

RYANS FAMILY STEAKHOUSES INC

Form 10-Q

August 18, 2003

FORM 10-Q

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

Quarterly Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

For the Quarter ended July 2, 2003

Commission File No. 0-10943

RYAN'S FAMILY STEAK HOUSES, INC.  
(Exact name of registrant as specified in its charter)

South Carolina No. 57-0657895  
(State or other jurisdiction (I.R.S. Employer  
of incorporation) Identification No.)

405 Lancaster Avenue (29650)  
P. O. Box 100  
Greer, South Carolina 29652  
(Address of principal executive  
offices, including zip code)

864-879-1000  
(Registrant's telephone number, including area code)

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

Yes X No \_\_\_\_\_

Indicate by check mark whether the registrant is an  
accelerated filer (as defined in Rule12b-2 of the Securities  
Exchange Act of 1934).

Yes X No \_\_\_\_\_

At July 2, 2003, there were 42,123,000 shares outstanding of  
the registrant's common stock, par value \$1.00 per share.

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RYAN'S FAMILY STEAK HOUSES, INC.

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

RYAN'S FAMILY STEAK HOUSES, INC.  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

(In thousands, except per share data)

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	Quarter Ended	
	July 2, 2003	July 3, 2002
Restaurant sales	\$208,504	201,027
Cost of sales:		
Food and beverage	73,801	71,480
Payroll and benefits	64,361	60,952
Depreciation	8,049	7,351
Other restaurant expenses	28,092	26,089
Total cost of sales	174,303	165,872
General and administrative expenses	10,299	9,578
Interest expense	2,322	2,326
Revenues from franchised restaurants	(404)	(463)
Other income, net	(475)	(530)
Earnings before income taxes	22,459	24,244
Income taxes	8,130	8,818
Net earnings	\$ 14,329	15,426
Net earnings per common share:		
Basic	\$ .34	.35
Diluted	.33	.34
Weighted-average shares:		
Basic	42,143	43,733
Diluted	43,670	45,977

See accompanying notes to consolidated financial statements.

RYAN'S FAMILY STEAK HOUSES, INC.  
CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

(In thousands, except per share data)

	Six Months Ended	
	July 2, 2003	July 3, 2002
Restaurant sales	\$401,696	394,597
Cost of sales:		
Food and beverage	141,806	142,202
Payroll and benefits	124,557	119,278
Depreciation	15,997	14,703
Other restaurant expenses	55,304	52,377
Total cost of sales	337,664	328,560
General and administrative expenses	20,113	18,787
Interest expense	4,728	4,601
Revenues from franchised restaurants	(807)	(895)
Other income, net	(1,424)	(1,671)
Earnings before income taxes	41,422	45,215
Income taxes	14,995	16,368
Net earnings	\$ 26,427	28,847

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Net earnings per common share:		
Basic	\$ .62	.65
Diluted	.60	.62
Weighted-average shares:		
Basic	42,313	44,284
Diluted	43,689	46,557

See accompanying notes to consolidated financial statements.

### RYAN'S FAMILY STEAK HOUSES, INC. CONSOLIDATED BALANCE SHEETS (In thousands)

	July 2, 2003	January 1, 2003
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 20,177	2,654
Receivables	5,641	5,010
Inventories	5,811	5,119
Prepaid expenses	776	1,266
Income taxes receivable	-	2,739
Deferred income taxes	4,676	4,676
Total current assets	37,081	21,464
Property and equipment:		
Land and improvements	149,271	144,859
Buildings	429,363	413,700
Equipment	243,076	231,244
Construction in progress	28,866	29,245
	850,576	819,048
Less accumulated depreciation	249,923	234,627
Net property and equipment	600,653	584,421
Other assets	7,698	7,194
	\$645,432	613,079
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	8,937	10,896
Income taxes payable	6,993	-
Accrued liabilities	42,751	35,748
Total current liabilities	58,681	46,644
Long-term debt	202,000	202,000
Deferred income taxes	39,525	39,375
Other long-term liabilities	5,043	4,579
Total liabilities	305,249	292,598
Shareholders' equity:		
Common stock of \$1.00 par value; authorized 100,000,000 shares; issued 42,123,000 in 2003 and 42,745,000 shares in 2002	42,123	42,745
Additional paid-in capital	-	2,066
Retained earnings	298,060	275,670
Total shareholders' equity	340,183	320,481
Commitments and contingencies		
	\$645,432	613,079

See accompanying notes to consolidated financial statements.

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### RYAN'S FAMILY STEAK HOUSES, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

	Six Months Ended	
	July 2, 2003	July 3, 2002
Cash flows from operating activities:		
Net earnings	\$ 26,427	28,847
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	16,858	15,385
Gain on sale of property and equipment	(395)	(8)
Tax benefit from exercise of stock options	284	1,686
Deferred income taxes	150	164
Decrease (increase) in:		
Receivables	(631)	294
Inventories	(692)	365
Prepaid expenses	490	(1,451)
Income taxes receivable	2,739	-
Other assets	(639)	(681)
Increase (decrease) in:		
Accounts payable	(1,959)	(659)
Income taxes payable	6,993	1,498
Accrued liabilities	7,003	3,283
Other long-term liabilities	464	766
Net cash provided by operating activities	57,092	49,489
Cash flows from investing activities:		
Proceeds from sale of property and equipment	3,774	3,697
Capital expenditures	(36,334)	(34,600)
Net cash used in investing activities	(32,560)	(30,903)
Cash flows from financing activities:		
Net proceeds from revolving credit facility	-	17,000
Proceeds from exercise of stock options	832	4,438
Purchases of common stock	(7,841)	(42,514)
Net cash used in financing activities	(7,009)	(21,076)
Net increase (decrease) in cash and cash equivalents	17,523	(2,490)
Cash and cash equivalents - beginning of period	2,654	13,323
Cash and cash equivalents - end of period	\$ 20,177	10,833
Supplemental disclosures		
Cash paid during the period for:		
Interest, net of amount capitalized	\$ 5,129	4,552

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Income taxes	4,829	11,334
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See accompanying notes to consolidated financial statements.

RYAN'S FAMILY STEAK HOUSES, INC.  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
(Unaudited)

(In thousands)

For the Six Months ended July 2, 2003

	\$1 Par Value Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balances at January 1, 2003	\$42,745	2,066	275,670	320,481
Net earnings	-	-	26,427	26,427
Issuance of common stock under stock option plans	134	698	-	832
Tax benefit from exercise of non-qualified stock options	-	284	-	284
Purchases of common stock	(756)	(3,048)	(4,037)	(7,841)
Balances at July 2, 2003	\$42,123	-	298,060	340,183

See accompanying notes to consolidated financial statements.

RYAN'S FAMILY STEAK HOUSES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

July 2, 2003  
(Unaudited)

Note 1. Description of Business

Ryan's Family Steak Houses, Inc. operates a restaurant chain consisting of 330 Company-owned and 20 franchised restaurants located principally in the southern and midwestern United States. Its restaurants operate under the Ryan's or Fire Mountain brand names, but are viewed as a single business unit for management and reporting purposes. The Company, organized in 1977, opened its first restaurant in 1978 and completed its initial public offering in 1982. The Company does not operate or franchise any international units.

Note 2. Basis of Presentation

The consolidated financial statements include the financial statements of Ryan's Family Steak Houses, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States

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of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Consolidated operating results for the six months ended July 2, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2003. For further information, refer to the consolidated financial statements and footnotes included in the Company's annual report on Form 10-K for the fiscal year ended January 1, 2003.

### Note 3. Relevant New Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Statement of Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations" in June 2001. SFAS 143 applies to legal obligations associated with the retirement of certain tangible long-lived assets. This statement is effective for fiscal years beginning after June 15, 2002. Accordingly, the Company adopted this statement on January 2, 2003. The adoption of SFAS 143 has not had a material impact on the Company's financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Obligations Associated with Disposal Activities," which addresses financial reporting and accounting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue 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 a liability be recognized for such costs only when the liability is incurred, which is in contrast to EITF 94-3, which requires the recognition of a liability upon the commitment to an exit plan. The statement is effective for exit or disposal activities that are initiated after December 31, 2002 and has not materially affected the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the disclosure provision of this statement (see Note 4).

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." FIN 45 addresses the requirements for financial statement disclosures to be made by a guarantor about its obligations under certain guarantees and clarifies that a guarantor is required to recognize a liability upon issuing a guarantee for the fair value of the obligation. The Company will apply FIN 45 to any guarantees issued or modified after December 31, 2002. The impact to the Company's financial results has been immaterial. The Company had no material guarantees at July 2, 2003.

In January 2003, the FASB issued Interpretation No. 46 ("FIN

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46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." This interpretation addresses the consolidation by business enterprises of variable interest entities, as defined in the interpretation, and sets forth additional disclosure regarding such interests. FIN 46 applies immediately to variable interest entities created, or in which the Company obtains an interest, after January 31, 2003, and becomes effective July 3, 2003 for all variable interest entities held by the Company prior to that date. The adoption of FIN 46 is not expected to have and has not had a material effect on the Company's consolidated financial statements.

On May 15, 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." The Statement requires issuers to classify as liabilities (or assets in some circumstances) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, the Statement is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The Company adopted the provisions of the Statement on July 3, 2003. The Company does not have any financial instruments within the scope of SFAS 150 at July 2, 2003 and, therefore, does not anticipate that SFAS 150 will have a material effect to the Company.

#### Note 4. Stock Options

As allowed by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company accounts for its stock option plans in accordance with the intrinsic value provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. As such, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. No compensation cost has been recognized for stock-based compensation in consolidated net earnings for the periods presented as all options granted under the Company's stock option plans had exercise prices equal to the market value of the underlying common stock on the date of the grant. Had the Company determined compensation cost based on the fair value recognition provisions of SFAS No. 123, the Company's net earnings and earnings per share would have been reduced to the pro forma amounts indicated in the following table:

(In thousands, except earnings per share)	Quarter Ended		Six Months Ended	
	July 2, 2003	July 3, 2002	July 2, 2003	July 3, 2002
Net earnings, as reported	\$14,329	15,426	26,427	28,847
Less total stock-based compensation expense determined under fair value based method, net of related tax effects	(229)	(368)	(554)	(736)
Pro forma net earnings	\$14,100	15,058	25,873	28,111
Earnings per share				



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### Basic:

As reported	.34	.35	.62	.65
Pro forma	.33	.34	.61	.63

### Diluted:

As reported	.33	.34	.60	.62
Pro forma	.32	.33	.59	.60

### Note 5. Earnings per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS includes common stock equivalents that arise from the hypothetical exercise of outstanding stock options using the treasury stock method. In order to prevent antidilution, outstanding stock options to purchase 40,500 and 3,000 shares of common stock at July 2, 2003 and July 3, 2002, respectively, were not included in the computation of diluted EPS.

### Note 6. Legal Contingencies

From time to time, the Company is involved in various legal claims and litigation arising in the normal course of business. Based on currently-known legal actions, management believes that, as a result of its legal defenses and insurance arrangements, none of these actions, if decided adversely, would have a material effect on the Company's business or financial condition, taken as a whole.

In November 2002, a lawsuit was filed in the United States District Court, Middle District of Tennessee, Nashville Division, on behalf of three plaintiffs alleging various violations by Ryan's of the Fair Labor Standards Act of 1938. The plaintiffs' attorneys have indicated that they intend to seek class-action status on this complaint. Management intends to vigorously defend this lawsuit and has retained two firms to serve as co-lead counsel for the Company. The presiding judge has recently indicated that decisions as to further class notification and any arbitration procedures could be expected in August or September 2003. Any potential financial impact to the Company cannot be determined at this time.

### Note 7. Subsequent Event

On July 25, 2003, the Company completed a private placement of \$100 million of its 4.65% senior notes due 2013. The net proceeds of the private placement were used to reduce both outstanding debt and the credit limit under the existing revolving credit facility. Annual principal payments with respect to the new notes will commence in 2007. The notes are secured by the stock of the Company's wholly-owned subsidiaries, as are the Company's existing 9.02% senior notes due 2008 and revolving credit facility. The note purchase agreement requires the Company to maintain certain financial ratios and a minimum level of shareholders' equity, and contains restrictions regarding capital expenditures, share repurchases and cash dividends, among other things.

As a result of this transaction, the Company's outstanding debt under the revolving credit facility decreased from \$127 million to \$27 million, and the facility's credit limit was

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permanently reduced from \$200 million to \$100 million.

### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### RESULTS OF OPERATIONS

Quarter ended July 2, 2003 versus July 3, 2002

Restaurant sales during the second quarter of 2003 increased by 3.7% over the comparable quarter of 2002. Average unit growth, based on the average number of restaurants in operation, amounted to 2.6% during the quarter. The Company owned and operated 330 restaurants at July 2, 2003 and 316 restaurants at July 3, 2002. Average unit sales ("AUS"), or average weekly sales volume per unit, for all stores (including newly opened restaurants) increased by 0.8% during the second quarter of 2003. Same-store sales decreased by 0.7% during the quarter compared to a 0.7% increase during the second quarter of 2002. The Company calculates same-store sales using AUS in units that have been open for at least 18 months and operating during comparable weeks during the current and prior years. Management believes that sales were adversely affected by a weak retail environment during the second quarter of 2003. In order to stimulate higher same-store sales, the Company implemented in April 2003 a comprehensive local marketing program in which store managers get the Ryan's name in front of potential customers through the use of both external merchandising and community marketing. Based on the positive feedback received from store managers, management believes that over time this program will favorably impact restaurant sales. Also, the Company is continuing its remodeling program that features the display cooking format (see "Liquidity and Capital Resources") and a new exterior lodge-look. Management has been encouraged by the sales results at the remodeled stores. However, at July 2, 2003, only 14 restaurants in the same-store sales base were part of the new remodeling program, and their impact on overall sales was limited. The Company plans to remodel an additional 15 to 20 stores during the second half of 2003. Each store is closed for approximately four to six weeks during the remodeling process.

Cost of sales includes food and beverage, payroll, payroll taxes and employee benefits, depreciation, repairs, maintenance, utilities, supplies, advertising, insurance, property taxes and licenses at Company-owned restaurants. Such costs, as a percentage of sales, were 83.6% during the second quarter of 2003 compared to 82.5% during the second quarter of 2002. Food and beverage costs decreased to 35.4% of sales in 2003 from 35.6% of sales in 2002 due to lower dairy costs substantially offset by higher sirloin, produce and soybean oil prices. Payroll and benefits increased to 30.9% of sales in 2003 from 30.3% of sales in 2002 due principally to higher manager pay and unemployment taxes. Manager pay increased due to better staffing and higher wage levels. Unemployment taxes were higher due to 2003 state unemployment tax rate increases. All other restaurant costs, including depreciation, increased to 17.3% of sales in 2003 from 16.6% of sales in 2002 due principally to higher depreciation expense associated with recent higher capital

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expenditure levels and higher utility costs due to natural gas rate increases. Based on these factors, the Company's margins at the restaurant level decreased by 1.1% of sales to 16.4% of sales in 2003 from 17.5% of sales in 2002.

General and administrative expenses increased to 4.9% of sales in 2003 from 4.8% of sales in 2002 due principally to higher wages and travel costs associated with the additional training team related to the remodeling program.

Interest expense for the second quarter of 2003 and 2002 amounted to 1.1% and 1.2% of sales, respectively. The effective average interest rate decreased to 5.0% during the second quarter of 2003 from 5.5% in 2002, resulting from a favorable interest rate environment. At July 2, 2003, approximately 63% of the Company's outstanding debt was variable-rate debt with interest rates based generally on the London Interbank Offered Rate ("LIBOR"). On July 25, 2003, the Company refinanced \$100 million of the variable-rate debt with fixed-rate senior notes (see "Subsequent Event"), reducing the variable-rate percentage from 63% to 13%.

An effective income tax rate of 36.2% was used for the second quarter of 2003 compared to 36.4% for the second quarter of 2002. The effective income tax rate for the full year 2002 was 36.2%.

Net earnings for the second quarter amounted to \$14.3 million in 2003 compared to \$15.4 million in 2002. Weighted-average shares (diluted) decreased 5.0% resulting principally from the Company's stock repurchase program (see "Liquidity and Capital Resources"). Accordingly, earnings per share (diluted) was 33 cents for 2003 and 34 cents for 2002.

Six months ended July 2, 2003 versus July 3, 2002

For the six months ended July 2, 2003, restaurant sales were up 1.8% compared to the same period in 2002. Principal factors affecting 2003 sales growth include the 2.7% unit growth of Company-owned restaurants and a 1.1% decrease in all-store AUS. Same-store sales for the first six months of 2003 decreased by 2.4%.

Cost of sales, as detailed above, for the first six months of 2003 and 2002 amounted to 84.1% and 83.3% of sales, respectively. Food and beverage costs decreased by 0.7% of sales due to lower pork, seafood, poultry and dairy costs. In addition to various specific items, all other costs, when expressed as a percent of sales, were impacted by lower AUS. Payroll and benefits increased by 0.8% of sales to 31.0% of sales for 2003 from 30.2% for 2002 due to higher hourly labor, manager pay and unemployment taxes. All other restaurant costs, including depreciation, increased by 0.8% of sales due to higher depreciation and utility costs partially offset by lower store closing costs. Based on these factors, the Company's operating margin at the restaurant level amounted to 15.9% of sales for the first six months of 2003 compared to 16.7% of sales in 2002.

General and administrative expenses increased by 0.2% of sales for the first six months of 2003 due principally to higher training costs and the impact of lower AUS on the many fixed-

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cost items included in this expense category.

An effective income tax rate of 36.2% was used for the first six months of both 2003 and 2002.

Net earnings for the first six months of 2003 amounted to \$26.4 million compared to \$28.8 million in 2002. Weighted-average shares (diluted) decreased 6.2% resulting from the Company's stock repurchase program (see "Liquidity and Capital Resources"). Accordingly, earnings per share (diluted) amounted to 60 cents in 2003 compared to 62 cents in 2002.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's restaurant sales are primarily derived from cash. Inventories are purchased on credit and are rapidly converted to cash, generally prior to the payment of the related vendors' invoices. Therefore, the Company does not maintain significant receivables or inventories, and other working capital requirements for operations are not significant. Cash balances in excess of immediate disbursement requirements are typically used for non-current items, such as capital expenditures, repayment of long-term debt or stock repurchases. Accordingly, the Company generally operates with a working capital deficit, which is managed through the utilization of a predictable cash flow from restaurant sales and available credit under a revolving credit facility.

At July 2, 2003, the Company's working capital deficit amounted to \$21.6 million compared to a \$25.2 million deficit at January 1, 2003. Management does not anticipate any adverse effects from the current working capital deficit due to (i) cash flow provided by operations, which amounted to \$57.1 million for the first six months of 2003 and \$82.4 million for the year ended January 1, 2003, and (ii) approximately \$64 million in funds available under a revolving credit facility.

Total capital expenditures for the first six months of 2003 amounted to \$36.3 million. The Company opened eight and closed two restaurants during the first six months of 2003. This activity included one opening and one closing for relocation purposes. Management defines a relocation as a restaurant opened within six months after closing another restaurant in the same marketing area. A relocation represents a redeployment of assets within a market. For the remainder of 2003, the Company plans to build and open 10 new restaurants, including four potential relocations. All new restaurants will open with the display cooking format. This format was introduced in 2000 and involves a glass-enclosed grill and cooking area that extends into the dining room. A variety of meats are grilled daily and available to customers as part of the buffet price. Customers go to the grill and can get hot, cooked-to-order steak, chicken or other grilled items placed directly from the grill onto their plates. Management also intends to convert approximately 30 to 35 restaurants during 2003 to the display cooking format. These conversions will generally include an exterior remodeling package that gives the building a new lodge-look. Management believes that the exterior package will favorably impact restaurant sales by signaling to potential customers that changes have taken place

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inside the restaurant. Total 2003 capital expenditures are estimated at \$74 million. The Company is currently concentrating its efforts on Company-owned Ryan's restaurants and is not actively pursuing any additional franchised locations, either domestically or internationally.

The Company began a stock repurchase program in March 1996 and is currently authorized to repurchase up to 55 million shares of the Company's common stock through December 2004. Repurchases may be made from time to time on the open market or in privately negotiated transactions in accordance with applicable securities regulations, depending on market conditions, share price and other factors. During the first six months of 2003, the Company purchased 756,300 shares at an aggregate cost of \$7.8 million. Through July 2, 2003, approximately 42.4 million shares, or 53% of total shares available at the beginning of the repurchase program, had been purchased at an aggregate cost of \$304.0 million. Management currently plans to purchase up to approximately \$16 million of its common stock during the remainder of 2003 if, in management's opinion, the share price is at an attractive level, subject to the continued availability of capital, the limitations imposed by the Company's credit agreements, applicable securities regulations and the other factors described in "Forward-Looking Information."

At July 2, 2003, the Company's outstanding debt consisted of \$75 million of 9.02% senior notes and a \$200 million revolving credit facility of which \$127 million was outstanding at that date. As noted above, after allowances for letters of credit and other items, there was approximately \$64 million in funds available under the revolving credit facility. The Company's ability to draw on these funds may be limited by restrictions in the agreements governing both the senior notes and the revolving credit facility. Management believes that, based on its current plans, these restrictions will not impair the Company's operations during 2003. See "Subsequent Event" for a financing transaction that closed after the end of the quarter.

Management believes that its current capital structure is sufficient to meet its 2003 cash requirements. The Company has entered into interest rate hedging transactions in the past, and although no such agreements are currently outstanding, management intends to continue monitoring the interest rate environment and may enter into such transactions in the future if deemed advantageous.

### SUBSEQUENT EVENT

On July 25, 2003, the Company completed a private placement of \$100 million of its 4.65% senior notes due 2013. The net proceeds of the private placement were used to reduce both outstanding debt and the credit limit under the existing revolving credit facility. Annual principal payments with respect to the new notes will commence in 2007. The notes are secured by the stock of the Company's wholly-owned subsidiaries, as are the Company's existing 9.02% senior notes due 2008 and revolving credit facility. The note purchase agreement requires the Company to maintain certain financial ratios and a minimum level of shareholders' equity, and contains restrictions regarding capital expenditures, share

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repurchases and cash dividends, among other things.

As a result of this transaction, the Company's outstanding debt under the revolving credit facility decreased from \$127 million to \$27 million, and the facility's credit limit was permanently reduced from \$200 million to \$100 million.

### CRITICAL ACCOUNTING POLICIES

Critical accounting policies are those policies that significantly impact the Company's financial statements and involve difficult or subjective estimates of future events by management. Management's estimates could differ significantly from actual results, leading to possible significant adjustments to future financial results. The following policies are considered by management to involve estimates that most critically impact reported financial results.

**Asset Lives** Property and equipment are recorded at cost, less accumulated depreciation. Buildings and land improvements are depreciated over estimated useful lives ranging from 25 to 39 years, and equipment is depreciated over estimated useful lives ranging from 3 to 10 years. Depreciation expense for financial statement purposes is calculated using the straight-line method. Management is responsible for estimating the initial useful lives and any revisions thereafter and bases its estimates principally on historical usage patterns of the assets. Material differences in the amount of reported depreciation could result if different assumptions were used.

**Impairment of Long-Lived Assets** Long-lived assets, which consist principally of restaurant properties, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For restaurants that will continue to be operated, the carrying amount is compared to the undiscounted future cash flows, including proceeds from future disposal, over the remaining useful life of the restaurant. The estimate of future cash flows is based on management's review of historical and current sales and cost trends of both the subject and similar restaurants. The estimate of proceeds from future disposal is based on management's knowledge of current and planned development near the restaurant site and on current market transactions. If the carrying amount exceeds the sum of the undiscounted future cash flows, the carrying value is reduced to the restaurant's current fair value. If the decision has been made to close and sell a restaurant, the carrying value of that restaurant is reduced to its current fair value less costs to sell and is no longer depreciated.

**Self-Insurance Liabilities** The Company self-insures a significant portion of expected losses from its workers' compensation, general liability and team member medical programs. For workers' compensation and general liability claims, individual amounts in excess of \$250,000 are covered by insurance purchased by the Company. Accrued liabilities are recorded for the estimated, undiscounted future net payments, or ultimate costs, to settle both reported claims and claims that have been incurred but not reported. On a quarterly basis, management reviews claim values as estimated by a third-party claims administrator ("TPA") and then adjusts

these values for estimated future increases in order to record ultimate costs. Both current and prior years' claims are reviewed as estimated claim values are frequently adjusted by the TPA as new information, such as updated medical reports or settlements, is received. Management reviews the relationship between historical claim estimates and payment history, overall number of accidents and historical claims experience in order to make an ultimate cost estimate. For team member medical claims, individual amounts in excess of \$300,000 are covered by insurance purchased by the Company. Accruals are based on management's review of historical claim experience. Unexpected changes in any of these factors could result in costs that are materially different than initially reported.

#### IMPACT OF INFLATION

The Company's operating costs that may be affected by inflation consist principally of food, payroll and utility costs. A significant number of the Company's restaurant team members are paid at the Federal minimum wage and accordingly, legislated changes to the minimum wage affect the Company's payroll costs. Although no minimum wage increases have been signed into law, legislation proposing to increase the minimum wage by \$1.50 to \$6.65 per hour over a 14-month period is currently under consideration by the U.S. Congress. The Company is typically able to increase menu prices to cover most of the payroll rate increases.

The Company considers its current price structure to be very competitive. This factor, among others, is considered by the Company when passing cost increases on to its customers. Annual menu price increases during the last five years have generally ranged from 2% to 4%.

#### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk relates primarily to changes in interest rates. Foreign currencies are not used in the Company's operations, and approximately 90% of the products used in the preparation of food at the Company's restaurants are not under purchase contract for more than one year in advance.

The Company is exposed to interest rate risk on its variable-rate debt, which is composed entirely of outstanding debt under the Company's revolving credit facility (see "Liquidity and Capital Resources"). At July 2, 2003, there was \$127 million in outstanding debt under this facility. Interest rates for the facility generally change in response to LIBOR. Management estimates that a one-percent change in interest rates throughout the quarter ended July 2, 2003 would have impacted interest expense by approximately \$281,000 and net earnings by \$179,000. On July 25, 2003, the Company completed a private placement of \$100 million of its 4.65% senior notes due 2013 (see "Subsequent Event" above). This transaction replaced variable-rate debt with fixed-rate debt, thereby reducing the Company's exposure to future interest rate fluctuations. If these new notes had been outstanding for the entire second quarter of 2003, management estimates that interest expense would have increased by approximately

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\$405,000 and net earnings would have decreased by approximately \$258,000.

While the Company has entered into interest rate derivative agreements in the past, there were no such agreements outstanding during the three months ended July 2, 2003. The Company does not enter into financial instrument agreements for trading or speculative purposes.

### Item 4. CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) or 15d-15(b) of the Securities Exchange Act of 1934, as amended, the Company's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Exchange Act) as of the end of the period covered by this report, and have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that information required to be disclosed is recorded, processed, summarized, and reported in a timely manner.

### FORWARD-LOOKING INFORMATION

In accordance with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions that the statements in this quarterly report and elsewhere that are forward-looking involve risks and uncertainties that may impact the Company's actual results of operations. All statements other than statements of historical fact that address activities, events or developments that the Company expects or anticipates will or may occur in the future, including such things as deadlines for completing projects, expected financial results, expected regulatory environment and other such matters, are forward-looking statements. The words "estimates", "plans", "anticipates", "expects", "intends", "believes" and similar expressions are intended to identify forward-looking statements. All forward-looking information reflects the Company's best judgment based on current information. However, there can be no assurance that other factors will not affect the accuracy of such information. While it is not possible to identify all factors, the following could cause actual results to differ materially from expectations: general economic conditions including consumer confidence levels; competition; developments affecting the public's perception of buffet-style restaurants; real estate availability; food and labor supply costs; food and labor availability; weather fluctuations; interest rate fluctuations; stock market conditions; political environment (including acts of terrorism and wars); and other risks and factors described from time to time in the Company's reports filed with the Securities and Exchange Commission, including the Company's annual report on Form 10-K for the fiscal year ended January 1, 2003. The ability of the Company to open new restaurants depends upon a number of factors, including its ability to find suitable locations and negotiate acceptable land acquisition and construction contracts, its ability to attract and retain sufficient numbers of restaurant managers and team members and the availability of reasonably priced capital. The extent of the Company's stock repurchase program during 2003 and future years depends upon the



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financial performance of the Company's restaurants, the investment required to open new restaurants, share price, the availability of reasonably priced capital, the financial covenants contained in the Company's loan agreements that govern the senior notes and the revolving credit facility, and the maximum debt and share repurchase levels authorized by the Company's Board of Directors.

### PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings.

In November 2002, a lawsuit was filed in the United States District Court, Middle District of Tennessee, Nashville Division, on behalf of three plaintiffs alleging various violations by Ryan's of the Fair Labor Standards Act of 1938. The plaintiffs' attorneys have indicated that they intend to seek class-action status on this complaint. Management intends to vigorously defend this lawsuit and has retained two firms to serve as co-lead counsel for the Company. The presiding judge has recently indicated that decisions as to further class notification and any arbitration procedures could be expected in August or September 2003. Any potential financial impact to the Company cannot be determined at this time.

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

The following table summarizes the results of the shareholder votes cast at the Annual Meeting of Shareholders held on April 30, 2003 (all votes are in thousands):

	For	Against	Withheld	Abstain	Broker- Nonvotes
(a) Election of Directors:					
C. D. Way	37,650	n/a	294	n/a	n/a
G. E. McCranie	37,650	n/a	294	n/a	n/a
B. L. Edwards	37,650	n/a	294	n/a	n/a
J. M. Shoemaker, Jr.	35,080	n/a	2,864	n/a	n/a
H. K. Roberts, Jr.	37,650	n/a	294	n/a	n/a
J. D. Cockman	37,650	n/a	294	n/a	n/a
B. S. MacKenzie	37,650	n/a	294	n/a	n/a
(b) Ratify the appointment of KPMG LLP for fiscal 2003	36,708	1,218	n/a	18	n/a

#### Item 5. Other Information.

Consistent with Section 10A(i)(2) of the Securities Exchange Act of 1934, the Company is required to disclose all non-audit services approved in the second quarter of 2003 by the Company's Audit Committee to be performed by KPMG LLP, the Company's external auditor. During the quarterly period covered by this filing, the Audit Committee did not approve the engagement of KPMG LLP for any non-audit services, and KPMG LLP did not perform any such services.

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Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits (numbered in accordance with Item 601 of Regulation S-K):

- | Exhibit # | Description                                                                                                                                                                                                       |
|-----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1      | Third Amendment dated as of July 25, 2003 to the Credit Agreement listed as Exhibit 10.23 to the Annual Report on Form 10-K for the period ended January 1, 2003 (Commission file no. 0-10943) (the "2002 10-K"). |
| 10.2      | First Amendment dated as of July 25, 2003 to the Note Purchase Agreement listed as Exhibit 10.24 to the 2002 10-K.                                                                                                |
| 10.3      | Note Purchase Agreement between Ryan's Family Steak Houses, Inc. and various lenders for \$100,000,000 of 4.65% Senior Notes due July 25, 2013.                                                                   |
| 31.1      | Section 302 Certification of Chief Executive Officer                                                                                                                                                              |
| 31.2      | Section 302 Certification of Chief Financial Officer                                                                                                                                                              |
| 32.1      | Section 906 Certification of Chief Executive Officer                                                                                                                                                              |
| 31.2      | Section 906 Certification of Chief Financial Officer                                                                                                                                                              |

(b) Reports on Form 8-K:

On April 24, 2003, the Company filed a report on Form 8-K regarding the press release on the Company's financial results as of and for the quarter ended April 2, 2003.

On April 25, 2003, the Company filed a report on Form 8-K regarding the conference call to review the Company's financial results as of and for the quarter ended April 2, 2003.

On July 23, 2003, the Company filed a report on Form 8-K regarding the press release on the Company's financial results as of and for the quarter and six months ended July 2, 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RYAN'S FAMILY STEAK HOUSES, INC.  
(Registrant)

August 15, 2003

/s/Charles D. Way  
Charles D. Way

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Chairman, President and Chief  
Executive Officer

August 15, 2003

/s/Fred T. Grant, Jr.  
Fred T. Grant, Jr.  
Senior Vice President-Finance and  
Treasurer

August 15, 2003

/s/Richard D. Sieradzki  
Richard D. Sieradzki  
Controller