

ALEXANDERS J CORP  
Form 10-Q  
August 13, 2008

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

**FORM 10-Q**

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

**For quarterly period ended June 29, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission file number: 1-8766**

**J. ALEXANDER S CORPORATION**

*(Exact name of registrant as specified in its charter)*

**Tennessee**

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

**62-0854056**

*(I.R.S. Employer  
Identification No.)*

**3401 West End Avenue, Suite 260**

**P.O. Box 24300**

**Nashville, Tennessee**

*(Address of principal executive offices)*

**37202**

*(Zip Code)*

Registrant's telephone number, including area code: **(615)269-1900**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of August 12, 2008, 6,675,468 shares of the registrant's Common Stock, \$.05 par value, were outstanding.

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	<b>June 29 2008</b>	December 30 2007
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	<b>\$ 8,715</b>	\$ 11,325
Accounts and notes receivable	<b>3,106</b>	3,365
Inventories	<b>1,090</b>	1,297
Deferred income taxes	<b>1,047</b>	1,047
Prepaid expenses and other current assets	<b>1,809</b>	1,596
<b>TOTAL CURRENT ASSETS</b>	<b>15,767</b>	18,630
<b>OTHER ASSETS</b>	<b>1,420</b>	1,341
<b>PROPERTY AND EQUIPMENT</b> , at cost, less allowances for depreciation and amortization of \$48,373 and \$45,698 at June 29, 2008 and December 30, 2007, respectively	<b>81,651</b>	78,551
<b>DEFERRED INCOME TAXES</b>	<b>5,341</b>	5,341
<b>DEFERRED CHARGES</b> , less amortization	<b>677</b>	716
	<b>\$ 104,856</b>	\$ 104,579

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	<b>June 29 2008</b>	December 30 2007
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 5,551	\$ 5,885
Accrued expenses and other current liabilities	3,699	5,123
Unearned revenue	1,476	2,255
Current portion of long-term debt and obligations under capital leases	925	955
<b>TOTAL CURRENT LIABILITIES</b>	<b>11,651</b>	14,218
<b>LONG-TERM DEBT AND OBLIGATIONS UNDER CAPITAL LEASES, net of portion classified as current</b>	<b>20,911</b>	21,349
<b>OTHER LONG-TERM LIABILITIES</b>	<b>6,681</b>	6,431
<b>STOCKHOLDERS EQUITY</b>		
Common Stock, par value \$.05 per share: Authorized 10,000,000 shares; issued and outstanding 6,674,468 and 6,655,625 shares at June 29, 2008 and December 30, 2007, respectively	334	333
Preferred Stock, no par value: Authorized 1,000,000 shares; none issued		
Additional paid-in capital	35,996	35,764
Retained earnings	29,283	26,484
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>65,613</b>	62,581
	<b>\$ 104,856</b>	\$ 104,579

See notes to condensed consolidated financial statements.

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**J. Alexander's Corporation and Subsidiaries**  
**Consolidated Statements of Income**  
**(Unaudited in thousands, except per share amounts)**

	Quarter Ended		Six Months Ended	
	<b>June 29 2008</b>	July 1 2007	<b>June 29 2008</b>	July 1 2007
Net sales	<b>\$ 34,767</b>	\$ 34,742	<b>\$ 72,253</b>	\$ 71,267
Costs and expenses:				
Cost of sales	<b>10,803</b>	11,279	<b>22,851</b>	22,993
Restaurant labor and related costs	<b>11,253</b>	11,138	<b>22,952</b>	22,362
Depreciation and amortization of restaurant property and equipment	<b>1,445</b>	1,298	<b>2,890</b>	2,577
Other operating expenses	<b>7,267</b>	6,911	<b>14,679</b>	13,835
Total restaurant operating expenses	<b>30,768</b>	30,626	<b>63,372</b>	61,767
General and administrative expenses	<b>2,391</b>	2,502	<b>4,924</b>	4,810
Pre-opening expense	<b>289</b>	56	<b>333</b>	56
Operating income	<b>1,319</b>	1,558	<b>3,624</b>	4,634
Other income (expense):				
Interest expense	<b>(427)</b>	(465)	<b>(879)</b>	(951)
Interest income	<b>41</b>	184	<b>103</b>	359
Other, net	<b>17</b>	21	<b>34</b>	38
Total other expense	<b>(369)</b>	(260)	<b>(742)</b>	(554)
Income before income taxes	<b>950</b>	1,298	<b>2,882</b>	4,080
Income tax benefit (provision)	<b>273</b>	(345)	<b>(83)</b>	(1,102)
Net income	<b>\$ 1,223</b>	\$ 953	<b>\$ 2,799</b>	\$ 2,978
Basic earnings per share	<b>\$ .18</b>	\$ .14	<b>\$ .42</b>	\$ .45
Diluted earnings per share	<b>\$ .18</b>	\$ .14	<b>\$ .41</b>	\$ .43

See notes to condensed consolidated financial statements.

**Table of Contents****J. Alexander's Corporation and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(Unaudited in thousands)**

	Six Months Ended	
	<b>June 29 2008</b>	July 1 2007
Cash flows from operating activities:		
Net income	<b>\$ 2,799</b>	\$ 2,978
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	<b>2,921</b>	2,618
Changes in working capital accounts	<b>(2,098)</b>	(1,771)
Other operating activities	<b>520</b>	460
Net cash provided by operating activities	<b>4,142</b>	4,285
Cash flows from investing activities:		
Purchase of property and equipment	<b>(5,081)</b>	(3,298)
Other investing activities	<b>(71)</b>	(46)
Net cash used in investing activities	<b>(5,152)</b>	(3,344)
Cash flows from financing activities:		
Payments on debt and obligations under capital leases	<b>(468)</b>	(438)
Decrease in bank overdraft	<b>(527)</b>	(317)
Payment of cash dividend	<b>(666)</b>	(657)
Exercise of stock options	<b>35</b>	373
Payment of required withholding taxes on behalf of an employee in connection with the net share settlement of an employee stock option exercised		(101)
Excess tax benefit related to share-based compensation	<b>26</b>	243
Net cash used in financing activities	<b>(1,600)</b>	(897)
(Decrease) increase in cash and cash equivalents	<b>(2,610)</b>	44
Cash and cash equivalents at beginning of period	<b>11,325</b>	14,688
Cash and cash equivalents at end of period	<b>\$ 8,715</b>	\$ 14,732
Supplemental disclosures of non-cash items:		
Property and equipment obligations accrued at beginning of period	<b>\$ 610</b>	\$ 123
Property and equipment obligations accrued at end of period	<b>\$ 1,609</b>	\$ 652
See notes to condensed consolidated financial statements.		





**Table of Contents****J. Alexander's Corporation and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Unaudited)****NOTE A BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and rules of the United States Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles 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. Operating results for the quarter and six months ended June 29, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending December 28, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the J. Alexander's Corporation (the Company's) Annual Report on Form 10-K for the fiscal year ended December 30, 2007.

Net income and comprehensive income are the same for all periods presented.

**NOTE B EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share:

	Quarter Ended		Six Months Ended	
	<b>June 29 2008</b>	July 1 2007	<b>June 29 2008</b>	July 1 2007
(In thousands, except per share amounts)				
<b>Numerator:</b>				
Net income (numerator for basic and diluted earnings per share)	<b>\$ 1,223</b>	\$ 953	<b>\$ 2,799</b>	\$ 2,978
<b>Denominator:</b>				
Weighted average shares (denominator for basic earnings per share)	<b>6,674</b>	6,611	<b>6,669</b>	6,591
Effect of dilutive securities	<b>205</b>	398	<b>210</b>	363
Adjusted weighted average shares (denominator for diluted earnings per share)	<b>6,879</b>	7,009	<b>6,879</b>	6,954
Basic earnings per share	<b>\$ .18</b>	\$ .14	<b>\$ .42</b>	\$ .45
Diluted earnings per share	<b>\$ .18</b>	\$ .14	<b>\$ .41</b>	\$ .43

The calculations of diluted earnings per share exclude stock options for the purchase of 659,500 shares and 300,000 shares of the Company's common stock for the quarters ended June 29, 2008 and July 1, 2007, respectively, because the effect of their inclusion would be anti-dilutive. Anti-dilutive options to purchase 522,250 and 150,000 shares of common stock were excluded from the diluted earnings per share calculation for the six months ended June 29, 2008 and July 1, 2007, respectively.

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**NOTE C INCOME TAXES**

The Company's income tax provisions for the first six months of 2008 and 2007 were based on estimated effective annual rates of 2.9% and 27.0%, respectively. These rates are lower than the statutory federal rate of 34% due primarily to the effect of FICA tip tax credits, with the effect of those credits being partially offset by the effect of state income taxes. An income tax benefit of \$273,000 was recorded in the second quarter of 2008 due to the effect of lowering the estimated annual effective rate for 2008 in the second quarter primarily because the Company's estimate of pre-tax income for the year was lowered.

**NOTE D COMMITMENTS AND CONTINGENCIES**

As a result of the disposition of its Wendy's operations in 1996, the Company remains secondarily liable for certain real property leases with remaining terms of one to eight years. The total estimated amount of lease payments remaining on these 12 leases at June 29, 2008 was approximately \$2.1 million. Also, in connection with the sale of its Mrs. Winner's Chicken & Biscuit restaurant operations in 1989 and certain previous dispositions, the Company remains secondarily liable for certain real property leases with remaining terms of one to five years. The total estimated amount of lease payments remaining on these 20 leases at June 29, 2008, was approximately \$800,000. Additionally, in connection with the previous disposition of certain other Wendy's restaurant operations, primarily the southern California restaurants in 1982, the Company remains secondarily liable for real property leases with remaining terms of one to five years. The total estimated amount of lease payments remaining on these eight leases as of June 29, 2008, was approximately \$500,000.

The Company is from time to time subject to routine litigation incidental to its business. The Company believes that the results of such legal proceedings will not have a materially adverse effect on the Company's financial condition, operating results or liquidity.

**NOTE E RECENT ACCOUNTING PRONOUNCEMENTS**

In 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities. The standard expands required disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years which began after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, which have been deferred for one year. Adoption of this Statement at the beginning of fiscal 2008 had no impact on the Company's Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159), which gives entities the option to measure eligible financial assets and financial liabilities at fair value on an instrument by instrument basis which are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is

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available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This Statement is effective for fiscal years which began after November 15, 2007. Adoption of this Statement at the beginning of fiscal 2008 had no impact on the Company's Condensed Consolidated Financial Statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS 161 ). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and is effective for fiscal years beginning after November 15, 2008, and the Company will adopt these provisions in the first quarter of fiscal 2009. The Company is currently evaluating the impact of adopting SFAS 161 on its 2009 Consolidated Financial Statements.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, Determination of the Useful Life of Intangible Assets ( FSP 142-3 ). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets and requires enhanced related disclosures. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and the Company will adopt these provisions in the first quarter of fiscal 2009. The Company is currently evaluating the impact of adopting FSP 142-3 on its 2009 Consolidated Financial Statements.

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

**Overview**

J. Alexander's Corporation (the Company) operates upscale casual dining restaurants. At June 29, 2008, the Company operated 30 J. Alexander's restaurants in 12 states. The Company's net sales are derived primarily from the sale of food and alcoholic beverages in its restaurants.

The Company's strategy is for J. Alexander's restaurants to compete in the restaurant industry by providing guests with outstanding professional service, high-quality food, and an attractive environment with an upscale, high-energy ambiance. Quality is emphasized throughout J. Alexander's operations and substantially all menu items are prepared on the restaurant premises using fresh, high-quality ingredients. The Company's goal is for each J. Alexander's restaurant to be perceived by guests in its market as a market leader in each of the categories above. J. Alexander's restaurants offer a contemporary American menu designed to appeal to a wide range of consumer tastes. The Company believes, however, that its restaurants are most popular with more discriminating guests with higher discretionary incomes. J. Alexander's typically does not advertise in the media and relies on each restaurant to increase sales by building its reputation as an outstanding dining establishment. The Company has generally been successful in achieving sales increases in its restaurants over time using this strategy. Currently, however, the Company is experiencing decreases in same store sales as is further discussed under Net Sales and management believes it will be very difficult to increase, or even maintain, same store sales until consumers regain their confidence and consumer spending improves.

The restaurant industry is highly competitive and is often affected by changes in consumer tastes and discretionary spending patterns; changes in general economic conditions; public safety conditions or concerns; demographic trends; weather conditions; the cost of food products, labor and energy; and governmental regulations. Because of these factors, the Company's management believes it is of critical importance to the Company's success to effectively execute the Company's operating strategy and to constantly evolve and refine the critical conceptual elements of J. Alexander's restaurants in order to distinguish them from other casual dining competitors and maintain the Company's competitive position.

The restaurant industry is also characterized by high capital investment for new restaurants and relatively high fixed or semi-variable restaurant operating expenses. Because a significant portion of restaurant operating expenses are fixed or semi-variable in nature, changes in sales in existing restaurants are generally expected to significantly affect restaurant profitability because many restaurant costs and expenses are not expected to change at the same rate as sales. Management believes that excellence in restaurant operations, and particularly providing exceptional guest service, will maintain or increase net sales in the Company's restaurants over time and will support menu pricing levels which allow the Company to achieve reasonable operating margins while absorbing the higher costs of providing high-quality dining experiences and operating cost increases.

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Changes in sales for existing restaurants are generally measured in the restaurant industry by computing the change in same store sales, which represents the change in sales for the same group of restaurants from the same period in the prior year. Same store sales changes can be the result of changes in guest counts, which the Company estimates based on a count of entrée items sold, and changes in the average check per guest. The average check per guest can be affected by menu price changes and the mix of menu items sold. Management regularly analyzes guest count, average check and product mix trends for each restaurant in order to improve menu pricing and product offering strategies. Management believes it is important to maintain or increase guest counts and average guest checks over time in order to improve the Company's profitability.

Other key indicators which can be used to evaluate and understand the Company's restaurant operations include cost of sales, restaurant labor and related costs and other operating expenses, with a focus on these expenses as a percentage of net sales. Since the Company uses primarily fresh ingredients for food preparation, the cost of food commodities can vary significantly from time to time due to a number of factors. The Company generally expects to increase menu prices in order to offset the increase in the cost of food products as well as increases which the Company experiences in labor and related costs and other operating expenses, but attempts to balance these increases with the goals of providing reasonable value to the Company's guests. Management believes that restaurant operating margin, which is net sales less total restaurant operating expenses expressed as a percentage of net sales, is an important indicator of the Company's success in managing its restaurant operations because it is affected by the level of sales achieved, menu pricing strategy, and the management and control of restaurant operating expenses in relation to net sales.

The number of restaurants opened or under development in a particular year can have a significant impact on the Company's operating results because pre-opening expense for new restaurants is significant and most new restaurants incur operating losses during their early months of operation.

Because large capital investments are required for J. Alexander's restaurants and because a significant portion of labor costs and other operating expenses are fixed or semi-variable in nature, management believes the sales required for a J. Alexander's restaurant to break even are relatively high compared to many other casual dining concepts and that it is necessary for the Company to achieve relatively high sales volumes in its restaurants in order to achieve desired financial returns. The Company's criteria for new restaurant development target locations with high population densities and high household incomes which management believes provide the best prospects for achieving attractive financial returns on the Company's investments in new restaurants. The Company expects to open three new restaurants in the last half of 2008.

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The following table sets forth, for the periods indicated, (i) the items in the Company's Condensed Consolidated Statements of Income expressed as a percentage of net sales, and (ii) other selected operating data:

	Quarter Ended		Six Months Ended	
	June 29 2008	July 1 2007	June 29 2008	July 1 2007
Net sales	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of sales	31.1	32.5	31.6	32.3
Restaurant labor and related costs	32.4	32.1	31.8	31.4
Depreciation and amortization of restaurant property and equipment	4.2	3.7	4.0	3.6
Other operating expenses	20.9	19.9	20.3	19.4
Total restaurant operating expenses	88.5	88.2	87.7	86.7
General and administrative expenses	6.9	7.2	6.8	6.7
Pre-opening expense	0.8	0.2	0.5	0.1
Operating income	3.8	4.5	5.0	6.5
Other income (expense):				
Interest expense	(1.2)	(1.3)	(1.2)	(1.3)
Interest income	0.1	0.5	0.1	0.5
Other, net		0.1		0.1
Total other expense	(1.1)	(0.7)	(1.0)	(0.8)
Income before income taxes	2.7	3.7	4.0	5.7
Income tax benefit (provision)	0.8	(1.0)	(0.1)	(1.5)
Net income	3.5%	2.7%	3.9%	4.2%

*Note: Certain percentage totals do not sum due to rounding.*

Restaurants open at end of period	30	28		
Average weekly sales per restaurant (1):				
All restaurants	\$ 89,300	\$ 95,400	\$ 92,900	\$ 97,800
Percent change	-6.4%		-5.0%	
Same store restaurants (2)	\$ 91,300	\$ 95,400	\$ 94,500	\$ 97,800
Percent change	-4.3%		-3.4%	

(1) The Company computes average weekly sales per restaurant by dividing total restaurant sales for the period by

the total number of days all restaurants were open for the period to obtain a daily sales average, with the daily sales average then multiplied by seven to arrive at weekly average sales per restaurant. Days on which restaurants are closed for business for any reason other than the scheduled closure of all J. Alexander's restaurants on Thanksgiving day and Christmas day are excluded from this calculation. Average weekly same store sales per restaurant are computed in the same manner as described above except that sales and sales days used in the calculation include only those for restaurants open for more than 18 months. Revenue associated with reductions in liabilities for gift cards which

are considered  
to be only  
remotely likely  
to be redeemed  
is not included  
in the  
calculation of  
average weekly  
sales per  
restaurant or  
average weekly  
same store sales  
per restaurant.

- (2) Includes the  
twenty-eight  
restaurants open  
for more than  
eighteen  
months.



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**Net Sales**

Net sales increased by \$25,000, or 0.1%, and \$986,000, or 1.4%, in the second quarter and first six months of 2008, respectively, compared to the same periods of 2007. These increases were due to net sales generated by two new restaurants opened in the fourth quarter of 2007 which more than offset decreases in net sales in the same store restaurant base.

The reported average weekly consolidated and same store sales per restaurant have been adjusted for the effect of 22 sales days and estimated net sales of approximately \$300,000 lost in the first half of 2008 due to a fire at the Company's Denver restaurant and severe winter weather conditions in the Ohio market. Also, the Company's fiscal calendar resulted in New Year's Eve, when the Company typically experiences much higher than normal net sales, being included as the first day of fiscal 2008, but not being included in the first half of 2007. Management estimates that average weekly same store sales excluding the first day of the first half of both fiscal 2008 and 2007 decreased by 3.8% compared to the 3.4% decrease for the full first half.

Management estimates the average check per guest, including alcoholic beverage sales, increased by 0.4% to \$24.23 in the second quarter of 2008 from \$24.14 in the second quarter of 2007 and by 1.2% to \$24.53 for the first half of 2008 compared to \$24.25 for the first half of 2007. Management believes these increases were due primarily to the effect of higher menu prices which it estimates averaged approximately 0.6% and 1.6% higher in the second quarter and first six months of 2008, respectively, than in the corresponding periods of 2007. These price increase estimates reflect menu price changes, without regard to any change in product mix because of price increases, and may not reflect amounts effectively paid by the customer. Management estimates that weekly average guest counts decreased on a same store basis, as adjusted for sales days lost for the 2008 periods, by approximately 4.5% and 4.4% in the second quarter and first six months of 2008, respectively, compared to the same periods of 2007.

The Company's same store sales have decreased in most weeks since mid-September of 2007. Management believes these decreases, as well as recent guest count losses, are due to a significant slowdown in discretionary consumer spending due to the effects of rising inflation, especially for food and fuel, the tightening of consumer credit and general concerns about the U.S economy. The downturn in same store sales trends in recent months has affected virtually all of the Company's restaurants, with the restaurants in Ohio and Illinois being affected more than those in most other markets.

**Restaurant Costs and Expenses**

Total restaurant operating expenses increased to 88.5% of net sales in the second quarter of 2008 from 88.2% in the second period of the previous year and to 87.7% of net sales in the first half of 2008 from 86.7% in the first half of 2007 due primarily to the effects of lower same store sales and the two new restaurants opened in the fourth quarter of 2007, with the effects of these factors being partially offset by lower cost of sales for the 2008 periods. Restaurant operating margins decreased to 11.5% in the second quarter of 2008 from 11.8% in the second quarter of 2007 and to 12.3% in the first half of 2008 compared to 13.3% in the same period of 2007.

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Cost of sales, which includes the cost of food and beverages, decreased as a percentage of net sales for both the second quarter and first six months of 2008 compared to the same periods of 2007 primarily due to lower prices paid for beef which was purchased at market prices beginning in March of 2008 rather than under a fixed price purchasing agreement as in 2007. The effect of this change reduced cost of sales by an estimated 1.3% of net sales in the second quarter of 2008 and 0.6% for the first half of 2008 compared to the same periods of 2007. The second quarter of 2008 also included the settlement of a claim against a prospective vendor which decreased cost of sales for the period by another 0.5% for the quarter and 0.2% for the first six months of the year compared to the prior year periods.

Beef purchases represent the largest component of the Company's cost of sales and comprise approximately 25% to 30% of this expense category. In recent years the Company has entered into fixed price beef purchase agreements in an effort to minimize the impact of significant increases in the market price of beef. However, because of uncertainty in the beef market and the high prices at which beef has been quoted to the Company on a forward fixed price basis relative to current market prices, the Company has not entered into a fixed price beef purchase agreement to replace the agreement which expired in March of 2008, and has purchased beef based on weekly market prices since that time. Market prices for beef have increased during the third quarter of 2008 to date compared to prices paid by the Company in the second quarter of 2008 and could increase further, perhaps significantly, during the remainder of the year. Management will continue to monitor the beef market in 2008 and if there are significant changes in market conditions or attractive opportunities to contract later in the year, will consider entering into a fixed price purchasing agreement.

Management expects the Company to experience increases in many of the food commodities it purchases in 2008, and believes a significant factor which will contribute to such increases is the increased price of petroleum which has increased fuel costs as well as the price of corn and other commodities as the result of increased demand for corn for use in producing corn ethanol as an alternative fuel source. Management is uncertain at this time whether it will raise menu prices in response to such increases because the Company is experiencing decreases in same store guest counts and continues to have concerns about spending pressures already being faced by consumers.

Restaurant labor and related costs increased to 32.4% of net sales in the second quarter of 2008 from 32.1% in the second quarter of 2007 and to 31.8% for the first half of 2008 from 31.4% for the first half of 2007. These increases were due primarily to the effects of lower same store sales and higher labor costs incurred in the two new restaurants opened in the fourth quarter of 2007, with the effects of these factors being partially offset by lower incentive compensation and other employee benefits expense.

The Company estimates that the impact of increases in minimum wage rates will be approximately \$150,000 in 2008. Most of these increases relate to increases in minimum cash rates required by certain states to be paid to tipped employees. The increases in the federal minimum wage rate for non-tipped employees in 2007 and 2008 have not had, and are not expected to have, a significant impact on the Company because most of the Company's non-tipped employees are already paid more than the federal minimum wage. The required federal minimum cash wage paid to tipped employees was not increased in 2007 or 2008.

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Depreciation and amortization of restaurant property and equipment increased by \$147,000 in the second quarter of 2008 and \$313,000 in the first six months of 2008 compared to the same periods in 2007 because of the effect of the new restaurants opened during the fourth quarter of 2007. The effect of the new restaurants as well as the effect of lower same store sales resulted in increases in this expense category as a percentage of net sales in the 2008 periods.

Other operating expenses, which include restaurant level expenses such as china and supplies, laundry and linen costs, repairs and maintenance, utilities, credit card fees, rent, property taxes and insurance, increased to 20.9% of net sales in the second quarter of 2008, from 19.9% of net sales in the second quarter of 2007 and to 20.3% of net sales for the first half of 2008 compared to 19.4% in the same period of 2007. These increases were also due to the effects of the two new restaurants opened in the fourth quarter of 2007 and lower sales in the same store restaurant base.

**General and Administrative Expenses**

General and administrative expenses, which include all supervisory costs and expenses, management training and relocation costs, and other costs incurred above the restaurant level, decreased by \$111,000 in the second quarter of 2008 versus the second quarter of 2007 due primarily to lower travel expenses and the absence in the 2008 quarter of bonus accruals for the corporate management staff, whereas such accruals were included in the second quarter of 2007. General and administrative expenses increased by \$114,000 in the first half of 2008 compared to the first half of 2007 due primarily to increases in management training and employee relocation expenses, higher legal and accounting fees, and higher share-based compensation expense. These increases were partially offset by the absence of bonus accruals for the corporate management staff in 2008 and lower travel expenses.

**Pre-Opening Expense**

Pre-opening expense consists of expenses incurred prior to opening a new restaurant and include principally manager salaries and relocation costs, payroll and related costs for training new employees, travel and lodging expenses for employees who assist with training new employees, and the cost of food and other expenses associated with practice of food preparation and service activities. Pre-opening expense also includes rent expense for leased properties for the period of time between the Company taking control of the property and the opening of the restaurant.

Pre-opening expense of \$289,000 and \$333,000 was incurred in the second quarter and first half of 2008, respectively, in connection with three J. Alexander's restaurants under development during those periods which are expected to open in the last half of the year. The Company estimates that it will incur approximately \$1.3 million of pre-opening expense during the last half of 2008 in connection with these restaurants.

**Other Income (Expense)**

Interest expense decreased in the second quarter and first half of 2008 compared to the same periods in 2007 due to the effect of reductions in outstanding debt and capitalization of interest costs in connection with new restaurant development. Interest income decreased in the second quarter and first half of 2008 compared to the corresponding periods of 2007 due to lower average balances of surplus funds invested in money market funds and lower interest rates earned on those funds.

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