney             | Director   | November 21, 2003 |
| /s/ JOANNE WINIK<br>Joanne Winik                   | Director   | November 21, 2003 |
| /s/ JIM W. WOLIVER<br>Jim W. Woliver               | Director   | November 21, 2003 |

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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)

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

December 19, 2003  
Date

LUBY'S, INC.  
(Registrant)

By:           /s/ ERNEST PEKMEZARIS            
Ernest Pekmezaris  
Senior Vice President and  
Chief Financial Officer

December 19, 2003  
Date

## EXHIBIT INDEX

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- 4(a) Description of Common Stock Purchase Rights of Luby's Cafeterias, Inc., in Form 8-A (filed April 17, 1991, effective April 26, 1991, File No. 1-8308, and incorporated herein by reference).
- 4(b) Amendment No. 1 dated December 19, 1991, to Rights Agreement dated April 16, 1991 (filed as Exhibit 4(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 1991, and incorporated herein by reference).
- 4(c) Amendment No. 2 dated February 7, 1995, to Rights Agreement dated April 16, 1991 (filed as Exhibit 4(d) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1995, and incorporated herein by reference).
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- 4(j) Fourth Amendment to Credit Agreement dated July 9, 2001, among Luby's, Inc., Bank of America, N.A. and other creditors of its bank group (filed as Exhibit 4(l) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
- 4(k) Deed of Trust, Assignment, Security Agreement, and Financing Statement dated July 2001, executed as part of the Fourth Amended to Credit Agreement (filed as Exhibit 4(m) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
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- 4(m) Convertible Subordinated Promissory Note dated June 29, 2001, between Christopher J. Pappas and Luby's, Inc. in the amount of \$1,500,000 (filed as Exhibit 4(o) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).
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- 10(a) Management Incentive Stock Plan of Luby's Cafeterias, Inc. (filed as Exhibit 10(i) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1989, and incorporated herein by reference).\*
- 10(b) Amendment to Management Incentive Stock Plan of Luby's Cafeterias, Inc. adopted January 14, 1997 (filed as Exhibit 10(k) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(c) Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted October 27, 1994 (filed as Exhibit 10(g) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 1994, and incorporated herein by reference).\*
- 10(d) Amendment to Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted January 14, 1997 (filed as Exhibit 10(m) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(e) Amendment to Nonemployee Director Deferred Compensation Plan of Luby's Cafeterias, Inc. adopted March 19, 1998 (filed as Exhibit 10(o) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998, and incorporated herein by reference).\*
- 10(f) Amended and Restated Nonemployee Director Stock Option Plan of Luby's, Inc. approved by the shareholders of Luby's, Inc. on January 14, 2000 (filed as Exhibit 10(j) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 2000, and incorporated herein by reference).\*
- 10(g) Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan dated May 30, 1996 (filed as Exhibit 10(j) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1996, and incorporated herein by reference).\*
- 10(h) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted January 14, 1997 (filed as Exhibit 10(r) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1997, and incorporated herein by reference).\*
- 10(i) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted January 9, 1998 (filed as Exhibit 10(u) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1998, and incorporated herein by reference).\*
- 10(j) Amendment to Luby's Cafeterias, Inc. Supplemental Executive Retirement Plan adopted May 21, 1999 (filed as Exhibit 10(q) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1999, and incorporated herein by reference).\*
- 10(k) Severance Agreement between Luby's, Inc. and Barry J.C. Parker dated December 19, 2000 (filed as Exhibit 10(r) to the Company's Quarterly Report on Form 10-Q for the quarter ended November 30, 2000, and incorporated herein by reference).\*
- 10(l) Luby's Incentive Stock Plan adopted October 16, 1998 (filed as Exhibit 10(cc) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 1998, and incorporated herein by reference).\*
- 10(m) Form of Change in Control Agreement entered into between Luby's, Inc. and each of its Senior Vice Presidents as of January 8, 1999 (filed as Exhibit 10(aa) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 28, 1999, and incorporated herein by reference).\*
- 10(n) Luby's, Inc. Deferred Compensation Plan effective June 1, 1999 (filed as Exhibit 10(cc) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1999, and incorporated herein by reference).\*
- 10(o) Registration Rights Agreement dated March 9, 2001, by and among Luby's, Inc., Christopher J. Pappas, and Harris J. Pappas (filed as Exhibit 10.4 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).
- 10(p) Purchase Agreement dated March 9, 2001, by and among Luby's, Inc. Harris J. Pappas, and Christopher J. Pappas (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).

- 10(q) Employment Agreement dated March 9, 2001, between Luby's, Inc. and Christopher J. Pappas (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).\*
- 10(r) Employment Agreement dated March 9, 2001, between Luby's, Inc. and Harris J. Pappas (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K dated March 9, 2001, and incorporated herein by reference).\*
- 10(s) Luby's, Inc. Incentive Bonus Plan for Fiscal 2001 (filed as Exhibit 10(z) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2000, and incorporated herein by reference).\*
- 10(t) Luby's, Inc. Stock Option granted to Christopher J. Pappas on March 9, 2001 (filed as Exhibit 10(w) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).\*
- 10(u) Luby's, Inc. Stock Option granted to Harris J. Pappas on March 9, 2001 (filed as Exhibit 10(x) to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001, and incorporated herein by reference).\*
- 10(v) Affiliate Services Agreement dated August 31, 2001, by and among Luby's, Inc., Christopher J. Pappas, Harris J. Pappas, Pappas Restaurants, L.P., and Pappas Restaurants, Inc. (filed as Exhibit 10(y) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, refiled as Exhibit 10(y) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2002, to include signature reference and an exhibit that were inadvertently omitted, and incorporated herein by reference).
- 10(w) Ground Lease for a cafeteria site dated March 25, 1994, by and between Luby's Cafeterias, Inc. and PHCG Investments, as amended by Lease Amendment dated July 6, 1994 (filed as Exhibit 10(z) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 10(x) Lease Agreement dated June 1, 2001, by and between Luby's, Inc. and Pappas Restaurants, Inc. (filed as Exhibit 10(aa) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 10(y) Final Severance Agreement and Release between Luby's, Inc. and Alan M. Davis dated July 20, 2001 (filed as Exhibit 10(bb) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference). While in search for new executive management, the Company entered into an employment agreement with Mr. Davis in January 2001. The value of that one-year contract was a year's salary upon termination. After new management was secured, the Company finalized the exhibited agreement that provides for the payment of monthly consulting fees to Mr. Davis until July 2002, but releases the Company from all prior employment commitments.\*
- 10(z) Consultant Agreement between Luby's Restaurants Limited Partnership and Alan M. Davis dated July 20, 2001 (filed as Exhibit 10(cc) to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).\*
- 10(aa) Luby's, Inc. Amended and Restated Nonemployee Director Phantom Stock Plan effective September 28, 2001 (filed as Exhibit 10(dd) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2002, and incorporated herein by reference).\*
- 10(bb) Final Severance Agreement and Release between Luby's, Inc. and S. Darrell Wood effective July 28, 2002 (filed as Exhibit 10(ee) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).\*
- 10(cc) Consultant Agreement dated August 30, 2002, between Luby's Restaurants Limited Partnership and S. Darrell Wood (filed as Exhibit 10(ff) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).\*
- 10(dd) Form of Indemnification Agreement entered into between Luby's, Inc. and each member of its Board of Directors initially dated July 23, 2002 (filed as Exhibit 10(gg) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).
- 10(ee) Amended and Restated Affiliate Services Agreement dated July 23, 2002, by and among Luby's, Inc., Pappas Restaurants, L.P., and Pappas Restaurants, Inc. (filed as Exhibit 10(hh) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).

- 10(ff) Master Sales Agreement dated July 23, 2002, by and among Luby's, Inc., Pappas Restaurants, L.P., and Pappas Restaurants, Inc. and Procedure adopted by the Finance and Audit Committee of the Board of Directors on July 23, 2002, pursuant to Section 2.3 of the Master Sales Agreement (filed as Exhibit 10(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended August 28, 2002, and incorporated herein by reference).
- 10(gg) Lease Agreement dated October 15, 2002, by and between Luby's, Inc. and Rush Truck Centers of Texas, L.P. and Amendment dated August 1, 2003, by and between Luby's, Inc. and Pappas Restaurants, Inc.
- 11 Weighted-average shares used in the recomputation of per share earnings in Note 15 of the Consolidated Notes to Financial Statements.
- 14(a) Policy Guide on Standards of Conduct and Ethics applicable to all employees, as well as the board of directors.
- 14(b) Supplemental Standards of Conduct and Ethics for the CEO, CFO, Controller, and all senior financial officers.
- 21 Subsidiaries of Luby's, Inc. (filed as Exhibit 21 to the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2001, and incorporated herein by reference).
- 31 Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certifications by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99(a) Corporate Governance Guidelines of Luby's, Inc., as amended March 5, 2003 (filed as Exhibit 99(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended February 13, 2003, and incorporated herein by reference).
- 99(b) Consent of Ernst & Young LLP.

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\*Denotes management contract or compensatory plan or arrangement.

## Directors

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### **Gaspar Mir, III**

Chairman of the Board, Luby's, Inc  
Executive Advisor to the Superintendent,  
Houston Independent School District <sup>(1\*, 2\*, 4)</sup>

### **Judith B. Craven, M.D.**

Former President, United Way  
of the Texas Gulf Coast <sup>(1, 2, 3, 5\*)</sup>

### **Arthur R. Emerson**

Chairman and CEO, Groves  
Rojas Emerson <sup>(4)</sup>

### **Jill Griffin**

Principal,  
Griffin Group <sup>(3, 5)</sup>

### **Roger R. Hemminghaus**

Retired Chairman and CEO,  
Ultramar Diamond Shamrock Corp. <sup>(1, 2, 3\*, 5)</sup>

### **J.S.B. Jenkins**

President and CEO,  
Tandy Brands Accessories, Inc. <sup>(4)</sup>

### **Frank Markantonis**

Attorney, Law Offices of  
Frank Markantonis <sup>(5)</sup>

### **Joe C. McKinney**

Vice Chairman,  
Broadway National Bank <sup>(1, 2, 4\*)</sup>

### **Christopher J. Pappas**

President and Chief Executive Officer,  
Luby's, Inc. <sup>(1, 2)</sup>

### **Harris J. Pappas**

Chief Operating Officer,  
Luby's, Inc. <sup>(2, 5)</sup>

### **Joanne Winik**

President and General  
Manager, KLRN-TV <sup>(3, 5)</sup>

### **Jim W. Woliver**

Investor and former executive  
officer of Luby's, Inc. <sup>(3, 5)</sup>

<sup>(1)</sup> Board Governance Committee

<sup>(2)</sup> Executive Committee

<sup>(3)</sup> Executive Compensation Committee

<sup>(4)</sup> Finance and Audit Committee

<sup>(5)</sup> Personnel and Administrative Policy Committee

\* Indicates Chair

## Officers

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*Luby's, Inc. and Luby's Management, Inc.*

### **Executive Officers**

**Gaspar Mir, III**  
Chairman of the Board

**Christopher J. Pappas**  
President and Chief  
Executive Officer

**Harris J. Pappas**  
Chief Operating Officer

**Ernest Pekmezaris**  
Senior Vice President and  
Chief Financial Officer

**Peter Tropoli**  
Senior Vice President-  
Administration and  
General Counsel

### **Vice Presidents**

**Susan L. Beggs**  
Shareholder Relations and  
Assistant Secretary

**Paula Y. Gold-Williams**  
Finance and Accounting

### **Corporate Secretary and Corporate Counsel**

**Drew R. Fuller, Jr.**  
Member of the law firm  
Hornberger Sheehan Fuller  
& Beiter Incorporated

*Luby's Management, Inc.*

### **Area Vice Presidents**

**Richard R. Pogue**

**J. Dan Rathmell**

### **Vice Presidents**

**Steven G. Barrow**  
Information Systems

**Janet L. Duckham**  
Operations Services

**Bill Gordon**  
Real Estate

**Ronald K. Wright**  
Operations

## Area Leaders

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**Daniel T. Bauman**

**Gary L. Black**

**Gerald F. Coffey**

**Edward Davis**

**Dave V. Ferry**

**Clyde C. Hays III**

**William J. Hollis, Jr.**

**Louis S. Lecoche, Jr.**

**Jeffrey L. Munt**

**Keith Martin**

**T. Lloyd Nichols**

**Frederick J. Silhanek III**

**John R. Terry**

**James G. Tibbett**

**Carl G. Wainscott**

**Kenneth C. Warzecha**

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