

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 27, 1998.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.

COMMISSION FILE NUMBER 0-12919

PIZZA INN, INC.  
(EXACT NAME OF REGISTRANT IN ITS CHARTER)

MISSOURI 47-0654575  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NO.)

5050 QUORUM DRIVE  
SUITE 500  
DALLAS, TEXAS 75240  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES,  
INCLUDING ZIP CODE)

(972) 701-9955  
(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 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 FILED ALL DOCUMENTS AND REPORTS REQUIRED TO BE FILED BY SECTIONS 12, 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 SUBSEQUENT TO THE DISTRIBUTION OF SECURITIES UNDER A PLAN CONFIRMED BY A COURT. YES  NO

AT FEBRUARY 9, 1999, AN AGGREGATE OF 11,485,490 SHARES OF THE REGISTRANT'S COMMON STOCK, PAR VALUE OF \$.01 EACH (BEING THE REGISTRANT'S ONLY CLASS OF COMMON STOCK), WERE OUTSTANDING.

PIZZA INN, INC.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL INFORMATION

PIZZA INN, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)  
(UNAUDITED)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DECEMBER 27, 1998	DECEMBER 28, 1997	DECEMBER 27, 1998	DECEMBER 28, 1997
REVENUES:				
Food and supply sales	\$ 15,390	\$ 14,701	\$ 29,832	\$ 29,162
Franchise revenue	1,396	1,571	2,850	3,365
Restaurant sales	550	747	1,146	1,444
Other income	27	51	119	149
	17,363	17,070	33,947	34,120
COSTS AND EXPENSES:				
Cost of sales	14,221	13,259	27,715	26,313
Franchise expenses	740	755	1,546	1,658
General and administrative expenses	1,240	1,142	2,731	2,442
Interest expense	143	118	256	258
	16,344	15,274	32,248	30,671
INCOME BEFORE INCOME TAXES	1,019	1,796	1,699	3,449
Provision for income taxes	314	611	524	1,173
NET INCOME	\$ 705	\$ 1,185	\$ 1,175	\$ 2,276
BASIC EARNINGS PER COMMON SHARE	\$ 0.06	\$ 0.09	\$ 0.10	\$ 0.18
DILUTED EARNINGS PER COMMON SHARE	\$ 0.06	\$ 0.09	\$ 0.09	\$ 0.17
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.06	\$ 0.06	\$ 0.12	\$ 0.12
WEIGHTED AVERAGE COMMON SHARES	11,597	12,713	11,903	12,696
WEIGHTED AVERAGE COMMON AND DILUTIVE POTENTIAL COMMON SHARES	12,206	13,868	12,606	13,579

See accompanying Notes to Consolidated Financial Statements.

PIZZA INN, INC.  
CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

	DECEMBER 27, 1998	JUNE 28, 1998
	-----	-----
ASSETS	(unaudited)	
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 578	\$ 2,335
Accounts receivable, less allowance for doubtful accounts of \$809 and \$825, respectively	6,847	6,021
Notes receivable, current portion, less allowance for doubtful accounts of \$202 and \$174, respectively	621	741
Inventories	1,888	1,953
Prepaid expenses and other	469	556
	-----	-----
Total current assets	10,403	11,606
<b>LONG-TERM ASSETS</b>		
Property, plant and equipment, net	1,830	1,921
Property under capital leases, net	1,344	761
Deferred taxes, net	6,246	6,705
Long-term notes receivable, less allowance for doubtful accounts of \$38 and \$8, respectively	479	436
Deposits and other	211	344
	-----	-----
	\$ 20,513	\$ 21,773
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable - trade	\$ 3,440	\$ 2,014
Accrued expenses	2,515	2,507
Current portion of capital lease obligations	281	125
	-----	-----
Total current liabilities	6,236	4,646
<b>LONG-TERM LIABILITIES</b>		
Long-term debt	7,037	4,700
Long-term capital lease obligations	1,150	754
Other long-term liabilities	751	756
	-----	-----
	15,174	10,856
	-----	-----
<b>SHAREHOLDERS' EQUITY</b>		
Common Stock, \$.01 par value; authorized 26,000,000 shares; outstanding 11,499,570 and 12,528,436 shares, respectively (after deducting shares in treasury: December - 3,420,486; June -2,381,386)	115	125
Additional paid-in capital	4,586	4,911
Retained earnings	638	5,881
	-----	-----
Total shareholders' equity	5,339	10,917
	-----	-----
	\$ 20,513	\$ 21,773
	=====	=====

See accompanying Notes to Consolidated Financial Statements.

PIZZA INN, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)  
(UNAUDITED)

SIX MONTHS ENDED  
-----  
DECEMBER 27,                      DECEMBER 28,  
1998                                      1997

CASH FLOWS FROM OPERATING ACTIVITIES:

Net income	\$	1,175	\$	2,276
Adjustments to reconcile net income to cash provided by operating activities:				
Depreciation and amortization		430		471
Provision for bad debt		92		25
Utilization of pre-reorganization net operating loss carryforwards		459		1,104
Changes in assets and liabilities:				
Notes and accounts receivable		(841)		(719)
Inventories		65		126
Accounts payable - trade		1,426		380
Accrued expenses		66		(695)
Prepaid expenses and other		150		(380)
CASH PROVIDED BY OPERATING ACTIVITIES		3,022		2,588

CASH FLOWS FROM INVESTING ACTIVITIES:

Capital expenditures		(388)		(250)
Proceeds from transfer of assets to capital lease		249		-
Acquisition of area development territory		-		(986)
CASH USED FOR INVESTING ACTIVITIES		(139)		(1,236)

CASH FLOWS FROM FINANCING ACTIVITIES:

Borrowings of long-term bank debt		2,337		-
Repayments of long-term bank debt and capital lease obligations		(117)		(1,453)
Dividends paid		(1,424)		(765)
Proceeds from exercise of stock options		21		405
Purchases of treasury stock		(5,457)		(1,306)
CASH USED FOR FINANCING ACTIVITIES		(4,640)		(3,119)

Net decrease in cash and cash equivalents		(1,757)		(1,767)
Cash and cash equivalents, beginning of period		2,335		2,037
Cash and cash equivalents, end of period	\$	578	\$	270

See accompanying Notes to Consolidated Financial Statements.

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION  
(IN THOUSANDS)  
(UNAUDITED)

SIX MONTHS ENDED	
DECEMBER 27, 1998	DECEMBER 28, 1997

CASH PAYMENTS FOR:

Interest	\$	193	\$	279
Income taxes		-		80

NONCASH FINANCING AND INVESTING ACTIVITIES:

Capital lease obligations incurred	\$	669	\$	-
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(1) The accompanying condensed consolidated financial statements of Pizza Inn, Inc. (the "Company") have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated financial statements should be read in conjunction with the notes to the Company's audited consolidated financial statements in its Form 10-K/A for the fiscal year ended June 28, 1998.

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. All adjustments contained herein are of a normal recurring nature.

(2) In October 1998, the Company's Board of Directors declared a quarterly dividend of \$.06 per share on the Company's common stock, payable January 22, 1999 to shareholders of record on January 11, 1999. The Company's balance sheet as of December 27, 1998 includes a current liability of \$690,000 for dividends declared and payable.

(3) In September 1998, the Company signed an agreement with its current lender to extend the term of its existing \$9.5 million revolving credit line through August 2000 and to modify certain financial covenants. As of December 27, 1998, the Company was in compliance with all of its debt covenants.

(4) Effective December 28, 1997, the Company adopted SFAS 128, "Earnings Per Share", which establishes standards for computing and presenting earnings per share (EPS). The statement requires dual presentation of basic and diluted EPS on the face of the income statement for entities with complex capital structures and requires a reconciliation of the numerator and denominator of the basic EPS computation, to the numerator and denominator of the diluted EPS calculation. Basic EPS excludes the effect of potentially dilutive securities while diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised, converted or resulted in the issuance of common stock that then shared in the earnings of the entity. 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).

	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
	-----	-----	-----
THREE MONTHS ENDED DECEMBER 27, 1998			
BASIC EPS			
Income Available to Common Shareholders	\$ 705	11,597	\$ 0.06
Effect of Dilutive Securities - Stock Options		609	
		-----	
DILUTED EPS			
Income Available to Common Shareholders & Assumed Conversions	\$ 705	12,206	\$ 0.06
	=====	=====	=====
THREE MONTHS ENDED DECEMBER 28, 1997			
BASIC EPS			
Income Available to Common Shareholders	\$ 1,185	12,713	\$ 0.09
Effect of Dilutive Securities - Stock Options		1,155	
		-----	
DILUTED EPS			
Income Available to Common Shareholders & Assumed Conversions	\$ 1,185	13,868	\$ 0.09
	=====	=====	=====
SIX MONTHS ENDED DECEMBER 27, 1998			
BASIC EPS			
Income Available to Common Shareholders	\$ 1,175	11,903	\$ 0.10
Effect of Dilutive Securities - Stock Options		703	
		-----	
DILUTED EPS			
Income Available to Common Shareholders & Assumed Conversions	\$ 1,175	12,606	\$ 0.09
	=====	=====	=====
SIX MONTHS ENDED DECEMBER 28, 1997			
BASIC EPS			
Income Available to Common Shareholders	\$ 2,276	12,696	\$ 0.18

## DILUTED EPS

Income Available to Common Shareholders  
& Assumed Conversions

\$	2,276	13,579	\$	0.17
=====	=====	=====	=====	=====

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
 -----  
 RESULTS OF OPERATIONS  
 -----

Quarter and six months ended December 27, 1998 compared to the quarter and six months ended December 28, 1997.

Diluted earnings per share for the second quarter of the current fiscal year decreased 33% to \$.06 from \$.09 for the same period last year. For the six months ended December 27, 1998, diluted earnings per share decreased 47% to \$.09 from \$.17 for the same period last year. Net income for the quarter decreased 41% to \$705,000 from \$1,185,000 for the same quarter last year. For the six months ended December 27, 1998, net income decreased 48% to \$1,175,000 from \$2,276,000 for the same period last year. Net income and earnings per share for the quarter and six months decreased primarily because of a lower volume of food product sales from lower chainwide sales, and lower revenues from area development territory sales. Restaurant cost of sales, as a percentage of sales, throughout our franchise community was up approximately 4 percentage points, due to extraordinarily higher cheese prices. This caused an adverse effect on chainwide sales because of decreased franchisee advertising as well as delayed new store openings and remodelings. The subsequent sharp drop in cheese prices in late January 1999 has already favorably affected comparable store sales growth.

Food and supply sales for the quarter increased 5% to \$15,390,000 from \$14,701,000 compared to the same period last year. This was primarily due to higher revenues from food sales due to higher cheese prices and increased equipment sales during the quarter, which were partially offset by a lower volume of food product sold due to lower chainwide sales as discussed above. For the six month period, food and supply sales increased 2% to \$29,832,000 from \$29,162,000 for the same period last year. During the first six months, food product revenues increased due to higher cheese prices, which were partially offset by a lower volume of food product sales.

Franchise revenue, which includes income from royalties, license fees and area development and foreign master license (collectively, "Territory") sales, for the quarter decreased 11% or \$175,000 compared to the same period of the prior year. The decrease in the quarter was primarily due to lower income recognized from Territory sales and license fees. For the six month period, franchise revenue decreased 15% or \$515,000. The prior year's six month period included the recognition of proceeds from the sale of foreign master license rights in Brazil, the Palestinian Territories and Korea in the amount of \$346,000 and area development fees of \$120,000. Current year revenues include partial recognition of proceeds from the sale of foreign master license rights in Puerto Rico in the amount of \$50,000 and area development fees of \$56,000. Royalty revenue was down \$109,000 compared to the first six months of last year, mainly resulting from a 4% decrease in chainwide sales and a slightly lower average royalty rate due to more restaurants within area development territories.

Restaurant sales, which consist of revenue generated by Company-owned stores, for the quarter decreased 26% or \$197,000 compared to the same period of the prior year. For the six month period, restaurant sales decreased 21% or \$298,000. This was due to the sale of one full service store to a licensee in December 1997 and the lease expiration and closing of one Delco store in August 1998. The Company owned and operated five and three stores for the periods ending December 27, 1998 and December 28, 1997, respectively.

Cost of sales increased 7% or \$962,000 and 5% or \$1,402,000 for the quarter and six month periods, respectively. The increases are primarily due to the increase in domestic food sales due to higher cheese prices and increased equipment sales. As a percentage of sales for the quarter and the first six months, cost of sales increased to 89% from 86% compared to the same periods last year. This was primarily due to the significantly higher cost of cheese, an increase in transportation expenses, an increase in allocation of corporate services expenses related to the Company's distribution center, and a lower volume of food product sold.

Franchise expenses include selling, general and administrative expenses directly related to the sale and service of franchises and Territories. These expenses decreased 2% or \$15,000 for the quarter and 7% or \$112,000 for the six

month period compared to the same periods last year. The decreases were due to an increase in corporate services expenses allocation to the distribution center resulting in a corresponding decrease in franchise expenses, and decreases in travel expenses. These decreases were partially offset by increased trade show spending. Additionally, franchise expenses for the first six months of the prior year also included the amortization of the Company's cost basis in a reacquired area development Territory.

General and administrative expenses increased 9% or \$98,000 for the quarter and 12% or \$289,000 for the first six months, compared to the same periods last year. This is principally due to an increase in the allowance for doubtful accounts, as well as higher insurance expense and professional fees. These increases were partially offset by a higher allocation of corporate services expenses to the distribution center to accurately reflect the total operating costs of the center.

Interest expense increased 21% or \$25,000 for the quarter compared to the same period of the prior year. This is a result of higher average debt, which was offset slightly by lower average interest rates. Interest expense was unchanged for the six month period compared to last year.

#### LIQUIDITY AND CAPITAL RESOURCES

During the first six months of fiscal 1999, the Company utilized cash provided by operations in the amount of \$3,022,000, bank borrowings of \$2,337,000, and a portion of its cash balances to purchase 1,039,100 shares of its own common stock for \$5,457,000 and to pay dividends of \$1,424,000 on the Company's common stock.

Capital expenditures of \$388,000 during the first six months included \$219,000 for upgrading the Company's computer system (including compliance with Year 2000 issues). During the first six months, \$249,000 of the computer system's upgrades was transferred to a 36-month capitalized lease.

In October 1998, the Company's Board of Directors declared a quarterly dividend of \$.06 per share on the Company's common stock, payable January 22, 1999 to shareholders of record on January 11, 1999. The Company's balance sheet as of December 27, 1998 includes a current liability of \$690,000 for dividends declared and payable.

The Company continues to realize substantial benefit from the utilization of its net operating loss carryforwards (which currently total \$13.1 million and expire in 2005) to reduce its federal tax liability from the 34% or 31% tax rate reflected on its statement of operations to an actual payment of approximately 2% of taxable income. Management believes that future operations will generate sufficient taxable income, along with the reversal of temporary differences, to fully realize its net deferred tax asset balance (\$6.2 million as of December 27, 1998) without reliance on material, non-routine income. Taxable income in future years at the current level would be sufficient for full realization of the net tax asset.

The Company continues to assess its computerized systems to determine their ability to correctly identify the year 2000 and is devoting the necessary internal and external resources to replace, upgrade or modify all significant systems related to the year 2000. The Company's assessment, purchase of new equipment and installation of new software are completed. The conversion and testing of data began in October 1998 and is approximately 65% completed. Management anticipates that all systems will be year 2000 compliant by June 1999. The Company's existing software system had a remaining book value of \$92,000 at December 27, 1998 which will be amortized over six months through June 1999.

Because third party computer failures could also have a material impact on a company's ability to conduct business, confirmations are being requested from our material vendors and suppliers to certify that plans are being developed by them to address and become compliant with the year 2000 issues. As of February 9, 1999, the Company had received responses from approximately 80% from such parties and all the responding companies have provided written assurances that they expect to address all their significant year 2000 issues on a timely basis. The Company believes that any year 2000 impact on its franchisee base will have no material effect on the Company's results of operations since sales information is not currently communicated through computer systems. Through the assessment of the Company's critical non-information technology systems, management has determined that no modifications are required for year 2000 compliance in this area.

Currently, the Company can not clearly identify or therefore address the most reasonably likely worst case scenario regarding year 2000 compliance. Additionally, we plan to have all new compliance systems noted above fully implemented by June 1999. Therefore, management does not believe there is an immediate need for a contingency plan. However, during the implementation

process, management plans to closely monitor any problems which should arise requiring a contingency plan and to then expeditiously develop such alternative plan based on these specific needs.

Although management presently believes the Company is taking appropriate steps to assess and correct its year 2000 issues, due to the general uncertainty inherent in the year 2000 issue, in part due to the uncertainty of year 2000 readiness of third parties, management is unable to determine at this time whether year 2000 issues will have a material adverse effect on the Company's results of operations or financial condition.

New software, testing, and conversion of systems and applications will cost approximately \$450,000 and new hardware components will cost approximately \$300,000. Total system upgrades are expected to position the Company for anticipated future growth and enhance corporate service capabilities. Of these costs, approximately \$631,000 has been incurred as of December 27, 1998. All the above capital expenditures are to be funded through a 36-month capitalized lease.

This report contains certain forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) relating to the Company that are based on the beliefs of the management of the Company, as well as assumptions and estimates made by and information currently available to the Company's management. When used in this report, the words "anticipate," "believe," "estimate," "expect," "intend" and similar expressions, as they relate to the Company or the Company's management, identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions relating to the operations and results of operations of the Company as well as its customers and suppliers, including as a result of competitive factors and pricing pressures, shifts in market demand, general economic conditions and other factors including but not limited to, changes in demand for Pizza Inn products or franchises, the impact of competitors' actions, changes in prices or supplies of food ingredients, and restrictions on international trade and business. Should one or more of these risks or uncertainties materialize, or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended.

PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Annual Meeting of Shareholders on December 15, 1998, the Company's shareholders elected all four nominees to the Board of Directors. The results of the voting were as follows:

NOMINEE	FOR	VOTES WITHHELD
-----	---	-----
Bobby L. Clairday	9,318,662	52,391
Ronald W. Parker	9,318,593	52,460
Ramon D. Phillips	9,318,662	52,391
Butler E. Powell	9,318,662	52,391

The shareholders also approved the proposed amendment of the Company's 1993 Stock Award Plan. The results of the voting were as follows:

FOR	AGAINST	ABSTAIN
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8,490,926	860,572	19,555

The shareholders also approved the proposed amendment of the Company's 1993 Outside Directors Stock Award Plan. The results of the voting were as follows:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
---	-----	-----	-----
8,980,010	342,026	49,016	1

The Annual Meeting of Shareholders was adjourned until January 30, 1999 at 10:00 a.m. at the Company's offices for the sole matter of voting on the proposed amendment to the Company's Restated Articles of Incorporation. At the close of the January 30, 1999 meeting the shareholders approved the proposed amendment, with the voting as follows:

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
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6,462,349

114,933

43,873

3,668,097

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K  
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There are no exhibits filed with this report. No reports on Form 8-K were filed in the quarter for which this report is filed.

SIGNATURES  
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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.

PIZZA INN, INC.  
Registrant

By: /s/Ronald W. Parker  
-----

Ronald W. Parker  
Executive Vice President and  
Principal Financial Officer

By: /s/Nancy Deemer  
-----

Nancy Deemer  
Controller and  
Principal Accounting Officer

Dated: February 8, 1999

6-MOS  
JUN-27-1999  
JUN-29-1998  
DEC-27-1998  
578  
0  
7468  
1011  
1888  
10403  
1830  
0  
20513  
6236  
0  
115  
0  
5224  
20513  
30978  
33947  
27715  
27715  
1546  
92  
256  
1699  
524  
1175  
0  
0  
0  
1175  
.10  
.09