

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended December 23, 2018
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-12919

RAVE RESTAURANT GROUP, INC.

(Exact name of registrant as specified in its charter)

Missouri
(State or other jurisdiction of Incorporation or organization)

45-3189287
(I.R.S. Employer Identification No.)

3551 Plano Parkway
The Colony, Texas 75056
(Address of principal executive offices)

(469) 384-5000
(Registrant's telephone number,
including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

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

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

As of January 31, 2019, 15,071,311 shares of the issuer's common stock were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RAVE RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
| | <u>December 23, 2018</u> | <u>December 24, 2017</u> | <u>December 23, 2018</u> | <u>December 24, 2017</u> |
| REVENUES: | \$ 3,195 | \$ 4,197 | \$ 6,186 | \$ 9,629 |
| COSTS AND EXPENSES: | | | | |
| Cost of sales | 174 | 1,055 | 333 | 3,142 |
| General and administrative expenses | 1,640 | 2,017 | 3,054 | 4,111 |
| Franchise expenses | 892 | 743 | 1,953 | 1,344 |
| Pre-opening expenses | - | (1) | - | 114 |
| Gain on sale of assets | (350) | (166) | (354) | (165) |
| Impairment of long-lived assets and other lease charges | 155 | 533 | 170 | 681 |
| Bad debt | 171 | 89 | 195 | 213 |
| Interest expense | 26 | 63 | 51 | 131 |
| Depreciation and amortization expense | 126 | 288 | 265 | 600 |
| Total costs and expenses | <u>2,834</u> | <u>4,621</u> | <u>5,667</u> | <u>10,171</u> |
| INCOME/(LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES | 361 | (424) | 519 | (542) |
| Income tax expense/(benefit) | 129 | (27) | 179 | (14) |
| INCOME/(LOSS) FROM CONTINUING OPERATIONS | <u>232</u> | <u>(397)</u> | <u>340</u> | <u>(528)</u> |
| Loss from discontinued operations, net of taxes | - | (180) | - | (405) |
| NET INCOME / (LOSS) | <u>\$ 232</u> | <u>\$ (577)</u> | <u>\$ 340</u> | <u>\$ (933)</u> |
| INCOME / (LOSS) PER SHARE OF COMMON STOCK - BASIC: | | | | |
| Income / (loss) from continuing operations | \$ 0.02 | \$ (0.03) | \$ 0.02 | \$ (0.04) |
| Loss from discontinued operations | - | (0.01) | - | (0.03) |
| Net income / (loss) | <u>\$ 0.02</u> | <u>\$ (0.04)</u> | <u>\$ 0.02</u> | <u>\$ (0.07)</u> |
| INCOME / (LOSS) PER SHARE OF COMMON STOCK - DILUTED: | | | | |
| Income / (loss) from continuing operations | \$ 0.02 | \$ (0.03) | \$ 0.02 | \$ (0.04) |
| Loss from discontinued operations | - | (0.01) | - | (0.03) |
| Net income / (loss) | <u>\$ 0.02</u> | <u>\$ (0.04)</u> | <u>\$ 0.02</u> | <u>\$ (0.07)</u> |
| Weighted average common shares outstanding - basic | <u>15,071</u> | <u>14,344</u> | <u>15,068</u> | <u>12,742</u> |
| Weighted average common and potential dilutive common shares outstanding | <u>15,904</u> | <u>14,344</u> | <u>15,901</u> | <u>12,742</u> |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

RAVE RESTAURANT GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

| | <u>December 23,</u> <u>2018 (Unaudited)</u> | <u>June 24,</u> <u>2018</u> |
|---|--|--------------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,906 | \$ 1,386 |
| Accounts receivable, less allowance for bad debts of \$164 and \$158, respectively | 1,520 | 1,518 |
| Other receivable | - | 300 |
| Notes receivable, less allowance of bad debt of \$186 and \$0, respectively | 798 | 712 |
| Inventories | 6 | 6 |
| Income tax receivable | - | 5 |
| Property held for sale | 496 | 539 |
| Deferred contract charges | 28 | - |
| Prepaid expenses and other | 410 | 273 |
| Total current assets | <u>5,164</u> | <u>4,739</u> |
| LONG-TERM ASSETS | | |
| Property, plant and equipment, net | 1,300 | 1,510 |
| Intangible assets definite-lived, net | 203 | 212 |
| Long-term notes receivable | 1,017 | 803 |
| Deferred tax asset, net | 3,334 | 3,479 |
| Long-term deferred contract charges | 189 | - |
| Deposits and other | 243 | 243 |
| Total assets | <u>\$ 11,450</u> | <u>\$ 10,986</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable - trade | \$ 285 | \$ 421 |
| Accounts payable - lease termination impairments | 488 | 353 |
| Accrued expenses | 914 | 1,109 |
| Deferred rent | 37 | 32 |
| Deferred revenues | 267 | 65 |
| Total current liabilities | <u>1,991</u> | <u>1,980</u> |
| LONG-TERM LIABILITIES | | |
| Convertible notes | 1,574 | 1,562 |
| Deferred rent, net of current portion | 415 | 433 |
| Deferred revenues, net of current portion | 2,088 | 670 |
| Other long-term liabilities | 51 | 42 |
| Total liabilities | <u>6,119</u> | <u>4,687</u> |
| COMMITMENTS AND CONTINGENCIES (SEE NOTE 3) | | |
| SHAREHOLDERS' EQUITY | | |
| Common stock, \$.01 par value; authorized 26,000,000 shares; issued 22,190,515 and 22,166,674 shares, respectively; outstanding 15,071,311 and 15,047,470 shares, respectively | 222 | 222 |
| Additional paid-in capital | 33,520 | 33,206 |
| Accumulated deficit | (3,775) | (2,493) |
| Treasury stock at cost | | |
| Shares in treasury: 7,119,204 | (24,636) | (24,636) |
| Total shareholders' equity | <u>5,331</u> | <u>6,299</u> |
| Total liabilities and shareholders' equity | <u>\$ 11,450</u> | <u>\$ 10,986</u> |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

RAVE RESTAURANT GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands)

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Treasury Stock | | Total |
|---|---------------|---------------|----------------------------------|------------------------|----------------|--------------------|-----------------|
| | Shares | Amount | | | Shares | Amount | |
| BALANCE, JUNE 24, 2018 | 15,047 | \$ 222 | \$ 33,206 | \$ (2,493) | (7,119) | \$ (24,636) | \$ 6,299 |
| ASC 606 cumulative adjustment | - | - | - | (1,622) | - | - | (1,622) |
| Stock compensation expense | - | - | 281 | - | - | - | 281 |
| Issuance of common stock | 24 | - | 36 | - | - | - | 36 |
| Equity issue costs - ATM Offering | - | - | (3) | - | - | - | (3) |
| Net income | - | - | - | 340 | - | - | 340 |
| BALANCE, DECEMBER 23, 2018 (Unaudited) | 15,071 | \$ 222 | \$ 33,520 | \$ (3,775) | (7,119) | \$ (24,636) | \$ 5,331 |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

RAVE RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Six Months Ended | |
|--|------------------------------|------------------------------|
| | December 23, 2018 | December 24, 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income/(loss) | \$ 340 | \$ (933) |
| Adjustments to reconcile net income/(loss) to cash provided by (used in) operating activities: | | |
| Impairment of fixed assets and other assets | 170 | 681 |
| Stock compensation expense | 281 | 19 |
| Depreciation and amortization | 245 | 581 |
| Amortization of intangible assets definite-lived | 20 | 19 |
| Amortization of debt issue costs | 12 | 23 |
| Gain/loss on the sale of assets | (354) | (165) |
| Provision for bad debt (accounts receivable) | 6 | 213 |
| Provision for bad debt (notes receivable) | 186 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 268 | 1,376 |
| Operating notes receivable | (200) | - |
| Inventories | - | 60 |
| Prepaid expenses, deposits and other, net | (137) | (150) |
| Deferred revenue | (219) | (690) |
| Accounts payable - trade | (136) | (2,770) |
| Accounts payable - lease termination impairments | (35) | (897) |
| Deferred tax assets | 145 | - |
| Accrued expenses, deferred rent and other | (199) | (841) |
| Cash provided by (used in) operating activities | 393 | (3,474) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sale of assets | 140 | 939 |
| Purchase of intangible assets definite-lived | - | (9) |
| Capital expenditures | (46) | (421) |
| Cash provided by investing activities | 94 | 509 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from sale of stock | 36 | 4,942 |
| Expenses from sale of stock | (3) | - |
| Net change in other debt | - | (1,000) |
| Cash provided by financing activities | 33 | 3,942 |
| Net increase in cash and cash equivalents | 520 | 977 |
| Cash and cash equivalents, beginning of period | 1,386 | 451 |
| Cash and cash equivalents, end of period | <u>\$ 1,906</u> | <u>\$ 1,428</u> |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| CASH PAID FOR: | | |
| Interest | \$ 3 | \$ 115 |
| Income taxes | \$ 145 | \$ 48 |
| Non-cash activities: | | |
| Capital expenditures included in accounts payable | \$ - | \$ 125 |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

RAVE RESTAURANT GROUP, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated financial statements of Rave Restaurant Group, Inc. (the "Company") have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in the financial statements have been omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 24, 2018.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to fairly present the Company's financial position and results of operations for the interim periods reflected. Except as noted, all adjustments are of a normal recurring nature. Results of operations for the fiscal periods presented are not necessarily indicative of fiscal year-end results.

(1) **Summary of Significant Accounting Policies**

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All appropriate intercompany balances and transactions have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Fiscal Quarters

The three and six month periods ended December 23, 2018 and December 24, 2017 each contained 13 weeks and 26 weeks, respectively.

Use of Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires the Company's management to make estimates and assumptions that affect its reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent liabilities. The Company bases its estimates on historical experience and other various assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed periodically, and actual results could differ materially from estimates.

Revenue Recognition

Revenue is measured based on consideration specified in contracts with customers and excludes incentives and amounts collected on behalf of third parties, primarily sales tax. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue.

As further described below, revenue recognition in fiscal 2019 follows ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)" and ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing." Prior year revenue recognition follows ASU Topic 605, "Revenue Recognition."

The following describes principal activities, separated by major product or service, from which the Company generates its revenues:

Restaurant Sales

Revenue from restaurant sales is recognized when food and beverage products are sold in Company-owned restaurants. The Company reports revenue net of sales taxes collected from customers and remitted to governmental taxing authorities.

Franchise Revenues

Franchise revenues consist of 1) franchise royalties, 2) supplier and distributor incentive revenues, 3) franchise license fees, 4) area development exclusivity fees and foreign master license fees, 5) advertising funds, and 6) supplier convention funds.

Franchise royalties, which are based on a percentage of franchise restaurant sales, are recognized as sales occur.

Supplier and distributor incentive revenues are recognized when title to the underlying commodities transfer.

Franchise license fees are typically billed upon execution of the franchise agreement and amortized over the term of the franchise agreement which can range from five to 20 years. Fees received for renewal periods are amortized over the life of the renewal period.

Area development exclusivity fees and foreign master license fees are typically billed upon execution of the area development and foreign master license agreements. Area development exclusivity fees are included in deferred revenue in the Condensed Consolidated Balance Sheets and allocated on a pro rata basis to all stores opened under that specific development agreement. Area development exclusivity fees that include rights to subfranchise are amortized as revenue over the term of the contract.

For periods prior to adoption of Topic 606, revenue was recognized when we performed our obligations related to such fees, primarily the store opening date for initial franchise fees and area development fees, or the date the renewal option was effective for renewal fees.

Advertising fund contributions for Pie Five units represent contributions collected where we have control over the activities of the fund. Contributions are based on a percentage of net retail sales. The adoption of Topic 606 revises the determination of whether these arrangements are considered principal versus agent. For Pie Five, we have determined that we are the principal in these arrangements, and advertising fund contributions and expenditures are, therefore, reported on a gross basis in the Condensed Consolidated Statements of Income. In general, we expect such advertising fund contributions and expenditures to be largely offsetting and, therefore, do not expect a significant impact on our reported income before income taxes. Our obligation related to these funds is to develop and conduct advertising activities. Pie Five marketing fund contributions are billed and collected weekly.

Supplier convention funds are deferred until the obligations of the agreement are met and the event takes place.

Accounting Standards Adopted

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance under GAAP, including industry-specific requirements, and provides companies with a single framework for recognizing revenue from contracts with customers. In March and April 2016, the FASB issued Topic 606. This update and subsequently issued amendments require companies to recognize revenue at amounts that reflect the consideration to which the companies expect to be entitled in exchange for those goods or services at the time of transfer. Topic 606 requires that we assess contracts to determine each separate and distinct performance obligation. If a contract has multiple performance obligations, we allocate the transaction price using our best estimate of the standalone selling price to each distinct good or service in the contract.

The Company adopted Topic 606 as of June 25, 2018. See Note 2 for additional information.

Stock-Based Compensation

The Company accounts for stock options using the fair value recognition provisions of the authoritative guidance on share-based payments. The Company uses the Black-Scholes formula to estimate the value of stock-based compensation for options granted to employees and directors and expects to continue to use this acceptable option valuation model in the future. The authoritative guidance also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow.

Restricted stock units (“RSU’s”) represent the right to receive shares of common stock upon the satisfaction of vesting requirements, performance criteria and other terms and conditions. Compensation cost for RSU’s is measured as an amount equal to the fair value of the RSU’s on the date of grant and is expensed over the vesting period if achievement of the performance criteria is deemed probable, with the amount of the expense recognized based on the best estimate of the ultimate achievement level.

Discontinuation of Norco Distribution Division

During the fiscal quarter ended December 24, 2017, the Company discontinued its Norco distribution division and revised its arrangements with third party suppliers and distributors of food, equipment and supplies. As a result, sale of food, equipment and supplies is no longer recognized as revenue and the cost of such items is no longer included in cost of sales. The Company now recognizes incentive revenues received from third party suppliers and distributors as revenue.

(2) Adoption of ASU 2014-09, “Revenue from Contracts with Customers”

The Company adopted ASU 2014-09 and Topic 606 using the modified retrospective transition method effective June 25, 2018. Results for reporting periods beginning on or after June 25, 2018 are presented in accordance with Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under Topic 605, “Revenue Recognition.”

A cumulative effect adjustment of \$1.6 million was recorded as a reduction to retained earnings as of June 25, 2018 to reflect the impact of adopting Topic 606. The reduction of retained earnings to reflect the cumulative impact of adopting Topic 606 was comprised of \$1.3 million related to domestic franchise and renewal fees, \$0.2 million related to domestic area development fees and \$0.3 million related to international development and franchise master license fees, partially offset by \$0.2 million in deferral of contract-related expenses.

The impact of applying Topic 606 for the three months ended December 23, 2018, was an increase in revenues of \$321 thousand and an increase in pre-tax income of \$129 thousand. The impact of applying Topic 606 for the six months ended December 23, 2018, was an increase in revenues of \$771 thousand and an increase in pre-tax income of \$160 thousand.

The adoption of Topic 606 did not impact the recognition and reporting of our two largest sources of revenue: franchise royalties and supplier and distributor incentives. The items impacted by the adoption include the timing of franchise and development revenue recognition and the presentation of advertising funds and supplier convention contributions.

The following chart presents the specific line items impacted by the cumulative adjustment to opening retained earnings:

| <i>(In thousands, except share amounts)</i> | As Reported June 24, 2018 | Total Adjustment | Adjusted Balance Sheet June 25, 2018 |
|--|--|-----------------------------|---|
| ASSETS | | | |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | \$ 1,386 | \$ - | \$ 1,386 |
| Accounts receivable, less allowance for bad debts of \$158 | 1,518 | - | 1,518 |
| Other receivable | 300 | - | 300 |
| Notes receivable | 712 | - | 712 |
| Inventories | 6 | - | 6 |
| Income tax receivable | 5 | - | 5 |
| Property held for sale | 539 | - | 539 |
| Deferred contract charges | - | 10 | 10 |
| Prepaid expenses and other | 273 | - | 273 |
| Total current assets | <u>4,739</u> | <u>10</u> | <u>4,749</u> |
| LONG-TERM ASSETS | | | |
| Property, plant and equipment, net | 1,510 | - | 1,510 |
| Intangible assets definite-lived, net | 212 | - | 212 |
| Long-term notes receivable | 803 | - | 803 |
| Deferred tax asset, net | 3,479 | - | 3,479 |
| Long term deferred contract charges | - | 182 | 182 |
| Deposits and other | 243 | - | 243 |
| Total assets | <u>\$ 10,986</u> | <u>\$ 192</u> | <u>\$ 11,178</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES | | | |
| Accounts payable - trade | \$ 421 | \$ - | \$ 421 |
| Accounts payable - lease termination impairments | 353 | - | 353 |
| Accrued expenses | 1,109 | (4) | 1,105 |
| Deferred rent | 32 | - | 32 |
| Deferred revenues | 65 | 243 | 308 |
| Total current liabilities | <u>1,980</u> | <u>239</u> | <u>2,219</u> |
| LONG-TERM LIABILITIES | | | |
| Convertible notes | 1,562 | - | 1,562 |
| Deferred rent, net of current portion | 433 | - | 433 |
| Deferred revenues, net of current portion | 670 | 1,575 | 2,245 |
| Other long-term liabilities | 42 | - | 42 |
| Total liabilities | <u>4,687</u> | <u>1,814</u> | <u>6,501</u> |
| COMMITMENTS AND CONTINGENCIES (SEE NOTE 3) | | | |
| SHAREHOLDERS' EQUITY | | | |
| Common stock, \$.01 par value; authorized 26,000,000 shares; issued 22,166,674 shares outstanding 15,047,470 shares | 222 | - | 222 |
| Additional paid-in capital | 33,206 | - | 33,206 |
| Accumulated deficit | (2,493) | (1,622) | (4,115) |
| Treasury stock at cost | | | |
| Shares in treasury: 7,119,204 | (24,636) | - | (24,636) |
| Total shareholders' equity | <u>6,299</u> | <u>(1,622)</u> | <u>4,677</u> |
| Total liabilities and shareholders' equity | <u>\$ 10,986</u> | <u>\$ 192</u> | <u>\$ 11,178</u> |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

The following charts present the specific line items impacted by the application of Topic 606 in the first two quarters of fiscal 2019.

| <i>(In thousands, except share amounts)</i> | As Reported December 23, 2018 (Unaudited) | Total Adjustment | Balance Sheet Without Adoption of Topic 606 |
|--|--|-----------------------------|--|
| ASSETS | | | |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | \$ 1,906 | \$ - | \$ 1,906 |
| Accounts receivable, less allowance for bad debts of \$179 | 1,520 | - | 1,520 |
| Other receivable | - | - | - |
| Notes receivable | 798 | - | 798 |
| Inventories | 6 | - | 6 |
| Income tax receivable | - | - | - |
| Property held for sale | 496 | - | 496 |
| Deferred contract charges | 28 | (28) | - |
| Prepaid expenses and other | 410 | 47 | 457 |
| Total current assets | <u>5,164</u> | <u>19</u> | <u>5,183</u> |
| LONG-TERM ASSETS | | | |
| Property, plant and equipment, net | 1,300 | - | 1,300 |
| Intangible assets definite-lived, net | 203 | - | 203 |
| Long-term notes receivable | 1,017 | - | 1,017 |
| Deferred tax asset, net | 3,334 | - | 3,334 |
| Long term deferred contract charges | 189 | (189) | - |
| Deposits and other | 243 | - | 243 |
| Total assets | <u>\$ 11,450</u> | <u>\$ (170)</u> | <u>\$ 11,280</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES | | | |
| Accounts payable - trade | \$ 285 | \$ - | \$ 285 |
| Accounts payable - lease termination impairments | 488 | - | 488 |
| Accrued expenses | 914 | (3) | 911 |
| Deferred rent | 37 | - | 37 |
| Deferred revenues | 267 | (114) | 153 |
| Total current liabilities | <u>1,991</u> | <u>(117)</u> | <u>1,874</u> |
| LONG-TERM LIABILITIES | | | |
| Convertible notes | 1,574 | - | 1,574 |
| Deferred rent, net of current portion | 415 | - | 415 |
| Deferred revenues, net of current portion | 2,088 | (1,515) | 573 |
| Other long-term liabilities | 51 | - | 51 |
| Total liabilities | <u>6,119</u> | <u>(1,632)</u> | <u>4,487</u> |
| COMMITMENTS AND CONTINGENCIES (SEE NOTE 3) | | | |
| SHAREHOLDERS' EQUITY | | | |
| Common stock, \$.01 par value; authorized 26,000,000 shares; issued 22,190,515 shares outstanding 15,071,311 shares | 222 | - | 222 |
| Additional paid-in capital | 33,520 | - | 33,520 |
| Accumulated deficit | (3,775) | 1,462 | (2,313) |
| Treasury stock at cost | 0 | - | - |
| Shares in treasury: 7,119,204 | (24,636) | - | (24,636) |
| Total shareholders' equity | <u>5,331</u> | <u>1,462</u> | <u>6,793</u> |
| Total liabilities and shareholders' equity | <u>\$ 11,450</u> | <u>\$ (170)</u> | <u>\$ 11,280</u> |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

| | As Reported Six Months Ended December 23, 2018 | Total Adjustments | Income Statement Without Adoption of Topic 606 |
|---|---|------------------------------|---|
| REVENUES: | \$ 6,186 | \$ (771) | \$ 5,415 |
| COSTS AND EXPENSES: | | | |
| Cost of sales | 333 | - | 333 |
| General and administrative expenses | 3,054 | - | 3,054 |
| Franchise expenses | 1,953 | (611) | 1,342 |
| Pre-opening expenses | - | - | - |
| Gain on sale of assets | (354) | - | (354) |
| Impairment of long-lived assets and other lease charges | 170 | - | 170 |
| Bad debt | 195 | - | 195 |
| Interest expense | 51 | - | 51 |
| Depreciation and amortization expense | 265 | - | 265 |
| Total costs and expenses | <u>5,667</u> | <u>(611)</u> | <u>5,056</u> |
| INCOME FROM CONTINUING OPERATIONS BEFORE TAXES | 519 | (160) | 359 |
| Income tax expense | 179 | - | 179 |
| INCOME FROM CONTINUING OPERATIONS | <u>340</u> | <u>(160)</u> | <u>180</u> |
| Loss from discontinued operations, net of taxes | - | - | - |
| NET INCOME | <u>\$ 340</u> | <u>\$ (160)</u> | <u>\$ 180</u> |
| INCOME PER SHARE OF COMMON STOCK - BASIC: | | | |
| Income from continuing operations | \$ 0.02 | \$ (0.01) | \$ 0.01 |
| Loss from discontinued operations | - | - | - |
| Net income | <u>\$ 0.02</u> | <u>\$ (0.01)</u> | <u>\$ 0.01</u> |
| INCOME PER SHARE OF COMMON STOCK - DILUTED: | | | |
| Income from continuing operations | \$ 0.02 | \$ (0.01) | \$ 0.01 |
| Loss from discontinued operations | - | - | - |
| Net income | <u>\$ 0.02</u> | <u>\$ (0.01)</u> | <u>\$ 0.01</u> |
| Weighted average common shares outstanding - basic | <u>15,068</u> | <u>15,068</u> | <u>15,068</u> |
| Weighted average common and potential dilutive common shares outstanding | <u>15,901</u> | <u>15,901</u> | <u>15,901</u> |

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

(3) Commitments and Contingencies

On May 23, 2007, the Company's board of directors approved a stock purchase plan (the "2007 Stock Purchase Plan") authorizing the purchase on our behalf of up to 1,016,000 shares of our common stock in the open market or in privately negotiated transactions. On June 2, 2008, the Company's board of directors amended the 2007 Stock Purchase Plan to increase the number of shares of common stock the Company may repurchase by 1,000,000 shares to a total of 2,016,000 shares. On April 22, 2009 the Company's board of directors amended the 2007 Stock Purchase Plan again to increase the number of shares of common stock the Company may repurchase by 1,000,000 shares to a total of 3,016,000 shares. The 2007 Stock Purchase Plan does not have an expiration date. There were no stock purchases in the fiscal quarter ended December 23, 2018.

The Company is subject to various claims and contingencies related to employment agreements, franchise disputes, lawsuits, taxes, food product purchase contracts and other matters arising out of the normal course of business. Management believes that any such claims and actions currently pending are either covered by insurance or would not have a material adverse effect on the Company's annual results of operations or financial condition if decided in a manner that is unfavorable to the Company.

(4) Stock-Based Compensation

Stock Options:

For the fiscal quarter ended December 23, 2018, the Company did not recognize any stock-based compensation expense related to stock options compared to \$10 thousand in the same period of the prior year. As of December 23, 2018, there was no unamortized stock-based compensation expense related to stock options.

The following table summarizes the number of shares of the Company's common stock subject to outstanding stock options:

| | Six Months Ended | |
|----------------------------------|------------------------------|------------------------------|
| | December 23, 2018 | December 24, 2017 |
| | Shares | Shares |
| Outstanding at beginning of year | 478,056 | 478,056 |
| Granted | - | - |
| Exercised | - | - |
| Forfeited/Canceled/Expired | (190,000) | - |
| Outstanding at end of period | <u>288,056</u> | <u>478,056</u> |
| Exercisable at end of Period | <u>288,056</u> | <u>438,056</u> |

Restricted Stock Units:

For the fiscal quarter ended December 23, 2018, the Company recognized \$0.2 million in stock-based compensation expense related to RSU's compared to no expense in the same period of the prior year. For the six month period ended December 23, 2018, the Company recognized \$0.3 million in stock-based compensation expense related to RSU's compared to no expense in the same period of the prior year. As of December 23, 2018, unamortized stock-based compensation expense related to RSU's was \$0.6 million.

A summary of the status of restricted stock units as of December 23, 2018 and changes during the fiscal six month period then ended is presented below:

| Number of Restricted Stock Units | |
|---|----------------|
| Unvested at June 24, 2018 | 908,293 |
| Granted | - |
| Vested | - |
| Forfeited | (164,520) |
| Unvested at December 23, 2018 | <u>743,773</u> |

(5) **Earnings per Share (EPS)**

The following table shows the reconciliation of the numerator and denominator of the basic EPS calculation to the numerator and denominator of the diluted EPS calculation (in thousands, except per share amounts).

| | Three Months Ended | | Six Months Ended | |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| Income/(loss) from continuing operations | \$ 232 | \$ (397) | \$ 340 | \$ (528) |
| Loss from discontinued operations | - | (180) | - | (405) |
| Net income/(loss) available to common stockholders | <u>\$ 232</u> | <u>\$ (577)</u> | <u>\$ 340</u> | <u>\$ (933)</u> |
| Interest saved on convertible notes of \$1,574 at 4% | \$ 16 | \$ - | \$ 31 | \$ - |
| Adjusted net income/(loss) | <u>\$ 248</u> | <u>\$ (577)</u> | <u>\$ 371</u> | <u>\$ (933)</u> |
| BASIC: | | | | |
| Weighted average common shares | 15,071 | 14,344 | 15,068 | 12,742 |
| Income/(loss) from continuing operations per common share | \$ 0.02 | \$ (0.03) | \$ 0.02 | \$ (0.04) |
| Loss from discontinued operations per common share | - | (0.01) | - | (0.03) |
| Net income/(loss) per common share | <u>\$ 0.02</u> | <u>\$ (0.04)</u> | <u>\$ 0.02</u> | <u>\$ (0.07)</u> |
| DILUTED: | | | | |
| Weighted average common shares | 15,071 | 14,344 | 15,068 | 12,742 |
| Convertible notes | 833 | - | 833 | - |
| Dilutive stock options | - | - | - | - |
| Weighted average common shares outstanding | <u>15,904</u> | <u>14,344</u> | <u>15,901</u> | <u>12,742</u> |
| Income/(loss) from continuing operations per common share | \$ 0.02 | \$ (0.03) | \$ 0.02 | \$ (0.04) |
| Loss from discontinued operations per common share | - | (0.01) | - | (0.03) |
| Net income/(loss) per common share | <u>\$ 0.02</u> | <u>\$ (0.04)</u> | <u>\$ 0.02</u> | <u>\$ (0.07)</u> |

For the three and six month periods ended December 23, 2018, options to purchase 288,056 shares of common stock at exercise prices ranging from \$1.55 to \$13.11 were excluded from the computation of diluted EPS.

(6) **Closed restaurants and discontinued operations**

In April, 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity,” which modifies the definition of discontinued operations to include only disposals of an entity that represent strategic shifts that have or will have a major effect on an entity’s operation and requires entities to disclose information about disposals of individually significant components that do not meet the definition of discontinued operations. The standard was effective prospectively for annual and interim periods beginning after December 15, 2014, with early adoption permitted.

The authoritative guidance on “Accounting for the Impairment or Disposal of Long-Lived Assets,” requires that discontinued operations that meet certain criteria be reflected in the statement of operations after results of continuing operations as a net amount. This guidance also requires that the operations of closed restaurants, including any impairment charges, be reclassified to discontinued operations for all periods presented.

The authoritative guidance on “Accounting for Costs Associated with Exit or Disposal Activities,” requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This authoritative guidance also establishes that fair value is the objective for initial measurement of the liability.

Discontinued operations include losses attributable to the discontinued Norco distribution and supply division, leased buildings associated with Company-owned restaurants closed in prior years, and Company-owned restaurants closed in the reported period.

(7) **Income Taxes**

For the three months ended December 23, 2018, the Company recorded an income tax expense of \$129 thousand calculated at a rate consistent with the 21% statutory U.S. federal rate. For the three months ended December 23, 2018, income tax expense consisted of \$1 thousand in state taxes and \$128 thousand in deferred taxes. For the six months ended December 23, 2018, the Company recorded an income tax expense of \$179 thousand calculated at a rate consistent with the 21% statutory U.S. federal rate. For the six months ended December 23, 2018, income tax expense consisted of \$29 thousand in state taxes and \$150 thousand in deferred taxes. The Company anticipates utilizing net operating loss carryforwards to offset any federal income taxes.

The Company continually reviews the realizability of its deferred tax assets, including an analysis of factors such as future taxable income, reversal of existing taxable temporary differences, and tax planning strategies. Future sources of taxable income are also considered in determining the amount of the recorded valuation allowance. Based on the review of this evidence, the Company determined it was appropriate to reverse a portion of the valuation allowance against the deferred tax assets as of June 24, 2018.

As of December 23, 2018, the Company had \$5.7 million of gross deferred tax assets partially offset by a valuation allowance of \$2.4 million. The Company determined it was not necessary to further adjust the valuation allowance. However, the Company will continue to review the need for an adjustment to the valuation allowance.

(8) Segment Reporting

The Company has three reportable operating segments as determined by management using the “management approach” as defined by the authoritative guidance on Disclosures about Segments of an Enterprise and Related Information: (1) Pizza Inn Franchising, (2) Pie Five Franchising and (3) Company-Owned Restaurants. These segments are a result of differences in the nature of the products and services sold. Corporate administration costs, which include, but are not limited to, general accounting, human resources, legal and credit and collections, are partially allocated to the three operating segments. Other revenue consists of non-recurring items.

The Pizza Inn and Pie Five Franchising segments establish franchisees, licensees and territorial rights. Revenue for these segments is derived from franchise royalties, franchise fees, sale of area development and foreign master license rights and incentive payments from third party suppliers and distributors. Assets for these segments include equipment, furniture and fixtures.

The Company-Owned Restaurant segment includes sales and operating results for all Company-owned restaurants. Assets for this segment include equipment, furniture and fixtures for the Company-owned restaurants.

Corporate administration and other assets primarily include cash and short-term investments, as well as furniture and fixtures located at the corporate office and trademarks and other intangible assets. All assets are located within the United States.

Summarized in the following table are net sales and operating revenues, depreciation and amortization expense and income from continuing operations before taxes for the Company's reportable segments as of the three and six months ended December 23, 2018 and December 24, 2017 (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| Net sales and operating revenues: | | | | |
| Pizza Inn Franchising | \$ 1,789 | \$ 1,718 | \$ 3,693 | \$ 3,492 |
| Pie Five Franchising | 1,283 | 912 | 2,246 | 2,395 |
| Company-Owned Restaurants (1) | 105 | 1,567 | 219 | 3,742 |
| Interest income | 18 | - | 28 | - |
| Consolidated revenues | <u>\$ 3,195</u> | <u>\$ 4,197</u> | <u>\$ 6,186</u> | <u>\$ 9,629</u> |
| Depreciation and amortization: | | | | |
| Pizza Inn Franchising | \$ - | \$ - | \$ - | \$ - |
| Pie Five Franchising | - | - | - | - |
| Company-Owned Restaurants (1) | 31 | 173 | 62 | 373 |
| Combined | <u>31</u> | <u>173</u> | <u>62</u> | <u>373</u> |
| Corporate administration and other (2) | 95 | 115 | 203 | 227 |
| Depreciation and amortization | <u>\$ 126</u> | <u>\$ 288</u> | <u>\$ 265</u> | <u>\$ 600</u> |
| Income/(Loss) from continuing operations before taxes: | | | | |
| Pizza Inn Franchising | \$ 1,426 | \$ 1,398 | \$ 2,773 | \$ 2,877 |
| Pie Five Franchising | 754 | 489 | 1,213 | 1,666 |
| Company-Owned Restaurants (1) | (295) | (464) | (424) | (1,342) |
| Combined | <u>1,885</u> | <u>1,423</u> | <u>3,562</u> | <u>3,201</u> |
| Corporate administration and other | (1,524) | (1,847) | (3,043) | (3,743) |
| Income/(loss) from continuing operations before taxes | <u>\$ 361</u> | <u>\$ (424)</u> | <u>\$ 519</u> | <u>\$ (542)</u> |
| Geographic information (revenues): | | | | |
| United States | \$ 3,115 | \$ 3,983 | \$ 6,009 | \$ 9,336 |
| Foreign countries | 80 | 214 | 177 | 293 |
| Consolidated total | <u>\$ 3,195</u> | <u>\$ 4,197</u> | <u>\$ 6,186</u> | <u>\$ 9,629</u> |

Notes:

- (1) Company stores that were closed are included in discontinued operations in the accompanying Condensed Consolidated Statement of Operations.
- (2) Portions of corporate administration and other have been allocated to segments.

(9) **Convertible Notes**

On March 3, 2017, the Company completed a registered shareholder rights offering of its 4% Convertible Senior Notes due 2022 (“Notes”). Shareholders exercised subscription rights to purchase all 30,000 of the Notes at the par value of \$100 per Note, resulting in gross offering proceeds to the Company of \$3.0 million. The Notes bear interest at the rate of 4% per annum on the principal or par value of \$100 per Note, payable annually in arrears on February 15 of each year, commencing February 15, 2018. Interest is payable in cash or, at the Company’s discretion, in shares of Company common stock.

The Notes mature on February 15, 2022, at which time all principal and unpaid interest will be payable in cash or, at the Company’s discretion, in shares of Company common stock. The Notes are secured by a pledge of all outstanding equity securities of the Company’s two primary direct operating subsidiaries. Noteholders may convert their Notes to common stock at a conversion rate of \$2.00 per share, unless the Company sooner elects to redeem the notes. Accrued interest will be paid through the effective date of the conversion in cash or, at the Company’s sole discretion, in shares of Company common stock.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and accompanying notes appearing elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended June 24, 2018 and may contain certain forward-looking statements that are based on current management expectations. Generally, verbs in the future tense and the words “believe,” “expect,” “anticipate,” “estimate,” “intends,” “opinion,” “potential” and similar expressions identify forward-looking statements. Forward-looking statements in this report include, without limitation, statements relating to our business objectives, our customers and franchisees, our liquidity and capital resources, and the impact of our historical and potential business strategies on our business, financial condition, and operating results. Our actual results could differ materially from our expectations. Further information concerning our business, including additional factors that could cause actual results to differ materially from the forward-looking statements contained in this Quarterly Report on Form 10-Q, are set forth in our Annual Report on Form 10-K for the year ended June 24, 2018. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The forward-looking statements contained herein speak only as of the date of this Quarterly Report on Form 10-Q and, except as may be required by applicable law, we do not undertake, and specifically disclaim any obligation to, publicly update or revise such statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Results of Operations

Overview

Rave Restaurant Group, Inc., through its subsidiaries (collectively, the “Company” or “we,” “us” or “our”) operates and franchises pizza buffet (“Buffet Units”), delivery/carry-out (“Delco Units”) and express (“Express Units”) restaurants under the trademark “Pizza Inn” and operates and franchises fast casual pizza restaurants (“Pie Five Units”) under the trademarks “Pie Five Pizza Company” or “Pie Five”. The Company also licenses Pizza Inn Express, or PIE, kiosks (“PIE Units”) under the trademark “Pizza Inn”. We facilitate food, equipment and supply distribution to our domestic and international system of restaurants through agreements with third party distributors. At December 23, 2018, Company-owned, franchised and licensed units consisted of the following:

Three Months Ended December 23, 2018

(in thousands, except unit data)

| | Pizza Inn | | Pie Five | | All Concepts | |
|------------------------------|--------------|------------------|--------------|------------------|--------------|------------------|
| | Ending Units | Retail Sales | Ending Units | Retail Sales | Ending Units | Retail Sales |
| Domestic Franchised/Licensed | 155 | \$ 21,273 | 64 | \$ 10,124 | 219 | \$ 31,397 |
| Company-Owned | - | - | 1 | 105 | 1 | 105 |
| Total Domestic Units | 155 | \$ 21,273 | 65 | \$ 10,229 | 220 | \$ 31,502 |
| International Franchised | 48 | | - | | 48 | |

Six Months Ended December 23, 2018

(in thousands, except unit data)

| | Pizza Inn | | Pie Five | | All Concepts | |
|------------------------------|--------------|------------------|--------------|------------------|--------------|------------------|
| | Ending Units | Retail Sales | Ending Units | Retail Sales | Ending Units | Retail Sales |
| Domestic Franchised/Licensed | 155 | \$ 43,260 | 64 | \$ 21,653 | 219 | \$ 64,913 |
| Company-Owned | - | - | 1 | 219 | 1 | 219 |
| Total Domestic Units | 155 | \$ 43,260 | 65 | \$ 21,872 | 220 | \$ 65,132 |
| International Franchised | 48 | | - | | 48 | |

Domestic units are located in 21 states predominantly situated in the southern half of the United States. International units are located in seven foreign countries.

The following table summarizes domestic comparable store retail sales for the Company.

| | Three Months Ended | | Six Months Ended | |
|--|----------------------|----------------------|----------------------|----------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| | (in thousands) | | (in thousands) | |
| Pizza Inn Domestic Comparable Store Retail Sales | \$ 20,270 | \$ 19,738 | \$ 41,151 | \$ 40,139 |
| Pie Five Domestic Comparable Store Retail Sales | 8,246 | 8,557 | 17,110 | 17,580 |
| Total Rave Comparable Store Retail Sales | \$ 28,516 | \$ 28,295 | \$ 58,261 | \$ 57,719 |

In the three month period ended December 23, 2018, total comparable store domestic retail sales increased by \$0.2 million, or 0.8% compared to the three month period of the prior year. In the six month period ended December 23, 2018, total comparable store domestic retail sales increased by \$0.5 million, or 0.9% compared to the six month period of the prior year. For both periods, the net increase was attributable to an increase in Pizza Inn comparable store retail sales partially offset by a decrease in Pie Five comparable store retail sales.

Basic and diluted income per common share improved \$0.06 per share to a net income of \$0.02 per share for the three months ended December 23, 2018, compared to a loss of \$0.04 per share in the comparable period in the prior fiscal year. The Company had a net income of \$0.2 million for the three months ended December 23, 2018, and net loss of \$0.6 million in the comparable period in the prior fiscal year, on revenues of \$3.2 million for the three months ended December 23, 2018 compared to \$4.2 million in the comparable period in the prior fiscal year. The improvement in quarterly net income from the prior year was primarily due to the closing of poorly performing stores, lower closed store expenses, increased gains from sale of assets, lower impairment expense and reduced general and administrative expenses.

Basic and diluted income per common share improved \$0.09 per share to a net income of \$0.02 per share for the six months ended December 23, 2018, compared to a loss of \$0.07 per share in the comparable period in the prior fiscal year. The Company had a net income of \$0.3 million for the six months ended December 23, 2018, and net loss of \$0.9 million in the comparable period in the prior fiscal year, on revenues of \$6.2 million for the six months ended December 23, 2018 compared to \$9.6 million in the comparable period in the prior fiscal year. The improvement in year to date net income from the prior year was primarily due to the closing of poorly performing stores, lower closed store expenses, increased gains from the sale of assets, lower impairment expense and reduced general and administrative expenses.

Adjusted EBITDA for the fiscal quarter ended December 23, 2018 increased \$0.7 million compared to the same period of the prior fiscal year. Year-to-date adjusted EBITDA increased to \$1.0 million compared to \$0.5 million in the prior fiscal year. The following table sets forth a reconciliation of net income to Adjusted EBITDA for the periods shown (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| Net income (loss) | \$ 232 | \$ (577) | \$ 340 | \$ (933) |
| Interest expense | 26 | 63 | 51 | 131 |
| Income taxes | 129 | (27) | 179 | (14) |
| Depreciation and amortization | 126 | 288 | 265 | 600 |
| EBITDA | \$ 513 | \$ (253) | \$ 835 | \$ (216) |
| Stock compensation expense | 180 | 10 | 281 | 19 |
| Pre-opening costs | - | (1) | - | 114 |
| Gain on sale/disposal of assets | (350) | (166) | (354) | (165) |
| Impairment of long-lived assets and other lease charges | 155 | 533 | 170 | 681 |
| Discontinued operations, excluding taxes | - | 180 | - | 408 |
| Closed and non-operating store costs | 59 | (471) | 81 | (336) |
| Adjusted EBITDA | \$ 557 | \$ (168) | \$ 1,013 | \$ 505 |

Pizza Inn Brand Summary

The following tables summarize certain key indicators for the Pizza Inn franchised and licensed domestic units that management believes are useful in evaluating performance.

| | Three Months Ended | | Six Months Ended | |
|---|---|------------------------------|---|------------------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| | (in thousands, except unit data) | | (in thousands, except unit data) | |
| Pizza Inn Retail Sales - Total Domestic Units | | | | |
| Domestic Units | | | | |
| Buffet Units - Franchised | \$ 19,468 | \$ 19,267 | \$ 39,601 | \$ 39,406 |
| Delco/Express Units - Franchised | 1,764 | 1,639 | 3,579 | 3,394 |
| PIE Units - Licensed | 41 | - | 80 | - |
| Total Domestic Retail Sales | <u>\$ 21,273</u> | <u>\$ 20,906</u> | <u>\$ 43,260</u> | <u>\$ 42,800</u> |
| Pizza Inn Comparable Store Retail Sales - Total Domestic | 20,270 | 19,738 | 41,151 | 40,139 |
| Pizza Inn Average Units Open in Period | | | | |
| Domestic Units | | | | |
| Buffet Units - Franchised | 87 | 91 | 88 | 91 |
| Delco/Express Units - Franchised | 60 | 67 | 60 | 67 |
| PIE Units - Licensed | 5 | - | 5 | - |
| Total Domestic Units | <u>152</u> | <u>158</u> | <u>153</u> | <u>158</u> |

Total Pizza Inn domestic retail sales increased \$0.4 million, or 1.8%, for the three months ended December 23, 2018 when compared to the same period of the prior year. Pizza Inn domestic comparable store retail sales increased by \$0.5 million, or 2.7%, for the three months ended December 23, 2018 when compared to the same period of the prior year.

Total Pizza Inn domestic retail sales increased \$0.5 million, or 1.1%, for the six months ended December 23, 2018 when compared to the same period of the prior year. Pizza Inn domestic comparable store retail sales increased by \$1.0 million, or 2.5%, for the six months ended December 23, 2018 when compared to the same period of the prior year.

The following chart summarizes Pizza Inn unit activity for the three month and six month periods ended December 23, 2018:

| Three Months Ended December 23, 2018 | | | | | |
|---|----------------------------|---------------|---------------------------|---------------|-------------------------|
| | Beginning Units | Opened | Concept Change | Closed | Ending Units |
| Domestic Units | | | | | |
| Buffet Units - Franchised | 88 | 3 | - | 2 | 89 |
| Delco/Express Units - Franchised | 60 | - | - | 1 | 59 |
| PIE Units - Licensed | 5 | 2 | - | - | 7 |
| Total Domestic Units | 153 | 5 | - | 3 | 155 |
| International Units (all types) | | | | | |
| | 51 | 1 | - | 4 | 48 |
| Total Units | 204 | 6 | - | 7 | 203 |

| Six Months Ended December 23, 2018 | | | | | |
|---|----------------------------|---------------|---------------------------|---------------|-------------------------|
| | Beginning Units | Opened | Concept Change | Closed | Ending Units |
| Domestic Units | | | | | |
| Buffet Units - Franchised | 90 | 3 | - | 4 | 89 |
| Delco/Express Units - Franchised | 60 | 1 | - | 2 | 59 |
| PIE Units - Licensed | 3 | 4 | - | - | 7 |
| Total Domestic Units | 153 | 8 | - | 6 | 155 |
| International Units (all types) | | | | | |
| | 58 | 2 | - | 12 | 48 |
| Total Units | 211 | 10 | - | 18 | 203 |

There was a net increase of two units in the total domestic Pizza Inn unit count during the three months ended December 23, 2018. We believe that the domestic unit count will continue to increase modestly in future periods. The number of international Pizza Inn units decreased by a net of three units in the three months ended December 23, 2018 due to closure of underperforming units in the Middle East.

There was a net increase of two units in the total domestic Pizza Inn unit count during the six months ended December 23, 2018, primarily driven by new licensed PIE units. The number of international Pizza Inn units decreased by ten in the six months ended December 23, 2018 due to closure of underperforming units in the Middle East. We believe that this represents a stabilizing of international unit count.

Pie Five Brand Summary

The following tables summarize certain key indicators for the Pie Five franchised and Company-owned restaurants that management believes are useful in evaluating performance.

| | Three Months Ended | | Six Months Ended | |
|---|----------------------------------|----------------------|----------------------------------|----------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| | (in thousands, except unit data) | | (in thousands, except unit data) | |
| Pie Five Retail Sales - Total Units | | | | |
| Domestic Units - Franchised | \$ 10,124 | \$ 9,986 | \$ 21,653 | \$ 20,252 |
| Domestic Units - Company-owned | 105 | 1,567 | 219 | 3,742 |
| Total Domestic Retail Sales | <u>\$ 10,229</u> | <u>\$ 11,553</u> | <u>\$ 21,872</u> | <u>\$ 23,994</u> |
| Pie Five Comparable Store Retail Sales - Total | \$ 8,246 | \$ 8,557 | \$ 17,110 | \$ 17,580 |
| Pie Five Average Units Open in Period | | | | |
| Domestic Units - Franchised | 68 | 72 | 70 | 71 |
| Domestic Units - Company-owned | 1 | 10 | 1 | 12 |
| Total Domestic Units | <u>69</u> | <u>82</u> | <u>71</u> | <u>83</u> |

Pie Five system-wide retail sales decreased \$1.3 million, or 11.5%, for the three month period ended December 23, 2018 when compared to the same period of the prior year. Compared to the same fiscal quarter of the prior year, average units open in the period decreased from 82 to 69. Comparable store retail sales decreased by \$0.3 million, or 3.6%, during the second quarter of fiscal 2019 compared to the same period of the prior year.

Pie Five system-wide retail sales decreased \$2.1 million, or 8.8%, for the six month period ended December 23, 2018 when compared to the same period of the prior year. Year-to-date fiscal 2019 compared to the year-to-date of the prior year, average units open in the period decreased from 83 to 71. Comparable store retail sales decreased by \$0.5 million, or 2.7%, during the six month period ended December 23, 2018 compared to the same period of the prior fiscal year.

The following chart summarizes Pie Five unit activity for the three and six month periods ended December 23, 2018:

| | Three Months Ended December 23, 2018 | | | | |
|--------------------------|--------------------------------------|----------|----------|-----------|--------------|
| | Beginning Units | Opened | Transfer | Closed | Ending Units |
| Domestic - Franchised | 70 | 2 | - | 8 | 64 |
| Domestic - Company-owned | 1 | - | - | - | 1 |
| Total Domestic Units | <u>71</u> | <u>2</u> | <u>-</u> | <u>8</u> | <u>65</u> |
| | Six Months Ended December 23, 2018 | | | | |
| | Beginning Units | Opened | Transfer | Closed | Ending Units |
| Domestic - Franchised | 72 | 4 | - | 12 | 64 |
| Domestic - Company-owned | 1 | - | - | - | 1 |
| Total Domestic Units | <u>73</u> | <u>4</u> | <u>-</u> | <u>12</u> | <u>65</u> |

The net decreases of Pie Five units during the three and six months ended December 23, 2018 were primarily the result of the closure of poor-performing stores. We believe that this trend of net store closures will moderate and then reverse in future periods. We do not anticipate the opening of new Company-owned Pie Five units in the near future.

Pie Five - Company-Owned Restaurants

(in thousands, except store weeks and average data)

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 23, 2018 | December 24, 2017 | December 23, 2018 | December 24, 2017 |
| Store weeks (excluding partial weeks) | 13 | 130 | 26 | 307 |
| Average weekly sales | 8,077 | 11,594 | 8,423 | 11,979 |
| Average number of units | 1 | 10 | 1 | 12 |
| Restaurant sales (excluding partial weeks) | 105 | 1,507 | 219 | 3,677 |
| Restaurant sales | 105 | 1,567 | 219 | 3,742 |
| Loss from continuing operations before taxes | (295) | (464) | (424) | (1,342) |
| Allocated marketing and advertising expenses | 5 | 78 | 11 | 187 |
| Depreciation/amortization expense | 31 | 173 | 62 | 373 |
| Pre-opening costs | - | (1) | - | 114 |
| Operations management and extraordinary expenses | - | 28 | - | 83 |
| Impairment, other lease charges and non-operating store costs | 214 | 61 | 251 | 345 |
| Restaurant operating cash flow | (45) | (125) | (100) | (240) |

Average weekly sales for Company-owned Pie Five units decreased \$3,517, or 30.3%, to \$8,077 for the three month period ended December 23, 2018 compared to \$11,594 for the same period of the prior fiscal year. Company-owned Pie Five restaurant operating cash flow increased \$81 thousand during the second quarter of fiscal 2019 compared to the same period of prior year. Loss from continuing operations before taxes for Company-owned Pie Five stores improved \$0.2 million for the three month period ended December 23, 2018 compared to the same period of the prior year. The decrease in retail sales was primarily due to decreased Company-owned unit count.

Average weekly sales for Company-owned Pie Five Units decreased \$3,556, or 29.7%, to \$8,423 for the six month period ended December 23, 2018 compared to \$11,979 for the same period of prior year. Company-owned Pie Five restaurant operating cash flow increased \$0.1 million during the six month period ended December 23, 2018 compared to the same period of prior year. Loss from continuing operations before taxes for Company-owned Pie Five stores improved \$0.9 million for the six month period ended December 23, 2018 compared to the same period of the prior year. The decrease in retail sales was primarily due to decreased Company-owned store count.

Non-GAAP Financial Measures and Other Terms

The Company's financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP"). However, the Company also presents and discusses certain non-GAAP financial measures that it believes are useful to investors as measures of operating performance. Management may also use such non-GAAP financial measures in evaluating the effectiveness of business strategies and for planning and budgeting purposes. However, these non-GAAP financial measures should not be viewed as an alternative or substitute for the results reflected in the Company's GAAP financial statements.

We consider EBITDA and Adjusted EBITDA to be important supplemental measures of operating performance that are commonly used by securities analysts, investors and other parties interested in our industry. We believe that EBITDA is helpful to investors in evaluating our results of operations without the impact of expenses affected by financing methods, accounting methods and the tax environment. We believe that Adjusted EBITDA provides additional useful information to investors by excluding non-operational or non-recurring expenses to provide a measure of operating performance that is more comparable from period to period. We believe that restaurant operating cash flow is a useful metric to investors in evaluating the ongoing operating performance of Company-owned restaurants and comparing such store operating performance from period to period. Management also uses these non-GAAP financial measures for evaluating operating performance, assessing the effectiveness of business strategies, projecting future capital needs, budgeting and other planning purposes.

The following key performance indicators presented herein, some of which represent non-GAAP financial measures, have the meaning and are calculated as follows:

- "EBITDA" represents earnings before interest, taxes, depreciation and amortization.
- "Adjusted EBITDA" represents earnings before interest, taxes, depreciation and amortization, stock compensation expense, pre-opening expense, gain/loss on sale of assets, costs related to impairment, discontinued operations and closed and non-operating store costs.
- "Retail sales" represents the restaurant sales reported by our franchisees and Company-owned restaurants, which may be segmented by brand or domestic/international locations.
- "System-wide retail sales" represents combined retail sales for franchisee and Company-owned restaurants for a specified brand.
- "Comparable store retail sales" includes the retail sales for restaurants that have been open for at least 18 months as of the end of the reporting period. The sales results for a restaurant that was closed temporarily for remodeling or relocation within the same trade area are included in the calculation only for the days that the restaurant was open in both periods being compared.
- "Store weeks" represent the total number of full weeks that specified restaurants were open during the period.
- "Average units open" reflects the number of restaurants open during a reporting period weighted by the percentage of the weeks in a reporting period that each restaurant was open.
- "Average weekly sales" for a specified period is calculated as total retail sales (excluding partial weeks) divided by store weeks in the period.
- "Restaurant operating cash flow" represents the pre-tax income earned by Company-owned restaurants before (1) allocated marketing and advertising expenses, (2) depreciation and amortization, (3) pre-opening expenses, (4) operations management and extraordinary expenses, (5) impairment and other lease charges, and (6) non-operating store costs.
- "Non-operating store costs" represent gain or loss on asset disposal, store closure expenses, lease termination expenses and expenses related to abandoned store sites.
- "Pre-opening expenses" consist primarily of certain costs incurred prior to the opening of a Company-owned restaurant, including: (1) marketing and promotional expenses, (2) accrued rent, and (3) manager salaries, employee payroll and related training costs.

Financial Results

During the fiscal quarter ended December 24, 2017, the Company discontinued its Norco distribution division and revised its arrangements with third party suppliers and distributors of food, equipment and supplies. As a result, sale of food, equipment and supplies is no longer recognized as revenue and the cost of such items is no longer included in cost of sales. The Company now recognizes incentive revenues received from third party suppliers and distributors as revenue.

In order to show the impact of this change and better reflect the current operational structure, the Company has redefined its operating segments as Pizza Inn Franchising, Pie Five Franchising and Company-Owned Restaurants. The following is additional business segment information for the three and six month periods ended December 23, 2018 and December 24, 2017 (in thousands):

| | Pizza Inn Franchising | | Pie Five Franchising | | Company-Owned Stores | | Corporate | | Total | |
|--|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| | Fiscal Quarter Ended Dec 23, 2018 | Fiscal Quarter Ended Dec 24, 2017 | Fiscal Quarter Ended Dec 23, 2018 | Fiscal Quarter Ended Dec 24, 2017 | Fiscal Quarter Ended Dec 23, 2018 | Fiscal Quarter Ended Dec 24, 2017 | Fiscal Quarter Ended Dec 23, 2018 | Fiscal Quarter Ended Dec 24, 2017 | Fiscal Quarter Ended Dec 23, 2018 | Fiscal Quarter Ended Dec 24, 2017 |
| REVENUES: | | | | | | | | | | |
| Franchise revenues | \$ 1,789 | \$ 1,718 | \$ 1,283 | \$ 912 | \$ - | \$ - | \$ - | \$ - | \$ 3,072 | \$ 2,630 |
| Restaurant sales | - | - | - | - | 105 | 1,567 | - | - | 105 | 1,567 |
| Interest income and other | - | - | - | - | - | - | 18 | - | 18 | - |
| Total revenues | 1,789 | 1,718 | 1,283 | 912 | 105 | 1,567 | 18 | - | 3,195 | 4,197 |
| COSTS AND EXPENSES: | | | | | | | | | | |
| Cost of sales | - | - | - | - | 174 | 1,055 | - | - | 174 | 1,055 |
| General and administrative expenses | - | - | - | - | 40 | 271 | 1,600 | 1,746 | 1,640 | 2,017 |
| Franchise expenses | 363 | 320 | 529 | 423 | - | - | - | - | 892 | 743 |
| Pre-opening expenses | - | - | - | - | - | (1) | - | - | - | (1) |
| (Gain)/loss on sale of assets | - | - | - | - | - | - | (350) | (166) | (350) | (166) |
| Impairment of long-lived assets and other lease charges | - | - | - | - | 155 | 533 | - | - | 155 | 533 |
| Bad debt | - | - | - | - | - | - | 171 | 89 | 171 | 89 |
| Interest expense | - | - | - | - | - | - | 26 | 63 | 26 | 63 |
| Amortization and depreciation expense | - | - | - | - | 31 | 173 | 95 | 115 | 126 | 288 |
| Total costs and expenses | 363 | 320 | 529 | 423 | 400 | 2,031 | 1,542 | 1,847 | 2,834 | 4,621 |
| INCOME/(LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES | <u>\$ 1,426</u> | <u>\$ 1,398</u> | <u>\$ 754</u> | <u>\$ 489</u> | <u>\$ (295)</u> | <u>\$ (464)</u> | <u>\$ (1,524)</u> | <u>\$ (1,847)</u> | <u>\$ 361</u> | <u>\$ (424)</u> |
| REVENUES: | | | | | | | | | | |
| Franchise revenues | \$ 3,693 | \$ 3,492 | \$ 2,246 | \$ 2,395 | \$ - | \$ - | \$ - | \$ - | \$ 5,939 | \$ 5,887 |
| Restaurant sales | - | - | - | - | 219 | 3,742 | - | - | 219 | 3,742 |
| Interest income and other | - | - | - | - | - | - | 28 | - | 28 | - |
| Total revenues | 3,693 | 3,492 | 2,246 | 2,395 | 219 | 3,742 | 28 | - | 6,186 | 9,629 |
| COSTS AND EXPENSES: | | | | | | | | | | |
| Cost of sales | - | - | - | - | 333 | 3,142 | - | - | 333 | 3,142 |
| General and administrative expenses | - | - | - | - | 78 | 650 | 2,976 | 3,461 | 3,054 | 4,111 |
| Franchise expenses | 920 | 615 | 1,033 | 729 | - | - | - | - | 1,953 | 1,344 |
| Pre-opening expenses | - | - | - | - | - | 114 | - | - | - | 114 |
| (Gain)/loss on sale of assets | - | - | - | - | - | - | (354) | (165) | (354) | (165) |
| Impairment of long-lived assets and other lease charges | - | - | - | - | 170 | 681 | - | - | 170 | 681 |
| Bad debt | - | - | - | - | - | 124 | 195 | 89 | 195 | 213 |
| Interest expense | - | - | - | - | - | - | 51 | 131 | 51 | 131 |
| Amortization and depreciation expense | - | - | - | - | 62 | 373 | 203 | 227 | 265 | 600 |
| Total costs and expenses | 920 | 615 | 1,033 | 729 | 643 | 5,084 | 3,071 | 3,743 | 5,667 | 10,171 |
| INCOME/(LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES | <u>\$ 2,773</u> | <u>\$ 2,877</u> | <u>\$ 1,213</u> | <u>\$ 1,666</u> | <u>\$ (424)</u> | <u>\$ (1,342)</u> | <u>\$ (3,043)</u> | <u>\$ (3,743)</u> | <u>\$ 519</u> | <u>\$ (542)</u> |

Revenues:

Revenues are primarily derived from franchise royalties, franchise fees, supplier incentives, advertising funds and convention funds and sales by Company-owned restaurants. The volume of supplier incentive revenues is dependent on the level of chain-wide retail sales, which are impacted by changes in comparable store sales and restaurant count, as well as the products sold to franchisees through third-party food distributors.

Total revenues for the three month period ended December 23, 2018 and for the same period in the prior fiscal year were \$3.2 million and \$4.2 million, respectively. Total revenues for the six month period ended December 23, 2018 were \$6.2 million compared to \$9.6 million in the same period in the prior fiscal year. The decrease in total revenues for the three and six month periods was primarily driven by the reduction in the number of Company-owned stores, partially offset by advertising fund contributions and convention fund contributions that were previously recorded as an offset to franchise expenses before adoption of Topic 606.

Pizza Inn Franchise Revenues

Pizza Inn franchise revenues increased by \$0.1 million to \$1.8 million for the three month period ended December 23, 2018 compared to \$1.7 million for the same period in the prior fiscal year. Pizza Inn franchise revenues increased to \$3.7 million for the six month period ended December 23, 2018 from \$3.5 million for the same period of the prior fiscal year. The increase in both the three and six month periods was primarily the result of higher retail sales from comparable franchise locations and higher royalty rates from new units.

Pie Five Franchise Revenues

Pie Five franchise revenues increased by \$0.4 million to \$1.3 million for the three month period ended December 23, 2018 compared to \$0.9 million for the same period in the prior fiscal year primarily driven by advertising fund contributions that were previously recorded as an offset to franchise expenses before the adoption of Topic 606 and revenues for defaulted area development agreements partially offset by reduced international set up fee revenues. Pie Five franchise revenues decreased to \$2.2 million for the six month period ended December 23, 2018 compared to \$2.4 million for the same period in the prior fiscal year primarily driven by decreased franchised store count and reduced international set up fee revenues, partially offset by advertising fund contributions and revenues from defaulted area development agreements.

Restaurant Sales

Restaurant sales, which consist of revenue generated by Company-owned restaurants, decreased 93.3%, or \$1.5 million, to \$0.1 million for the three month period ended December 23, 2018, compared to \$1.6 million for the comparable period in the prior year. In the six month period ended December 23, 2018, restaurant sales decreased 94.1%, or \$3.5 million, to \$0.2 million compared to \$3.7 million for the comparable period in the prior year. In both periods, the decrease in restaurant sales was primarily a result of decreased Company-owned store count.

Costs and Expenses:

Cost of Sales - Total

Total cost of sales, which primarily includes food and supply costs, labor and general and administrative expenses directly related to Company-owned restaurant sales, decreased to \$0.2 million for the three month period ended December 23, 2018 compared to \$1.1 million in the three month period ended December 24, 2017. For the six month period ended December 23, 2018, total cost of sales decreased to \$0.3 million from \$3.1 million. The decreases in costs in both three and six month periods were primarily the result of decreased Company-owned store count.

General and Administrative Expenses - Total

Total general and administrative expenses decreased to \$1.6 million and \$3.1 million for the three and six month periods ended December 23, 2018, respectively, compared to \$2.0 million and \$4.1 million for the three and six month periods ended December 24, 2017, respectively. In both the three and six month periods, the decrease was primarily the result of the lower number of Company-owned restaurants and reduced corporate overhead.

General and Administrative Expenses – Company-Owned Restaurants

General and administrative expenses for Company-owned restaurants decreased to \$40 thousand for the three month period ended December 23, 2018 compared to \$0.3 million in the three month period ended December 24, 2017 primarily as a result of lower number of Company-owned restaurants. For the six month period ended December 23, 2018, general and administrative expenses for Company-owned restaurants decreased to \$78 thousand from \$0.7 million for the same reason.

General and Administrative Expenses - Corporate

General and administrative expenses for corporate decreased to \$1.6 million for the three month period ended December 23, 2018 compared to \$1.7 million for the three month period ended December 24, 2017. General and administrative expenses for corporate decreased to \$3.0 million for the six month period ended December 23, 2018 compared to \$3.5 million for the six month period ended December 24, 2017. The decrease in both the three and six month periods was primarily attributable to a reduction in legal fees and the number of general and administrative employees.

Franchise Expenses - Total

Franchise expenses include general and administrative expenses directly related to the continuing service of domestic and international franchises. Franchise expenses increased to \$0.9 million for the three month period ended December 23, 2018 compared to \$0.7 million for the three month period ended December 24, 2017, primarily related to the change in treatment of advertising fund contributions due to adoption of Topic 606. Franchise expenses increased to \$2.0 million for the six month period ended December 23, 2018 compared to \$1.3 million for the six month period ended December 24, 2017 for the same reason.

Franchise Expenses – Pizza Inn

Pizza Inn franchise expenses include general and administrative expenses directly related to the continuing service of the Pizza Inn domestic and international franchises. Franchise expenses increased \$43 thousand for the three month period ended December 23, 2018 compared to the three month period ended December 24, 2017. Franchise expenses increased \$0.3 million for the six month period ended December 23, 2018 compared to the six month period ended December 24, 2017 primarily as a result of the change in treatment of convention fund contributions due to adoption of Topic 606.

Franchise Expenses – Pie Five

Pie Five franchise expenses include general and administrative expenses directly related to the continuing service of the Pie Five domestic and international franchises. Franchise expenses increased to \$0.5 million for the three month period ended December 23, 2018 compared to \$0.4 million for the three month period ended December 24, 2017. Pie Five franchise expenses increased to \$1.0 million in the six month period ended December 23, 2018 compared \$0.7 million in the same period of the prior year. The increase in both the three and six month periods was primarily related to the change in treatment of advertising fund contributions due to adoption of Topic 606.

Pre-Opening Expenses

Pre-opening expenses are directly related to the number of new corporate store openings. Pre-opening expenses decreased to zero for the second quarter of fiscal 2019 compared to pre-opening income of \$1 thousand in the same period of the prior year. Pre-opening expenses were also zero for the six month period ended December 23, 2018 compared to \$0.1 million for the same period of the prior year due to the reduction in openings of Company-owned restaurants.

Impairment of Long-lived Assets and Other Lease Charges

Impairment of long-lived assets and other lease charges were \$0.2 million for three month period ended December 23, 2018 compared to \$0.5 million for the same period in the prior fiscal year. Impairment of long-lived assets and other lease charges were \$0.2 million for the six month period ended December 23, 2018 compared to \$0.7 million for the same period of the prior fiscal year. For the three and six month periods ended December 23, 2018, these charges related to lease termination expenses.

Bad Debt Expense

The Company monitors franchisee receivable balances and adjusts credit terms when necessary to minimize the Company's exposure to high risk accounts receivable. Bad debt expense increased \$0.1 million for the three month period ended December 23, 2018 as compared to the comparable period in the prior fiscal year. Bad debt expense remained relatively stable at \$0.2 million for the six month period ended December 23, 2018 compared to the same period of the prior fiscal year.

Interest Expense

Interest expense decreased to \$26 thousand in the three month period ended December 23, 2018 compared to \$63 thousand during the comparable fiscal quarter of the prior fiscal year. Interest expense was \$51 thousand for the six month period ended December 23, 2018 compared to \$131 thousand in the comparable period in the prior fiscal year. The decrease in interest expense during both the three and six month periods was primarily due to a decrease in outstanding principal balance of senior convertible notes as a result of conversions during the second quarter of fiscal 2018.

Provision for Income Tax

For the three months ended December 23, 2018, the Company recorded an income tax expense of \$129 thousand calculated at a rate consistent with the 21% statutory U.S. federal rate. For the three months ended December 23, 2018, income tax expense consisted of \$1 thousand in state taxes and \$128 thousand in deferred taxes. For the six months ended December 23, 2018, the Company recorded an income tax expense of \$179 thousand calculated at a rate consistent with the 21% statutory U.S. federal rate. For the six months ended December 23, 2018, income tax expense consisted of \$29 thousand in state taxes and \$150 thousand in deferred taxes. The Company anticipates utilizing net operating loss carryforwards to offset any federal income taxes.

The Company continually reviews the realizability of its deferred tax assets, including an analysis of factors such as future taxable income, reversal of existing taxable temporary differences, and tax planning strategies. Future sources of taxable income are also considered in determining the amount of the recorded valuation allowance. Based on the review of this evidence, the Company determined it was appropriate to reverse a portion of the valuation allowance against the deferred tax assets as of June 24, 2018.

As of December 23, 2018, the Company had \$5.7 million of gross deferred tax assets partially offset by a valuation allowance of \$2.4 million. The Company determined it was not necessary to further adjust the valuation allowance. However, the Company will continue to review the need for an adjustment to the valuation allowance.

Discontinued Operations

Net losses from the Norco food and supply distribution division are included within discontinued operations. The discontinuation of the Norco food and supply distribution entity was a strategic shift for the Company during the second quarter of fiscal 2018, releasing the Company from added credit risk, overhead expense, and direct supply and delivery responsibilities. Discontinued operations also include losses from leased buildings and operating losses associated with Company-owned restaurants closed in prior years.

Liquidity and Capital Resources

During the three and six month periods ended December 23, 2018, our primary source of liquidity was proceeds from operating activities.

Cash flows from operating activities generally reflect net income or losses adjusted for certain non-cash items including depreciation and amortization, changes in deferred tax assets, share based compensation, and changes in working capital. Cash provided by operating activities increased \$3.9 million to cash provided of \$0.4 million for the six month period ended December 23, 2018 compared to cash used of \$3.5 million for the six month period ended December 24, 2017. The primary drivers of increased cash flows during the six month period ended December 23, 2018 were growth in net income and reduced paydowns of accounts payable partially offset by reduced net collections of accounts receivable.

Cash flows from investing activities reflect net proceeds from the sale of assets and capital expenditures for the purchase of Company assets. Cash provided by investing activities during the six month period ended December 23, 2018 of \$0.1 million was primarily attributable to \$140 thousand in net proceeds from sales of assets partially offset by \$46 thousand in capital expenditures for technology. This compares to cash provided by investing activities of \$0.5 million during the same period in the prior fiscal year primarily attributable to \$0.9 million in net proceeds from sales of assets partially offset by capital expenditures related to new store openings.

Cash flows from financing activities generally reflect changes in the Company's stock and debt activity during the period. Net cash provided by financing activities was \$33 thousand for the six month period ended December 23, 2018 compared to \$3.9 million for the six month period ended December 24, 2017. Cash flows from financing activities for the six months ended December 23, 2018 were primarily attributable to at-the-market sales of common stock. Cash flows from financing activities for the six months ended December 24, 2017 were from the sale of stock in connection with a shareholder rights offering offset by cash used towards debt repayment.

On December 5, 2017, the Company entered into an At Market Issuance Sales Agreement with B. Riley FBR, Inc. ("B. Riley FBR") pursuant to which the Company may offer and sell shares of its common stock having an aggregate offering price of up to \$5,000,000 from time to time through B. Riley FBR acting as agent (the "2017 ATM Offering"). The 2017 ATM Offering is being undertaken pursuant to Rule 415 and a shelf Registration Statement on Form S-3 which was declared effective by the SEC on November 6, 2017. Through December 23, 2018, the Company had sold an aggregate of 173,852 shares in the 2017 ATM Offering, realizing aggregate gross proceeds of \$0.3 million.

Management believes the cash on hand combined with cash from operations and proceeds from at-the-market sales of common stock under its shelf registration will be sufficient to fund operations for the next 12 months.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect our reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent liabilities. The Company bases its estimates on historical experience and various other assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed periodically. Actual results could differ materially from estimates.

The Company believes the following critical accounting policies require estimates about the effect of matters that are inherently uncertain, are susceptible to change, and therefore require subjective judgments. Changes in the estimates and judgments could significantly impact the Company's results of operations and financial condition in future periods.

Accounts receivable consist primarily of receivables generated from franchise royalties and supplier concessions. The Company records a provision for doubtful receivables to allow for any amounts which may be unrecoverable based upon an analysis of the Company's prior collection experience, customer creditworthiness and current economic trends. Actual realization of accounts receivable could differ materially from the Company's estimates.

Inventory consists primarily of food, paper products and supplies stored in and used by Company-owned restaurants and is stated at lower of first-in, first-out (“FIFO”) or market. The valuation of such restaurant inventory requires us to estimate the amount of obsolete and excess inventory based on estimates of future retail sales by Company-owned restaurants. Overestimating retail sales by Company-owned restaurants could result in the write-down of inventory which would have a negative impact on the gross margin of such Company-owned restaurants.

The Company reviews long-lived assets for impairment when events or circumstances indicate that the carrying value of such assets may not be fully recoverable. Impairment is evaluated based on the sum of undiscounted estimated future cash flows expected to result from use of the assets compared to their carrying value. If impairment is recognized, the carrying value of an impaired asset is reduced to its fair value, based on discounted estimated future cash flows.

Franchise revenue consists of income from license fees, royalties, area development and foreign master license agreements, advertising fund revenues, supplier incentive and convention contribution revenues. Franchise fees, area development and foreign master license agreement fees are amortized into revenue on a straight-line basis over the term of the related contract agreement. Royalties and advertising fund revenues, which are based on a percentage of franchise retail sales, are recognized as income as retail sales occur. Supplier incentive revenues are recognized as earned, typically as the underlying commodities are shipped. For periods prior to adoption of Topic 606, franchise fees, area development and foreign master license agreement fees were recognized when we performed our obligations related to such fees, primarily the store opening date.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. The new lease standard is effective for public companies for fiscal years, (including interim periods therein), beginning after December 15, 2018. Application of ASU 2016-02 will be required beginning in the first quarter of our fiscal 2020. Early adoption of ASU 2016-02 as of its issuance is permitted. This new guidance requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for a smaller reporting company.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures designed to ensure that information it is required to disclose in the reports filed or submitted under the Securities Exchange Act of 1934 (the “Exchange Act”) is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. The Company’s disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act is accumulated and communicated to the Company’s management, including its principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company’s management, including the Company’s principal executive officer and principal financial officer, or persons performing similar functions, have evaluated the Company’s disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Company’s principal executive officer and principal financial officer, or persons performing similar functions, have concluded that the Company’s disclosure controls and procedures were effective as of the end of the period covered by this report. During the most recent fiscal quarter, there have been no changes in the Company’s internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to claims and legal actions in the ordinary course of its business. The Company believes that all such claims and actions currently pending against it are either adequately covered by insurance or would not have a material adverse effect on the Company's annual results of operations, cash flows or financial condition if decided in a manner that is unfavorable to the Company.

Item 1A. Risk Factors

Not required for a smaller reporting company.

Item 2. Unregistered Sales of Equity Securities and the Use of Proceeds

On May 23, 2007, the Company's board of directors approved a stock purchase plan (the "2007 Stock Purchase Plan") authorizing the purchase on our behalf of up to 1,016,000 shares of our common stock in the open market or in privately negotiated transactions. On June 2, 2008, the Company's board of directors amended the 2007 Stock Purchase Plan to increase the number of shares of common stock the Company may repurchase by 1,000,000 shares to a total of 2,016,000 shares. On April 22, 2009 the Company's board of directors amended the 2007 Stock Purchase Plan again to increase the number of shares of common stock the Company may repurchase by 1,000,000 shares to a total of 3,016,000 shares. The 2007 Stock Purchase Plan does not have an expiration date. There were no stock repurchases in the fiscal quarter ended December 23, 2018.

The Company's ability to repurchase shares of our common stock is subject to various laws, regulations and policies as well as the rules and regulations of the SEC. Subsequent to December 23, 2018, the Company has not repurchased any outstanding shares but may make further repurchases under the 2007 Stock Purchase Plan. The Company may also repurchase shares of our common stock other than pursuant to the 2007 Stock Purchase Plan or other publicly announced plans or programs.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

- [3.1](#) Amended and Restated Articles of Incorporation of Rave Restaurant Group, Inc. (incorporated by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K filed January 8, 2015).
- [3.2](#) Amended and Restated By-laws of Rave Restaurant Group, Inc. (incorporated by reference to Exhibit 3.2 to the registrant's Current Report on Form 8-K filed January 8, 2015).
- [4.1](#) Indenture for 4% Convertible Senior Notes due 2022 (filed as Exhibit 4.1 to Form S-3/A filed January 6, 2017 and incorporated herein by reference).
- [4.2](#) Pledge Agreement (filed as Exhibit 4.2 to Form S-3/A filed January 6, 2017 and incorporated herein by reference).
- [4.3](#) Supplemental Indenture Number 1 dated as of October 31, 2017, between Rave Restaurant Group, Inc. and Securities Transfer Corporation (filed as Exhibit 4.1 to Form 8-K filed November 9, 2017 and incorporated herein by reference).
- [31.1](#) Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.
- [31.2](#) Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.
- [32.1](#) Section 1350 Certification of Principal Executive Officer.
- [32.2](#) Section 1350 Certification of Principal Financial Officer.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T

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.

RAVE RESTAURANT GROUP, INC
(Registrant)

By: /s/ Scott Crane
Scott Crane
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Andrea K. Allen
Andrea K. Allen
Chief Accounting and Administrative Officer
(Principal Financial Officer)

Dated: February 6, 2019

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Scott Crane, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rave Restaurant Group, Inc. (“the Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: February 6, 2019

By: /s/ Scott Crane
Scott Crane
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Andrea K. Allen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rave Restaurant Group, Inc. (“the Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: February 6, 2019

By: /s/ Andrea K. Allen
Andrea K. Allen
Chief Accounting and Administrative Officer
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), the undersigned officer of Rave Restaurant Group, Inc. (the "Company"), does hereby certify, to such officer's knowledge, that:

The accompanying Quarterly Report on Form 10-Q for the quarter ended December 23, 2018 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-Q.

Date: February 6, 2019

By: /s/ Scott Crane
Scott Crane
Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is being furnished as an exhibit to the Form 10-Q pursuant to Item 601(b)(32) of Regulation S-K and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-Q for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), the undersigned officer of Rave Restaurant Group, Inc. (the "Company"), does hereby certify, to such officer's knowledge, that:

The accompanying Quarterly Report on Form 10-Q for the quarter ended December 23, 2018 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-Q.

Date: February 6, 2019

By: /s/ Andrea K. Allen
Andrea K. Allen
Chief Accounting and Administrative Officer
(Principal Financial Officer)

The foregoing certification is being furnished as an exhibit to the Form 10-Q pursuant to Item 601(b)(32) of Regulation S-K and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-Q for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.
