

STEAK & SHAKE CO  
Form 10-Q  
August 15, 2005

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TWELVE WEEKS ENDED JULY 6, 2005

OR

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

Commission file number 0-8445

THE STEAK N SHAKE COMPANY  
(Exact name of registrant as specified in its charter)  
INDIANA 37-0684070  
(State or other jurisdiction (I.R.S. Employer  
of incorporation or Identification No.)  
organization)  
36 S. Pennsylvania Street, Suite 500  
Indianapolis, Indiana 46204  
(317) 633-4100  
(Address, including zip code, and telephone number,  
including area code, of registrant's principal executive  
offices)

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

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

Number of shares of Common Stock outstanding at August 1, 2005: 27,859,415



**THE STEAK N SHAKE COMPANY**

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**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Condensed Consolidated Statements of Financial Position**

The Steak n Shake Company

(Amounts in \$000s except share and per share data)

|   | <b>July 6,<br/>2005<br/>(Unaudited)</b> | September 29,<br>2004 |
|---|---|-----------------------|
| <b>Assets:</b>  |   |                       |
| <b>Current Assets</b>   |   |                       |
| Cash, including cash equivalents of \$9,175 in fiscal 2005 and \$23,590 in fiscal 2004  | \$ 14,638                               | \$ 25,150             |
| Short-term investments  | -                                       | 466                   |
| Receivables, net  | 3,503                                   | 4,123                 |
| Inventories   | 6,644                                   | 6,204                 |
| Deferred income taxes   | 2,591                                   | 2,755                 |
| Assets held for sale  | 1,756                                   | 1,756                 |
| Other current assets  | 5,264                                   | 4,946                 |
| <b>Total current assets</b>   | <b>34,396</b>                           | <b>45,400</b>         |
| <b>Net Property and Equipment</b>   | <b>431,069</b>                          | <b>385,258</b>        |
| <b>Goodwill and Other Intangibles</b>   | <b>8,928</b>                            | <b>1,195</b>          |
| <b>Other Assets</b>   | <b>4,748</b>                            | <b>4,000</b>          |
| <b>Total assets</b>   | <b>\$ 479,141</b>                       | <b>\$ 435,853</b>     |
| <b>Liabilities and Shareholders' Equity:</b>  |   |                       |
| <b>Current Liabilities</b>  |   |                       |
| Accounts payable  | \$ 21,993                               | \$ 18,563             |
| Accrued expenses  | 35,796                                  | 29,379                |
| Current portion of long-term debt   | 7,145                                   | 6,775                 |
| Current portion of obligations under leases   | 3,916                                   | 3,887                 |
| <b>Total current liabilities</b>  | <b>68,850</b>                           | <b>58,604</b>         |
| Deferred Income Taxes   | 4,028                                   | 2,969                 |
| Other Long-term Liabilities   | 2,041                                   | 1,272                 |
| Obligations Under Leases  | 148,550                                 | 144,647               |
| Long-term Debt  | 11,827                                  | 9,429                 |
| <b>Commitments and Contingencies</b>  |   |                       |
| <b>Shareholders' Equity:</b>  |   |                       |
| Common stock — \$.50 stated value, 50,000,000 shares authorized — shares issued: 30,332,839 in fiscal 2005 and in fiscal 2004 | 15,166                                  | 15,166                |
| Additional paid-in capital  | 123,886                                 | 123,787               |
| Retained earnings   | 136,559                                 | 114,993               |
| Less: Unamortized value of restricted shares  | (2,508)                                 | (1,393)               |

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Treasury stock — at cost: 2,481,444  
shares in fiscal 2005;

|  |                   |                   |
|--|-------------------|-------------------|
| 2,856,154 shares in fiscal 2004            | <b>(29,258)</b>   | (33,621)          |
| Total shareholders' equity                 | <b>243,845</b>    | 218,932           |
| Total liabilities and shareholders' equity | <b>\$ 479,141</b> | <b>\$ 435,853</b> |

*See accompanying notes.*

**Condensed Consolidated Statements of Earnings**

The Steak n Shake Company

(Unaudited)

(Amounts in 000s, except share and per share data)

|   | <b>Twelve Weeks Ended</b> |                      | <b>Forty Weeks Ended</b> |                      |
|---|---------------------------|----------------------|--------------------------|----------------------|
|   | <b>July 6,</b>            | <b>June 30,</b>      | <b>July 6,</b>           | <b>June 30,</b>      |
|   | <b>2005</b>               | <b>2004</b>          | <b>2005</b>              | <b>2004</b>          |
|   |                           | <b>(as restated)</b> |                          | <b>(as restated)</b> |
| <b>Revenues</b>   |                           |                      |                          |                      |
| Net sales   | \$ 147,057                | \$ 129,555           | \$ 458,307               | \$ 405,554           |
| Franchise fees  | 797                       | 1,072                | 2,897                    | 3,336                |
| Total revenues  | 147,854                   | 130,627              | 461,204                  | 408,890              |
| <b>Costs and Expenses</b>                                   |                           |                      |                          |                      |
| Cost of sales   | 34,224                    | 31,078               | 107,009                  | 95,022               |
| Restaurant operating costs                                  | 71,221                    | 63,097               | 225,220                  | 199,530              |
| General and administrative                                  | 11,464                    | 9,402                | 37,006                   | 32,023               |
| Depreciation and amortization                               | 6,365                     | 5,720                | 20,228                   | 18,746               |
| Marketing   | 6,872                     | 5,366                | 20,922                   | 16,767               |
| Interest  | 2,940                     | 2,999                | 9,736                    | 10,117               |
| Rent  | 2,423                     | 2,087                | 7,683                    | 6,468                |
| Pre-opening costs   | 901                       | 345                  | 2,165                    | 1,324                |
| Provision for restaurant closing                            | -                         | (394)                | -                        | (394)                |
| Other income, net   | (364)                     | (391)                | (1,456)                  | (1,416)              |
| Total costs and expenses                                    | 136,046                   | 119,309              | 428,513                  | 378,187              |
| <b>Earnings Before Income Taxes</b>                         | 11,808                    | 11,318               | 32,691                   | 30,703               |
| <b>Income Taxes</b>   | 4,037                     | 3,916                | 11,125                   | 10,745               |
| <b>Net Earnings</b>   | \$ 7,771                  | \$ 7,402             | \$ 21,566                | \$ 19,958            |
| <b>Net Earnings Per Common and Common Equivalent Share:</b> |                           |                      |                          |                      |
| Basic   | \$ .28                    | \$ .27               | \$ .79                   | \$ .73               |
| Diluted   | \$ .28                    | \$ .27               | \$ .77                   | \$ .72               |
| <b>Weighted Average Shares and</b>                          |                           |                      |                          |                      |

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| <b>Equivalents:</b> |            |            |            |            |
|---------------------|------------|------------|------------|------------|
| Basic               | 27,562,084 | 27,462,379 | 27,470,571 | 27,356,558 |
| Diluted             | 28,102,280 | 27,778,480 | 28,028,675 | 27,704,779 |

*See accompanying notes.*

**Condensed Consolidated Statements of Cash Flows**

The Steak n Shake Company

(Unaudited)

(Amounts in \$000's)

**Forty Weeks Ended****July 6,  
2005**June 30,  
2004

(as restated)

**Operating Activities**

|   |    |                |    |         |
|---|----|----------------|----|---------|
| Net earnings  | \$ | <b>21,566</b>  | \$ | 19,958  |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |    |                |    |         |
| Depreciation and amortization   |    | <b>20,228</b>  |    | 18,746  |
| Provision for deferred income tax   |    | <b>848</b>     |    | 81      |
| Loss on disposal of property and equipment  |    | <b>657</b>     |    | 434     |
| Provision for restaurant closings   |    | -              |    | (394)   |
| Changes in receivables and inventories  |    | <b>584</b>     |    | (789)   |
| Changes in other assets   |    | <b>(2,122)</b> |    | (2,913) |
| Changes in accounts payable and accrued expenses                                    |    | <b>8,293</b>   |    | 6,826   |
| Net cash provided by operating activities   |    | <b>50,054</b>  |    | 41,949  |

**Investing Activities**

|  |  |                 |  |          |
|--|--|-----------------|--|----------|
| Additions of property and equipment              |  | <b>(45,065)</b> |  | (29,044) |
| Purchase of Kelley Restaurants, Inc.             |  | <b>(15,893)</b> |  | -        |
| Proceeds from sale of long-term investments      |  | -               |  | 5,095    |
| Proceeds from sale of short-term investments     |  | <b>466</b>      |  | 949      |
| Purchase of short-term investments               |  | -               |  | (621)    |
| Proceeds from disposal of property and equipment |  | <b>980</b>      |  | 1,429    |
| Net cash used in investing activities            |  | <b>(59,512)</b> |  | (22,192) |

**Financing Activities**

|   |  |                |  |         |
|---|--|----------------|--|---------|
| Principal payments on lease obligations     |  | <b>(2,742)</b> |  | (3,502) |
| Principal payments on long-term debt        |  | <b>(1,193)</b> |  | (3,179) |
| Proceeds from equipment and property leases |  | <b>650</b>     |  | 600     |
| Proceeds from employee stock purchase plan  |  | <b>1,573</b>   |  | 1,267   |
| Proceeds from exercise of stock options     |  | <b>658</b>     |  | 753     |
| Net cash used in financing activities       |  | <b>(1,054)</b> |  | (4,061) |

|   |                  |                  |
|---|------------------|------------------|
| <b>Increase (Decrease) in Cash and Cash Equivalents</b> | <b>(10,512)</b>  | 15,696           |
| <b>Cash and Cash Equivalents at Beginning of Period</b> | <b>25,150</b>    | 24,795           |
| <b>Cash and Cash Equivalents at End of Period</b>       | <b>\$ 14,638</b> | <b>\$ 40,491</b> |

*See accompanying notes.*

**Notes to Condensed Consolidated Financial Statements**

The Steak n Shake Company

(Unaudited)

(Amounts in \$000's, except share and per share data)

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

In the opinion of the Company, all adjustments considered necessary to present fairly the consolidated statement of financial position as of July 6, 2005, and the consolidated statements of earnings for the twelve and forty weeks ended July 6, 2005 and June 30, 2004, and cash flows for the forty weeks ended July 6, 2005 and June 30, 2004, have been included.

The consolidated statements of earnings for the forty weeks ended July 6, 2005 and June 30, 2004 are not necessarily indicative of the consolidated statements of earnings for the entire year. For further information, refer to the consolidated financial statements and notes thereto included in the Company's amended Annual Report on Form 10-K/A for the fiscal year ended September 29, 2004.

**Seasonal Aspects**

The Company has substantial fixed costs, which do not decline as a result of a decline in sales. The Company's first and second fiscal quarters, which include the winter months, usually reflect lower average weekly unit volumes as compared to the third and fourth fiscal quarters. Additionally, sales in the first two fiscal quarters can be adversely affected by severe winter weather. The Company may also be negatively affected by adverse weather during the first and fourth fiscal quarters as hurricanes and tropical storms may impact the Southeastern portion of the United States, where the Company has a significant number of restaurants.

**Stock-Based Compensation**

The Company accounts for its Stock Option and Employee Stock Purchase Plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. No stock-based employee compensation is reflected in net earnings, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

|   | <b>Twelve Weeks Ended</b> |                          | <b>Forty Weeks Ended</b> |                          |
|---|---------------------------|--------------------------|--------------------------|--------------------------|
|   | <b>July 6,<br/>2005</b>   | <b>June 30,<br/>2004</b> | <b>July 6,<br/>2005</b>  | <b>June 30,<br/>2004</b> |
| Net earnings as reported                | \$ 7,771                  | \$ 7,402                 | \$ 21,566                | \$ 19,958                |
| Less pro forma<br>compensation expense, | (527)                     | (280)                    | (1,518)                  | (1,024)                  |

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|  |    |       |    |       |    |        |    |        |
|--|----|-------|----|-------|----|--------|----|--------|
| net of tax                             |    |       |    |       |    |        |    |        |
| Proforma net earnings                  | \$ | 7,244 | \$ | 7,122 | \$ | 20,048 | \$ | 18,934 |
| Basic earnings per share as reported   |    |       |    |       |    |        |    |        |
|  | \$ | .28   | \$ | .27   | \$ | .79    | \$ | .73    |
| Pro forma basic earnings per share     |    |       |    |       |    |        |    |        |
|  | \$ | .26   | \$ | .26   | \$ | .73    | \$ | .69    |
| Diluted earnings per share as reported |    |       |    |       |    |        |    |        |
|  | \$ | .28   | \$ | .27   | \$ | .77    | \$ | .72    |
| Pro forma diluted earnings per share   |    |       |    |       |    |        |    |        |
|  | \$ | .26   | \$ | .26   | \$ | .72    | \$ | .68    |

In December of 2004, the Financial Accounting Standards Board ("FASB") reissued SFAS No. 123 as SFAS No. 123R, *Share Based Compensation*. SFAS No. 123R replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123R requires that the cost of employee services received in exchange for equity instruments issued or liabilities incurred be recognized in the financial statements. Compensation costs will be measured using a fair-value-based method over the period that the employee provides service in exchange for the award. This statement will apply to all awards granted after the effective date and to modifications, repurchases or cancellations of existing awards. Additionally, under the transition method, the Company will recognize compensation cost on the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS Nos. 123 and 148 for pro forma disclosures. As the employee stock purchase plan is currently written, the Company will also be required to record compensation expense for the employee stock purchase plan. Compensation expense is recognized over each award's service period, the period during which an employee is required to provide service in exchange for an award. At the end of the service period, the award is vested and is eligible for issuance. The Company's stock-based compensation plans allow early vesting when an employee reaches retirement age and ceases continuous service. For employees reaching retirement age during the vesting period, an evaluation of each employee's expected retirement date is made, and the accrual of compensation expense is accelerated if necessary. SFAS No. 123R will require acceleration of compensation expense through an employee's retirement age, whether or not the employee is expected to cease continuous service on that date. SFAS No. 123R will be effective in the first fiscal quarter of fiscal 2006. The Company has not yet determined the impact that adopting this SFAS will have on its results of operations.

**Earnings Per Share**

Earnings per share of common stock is based on the weighted average number of shares outstanding during the year. The following table presents a reconciliation of the basic and diluted weighted average common shares as required by SFAS No. 128, *Earnings Per Share*:

|  | <b>Twelve Weeks Ended</b> |                          | <b>Forty Weeks Ended</b> |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>July 6,<br/>2005</b>   | <b>June 30,<br/>2004</b> | <b>July 6,<br/>2005</b>  | <b>June 30,<br/>2004</b> |
| Basic earnings per share:  |                           |                          |                          |                          |
| Weighted average common shares   | 27,562,084                | 27,462,379               | 27,470,571               | 27,356,558               |
| Diluted earnings per share:  |                           |                          |                          |                          |
| Weighted average common shares   | 27,562,084                | 27,462,379               | 27,470,571               | 27,356,558               |
| Diluted effect of stock options  | 540,196                   | 316,101                  | 558,104                  | 348,221                  |
| Weighted average common and incremental shares   | 28,102,280                | 27,778,480               | 28,028,675               | 27,704,779               |
| Number of stock options excluded from the calculation of earnings per share as the options' exercise prices were greater than the market price of the Company's common stock | 58,742                    | 43,907                   | 113,091                  | 37,064                   |

**Shareholders' Equity**

During the forty weeks ended July 6, 2005, the Company issued 133,500 shares of restricted common stock under its Capital Appreciation Plan to certain employees. The shares are restricted for a period of three years. The total value of the stock grant (based upon market value at the date of grant) of \$2,356 is recorded to unamortized value of restricted shares and is amortized to compensation expense ratably over the three-year period.

**Net Property and Equipment**

Net property and equipment consists of the following:

| <b>July 6,<br/>2005</b> | <b>September<br/>29,<br/>2004</b> |
|-------------------------|-----------------------------------|
|-------------------------|-----------------------------------|

|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Land   | \$ | 168,352   | \$ | 144,818   |
| Buildings                                      |    | 158,610   |    | 148,802   |
| Land and leasehold improvements                |    | 109,835   |    | 95,234    |
| Equipment                                      |    | 163,547   |    | 153,409   |
| Construction in progress                       |    | 13,539    |    | 11,048    |
|  |    | 613,883   |    | 553,311   |
| Less accumulated depreciation and amortization |    | (182,814) |    | (168,053) |
| Net property and equipment                     | \$ | 431,069   | \$ | 385,258   |

### Assets Held for Sale

Assets held for sale consist of property and equipment related to the under-performing restaurants identified for disposal in fiscal 2003, and are comprised of the following: Land and Buildings - \$1,546; Land and Leasehold Improvements - \$146; and Equipment - \$64.

### Goodwill and Other Intangibles

Goodwill and other intangibles consist of the following:

|                   |    | July 6,<br>2005 | September<br>29,<br>2004 |
|-------------------|----|-----------------|--------------------------|
| Goodwill          | \$ | 7,147           | -                        |
| Intangible assets |    | 1,781           | \$ 1,195                 |
|                   | \$ | 8,928           | \$ 1,195                 |

In connection with the Company's acquisition of Kelley Restaurants, Inc., the Company recorded goodwill and other intangible assets in accordance with SFAS 141, *Business Combinations*. The balance of goodwill represents the excess of the purchase price over the fair value of the assets acquired and liabilities assumed. In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized, but is assessed annually for impairment or more frequently if events occur that indicate the balance of goodwill may be impaired.

Intangible assets are subject to amortization and consist of "a right to operate" and favorable leases. The favorable leases were acquired in connection with the Company's acquisition of Kelley Restaurants Inc., and have a weighted average amortization period of 8 years. Amortization expense for the twelve and forty week periods ended July 6, 2005 was \$42 and \$125, respectively. Amortization expense for the twelve and forty week periods ended June 30, 2004 was \$28 and \$92, respectively. Annual amortization expense for each of the next five fiscal years is estimated to be approximately \$181.

### Other Assets

Other assets include capitalized software costs as well as deposits. Capitalized software costs are amortized over their estimated useful lives and the related amortization is included in depreciation and amortization expense.

### Other Long-term Liabilities

Other liabilities include deferred amounts related to the Company's Non-Qualified Savings Plan. The plan allows for the highly compensated employees to defer amounts from their salaries for retirement savings. The plan includes an employee match equal to the amount of the match the employee would have received in the Company's 401(k) plan. In addition, the amount includes the balance of deferred rent expense for escalating rent payments.



**Kelley Restaurants Acquisition**

On December 29, 2004 the Company completed its acquisition of Kelley Restaurants Inc. for approximately \$15.9 million, which included adjustments for debt repayment, working capital and other adjustments. At the acquisition date, Kelley Restaurants operated 17 Steak n Shake restaurants in Atlanta, Georgia and Charlotte, North Carolina. This acquisition will allow the Company to further develop the Atlanta and Charlotte markets, which is consistent with the Company's long term growth plans. The President of Kelley Restaurants, Inc. is a member of the Company's board of directors.

The transaction is being accounted for using the purchase method of accounting as required by SFAS 141, "Business Combinations." The purchase price has been allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the date of the acquisition. The excess of the purchase price over the fair value of net assets acquired was recorded as goodwill. See above for further discussion of "Goodwill and Other Intangibles." The allocation of the purchase price to specific assets and liabilities is based, in part, upon internal estimates of assets and liabilities. The Company has received independent appraisals for certain assets and is in the process of refining its internal fair value estimates. Therefore, the allocation of the purchase price is preliminary and the final allocation may differ. Based on the preliminary purchase price allocation, the following table summarizes the fair value of the assets acquired and liabilities assumed at the acquisition date.

|                                  |                  |
|----------------------------------|------------------|
| Current assets                   | \$ 617           |
| Property and equipment           | 21,659           |
| Goodwill                         | 7,147            |
| Intangible assets                | 711              |
| Other assets                     | 46               |
| <b>Total assets acquired</b>     | <b>30,180</b>    |
| Current liabilities              | 3,833            |
| Deferred income taxes            | 400              |
| Obligations under lease          | 6,463            |
| Long-term debt                   | 3,591            |
| <b>Total liabilities assumed</b> | <b>14,287</b>    |
| <b>Net assets acquired</b>       | <b>\$ 15,893</b> |

**Provision for Restaurant Closings**

During the fourth quarter of fiscal year 2003, the Company identified nine under-performing restaurants for disposal. In connection with the decision to dispose of these restaurants, the Company recorded a charge of \$5,200 for property and equipment write-downs, lease termination costs, and closing costs. During fiscal year 2004, the Company disposed of five of these restaurants. The Company is currently seeking buyers for the remaining four properties, which are classified as held for sale, and anticipates completing the disposal of these properties within the next six months.

Activity related to the provision for restaurant closings is as follows:

|                         | <b>Balance at<br/>September<br/>29, 2004</b> | <b>Non-cash<br/>charges<br/>during<br/>forty<br/>weeks<br/>ended<br/>July 6,<br/>2005</b> | <b>Cash<br/>charges<br/>during<br/>forty weeks<br/>ended July<br/>6, 2005</b> | <b>Balance at<br/>July 6, 2005</b> |
|-------------------------|--|---|---|------------------------------------|
| Asset write-downs       | \$ 3,058                                     | \$ (5)  | -   | \$ 3,053                           |
| Lease termination costs | -  | -   | -   | -                                  |
| Closing costs           | 24   | -   | \$ (11)   | 13                                 |
| Total                   | \$ 3,082                                     | \$ (5)  | \$ (11)   | \$ 3,066                           |

|                         | <b>Balance at<br/>September<br/>24, 2003</b> | <b>Non-cash<br/>charges<br/>during<br/>forty weeks<br/>ended June<br/>30, 2004</b> | <b>Cash<br/>charges<br/>or adjustments<br/>to estimates<br/>during forty<br/>weeks ended<br/>June 30,<br/>2004</b> | <b>Balance at<br/>June 30,<br/>2004</b> |
|-------------------------|--|--|--|---|
| Asset write-downs       | \$ 4,860                                     | \$ (479)   | \$ (389)   | \$ 3,992                                |
| Lease termination costs | 225  | -  | (225)  | -                                       |
| Closing costs           | 115  | -  | (67)   | 48                                      |
| Total                   | \$ 5,200                                     | \$ (479)   | \$ (681)   | \$ 4,040                                |

### Revolving Credit Agreement

The Company amended its Revolving Credit Agreement ("the Agreement") on January 30, 2005. Under the Agreement, the Company can borrow up to \$50,000. The Agreement expires on January 30, 2008. The Agreement bears interest at a rate based on LIBOR plus 55 basis points or the lender's prime rate minus 100 basis points, at the election of the Company. The Agreement is unsecured and contains restrictions, which among other things, require the Company to maintain certain financial ratios. The Company is in compliance with all restrictive covenants under the Agreement as of July 6, 2005.

### Supplemental Cash Flow Information

During the forty week period ended July 6, 2005, the Company issued 133,500 shares of restricted stock under its Capital Appreciation Plan with a market value of \$2,356. During the forty week period ended June 30, 2004, the Company issued 136,000 shares of restricted stock under its Capital Appreciation Plan with a market value of \$2,104.

### Commitments and Contingencies

The Company is engaged in various legal proceedings and has certain unresolved claims pending. The ultimate liability, in any, for the aggregate amounts claimed cannot be determined at this time. However, management of the Company, believes, based on examination of these matters and experiences to date, that the ultimate liability, if any, in excess of amounts already provided in the Company's consolidated financial statements is not likely to have a material effect on our results of operations, financial position or cash flows.

**Reclassifications**

Certain amounts in the fiscal 2004 financial statements have been reclassified to conform to the fiscal 2005 presentation.

**New Accounting Pronouncements**

In June 2005, the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force reached a consensus on Issue No. 05-06, "Determining the Amortization Period for Leasehold Improvements" ("EITF 05-6"). The guidance requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. The guidance is effective for periods beginning after June 29, 2005. The adoption of EITF 05-6 is not expected to have an impact on our consolidated financial statements.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154 ("SFAS No. 154"), "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

**Restatement**

On May 20, 2005, the Company filed an amended Annual Report on Form 10 - K/A for the fiscal year ended September 29, 2004, and an amended quarterly report on Form 10 - Q/A for the fiscal quarter ended December 22, 2004.

Historically, when accounting for ground leases with renewal options, the Company depreciated its buildings over a period of 25 years (estimated economic life of buildings). In certain cases, the term of 25 years included both the initial lease term and certain renewal option periods under the lease. The Company recorded rent expense from the rent commencement date through the initial term of the lease. The restatement reflects rent expense being recognized on a straight-line basis over the lease term, including any additional cancelable option periods where failure to exercise such options would have resulted in an economic penalty.

Additionally, the Company had recognized rent expense for its operating leases using a lease term that commenced when rent payments began, which generally coincided with a point in time near the date the Company's restaurants opened. This generally had the effect of excluding the restaurant build-out period (during which the Company typically made no rent payments) from the calculation of the period over which rent was expensed. The Company has determined that, under GAAP, it should have recognized rent expense over a lease term that included the build-out period, which, in most cases, will cause rent expense to be recognized sooner than previously reported. The restatement reflects rent expense beginning in the build-out period.

The Company has also determined that certain build-to-suit leases should have been treated as sale leaseback transactions to more fully reflect the provisions of Statement of Financial Accounting Standards No. 98, "Accounting for Leases" and Emerging Issues Task Force 97-10, "The Effect of Lessee Involvement in Asset Construction." Under an interpretation of the statement, the Company was determined to have continued involvement in the property, which required the proceeds from these build-to-suit leases to have been accounted for as a "finance obligations," reflected as a liability and amortized over the life of the related lease. The related assets should be depreciated over their estimated useful lives. The restatement reflects lease payments on the above mentioned leases being recorded as interest expense and debt repayment, as opposed to rent expense. In addition, the Company recorded additional depreciation expense for the related assets.

The total impact of the adjustments reduced the Company's net income for the fiscal years ended September 29, 2004, September 24, 2003, and September 25, 2002 by \$71, \$78 and \$97 respectively. Additionally, beginning retained earnings for the fiscal year ended September 25, 2002 were reduced by \$537. Please refer to the Company's Current Report on Form 8 - K filed on May 16, 2005 for more information related to the restatement. The following tables are a summary of the effects of the restatement on the financial statements.

**Condensed Consolidated  
Statements of Earnings  
Summary of  
Restatement Impacts**  
The Steak n Shake  
Company  
*(Twelve Weeks and Forty  
Weeks Ended June 30,  
2004)*  
*(Amounts in \$000s except  
per share data)*

Twelve Weeks Ended

Forty Weeks Ended

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For the fiscal period  
ended:

|  | June 30, 2004                |                | June 30, 2004                |                |
|--|------------------------------|----------------|------------------------------|----------------|
|  | As<br>Previously<br>Reported | As<br>Restated | As<br>Previously<br>Reported | As<br>Restated |
| Depreciation and<br>Amortization                                 | \$ 5,686                     | \$ 5,720       | \$ 18,632                    | \$ 18,746      |
| Interest   | 2,943                        | 2,999          | 9,926                        | 10,117         |
| Rent   | 2,153                        | 2,087          | 6,687                        | 6,468          |
| Total costs and expenses   | 119,285                      | 119,309        | 378,101                      | 378,187        |
| Earnings Before Income<br>Taxes                                  | 11,342                       | 11,318         | 30,789                       | 30,703         |
| Income Taxes   | 3,925                        | 3,916          | 10,775                       | 10,745         |
| Net Earnings   | \$ 7,417                     | \$ 7,402       | \$ 20,014                    | \$ 19,958      |
| Basic Earnings Per<br>Common and<br>Common Equivalent<br>Share   | \$ .27                       | \$ .27         | \$ .73                       | \$ .73         |
| Diluted Earnings Per<br>Common and<br>Common Equivalent<br>Share | \$ .27                       | \$ .27         | \$ .72                       | \$ .72         |

**Condensed Consolidated Statements of Cash  
Flows**

**Summary of Restatement Impacts**

The Steak n Shake Company

(Forty Weeks Ended June 30, 2004)

(Amounts in \$000s except share and per share data)

For the fiscal period ended:

|  | As<br>Previously<br>Reported | As<br>Restated |
|--|------------------------------|----------------|
| Operating Activities:                                  |                              |                |
| Net earnings   | \$ 20,014                    | \$ 19,958      |
| Depreciation and amortization                          | 18,632                       | 18,746         |
| Provision for deferred income taxes                    | 111                          | 81             |
| Changes in accounts payable and accrued expenses       | 6,750                        | 6,826          |
| Net cash provided by operating activities              | 41,844                       | 41,949         |
| Financing Activities:                                  |                              |                |
| Principal payments on lease obligations <sup>(1)</sup> | (3,397)                      | (3,502)        |
| Net cash used in financing activities                  | \$ (3,957)                   | \$ (4,061)     |

(1) The amount as previously reported excludes \$3,179 for principal payments on long-term debt that was reclassified to a separate line in the financing activities section of the condensed consolidated statements of cash flows to conform to the current year presentation.

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

(Amounts in \$000's, except share and per share data)

### Overview

In the following discussion, the term "same store sales" refers to the sales of only those units open eighteen months as of the beginning of the current fiscal period and which remained open through the end of the fiscal period.

The Steak n Shake Company reported higher revenues, net income, and diluted earnings per share in the twelve weeks ended July 6, 2005 as compared to the twelve weeks ended June 30, 2004.

- The Company's revenues increased by 13.2% to \$147,854 compared to \$130,627 for the same period last year.
  - Net earnings increased 5.0% to \$7,771 compared to \$7,402 in the prior year.
    - Diluted earnings per share increased to \$0.28 from \$0.27.
- The key driver for the Company's revenue growth was a 2.8% increase in same store sales in addition to revenue generated from the additional restaurants acquired through the Kelley Restaurants acquisition of approximately \$9.1 million. The same store sales growth is primarily attributable to check average increases of 3.8%.

In addition to the above financial information, the Company also considers the following quarterly highlights:

- During the twelve week period ended July 6, 2005, the Company opened 4 new Company-owned restaurants.
- The positive same stores sales for the quarter marked the tenth consecutive quarter of positive same store sales.

Management continues to prepare for expansion while strengthening the foundation of the Company. The Company has now had ten consecutive quarters of positive same store sales as a result of efforts to strengthen the brand through the "virtuous cycle." The components of the virtuous cycle include: developing effective field leaders, improving associate satisfaction and training, growing guest counts, improving margins, and expanding the brand.

On May 20, 2005, the Company filed an amended Annual Report on Form 10 - K / A for the fiscal year ended September 29, 2004, and an amended quarterly report on Form 10 - Q / A for the fiscal quarter ended December 22, 2004. Prior period amounts in this report which have been affected by the restatement, have been restated. Please refer to the Company's Current Report on Form 8 - K filed on May 16, 2005 for more information related to the restatement.

### Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use its judgment to make estimates and assumptions that can have a material impact on the results of operations and reported amounts of assets and liabilities. The Company evaluates its assumptions and estimates on an ongoing basis based on historical experience and various other factors that are believed to be relevant under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes that, of its significant accounting policies, the following policies involve a higher degree of risk, judgement and/or complexity.

### *Property and Equipment*

Property and equipment are recorded at cost with depreciation and amortization being recognized on the straight-line method over the estimated useful lives of the assets (15 to 25 years for building and land improvements, 3 to 10 years for equipment, and the shorter of the estimated useful life or the lease term for leasehold improvements). The Company reviews its restaurants for impairment on a restaurant-by-restaurant basis when events or circumstances indicate a possible impairment. The Company tests for impairment by comparing the carrying value of the asset to the future cash flows expected to be generated by the asset. If the total estimated future cash flows are less than the carrying amount of the asset, the carrying amount is written down to the estimated fair value, and a loss is recognized in earnings. Because depreciation and amortization expense is based upon useful lives of assets and the net salvage value at the end of their lives, significant judgment is required in estimating this expense. Additionally, the future cash flows expected to be generated by an asset requires significant judgment regarding future performance of the asset, fair market value if the asset were to be sold, and other financial and economic assumptions. Accordingly, management believes that accounting estimates related to property and equipment are critical.

### *Insurance Reserves*

The Company self-insures a significant portion of expected losses under its workers' compensation, general liability, and auto liability insurance programs. The Company purchases reinsurance for individual and aggregate claims that exceed predetermined limits. The Company records a liability for all unresolved claims and its estimate of incurred but not reported ("IBNR") claims at the anticipated cost to the Company. The liability estimate is based on information received from insurance companies, combined with management's judgments regarding frequency and severity of claims, claims development history, and settlement practices. Significant judgment is required to estimate IBNR claims as parties have yet to assert a claim and therefore the degree to which injuries have been incurred, and the related costs, have not yet been determined. Additionally, estimates about future costs involve significant judgment regarding legislation, case jurisdictions and other matters. Accordingly, management believes that estimates related to self-insurance reserves are critical.

### *Income Taxes*

The Company records deferred tax assets or liabilities based on differences between financial reporting and tax bases of assets and liabilities using currently enacted rates and laws that will be in effect when the differences are expected to reverse. Management records deferred tax assets to the extent it believes there will be sufficient future taxable income to utilize those assets prior to their expiration. To the extent deferred tax assets would be unable to be utilized, management would record a valuation allowance against the unrealizable amount, and record that amount as a charge against earnings. Due to changing tax laws and state income tax rates, significant judgment is required to estimate the effective tax rate expected to apply to tax differences that are expected to reverse in the future. Management must also make estimates about the sufficiency of taxable income in future periods to offset any deductions related to deferred tax assets currently recorded. Accordingly, management believes estimates related to income taxes are critical.

### *Goodwill*

The Company evaluates goodwill annually, or more frequently if indicators of impairment are present. If the determined fair values of these assets are less than the related carrying amounts an impairment loss is recognized. The methods used to estimate fair value include future cash flow assumptions, which may differ from actual cash flows due to, among other things, economic conditions or changes in operating performance.

### *Operating Leases*

The Company leases certain properties under operating leases. Many lease agreements contain rent holidays, rent escalation clauses and/or contingent rent provisions. The Company recognizes rent expense on a straight-line basis over the expected lease term, including cancelable option periods where failure to exercise such options would result in an economic penalty. The Company uses a time period for its straight-line rent expense calculation that equals or exceeds the time period used for depreciation. In addition, the commencement date of the lease term is the earlier of the date when the Company becomes legally obligated for the rent payments or the date when the Company takes

access to the grounds for buildout.

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**Results of Operations**

The following table sets forth the percentage relationship to total revenues, unless otherwise indicated, of items included in the Company's consolidated statements of earnings for the periods indicated:

|  | <b>Twelve Weeks Ended</b> |                          | <b>Forty Weeks Ended</b> |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>July 6,<br/>2005</b>   | <b>June 30,<br/>2004</b> | <b>July 6,<br/>2005</b>  | <b>June 30,<br/>2004</b> |
| <b>Revenues</b>  |                           |                          |                          |                          |
| Net sales  | 99.5%                     | 99.2%                    | 99.4%                    | 99.2%                    |
| Franchise fees   | .5                        | .8                       | .6                       | .8                       |
|  | 100.0                     | 100.0                    | 100.0                    | 100.0                    |
| <b>Costs and Expenses</b>  |                           |                          |                          |                          |
| Cost of sales <sup>(1)</sup>   | 23.3                      | 24.0                     | 23.3                     | 23.4                     |
| Restaurant operating costs <sup>(1)</sup>  | 48.4                      | 48.7                     | 49.1                     | 49.2                     |
| General and administrative   | 7.8                       | 7.2                      | 8.0                      | 7.8                      |
| Depreciation and amortization  | 4.3                       | 4.4                      | 4.4                      | 4.6                      |
| Marketing  | 4.6                       | 4.1                      | 4.5                      | 4.1                      |
| Interest   | 2.0                       | 2.3                      | 2.1                      | 2.5                      |
| Rent   | 1.6                       | 1.6                      | 1.7                      | 1.6                      |
| Pre-opening costs  | 0.6                       | 0.3                      | 0.5                      | 0.3                      |
| Provision for restaurant closings  | 0.0                       | (0.3)                    | 0.0                      | (0.1)                    |
| Other income, net  | (0.2)                     | (0.3)                    | (0.3)                    | (0.3)                    |
|  | 92.0                      | 91.3                     | 92.9                     | 92.5                     |
| <b>Earnings Before Income Taxes</b>  |                           |                          |                          |                          |
|  | 8.0                       | 8.7                      | 7.1                      | 7.5                      |
| <b>Income Taxes</b>  |                           |                          |                          |                          |
|  | 2.7                       | 3.0                      | 2.4                      | 2.6                      |
| <b>Net Earnings</b>  |                           |                          |                          |                          |
|  | 5.3%                      | 5.7%                     | 4.7%                     | 4.9%                     |
| (1) Cost of sales and restaurant operating costs are expressed as a percentage of net sales. |                           |                          |                          |                          |

**Comparison of Twelve Weeks Ended July 6, 2005 to Twelve Weeks Ended June 30, 2004**

(Amounts in \$000's)

**Revenues**

Net sales increased \$17,502 (13.5%) to \$147,057 primarily due to an 2.8% increase in same store sales and the addition of the 17 restaurants acquired in the Kelley Restaurants acquisition which closed in the second quarter of the current fiscal year. A significant component of the increase in same store sales comes on top of an increase in same store sales in the prior year of 6.3%. The increase in same store sales is due to the increase in shake sales in response to the Company's new Sippable Sundae™ line of milk shakes and Side by Side™ milk shakes, which have been well received. The same store sales increase consists of a 3.8% increase in check average and a decrease in guest traffic of

1.0%. The increase in check average results primarily from a 2.9% weighted average menu price increase compared to the same period in the prior year.

#### *Costs and Expenses*

Cost of sales increased \$3,146 (10.1%) to \$34,224 primarily due to increased net sales and higher food costs. Cost of sales as a percentage of net sales decreased to 23.3% from 24.0%, primarily as a result of lower commodity costs, the positive impact of pricing actions and strong food cost control.

Restaurant operating costs increased \$8,124 (12.9%) to \$71,221 due to increased net sales. Restaurant operating costs as a percentage of net sales decreased from 48.7% to 48.4%, primarily due to increased labor efficiencies compared to the prior year. In the prior year the Company had increased training labor costs associated with the introduction of Side by Side™ milk shakes.

General and administrative expenses increased \$2,062 (21.9%) to \$11,464, and increased to 7.8% as a percentage of revenue, compared to 7.2% in the same period in the prior year. The higher spending as a percent of revenues versus prior year was driven by the acquisition of Kelley Restaurants, Inc., investments in Real Estate, Human Resources, and IT to support accelerated expansion, Sarbanes-Oxley compliance costs and the timing of initiative spending.

Depreciation and amortization expense increased \$645 (11.3%) to \$6,365. The increase is attributable to additional restaurants, including the 17 restaurants that were acquired from Kelley Restaurants, Inc in the second quarter of the current fiscal year. As a percentage of total revenues, depreciation and amortization expense decreased to 4.3% from 4.4% in the prior year.

Marketing expense increased \$1,506 (28.1%) to \$6,872, and as a percentage of revenue increased to 4.6% from 4.1% in the same period in the prior year. The increase versus prior year is primarily due to the acquisition of Kelley Restaurants, Inc., incremental television related to 2004 new markets, and the timing of other marketing initiatives.

Interest expense decreased \$59 (2.0%) to \$2,940. The slight decrease is a result of decreased net borrowings under the Company's Senior Note Agreement, combined with lower lease obligation balances than the same period in the prior year, slightly offset by amounts assumed through the Kelley Restaurants, Inc. acquisition.

Rent expense increased \$336 (16.1%) to \$2,423 as a result of an increased number of restaurants. The biggest increase relates to the 17 restaurants acquired through the Kelley Restaurants, Inc. acquisition. As a percentage of revenue, rent expense remained consistent at 1.6% of total revenue.

Pre-opening costs increased \$556 (161.2%) to \$901 as the Company was in the process of opening more restaurants in the current year versus the prior year. During the quarter, the Company opened four new restaurants compared to one in the prior year.

Other income remained fairly consistent at \$364 in the current year versus \$391 in the prior year.

#### *Income Taxes*

The Company's effective income tax rate decreased to 34.2% from 34.6% in the same period in the prior year. The decrease in the tax rate for 2005 is based upon the estimated effect of the passage of the Work Opportunity and Welfare to Work federal tax credit legislation signed in October of 2004 retroactive to January 1, 2004. The variation between the statutory tax rate and the effective tax rate is due to state income taxes offset by employer tax credits for FICA taxes paid on employee tip income and the aforementioned other tax credits.

**Comparison of Forty Weeks Ended July 6, 2005 to Forty Weeks Ended June 30, 2004**

*(Amounts in \$000's)*

*Revenues*

Net sales increased \$52,753 (13.0%) to \$458,307, primarily due to a 4.9% increase in same store sales. Same store sales were impacted by a 3.5% increase in check average, including a 2.7% weighted average menu price increase, and a 1.4% increase in guest counts. In addition, the Company had additional net sales from 17 acquired restaurants and from new Company-owned restaurants which opened in the past year.

*Costs and Expenses*

Cost of sales increased \$11,987 (12.6%) to \$107,009 as a result of increased sales and higher food costs. As a percentage of net sales, cost of sales decreased slightly to 23.3% from 23.4% in the prior year period. The slight decrease as a percentage of sales is related to menu price increases which outpaced commodity price increases.

Restaurant operating costs increased \$25,690 (12.9%) to \$225,220, primarily due to increased net sales. Restaurant operating costs as a percentage of net sales decreased slightly to 49.1% from 49.2% in the prior year, primarily due to increased in-store efficiencies.

General and administrative expenses increased \$4,983 (15.6%) to \$37,006, and increased to 8.0% as a percentage of revenues, from 7.8% in the prior year. The higher spending as a percent of revenues versus prior year was driven by the acquisition of Kelley Restaurants, Inc., investments in Real Estate, Human Resources, and IT to support accelerated expansion, Sarbanes-Oxley compliance costs and the timing of initiative spending.

Depreciation and amortization expense increased \$1,482 (7.9%) to \$20,228 principally from property and equipment additions from opening new restaurants.

Marketing expenses increased \$4,155 (24.8%) to \$20,922, and as a percentage of revenues increased to 4.5% from 4.1% in the prior year. The increase versus prior year is related to additional restaurants from the Kelley Restaurants, Inc. acquisition and incremental television related to 2004 new markets.

Interest expense decreased \$381 (3.8%) to \$9,736 due to lower average net borrowings and lease obligation balances than in the prior year, slightly offset by amounts assumed through the Kelley Restaurants, Inc. acquisition.

Rent expense increased \$1,215 (18.8%) to \$7,683 as a result of an increased number of restaurants.

Pre-opening costs increased \$841 (63.5%) to \$2,165 as the Company is opening more restaurants in the current year versus that of the prior year.

Other income remained fairly consistent with the prior year amounts.

*Income Taxes*

The Company's effective income tax rate decreased to 34.0% from 35.0% in the same period in the prior year. The decrease in the tax rate for 2005 is based upon the estimated effect of the passage of the Work Opportunity and Welfare to Work federal tax credit legislation signed in October of 2004 retroactive to January 1, 2004. The variation between the statutory tax rate and the effective tax rate is due to state income taxes offset by employer tax credits for FICA taxes paid on employee tip income and the aforementioned other tax credits

**Liquidity and Capital Resources**

During the forty week period ended July 6, 2005, the Company opened 11 Company-owned Steak n Shake restaurants and 2 franchised restaurants, rebuilt or replaced 4 restaurants, and acquired 17 restaurants as a part of the Kelley Restaurants, Inc. acquisition. In the twelve week period ended July 6, 2005, the Company opened 4

Company-owned Steak n Shake restaurants and opened one rebuilt location. Eleven new restaurants and two rebuilds were under construction at the end of the quarter. For the forty weeks ended July 6, 2005, capital expenditures totaled \$45,065 as compared to \$29,044 for the same period in the prior year. This amount does not include the acquisition of Kelley Restaurants, Inc. for which the Company spent \$15,893.

The Company anticipates opening 18 to 24 new Steak n Shake restaurants during fiscal year 2005. The new store openings will allow the Company to continue its expansion in newer markets such as Texas, while reinforcing its strong brand recognition and operating organization throughout the Midwest and Florida. The average cost of a new Company-operated Steak n Shake restaurant, including land, site improvements, building and equipment is approximately \$2,000. Total capital expenditures for fiscal year 2005 are estimated to be \$55,000 to \$65,000 which include corporate expenditures and existing location expenditures. The Company intends to fund 2005 capital expenditures, and meet other working capital needs with existing cash and investments and anticipated cash flows from operations.

During the forty weeks ended July 6, 2005, cash provided by operations totaled \$50,054, compared to \$41,949 in the same period in the prior year. This increase in cash provided by operations is attributable primarily to increased net earnings and an increase in accounts payable and accrued expense balances. The increase in the accounts payable and accrued expense balance is largely due to the increased restaurant base compared to the prior year. Net cash used in financing activities for the forty weeks ended July 6, 2005, totaled \$1,054 compared to \$4,061 in the comparable prior period. This decline was due to a decrease in scheduled debt payments in the current year period.

As of July 6, 2005, the Company had outstanding borrowings of \$15,203 under its Senior Note Agreement and Private Shelf Facility ("Senior Note Agreement") and \$75,000 of additional borrowing capacity available. Borrowings under the Senior Note Agreement bear interest at an average fixed rate of 7.6%.

The Company maintains a \$50,000 Revolving Credit Agreement ("Revolving Credit Agreement") that bears interest based on LIBOR plus 55 basis points, or the prime rate minus 100 basis points, at the election of the Company, and matures on January 30, 2008. There were no borrowings under the Revolving Credit Agreement at July 6, 2005.

In addition, the Company assumed four mortgages on properties during the Kelley Restaurants Inc. acquisition. The amount outstanding as of July 6, 2005 is \$3,769. Three of the mortgages bear interest at LIBOR + 1.75%, and the remaining mortgage is at a fixed rate of 5%.

The Company's debt agreements contain restrictions which, among other things, require the Company to maintain certain financial ratios. The Company was in compliance with all restrictive covenants under these borrowing agreements at July 6, 2005.

#### **Effects of Governmental Regulations and Inflation**

Most of the Company's employees are paid hourly rates related to federal and state minimum wage laws. Any increase in the legal minimum wage would directly increase the Company's operating costs. The Company is also subject to various federal, state and local laws related to zoning, land use, safety standards, working conditions and accessibility standards. Any changes in these laws that require improvements to our restaurants would increase their operating costs. In addition, the Company is subject to franchise registration requirements and certain related federal and state laws regarding franchise operations. Any changes in these laws could affect the Company's ability to attract and retain franchisees.

Inflation in food, labor, fringe benefits, and other operating costs directly affects the Company's operations. The Company's results of operations have not been significantly affected by inflation in the recent past.

#### **Risks Associated with Forward-Looking Statements**

Certain statements contained in this report represent forward-looking statements. In general, forward-looking statements include estimates of future revenues, cash flows, capital expenditures, or other financial items, and assumptions underlying any of the foregoing. Forward-looking statements reflect management's current expectations regarding future events and use words such as "anticipate", "believe", "expect", "may", "will", and other similar terminology. These statements speak only as of the date they were made and involve a number of risks and uncertainties that could cause actual results to differ materially from those expressed in forward-looking statements. Several factors, many beyond our control, could cause actual results to differ significantly from our expectations, such as the following: effectiveness of operating initiatives; changes in economic conditions; effectiveness of advertising and marketing initiatives; harsh weather conditions; availability and cost of qualified restaurant personnel; changes in consumer tastes; changes in consumer behavior based on publicity or concerns relating to food safety or food-borne illnesses; effectiveness of our expansion plans; changes in minimum wage rates; and changes in applicable accounting policies and practices. The foregoing list of important factors is not intended to be all-inclusive as other general market, industry, economic, and political factors may also impact our operations. Readers are cautioned not to place undue reliance on our forward-looking statements, as we assume no obligation to update forward-looking statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's primary market risk exposure with regard to financial instruments is to changes in interest rates. Pursuant to the terms of the Senior Note Agreement, the Company may from time to time issue notes in increments of at least \$5,000,000. The interest rate on the notes is based upon market rates at the time of the borrowing. Once the interest rate is established at the time of the initial borrowing, the interest rate remains fixed over the term of the underlying note. The Revolving Credit Agreement bears interest at a rate based upon LIBOR plus 55 basis points or the prime rate minus 100 basis points, at the election of the Company. The Company also has three mortgages with interest rates of LIBOR plus 175 basis points. Historically, the Company has not used derivative financial instruments to manage exposure to interest rate changes. At July 6, 2005, a hypothetical 100 basis point increase in short-term rates would have an immaterial impact on the Company's earnings.

The Company purchases certain food products, which may be affected by volatility in commodity prices due to weather conditions, supply levels, and other market conditions. The Company utilizes various purchasing and contract pricing techniques to minimize volatility, but does not enter into financial derivative contracts.

**ITEM 4. CONTROLS AND PROCEDURES**

Based on an evaluation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(c)), the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of July 6, 2005, in timely alerting the Company's management to material information required to be included in this Form 10-Q and other Exchange Act filings. There have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## ITEM 5. OTHER INFORMATION

### (a) Non-audit Services

During the period covered by this report, the Audit Committee of the Board of Directors approved management to purchase a subscription to use Deloitte and Touche LLP's online accounting research tool. This disclosure is made pursuant to Section 10A(i)(2) of the Securities Exchange Act of 1934, as added by Section 202 of the Sarbanes-Oxley Act of 2002.

## ITEM 6. EXHIBITS

### Exhibits

31.1 Rule 13a - 14(a) / 15d - 14(a) Certification of Chief Executive Officer.

31.2 Rule 13a - 14(a) / 15d - 14(a) Certification of Chief Financial Officer.

32 Section 1350 Certifications.

## SIGNATURE

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, on August 15, 2005.

THE STEAK N SHAKE COMPANY

(Registrant)

By /s/ Jeffrey A. Blade

Jeffrey A. Blade

Senior Vice President

and Chief Financial Officer

