PUBLIC SERVICE ENTERPRISE GROUP INC
Form 11-K
June 29, 2017

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

FORM 11-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2016

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-09120

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

LONG ISLAND ELECTRIC UTILITY SERVCO LLC
INCENTIVE THRIFT PLAN I

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED
80 PARK PLAZA
NEWARK, NEW JERSEY 07102

LONG ISLAND ELECTRIC UTILITY SERVCO LLC
INCENTIVE THRIFT PLAN I

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All other schedules required by Section 2520.103.10 of the Department of Labor’s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 have been omitted because they are not applicable.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Trustee and Participants of Long Island Electric Utility ServCo LLC
Incentive Thrift Plan I:

We have audited the accompanying statements of net assets available for benefits (modified cash basis) of Long Island Electric Utility ServCo LLC Incentive Thrift Plan I (the "Plan") as of December 31, 2016 and 2015 and the related statement of changes in net assets available for benefits (modified cash basis) for the year ended December 31, 2016. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, these financial statements and supplemental schedule were prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2016 and 2015 and the changes in net assets available for benefits for the year ended December 31, 2016, on the basis of accounting described in Note 2.

The supplemental information in the accompanying schedule of assets (held at end of year) (modified cash basis) as of December 31, 2016 has been subjected to audit procedures performed in conjunction with the audit of the Plan's financial statements. The supplemental information is the responsibility of the Plan's management. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information in the accompanying schedule, we evaluated whether the supplemental information, including its form and content, is presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. In our opinion, the supplemental information in the accompanying schedule is fairly stated in all material respects in relation to the financial statements as a whole.

/s/ Kronick Kalada Berdy & Co., P.C.
Kingston, Pennsylvania
June 29, 2017

LONG ISLAND ELECTRIC UTILITY SERVCO LLC
INCENTIVE THRIFT PLAN I

STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS (MODIFIED CASH BASIS)

	As of December 31,	
	2016	2015
	(Thousands)	
ASSETS		
Investment at Fair Value:		
Plan Interest in Master Employee Benefit Plan Trust (Note 3)	$101,128	$79,712
Total Investments	101,128	79,712
Receivable:		
Participant Loans	2,658	2,279
Total Receivable	2,658	2,279
Total Assets	103,786	81,991
LIABILITIES	—	—
NET ASSETS AVAILABLE FOR BENEFITS	$103,786	$81,991

See Notes to Financial Statements.

LONG ISLAND ELECTRIC UTILITY SERVCO LLC
INCENTIVE THRIFT PLAN I

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS (MODIFIED CASH BASIS)
YEAR ENDED DECEMBER 31, 2016

	(Thousands)
ADDITIONS	
Net Investment Income	
Plan Interest in Income of Master Employee Benefit Plan Trust (Note 3)	$ 7,290
Interest on Participant Loans	77
Total Net Investment Income	7,367
Deposits and Contributions	
Employees	10,408
Employer	4,902
Rollovers	2,360
Total Deposits and Contributions	17,670
Total Additions	25,037
DEDUCTIONS	
Benefit Payments to Participants	3,464
Administrative Expenses	50
Total Deductions	3,514
INCREASE IN NET ASSETS AVAILABLE FOR BENEFITS, PRIOR TO TRANSFERS	21,523
Transfers from Other Plans - Net	272
INCREASE IN NET ASSETS AVAILABLE FOR BENEFITS	21,795
NET ASSETS AVAILABLE FOR BENEFITS	
Beginning of Year	81,991
End of Year	$ 103,786

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF THE PLAN

General

The following description of the Long Island Electric Utility ServCo LLC Incentive Thrift Plan I (“Plan”) is provided for general information purposes only. Participants should refer to the Summary Plan Description (“SPD”) for more information.

The Plan was established effective January 1, 2014. The Plan is a defined contribution retirement plan covering substantially all non-bargaining unit employees of Long Island Electric Utility ServCo LLC (“ServCo”). This includes, but is not limited to, individuals who were employed by National Grid Companies USA (“NatGrid”) or an affiliate thereof, who were participants in the National Grid USA Companies’ Incentive Thrift Plan I on December 31, 2013, and who became employees of ServCo on January 1, 2014 (“Transition Employees”). ServCo is an indirect subsidiary of Public Service Enterprise Group Incorporated (“PSEG”).

The ServCo Employee Benefits Committee (“Benefits Committee”) is the Named Fiduciary of the Plan and controls and manages its operation and administration. The ServCo Pension Investment Committee (“PIC”) is the Named Fiduciary of the Plan responsible for management of the Plan investments and the selection and monitoring of the funds offered under the Plan. The Vanguard Group Inc. (“Trustee”) is responsible for the custody of the Plan’s assets. Vanguard Participant Services is the record-keeper of the Plan. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

Substantially all of the Plan’s assets are held in a trust account by the Trustee and consist of a divided interest in an investment account of the Master Employee Benefit Plan Trust (“Master Trust”), a master trust established by ServCo and administered by the Trustee.

Contributions and Investment Options

Each Participant enters into a contribution agreement in order to make pre-tax contributions or Roth 401(k) contributions (together “Elective Contributions”) and/or after-tax contributions, subject to certain Internal Revenue Code (“IRC”) limitations. Generally, a Participant may elect to make after-tax contributions from 1% to 15% of their annual eligible compensation. The combined limit for Elective Contributions and after-tax contributions cannot exceed 50% of the Participant’s annual eligible compensation. Participants may also contribute amounts representing distributions from other qualified plans and certain Individual Retirement Accounts (“IRAs”).

ServCo will make matching contributions (“Matching Contributions”) which shall be equal to 50% of the Elective Contributions and/or after-tax contributions made by each Participant, which do not exceed the first 8% of the Participant’s annual eligible compensation. Matching Contributions begin after that Participant has completed three months of service, as defined in the Plan, with ServCo.

ServCo also provides additional contributions (“Core Contributions”) to Participants who are not eligible for benefits under the Long Island Electric Utility ServCo LLC Retirement Income Plan. Core Contributions are based on the Participant’s age and years of service. Years of service include service with NatGrid for Transition Employees. For participants who were hired on January 1, 2014 and had a termination date from the Long Island Power Authority (“LIPA”) on December 31, 2013, years of service include service with LIPA. For participants who move to ServCo from another PSEG entity, years of service includes service with that entity after January 1, 2014.

NOTES TO FINANCIAL STATEMENTS

Participants may direct the investment of their accounts into various investment options offered by the Plan through the Master Trust. The Plan offers investment options in the Common Stock of PSEG (“PSEG Share Fund”), which has been designated as an Employee Stock Ownership Plan ("ESOP") under section 4975(e) of the Code, and mutual funds consisting of various target-date funds and other registered investment company mutual funds.

Participant Accounts

Individual accounts are maintained for each Participant. Each Participant’s account consists of (a) Participant’s contributions, (b) Matching contributions, (c) Core contributions, if applicable, (d) earnings and/or losses, and (e) specific Participant transactions. The Participant’s account is reduced for certain administrative expenses. The benefit to which a Participant is entitled upon disability, retirement or termination of service, as applicable, or a beneficiary upon the death of a Participant is the benefit that can be provided from the Participant’s vested account.

Dividends on PSEG Common Stock held in the accounts of Participants who have elected to participate in the PSEG Share Fund will be reinvested in the PSEG Share Fund.

Participant Loans

Except as discussed in the following paragraph, Participants may borrow from their Plan accounts a minimum of $1,000 up to a maximum equal to the lesser of $50,000 or 50% of their vested account balance at the time the loan is originated. The loans are secured by the balance in the Participant’s account and existing loans bear interest at rates that at December 31, 2016, range from 3.25% to 9.25% which are commensurate with local prevailing rates at the time that the loan was originated, as determined, at such time by the Benefits Committee. Principal and interest is paid ratably through payroll deductions.

Participants may have no more than two loans outstanding at any one time.

These loans are measured at their unpaid principal balances plus any accrued but unpaid interest.

Payment of Benefits

Upon termination of employment, a Participant may elect to receive an amount equal to the value of the vested interest in his or her account in either a lump-sum payment, or through various periodic installment methods (not less frequently than annually). If a Participant’s account balance is less than $1,000 at the time of termination, the Participant will receive an automatic lump-sum payment for the entire account balance. For termination due to death, the Participant’s beneficiary will receive a lump-sum distribution equal to the value of the Participant’s vested interest in his or her account. If a Participant is no longer working for ServCo and has a balance in the Plan, he or she must begin to receive distributions from his or her account no later than April 1 following the calendar year in which he or she reaches age 70½.

A Participant who is currently an employee and who has not attained age 59½ may withdraw all or part of his or her after-tax contributions and/or vested Matching Contributions that have been in the Plan for more than two years. Elective Contributions may not be withdrawn during employment prior to age 59½ except for reasons of extraordinary financial hardship and to the extent permitted by the IRC (“hardship withdrawals”). Hardship withdrawals are subject to taxes and penalties. Participants who require a hardship withdrawal are prohibited from contributing to the Plan for six months following such distribution.

NOTES TO FINANCIAL STATEMENTS

Vesting

All Participant contributions are always 100% vested in the Plan. Matching and Core Contributions to a Participant's account are vested upon a Participant's completion of three years of service, or when a Participant reaches the age of 65, is disabled or dies. Years of service include service with National Grid for Transition Employees. For participants who were hired on January 1, 2014 and had a termination date from LIPA on December 31, 2013, years of service include service with LIPA. For participants who move to ServCo from another PSEG entity, years of service includes service with that entity.

Make Whole Benefits

Participants who are Transition Employees and were not fully vested in their Matching and/or Core Contributions under the NatGrid plan as of their date of hire with ServCo will be entitled to a make whole benefit when their NatGrid service plus their ServCo service equals three years. The make whole benefit is equal to their forfeited account balance under the NatGrid plan, adjusted for earnings.

Forfeitures

Any nonvested contributions in a Participant’s Account are forfeited upon the Participant’s date of termination from ServCo, and shall be used to pay Plan expenses or reduce subsequent employer contributions. If such former Participant is rehired and remains employed by ServCo or another PSEG subsidiary at the end of the fifth Plan Year after the Plan Year in which such severance occurred, then such nonvested portion of the Participant’s Account will be reinstated by the employer and the Participant’s right thereto will be determined as if the Participant had not terminated employment, provided that the Participant repays to the Plan the amount of any distribution paid to him or her resulting from the severance from employment.

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NOTES TO FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements are prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles ("GAAP"). The modified cash basis of accounting utilizes the cash basis of accounting while carrying investments at fair value and recording investment income on the accrual basis.

Use of Estimates

The preparation of financial statements requires Plan management to make estimates and assumptions that affect the reported amounts of net assets available for benefits and changes therein and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Risks and Uncertainties

The Plan permits Participants to select from among various investment options. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near-term and that such changes could materially affect Participants' account balances and the amounts reported in the financial statements.

Investment Valuation and Income Recognition

The Plan's investment is in the Master Trust. The investments maintained in the Master Trust are stated at fair value. Mutual funds are valued at the daily closing price as reported by the fund. Mutual funds held by the Master Trust are open-end mutual funds that are registered with the U.S. Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Master Trust are deemed to be actively traded and are redeemable daily without restriction. Shares held by the PSEG Share Fund are valued at their closing price reported on the active market on which the security is traded daily.

Purchases and sales of investments are recorded on a trade-date basis. Interest income is accrued when earned. Dividend income is recorded on the ex-dividend date. Capital gain distributions are included in dividend income.

Payment of Benefits

Benefit payments to Participants are recorded when paid.

Administrative Expenses of the Plan

Certain expenses incurred with the general administration of the Plan, including taxes and brokerage costs, are recorded in the accompanying Statement of Changes in Net Assets Available for Benefits. Certain administrative functions performed by the officers and employees of ServCo are paid by Employers (Note 6).

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NOTES TO FINANCIAL STATEMENTS

3. INVESTMENT OF THE PLAN AND THE LONG ISLAND ELECTRIC UTILITY SERVCO LLC INCENTIVE THRIFT PLAN II (THRIFT PLAN II) IN THE MASTER TRUST

Use of the Master Trust permits the commingling of trust assets with the assets of the Thrift Plan II for investment and administrative purposes. The Thrift Plan II is a defined contribution retirement plan available to represented employees of ServCo. Although assets of both plans are commingled in the Master Trust, the Trustee maintains supporting records for the purpose of allocating the net assets and net income or loss of the investment account to the respective participating plans. The net assets and the net investment income or loss of the investment assets is allocated by the Trustee to each participating plan based on the relationship of the interest of each plan to the total of the interests of the participating plans. As of December 31, 2016 and 2015, the Plan's interests in the assets of the Master Trust were approximately 35%. Assets and investment income of the Master Trust consist of:

	As of December 31,	
	2016	2015
	(Thousands)	
Investments of Master Trust at Fair Value:		
PSEG Share Fund*	$6,150	$ 4,383
Mutual Funds	281,535	239,987
Total Investments	$287,685	$ 244,370

	For the Year Ended December 31, 2016 (Thousands)
Investment Income of Master Trust:	
Net Appreciation in Fair Value of Mutual Funds	$ 19,128
Net Appreciation in Fair Value of PSEG Share Fund*	482
Dividends from PSEG Share Fund*	215
Total Investment Income, Net	$ 19,825

* Permitted party-in-interest.

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NOTES TO FINANCIAL STATEMENTS

The changes in net assets of the Master Trust for the year ended December 31, 2016 are summarized as follows:

(Thousands)
$ 41,100

Our investment portfolio consists of highly rated investment-grade auction rate securities. These auction rate securities, AAA rated when purchased, are long-term debt obligations secured by student loans, which loans are generally 97% guaranteed by the U.S. Government under the Federal Family Education Loan Program (FFELP). In addition to the U.S. Government guarantee on such student loans, many of the securities also have separate insurance policies guaranteeing both the principal and accrued interest. While the final maturity dates of these auction rate securities investments are between 2020 and 2047, the liquidity for these securities has historically been provided by an auction process that resets the applicable interest rate at pre-determined intervals up to 35 days. The value of these investments is determined by not only the credit rating of these investments, but also by the liquidity of the markets in which they trade. Therefore, due to the liquidity provided by the auction process, the Company previously classified these investments as held to maturity. However, the recent uncertainties in the credit markets have affected our holdings in auction rate securities investments, since auctions for these securities have failed to settle on their respective settlement dates since February 2008. While we continue to earn interest on our auction rate securities investments, these investments are not currently trading and, therefore, do not currently have a readily determinable market value. Accordingly, we believe the estimated fair value of these auction rate securities investments no longer approximates their cost or par value.

In accordance with FAS 157, we estimated the fair value of our auction rate securities investments using valuation models and methodologies provided by third parties, including our investment manager. These types of pricing inputs may generally be considered Level 2, as defined by FAS 157; however, since there are no currently active markets for our auction rate securities investments, these pricing inputs are currently deemed Level 3 in accordance with FAS 157. Based on these valuation models and methodologies, we recognized a temporary decline in the fair value of our auction rate securities investments of approximately $2.0 million as of July 1, 2008. See Note 3 in this section of our Form 10-Q.

Due to our belief that the market for these auction rate securities investments may take in excess of twelve months to fully recover, we have recorded a temporary change in fair value for these investments in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115). Under FAS 115, a temporary change in fair value of available-for-sale investments results in an unrealized holding loss being recorded in the other comprehensive income (loss) component of shareholders equity. Such an unrealized holding loss does not affect net income for the applicable accounting period. We have also classified these investments as non-current investments for the current reporting period due to the current illiquidity of these investments and the uncertainty regarding the auction rate securities market. We currently anticipate holding these auction rate securities investments until a recovery of the auction process or until maturity. Any future fluctuation in estimated fair value related to these investments that we consider temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income (loss). If we determine that any future valuation adjustment was other than temporary, we would record a charge to earnings as appropriate.

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3. FAIR VALUE MEASUREMENT

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. FAS 157 applies whenever other statements require or permit asset or liabilities to be measured at fair value. We adopted the provisions of FAS 157 as of January 2, 2008, for our consolidated financial instruments.

FAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. These tiers include:

Level 1: Defined as observable inputs such as quoted prices in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Defined as pricing inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures.

Level 3: Defined as pricing inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value.

As of July 1, 2008, we held auction rate securities investments which are classified as available-for-sale investments and are required to be measured at fair value on a recurring basis. As discussed in Note 2 in this section of our Form 10-Q, the recent uncertainties in the credit markets have affected our holdings in auction rate securities investments, since the auctions for these securities have failed to settle on their respective settlement dates. Therefore, in absence of an active market, we estimated the fair value of these investments using valuation models and methodologies provided by third parties, including our investment manager, as of July 1, 2008. These analyses considered, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of the expected future cash flows, the investments interest rate compared to like investments and treasury strips interest rates with comparable maturities, the current illiquidity of the investments, and the expectation of the next time the security is expected to have a successful auction.

As a result of the temporary decline in fair value of our auction rate securities investments, which we attribute to liquidity issues rather than credit issues, we recorded an unrealized holding loss of approximately $2.0 million to accumulated other comprehensive income (loss) as of July 1, 2008. Any future fluctuation in fair value related to these investments that we deem to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income (loss). If we determine that any future valuation adjustment was other than temporary, we would record a charge to earnings as appropriate.

The assets measured at fair value on a recurring basis subject to the disclosure requirements of FAS 157 at July 1, 2008, were as follows (in thousands):

	Fair Value Measurement at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Auction rate securities investments, par value	$	$	$ 37,100
Total gains or losses (realized and unrealized):			

Included in net income						
Included in accumulated other comprehensive income (loss)						(2,005)
Balance at July 1, 2008	$		$		$	35,095

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4. NET INCOME PER SHARE

Basic net income per share is computed by dividing the net income attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net income per share reflects the potential dilution that could occur if stock options and restricted stock units issued by the Company to sell common stock at set prices were exercised. The financial statements present basic and diluted net income per share. Common share equivalents included in the diluted computation represent shares to be issued upon assumed exercises of outstanding stock options and restricted stock units using the treasury stock method.

In accordance with the provisions of FASB Statement No. 128, *Earnings Per Share* (FAS 128), basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. At July 1, 2008, approximately 388,800 shares of restricted stock units issued to employees were unvested, and were therefore excluded from the calculation of basic earnings per share for the thirteen weeks and twenty-six weeks ended July 1, 2008. Diluted net income per share includes the dilutive effect of both outstanding stock options and restricted stock units, calculated using the treasury stock method. Assumed proceeds from the in-the-money options, include the windfall tax benefits, net of shortfalls, calculated under the as-if method as prescribed by FASB Statement No. 123(R), *Share-Based Payment* (FAS 123(R)).

The following table presents a reconciliation of basic and diluted net income per share computations and the number of dilutive securities (stock options and restricted stock units) that were included in the dilutive net income per share computation (in thousands).

	For The Thirteen Weeks Ended		For The Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007	July 1, 2008	July 3, 2007
Numerator:				
Net income for basic and diluted net income per share	$ 2,893	$ 3,274	$ 6,013	$ 4,900
Denominator:				
Weighted average shares outstanding - basic	26,361	26,094	26,359	26,083
Effect of dilutive common stock equivalents	346	734	360	743
Weighted average shares outstanding - diluted	26,707	26,828	26,719	26,826

For the thirteen weeks ended July 1, 2008 and July 3, 2007, there were approximately 1,035,900 and 426,800 stock options outstanding, respectively, whereby the exercise price exceeded the average common stock market value, respectively. For the twenty-six weeks ended July 1, 2008 and July 3, 2007, there were approximately 924,600 and 426,800 stock options outstanding, respectively, whereby the exercise price exceeded the average common stock market value, respectively. The effects of the shares which would be issued upon the exercise of these options have been excluded from the calculation of diluted net income per share because they are anti-dilutive.

5. RELATED PARTY

As of July 1, 2008, we believe that Jacmar Companies and their affiliates (collectively referred to herein as Jacmar) owned approximately 16.5% of our outstanding common stock. Jacmar, through its specialty wholesale food distributorship, is currently the Company s largest supplier of food, beverage and paper products. Jacmar also owns the Shakey s pizza parlor chain. In July 2006, after an extensive competitive bidding process, the Company entered into a three-year agreement with a national foodservice distribution system whose shareholders are prominent regional foodservice distributors, of which Jacmar is one. We believe that Jacmar sells products to us at prices comparable to those offered by unrelated third parties. Jacmar supplied us with approximately $23.4 million and $21.0 million of food, beverage and paper products for the twenty-six weeks ended July 1, 2008 and July 3, 2007, respectively, which represents 52.0% and 54.7% of our total costs for these products, respectively. We had trade payables related to these products of approximately $3.8 million and $1.8 million at July 1, 2008 and July 3, 2007, respectively.

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6. STOCK-BASED COMPENSATION

We have two stock-based compensation plans the 2005 Equity Incentive Plan and the 1996 Stock Option Plan under which we may issue shares of our common stock to employees, officers, directors and consultants. Upon effectiveness of the 2005 Equity Incentive Plan, the 1996 Stock Option Plan was closed for purposes of new grants and the remaining available shares for grant, including those shares related to option awards forfeited or terminated without exercise under the 1996 Stock Option Plan accrue to the 2005 Equity Incentive Plan. Both of these plans have been approved by our shareholders. Under the 2005 Equity Incentive Plan, we have granted incentive stock options, non-qualified stock options, and restricted stock units.

Beginning in 2007, substantially all of our restaurant general managers, executive kitchen managers, regional kitchen operations managers, area/regional directors and certain brewery operations positions become eligible to participate in a new equity-based incentive program called the BJ s Gold Standard Stock Ownership Program (the GSSOP) under our 2005 Equity Incentive Plan. The GSSOP is a longer-term equity incentive program that utilizes Company restricted stock units (RSUs). The GSSOP is dependent on each participant s extended service with us in their respective positions and their achievement of certain agreed-upon performance objectives during that service period (i.e., five years).

Beginning in 2008, we also began issuing restricted stock units as a component of the annual equity grant award to officers and other employees. Under our 2005 Equity Incentive Plan we have issued 388,800 RSUs as of July 1, 2008.

We account for equity grants under these plans in accordance with the fair value recognition provisions of FAS 123(R), using the modified-prospective-transition method. Compensation expense recognized in the twenty-six weeks ended July 1, 2008 and July 3, 2007 include; (a) compensation expense for all share-based payments granted prior to, but not yet vested as of January 4, 2006 (adoption date of FAS 123(R)), based on the grant date fair value estimated in accordance with the original provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123), and (b) compensation expense for all share-based payments granted subsequent to January 4, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123(R).

The following table presents information related to stock-based compensation (in thousands):

	For The Thirteen Weeks Ended		For The Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007	July 1, 2008	July 3, 2007
Labor and benefits stock-based compensation	$ 221	$ 162	$ 429	$ 323
General and administrative stock-based compensation	$ 617	$ 555	$ 1,225	$ 1,094
Capitalized stock-based compensation (1)	$ 81	$ 48	$ 161	$ 129

(1) On the Consolidated Balance Sheets, capitalized stock-based compensation is included in Property and equipment, net.

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Stock Options

The exercise price of the shares under the Company s stock-based compensation plans shall be equal to or exceed 100% of the fair market value of the shares at the date of option grant. Stock options generally vest at 20% per year or cliff vest, either ratably in years three through five or 100% in year five and expire ten years from date of grant. Stock option activity during the twenty-six weeks ended July 1, 2008 was as follows (in thousands):

	Options Outstanding		Options Exercisable	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding options at January 1, 2008	2,174	$ 13.79	1,266	$ 10.36
Granted	209	15.87		
Exercised	(5)	14.53		
Forfeited	(4)	20.29		
Expired	(1)	23.26		
Outstanding options at July 1, 2008	2,373	$ 13.96	1,511	$ 11.38

The fair value of each stock option grant issued is estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For The Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007
Expected volatility	43.6%	41.4%
Risk free interest rate	3.22%	4.66%
Expected option life	5 years	5 years
Dividend yield	0%	0%
Fair value of options granted	$ 6.16	$ 8.36

FAS 123(R) requires us to make certain assumptions and judgments regarding the grant date fair value. These judgments include expected volatility, risk free interest rate, expected option life, dividend yield and vesting percentage. These estimations and judgments are determined by us using many different variables that, in many cases, are outside of our control. The changes in these variables or trends, including stock price volatility and risk free interest rate, may significantly impact the grant date fair value resulting in a significant impact to our financial results. As of July 1, 2008, total unrecognized stock based compensation expense related to non-vested stock options was $5.2 million, which is expected to be generally recognized over five years.

Restricted Stock Units

Restricted stock unit activity during the twenty-six weeks ended July 1, 2008 was as follows (in thousands):

	Shares	Weighted Average Fair Value
Outstanding RSUs at January 1, 2008	253	$ 20.30
Granted	144	14.38

Vested			
Forfeited	(8)		19.89
Outstanding RSUs at July 1, 2008	389	$	17.86

The fair value of the RSUs is the quoted market value of the Company s common stock on the date of grant. The fair value of each RSU is expensed over the period during which the restrictions are expected to lapse (i.e., generally five years). The Company recorded stock-based compensation expense related to RSUs of approximately $617,500 during the twenty-six weeks ended July 1, 2008. In addition, total unrecognized stock-based compensation expense related to non-vested RSUs was $5.5 million, which is expected to be generally recognized over five years.

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7. INCOME TAXES

We utilize the liability method of accounting for income taxes as set forth in FASB Statement No. 109, *Accounting for Income Taxes* (FAS 109).

Deferred income taxes are recognized based on the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The provision for income taxes represents the tax payable for the period and the change during the period in deferred tax assets and liabilities.

We recognize the impact of a tax position in our financial statements if that position is more likely than not of being sustained on audit, based on the technical merits of the position, in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of FAS 109. Interest and penalties related to uncertain tax positions are included in income tax expense.

As of July 1, 2008, a valuation allowance of approximately $856,000 was established for the deferred tax asset generated by the recording of the temporary change in fair value on our auction rate securities investments, since we would only be able to use this deferred tax asset to offset any future capital gains. As of July 1, 2008, we did not have any capital gains, nor do we expect to have any capital gains in the future. The deferred tax asset and corresponding valuation allowance were recorded in the accumulated other comprehensive income (loss) component of shareholders equity. Subsequent release of this valuation allowance will not have an effect on our consolidated statement of operations.

8. DIVIDEND POLICY

We have not paid any cash dividends since our inception and have currently not allocated any funds for the payment of dividends. Rather, it is our current policy to retain earnings, if any, for expansion of our restaurant and brewing operations, remodeling of existing restaurants and other general corporate purposes. We have no plans to pay any cash dividends in the foreseeable future. Should we decide to pay cash dividends in the future, such payments would be at the discretion of the Board of Directors.

9. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) consisted of the following (in thousands):

	For The Thirteen Weeks Ended		For The Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007	July 1, 2008	July 3, 2007
Net income	$ 2,893	$ 3,274	$ 6,013	$ 4,900
Net unrealized holding loss on investments	(532)		(2,005)	
Total other comprehensive income (loss)	$ 2,361	$ 3,274	$ 4,008	$ 4,900

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS STATEMENT REGARDING FORWARD-LOOKING DISCLOSURE

Certain information included in this Form 10-Q and other materials filed or to be filed by us with the Securities and Exchange Commission (as well as information included in oral or written statements made by us or on our behalf), may contain forward-looking statements about our current and expected performance trends, growth plans, business goals and other matters. These statements may be contained in our filings with the Securities and Exchange Commission, in our press releases, in other written communications, and in oral statements made by or with the approval of one of our authorized officers. Words or phrases such as believe, plan, will likely result, expect, intend, will continue, is ant estimate, project, may, could, would, should, and similar

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expressions are intended to identify forward-looking statements. These statements, and any other statements that are not historical facts, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as codified in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended from time to time (the Act). The cautionary statements made in this Form 10-Q should be read as being applicable to all related forward-looking statements wherever they appear in this Form 10-Q.

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. Except for the historical information contained herein, the discussion in this Form 10-Q contains certain forward-looking statements that involve known and unknown risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results may vary materially from forward-looking statements described in this document. These forward-looking statements include, among others, statements concerning:

- our restaurant concept, its competitive advantages and our strategies for its continued evolution and expansion;
- the rate and scope of our planned future restaurant development;
- expectations as to the number and timing of the availability of suitable retail projects in which we would desire to open new restaurants;
- anticipated dates on which we will commence or complete development of new restaurants;
- expectations as to the timing and success of the planned expansion of our contract brewing strategy;
- expectations for consumer spending on casual dining restaurant occasions in general;
- expectations as to the availability and costs of key commodities used in our restaurants and brewing operations;
- expectations as to our menu price increases or sales building initiatives and their effect, if any, on revenue;
- expectations as to our capital requirements and our ability to liquidate our investments in auction rate securities;
- expectations as to our future revenues, operating costs and expenses, and capital requirements; and,
- other statements of expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

These forward-looking statements are subject to risks and uncertainties, including financial, regulatory, consumer behavior, demographic, industry growth and trend projections, that could cause actual events or results to differ materially from those expressed or implied by the statements. Factors that could prevent us from achieving our stated goals include, but are not limited to:

If we do not successfully expand our restaurant operations and maintain our historical restaurant level economics, our growth rate and results of operations would be adversely affected.

Our ability to open new restaurants on schedule in accordance with our projected growth rate may be adversely affected by delays or problems associated with securing sufficient capital resources, suitable restaurant locations and by other factors, some of which are beyond our control and the timing of which is difficult to forecast accurately.

Our future operating results may fluctuate significantly due to our limited number of existing restaurants and the cost and expenses required to open new restaurants, as well as the timing of new restaurant openings.

Our expansion into new markets may present increased risks due to our unfamiliarity with the markets and the unfamiliarity of consumers with our concept in these markets.

The availability of key commodities that are necessary to support our operations may be disrupted and the costs of such commodities may significantly increase due to factors outside of our control, either of which could have an adverse affect on our growth rate and results of operations.

Disruptions in the global credit markets may adversely affect our investments in auction rate securities and increase the cost of capital or restrain our access to the capital necessary to fund our growth.

Labor shortages, both for hourly and restaurant management employees, or increases in labor costs could slow our growth or adversely affect our business.

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Our expansion into certain new markets may impact the availability, leveragability and profitability of the sales of our proprietary handcrafted beer in our restaurants, based on regulatory and supply chain constraints in these markets.

Factors that impact California, where 40 of our current 77 restaurants are located as of August 1, 2008.

For a more detailed description of these risk factors and other considerations, see Part II, Item 1A Risk Factors of this Form 10-Q and the risk factors identified in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 1, 2008.

GENERAL

On August 1, 2008, we owned and operated 77 restaurants located in Arizona, California, Colorado, Florida, Indiana, Kentucky, Louisiana, Nevada, Ohio, Oklahoma, Oregon, Texas and Washington. A licensee also operates one restaurant in Lahaina, Maui. Each of our restaurants is operated either as a BJ s Restaurant & Brewery® which includes a brewery within the restaurant, a BJ s Restaurant & Brewhouse® which receives the beer it sells from one of our breweries or an approved third party craft brewer of our proprietary recipe beers (contract brewer), or a BJ s Pizza & Grill® which is a smaller format, full service restaurant. Our menu features our BJ s® award-winning, signature deep-dish pizza, our own hand-crafted beers as well as a wide selection of appetizers, entrees, pastas, sandwiches, specialty salads and desserts, including our unique Pizookie® dessert. Our BJ s Restaurant & Brewery restaurants feature in-house brewing facilities where BJ s proprietary hand-crafted beers are produced for many of our restaurants.

Our revenues are comprised of food and beverage sales at our restaurants. Revenues from restaurant sales are recognized when payment is tendered at the point of sale. Revenues from our gift cards are recognized upon redemption in our restaurants.

Effective June 2007, we began recognizing gift card breakage as Other income on our Consolidated Statements of Income. Gift card breakage is recorded when the likelihood of the redemption of the gift cards becomes remote, which is typically 24 months after original gift card issuance.

Cost of sales is comprised of food and beverage commodities and related supplies, including the cost to produce and distribute our proprietary beers. The components of cost of sales are variable and typically fluctuate with sales volumes. Labor and benefit costs include direct hourly and management wages, bonuses and payroll taxes and fringe benefits for restaurant employees, as well as stock-based compensation expense for restaurant managers.

Occupancy and operating expenses include restaurant supplies, credit card fees, marketing costs, fixed rent, percentage rent, common area maintenance charges, utilities, real estate taxes, repairs and maintenance and other related restaurant costs. Occupancy and operating expenses generally fluctuate with sales volumes, but typically not as much due to the semi-variable and fixed nature of many of the expenses.

General and administrative expenses include all corporate, field supervision and administrative functions that support existing operations and provide infrastructure to facilitate our future growth. Components of this category include corporate management, field supervision and corporate hourly staff salaries and related employee benefits (including stock-based compensation expense), travel and relocation costs, information systems, the cost to recruit and train new restaurant management employees, corporate rent and professional and consulting fees. Depreciation and amortization principally include depreciation on capital expenditures for restaurants. Restaurant opening expenses, which are expensed as incurred, consist of the costs of hiring and training the initial hourly work force for each new restaurant, travel, the cost of food and supplies used in training, grand opening promotional costs, the cost of the initial stocking of operating supplies and other direct costs related to the opening of a restaurant, including rent during the construction and in-restaurant training period.

We also have two of our smaller, legacy BJ s Pizza & Grill locations and one BJ s Restaurant & Brewhouse location that are operating on month-to-month leases. We are currently negotiating with the landlords for longer-term leases for these locations. However, there can be no assurances that either party may be able to agree to acceptable terms for a long term lease. In addition, we closed one of our smaller, legacy BJ s Pizza and Grill locations in the Portland, Oregon area upon the expiration of the lease in March 2008. The closing of this restaurant did not have a material impact on our financial results.

In calculating comparable company-owned restaurant sales, we include a restaurant in the comparable base once it has been open for 18 months.

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RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, our unaudited Consolidated Statements of Income expressed as percentages of total revenues. The results of operations for the twenty-six weeks ended July 1, 2008 and July 3, 2007 are not necessarily indicative of the results to be expected for the full fiscal year.

	For The Thirteen Weeks Ended		For The Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007	July 1, 2008	July 3, 2007
Revenues	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of sales	25.0	25.6	25.1	25.5
Labor and benefits	35.2	35.4	35.3	35.7
Occupancy and operating expenses	20.7	19.2	20.6	19.0
General and administrative	7.6	8.5	8.0	8.6
Depreciation and amortization	4.9	4.3	4.9	4.3
Restaurant opening expense	2.4	2.3	1.9	2.1
Loss on disposal of assets	0.3		0.2	1.3
Total costs and expenses	96.1	95.3	96.0	96.5
Income from operations	3.9	4.7	4.0	3.5
Other income:				
Interest income, net	0.4	1.1	0.6	1.2
Other income, net	0.1	0.4	0.1	0.2
Total other income	0.5	1.5	0.7	1.4
Income before income taxes	4.4	6.2	4.7	4.9
Income tax expense	1.3	2.0	1.4	1.6
Net income	3.1%	4.2%	3.3%	3.3%

Thirteen Weeks Ended July 1, 2008 Compared to Thirteen Weeks Ended July 3, 2007.

Revenues. Total revenues increased by $12.9 million, or 16.3%, to $92.2 million during the thirteen weeks ended July 1, 2008 from $79.3 million during the comparable thirteen week period of 2007. The $12.9 million increase in revenues was primarily attributable to an approximate 19% increase in restaurant weeks resulting from the 14 new restaurants that we have opened since the second quarter of 2007, partially offset by an approximate 2.0% decrease in our average sales per restaurant week. Comparable restaurant sales increased 0.6% during the thirteen weeks ended July 1, 2008. Estimated higher menu pricing of approximately 4.8% was nearly offset by reduced guest traffic in our comparable restaurants during the quarter. In particular, lower levels of guest traffic were experienced by our comparable restaurants located in the Inland Empire and Sacramento areas of California and in the Phoenix area of Arizona, which together contain approximately 25% of our total comparable restaurants for the current quarter. These areas have been, and continue to be, significantly impacted by the slowing national economy, the credit crunch and the resulting pressures in general on consumer spending and confidence. The slowing U.S. economy and the accompanying pressures of lower housing values, reduced credit availability, and higher food and fuel costs on the U.S. consumer has negatively impacted overall consumer traffic for casual dining restaurants in general during fiscal 2007 and fiscal 2008 to date. Accordingly, we expect that overall casual dining consumer traffic, as well as our overall guest traffic, will continue to be under pressure during the remainder of fiscal 2008.

Based on our assessment of the potential impact of known commodity, labor and other operating cost increases as of August 1, 2008, we currently plan to implement additional menu price increases during the remainder of fiscal 2008 to achieve an approximate targeted 4% menu price increase for the full year. However, there can be no assurance that unknown cost pressures will not arise and impact our results of operations. Additionally, if our guests do not accept our price increases, either by reducing their visits to our restaurants or by changing their purchasing patterns at our restaurants, the expected benefit of menu price increases on our operating margins could be negated. All potential menu price increases must be carefully considered in light of their ultimate acceptability by our restaurant guests. Other factors outside of our control, such as inclement weather, shifts in the holiday calendar, competitive restaurant intrusions into our trade areas, general economic and competitive conditions and other factors, as described in the Risk Factors section in Part I, Item 1A of our Annual Report on Form 10-K for the year ended January 1, 2008, can impact comparable sales comparisons. Accordingly, there can be no assurance that increases in comparable sales will be achieved as a result of increased menu prices or other factors.

Cost of Sales. Cost of sales increased by $2.7 million, or 13.3%, to $23.0 million during the thirteen weeks ended July 1, 2008 from $20.3 million during the comparable thirteen week period of 2007. As a percentage of revenues, cost of sales decreased to 25.0% for the current thirteen week period from 25.6% for the prior year comparable thirteen week period. This decrease is primarily due to increased revenues from our estimated effective menu price increases and reduced food waste (largely resulting from our newly-implemented theoretical food cost system), partially offset by increased commodity costs, including meat, cheese, produce, cooking oils and grocery costs.

We do anticipate that cost of sales in our new restaurants will typically be higher during the first 90-180 days of operations versus our mature restaurants, as management teams become accustomed to optimally predicting, managing and servicing sales volumes at our new restaurants. Accordingly, a comparatively large number of new restaurant openings in any single quarter may significantly impact total cost of sales comparisons for the entire Company. Additionally, restaurants opened in new markets may initially experience higher commodity costs than our established restaurants where we have greater market penetration resulting in purchasing and distribution economies of scale.

We provide our customers a large variety of menu items and therefore we are not overly dependent on a single group of commodities. However, we believe the overall cost environment for food commodities in general will remain under significant pressure during 2008, primarily due to domestic and worldwide agricultural, supply/demand and other macroeconomic factors that are outside of our control. We also believe that these pressures may result in higher commodity costs for 2009. Based on information available to us as of August 1, 2008, our preliminary expectations are that the overall cost of our basket of food commodities is likely to increase in the range of 6% to 8% during 2009. This expectation is based on our belief as to current and expected market conditions and is subject to significant risks, uncertainties, including the continuing volatility in the domestic and worldwide food and energy commodity markets. Refer to Business Supply Chain Management in Part I, Item 1 of our Annual Report on Form 10-K for the year ended January 1, 2008. We continue to work with our suppliers to attempt to control food costs. However, there can be no assurance that future supplies and costs for commodities used in our restaurants will not fluctuate due to weather and other market conditions outside of our control.

The cost to produce and distribute our proprietary beer is included in our cost of sales. After several months of operational due diligence, in April 2008 we retained one of the larger commercial brewers of quality craft beer in the United States to begin producing two of our higher-volume proprietary craft beers. Since 2002, we have also utilized a smaller contract brewer to brew our proprietary beers for our Texas restaurants due to legal requirements in that state. During 2007, approximately 15% of our proprietary beer was contract brewed, and we currently expect this percentage to gradually grow to the 35% annual run-rate range by the end of 2008. Our longer-term objective is to have large contract brewers produce substantially all of our larger-volume beers. We currently expect to continue to create and brew our smaller-volume seasonal and specialty beers. We believe the larger-scale contract brewers have greater economies of scale, stronger quality control systems and more effective, leverageable supply chain relationships than we have as a relatively small restaurant company. As a result, over the longer-term we expect that the production cost of our larger volume proprietary beers can be gradually reduced, while simultaneously providing an improvement in the overall consistency of our beer.

Labor and Benefits. Labor and benefit costs for our restaurants increased by $4.4 million, or 15.7%, to $32.5 million during the thirteen weeks ended July 1, 2008 from $28.1 million during the comparable thirteen week period of 2007. This increase was primarily due to the opening of 14 new restaurants since the thirteen weeks ended July 3, 2007, coupled with minimum wage increases in California and certain other states. As a percentage of revenues, labor and benefit costs decreased to 35.2% for the current thirteen week period from 35.4% for the prior year comparable thirteen week period. This percentage decrease is primarily due to hourly labor efficiencies and productivity, offset by higher minimum wages and higher fixed management costs, as a percentage of sales, due to the de-leveraging related to lower comparable restaurant revenues. Included in labor and benefits is approximately $221,000 and $162,000 related to our stock-based compensation plans for both the thirteen weeks ended July 1, 2008 and July 3, 2007, respectively. See Note 6, Stock-Based Compensation, in this Form 10-Q.

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The California minimum wage increased $0.50 to $8.00 per hour effective January 1, 2008. Other state minimum wages will likely increase in 2008. Additionally, the federal minimum wage increased $0.70 to $6.55 per hour effective July 24, 2008. In the past, we have been able to react to changes in our key operating costs, including minimum wage increases, by gradually increasing our menu prices and improving our productivity in our restaurants. However, we cannot guarantee that all or any future cost increases can be offset by increased menu prices or that increased menu prices will be accepted by our restaurant guests without any resulting changes in their visit frequencies or purchasing patterns.

For new restaurants, labor expenses will typically be higher than normal during the first 90-180 days of operations until our management team at each new restaurant becomes more accustomed to optimally predicting, managing and servicing the sales volumes expected at our new restaurants. Accordingly, a comparatively large number of new restaurant openings in any single quarter may significantly impact labor cost comparisons for the entire Company.

Occupancy and Operating Expenses. Occupancy and operating expenses increased by $3.9 million, or 25.4%, to $19.1 million during the thirteen weeks ended July 1, 2008 from $15.2 million during the comparable thirteen week period of 2007. The increase reflects additional operating and occupancy expenses related to 14 new restaurants opened since the thirteen weeks ended July 3, 2007. As a percentage of revenues, occupancy and operating expenses increased to 20.7% for the thirteen week period from 19.2% for the prior year comparable thirteen week period. This percentage increase is principally a result of the absolute dollar increases for upgraded china, silverware, glassware and linen napkins in our restaurants; increased costs for upgraded security systems; and, increased expenses related to gross receipts tax, license fees, utility rates and credit card fees, coupled with the de-leveraging of these costs, as a percentage of revenues, principally due to a lesser rate of increase in comparable restaurant revenues during the quarter.

General and Administrative Expenses. General and administrative expenses increased by $261,000, or 3.9%, to $7.0 million during the thirteen weeks ended July 1, 2008 from $6.7 million during the comparable thirteen week period of 2007. Included in general and administrative costs for the thirteen weeks ended July 1, 2008 and July 3, 2007 is $617,000 and $555,000, respectively, of stock-based compensation expense in accordance with FAS 123(R). The increase in general and administrative costs is primarily due to higher costs related to our regional supervision including travel and lodging. As a percentage of revenues, general and administrative expenses decreased to 7.6% for the current thirteen week period from 8.5% for the prior year comparable thirteen week period. This decrease is primarily due to leverage of the fixed component of these expenses over a higher revenue base.

Depreciation and Amortization. Depreciation and amortization increased by $1.1 million, or 30.5%, to $4.5 million during the thirteen weeks ended July 1, 2008 from $3.4 million during the comparable thirteen week period of 2007. As a percentage of revenues, depreciation and amortization increased to 4.9% for the thirteen week period from 4.3% for the prior year comparable thirteen week period. This increase is primarily due to increased construction costs for more recently opened restaurants and depreciation on our new operating toolsets, restaurant remodels and initiatives.

Restaurant Opening Expense. Restaurant opening expense increased by $421,000, or 23.5%, to $2.2 million during the thirteen weeks ended July 1, 2008 from $1.8 million during the comparable thirteen week period of 2007. This increase is primarily due to opening costs related to four restaurant openings and six restaurants in-progress during the thirteen weeks ended July 1, 2008, as compared to three restaurant openings and two restaurants in-progress during the thirteen weeks ended July 3, 2007 coupled with higher travel and lodging costs related to openings in our new states.

We currently expect our opening costs to average approximately $500,000 per new restaurant. Our opening costs will fluctuate from period to period, depending upon, but not limited to, the number of restaurant openings, the size and concept of the restaurants being opened, the location of the restaurants and the complexity of the staff hiring and training process. We opened four new restaurants in the second quarter of 2008 in Kissimmee, Florida (a suburb of Orlando); Greenwood, Indiana (a suburb of Indianapolis); Baton Rouge, Louisiana; and Torrance, California. As of August 1, 2008, we currently expect to open approximately six new restaurants in the third quarter (of which four have already opened), and as many as three new restaurants in the fourth quarter. The actual timing of restaurant openings is inherently difficult to precisely predict and is subject to weather conditions and other factors outside of the Company s control, including factors that are under the control of the Company s landlords, municipalities and contractors.

Loss on Disposal of Assets. The loss on disposal of assets of $299,000, or 0.3% as a percentage of revenues, during the thirteen weeks ended July 1, 2008 is primarily the result of asset disposal costs related to selected restaurant remodels in the current quarter.

We currently believe that, over the long run, it will become more beneficial to increase the percentage of our proprietary beer that is brewed by large commercial brewers of craft beer due to the economies of scale that can be obtained from brewing beer in large quantities, as well as legal considerations in some states where we desire to open restaurants. As such, we expect to gradually increase our contract brewing relationships over the next several years. As a result of this expected increase in contract brewing, we intend to gradually rebalance our internal beer production activities and may decide to de-commission other internally-operated breweries, which may result in additional disposals of related assets in the future. See Results of Operations Cost of Sales in this Form 10-Q. We may also remodel additional restaurants in the future that may also result in additional asset disposal costs.

Interest Income, Net. Net interest income decreased by $474,000, or 55.8%, to $375,000 during the thirteen weeks ended July 1, 2008 from $849,000 during the comparable thirteen week period of 2007. This decrease is primarily due to the lower investment balances compared to the same quarter as last year.

Other Income, Net. Other income, net decreased to $61,000 during comparable thirteen weeks ended July 1, 2008 from $290,000 during the comparable thirteen week period of 2007, a decrease of $229,000. This decrease is primarily due to the initial recognition of income from gift card breakage, which we began to recognize in the second quarter of 2007. Based on an analysis of our gift card program since its inception, we determined that 24 months after issuance date, the likelihood of gift card redemption is remote.

Income Tax Expense. Our effective income tax rate for the thirteen weeks ended July 1, 2008 was 29.0% compared to 32.7% for the comparable thirteen week period of 2007. The effective income tax rate for the thirteen weeks ended July 1, 2008 differs from the statutory income tax rate primarily due to anticipated FICA tip credits, the non-deductibility of incentive stock option compensation until the time of a disqualifying disposition and the tax exempt nature of our interest income from our investments. We currently estimate our effective tax rate to be approximately 29.0% to 30.0% for fiscal 2008 based on the current estimates of our tax exempt interest income and FICA tip credits. However, the actual effective tax rate for fiscal 2008 may be different than our current estimate due to actual revenues, pre-tax income and tax credits achieved during the year.

Twenty-Six Weeks Ended July 1, 2008 Compared to Twenty-Six Weeks Ended July 3, 2007.

Revenues. Total revenues increased by $28.5 million, or 19.0%, to $179.0 million during the twenty-six weeks ended July 1, 2008 from $150.5 million during the comparable twenty-six week period of 2007. The $28.5 million increase in revenues was primarily attributable to an approximate 21% increase in restaurant weeks resulting from the 14 new restaurants that we have opened since the second quarter of 2007, partially offset by a 2.0% decrease in our average sales per restaurant week. Comparable restaurant sales increased approximately 0.4% during the twenty-six weeks ended July 1, 2008. Estimated higher menu pricing of approximately 5.3% was nearly offset by reduced guest traffic in our comparable restaurants during the twenty-six week period ended July 1, 2008. In particular, lower levels of guest traffic were experienced by our comparable restaurants located in the Inland Empire and Sacramento areas of California and in the Phoenix area of Arizona during the twenty-six week period ended July 1, 2008.

Cost of Sales. Cost of sales increased by $6.5 million, or 17.1%, to $44.9 million during the twenty-six weeks ended July 1, 2008 from $38.4 million during the comparable twenty-six week period of 2007. As a percentage of revenues, cost of sales decreased slightly to 25.1% for the current twenty-six week period from 25.5% for the prior year comparable twenty-six week period. This decrease is primarily due to increased revenues from our estimated effective menu price increases and reduced food waste (largely resulting from our newly-implemented theoretical food cost system), partially offset by increased commodity costs, including meat, chicken, cheese, produce, cooking oils and grocery costs.

Labor and Benefits. Labor and benefit costs for our restaurants increased by $9.5 million, or 17.6%, to $63.2 million during the twenty-six weeks ended July 1, 2008 from $53.7 million during the comparable twenty-six week period of 2007. This increase was primarily due to the opening of 14 new restaurants since the twenty-six weeks ended July 3, 2007. As a percentage of revenues, labor and benefit costs decreased to 35.3% for the current twenty-six week period from 35.7% for the prior year comparable twenty-six week period. This percentage decrease is primarily due to hourly labor efficiencies and productivity and lower workers compensation costs as a percent of

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sales, offset by higher minimum wages and approximately 0.4% increase in comparable restaurant sales. Included in labor and benefits is approximately $429,000 and $323,000 related to our stock-based compensation plans for both the twenty-six weeks ended July 1, 2008 and July 3, 2007, respectively. See Note 6, Stock-Based Compensation, in this Form 10-Q.

Occupancy and Operating Expenses. Occupancy and operating expenses increased by $8.2 million, or 28.8%, to $36.8 million during the twenty-six weeks ended July 1, 2008 from $28.6 million during the comparable twenty-six week period of 2007. The increase reflects additional operating and occupancy expenses related to 14 new restaurants opened since the twenty-six weeks ended July 3, 2007. As a percentage of revenues, occupancy and operating expenses increased to 20.6% for the twenty-six week period from 19.0% for the prior year comparable twenty-six week period. This percentage increase is principally a result of absolute dollar increases for upgraded china, silverware, glassware and linen napkins in our restaurants; increased costs for upgraded security systems; and, increased expenses related to gross receipts tax, license fees, utility rates and credit card fees as well as some deleveraging due to our 0.4% comparable restaurant sales through the twenty-six week period ending July, 1 2008.

General and Administrative Expenses. General and administrative expenses increased by $1.4 million, or 10.9%, to $14.4 million during the twenty-six weeks ended July 1, 2008 from $13.0 million during the comparable twenty-six week period of 2007. Included in general and administrative costs for the twenty-six weeks ended July 1, 2008 and July 3, 2007 is $1.2 million and $1.1 million, respectively, of stock-based compensation expense in accordance with FAS 123(R). The increase in general and administrative costs is primarily due to planned investments in our restaurant management recruiting and training program to support the expected openings of as many as 15 new restaurants in 2008 and higher travel and lodging costs to support our growing base of restaurants. As a percentage of revenues, general and administrative expenses decreased to 8.0% for the current twenty-six week period from 8.6% for the prior year comparable twenty-six week period. This decrease is primarily due to leverage of the fixed component of these expenses over a higher revenue base.

Depreciation and Amortization. Depreciation and amortization increased by $2.3 million, or 34.9%, to $8.8 million during the twenty-six weeks ended July 1, 2008 from $6.5 million during the comparable twenty-six week period of 2007. As a percentage of revenues, depreciation and amortization increased to 4.9% for the twenty-six week period from 4.3% for the prior year comparable twenty-six week period. This increase is primarily due to increased construction costs for new restaurants and depreciation on our new operating toolsets, restaurant remodels and initiatives, coupled with the 0.4% increase in comparable restaurant sales for the first half of 2008.

Restaurant Opening Expense. Restaurant opening expense increased by $127,000, or 4.0%, to $3.3 million during the twenty-six weeks ended July 1, 2008 from $3.2 million during the comparable twenty-six week period of 2007. This increase is primarily due to opening costs related to six restaurant openings and five restaurants in-progress during the twenty-six weeks ended July 1, 2008, as compared to five restaurant openings and two restaurants in-progress during the twenty-six weeks ended July 3, 2007 coupled with higher travel and lodging costs related to openings in our new states.

Loss on Disposal of Assets. Loss on disposal of assets decreased to $351,000 during the comparable twenty-six weeks ended July 1, 2008 from $2.0 million during the comparable twenty-six week period of 2007, a decrease of $1.7 million. The current period s loss on disposal of assets pertains to asset disposal costs related to selected restaurant remodels; whereas, for the same twenty-six weeks of the prior year, the loss on disposal of assets of $2.0 million pertains to the disposal of certain assets from the implementation of our strategic and growth initiatives. As a result of these initiatives, we replaced our existing televisions with new flat panel, high definition televisions, and implemented a more contemporary china/silverware/glassware program in our restaurants. We also decommissioned four of our older, smaller and inefficient legacy breweries and shifted the related production to our new, larger and more efficient brewery in Reno, Nevada.

Interest Income, Net. Net interest income decreased by $800,000, or 43.8%, to $1.0 million during the twenty-six weeks ended July 1, 2008 from $1.8 million during the comparable twenty-six week period of 2007. This decrease is primarily due to the lower investment balances compared to the same period as last year.

Other Income, Net. Other income, net decreased to $201,000 during the comparable twenty-six weeks ended July 1, 2008 from $312,000 during the comparable twenty-six week period of 2007, a decrease of $111,000. This decrease is primarily due to the initial recognition of income from gift card breakage, which we began to recognize in the

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second quarter of 2007. Based on an analysis of our gift card program since its inception, we determined that 24 months after issuance date, the likelihood of gift card redemption is remote.

Income Tax Expense. Our effective income tax rate for the twenty-six weeks ended July 1, 2008 was 29.5% compared to 32.9% for the comparable twenty-six week period of 2007. The effective income tax rate for the twenty-six weeks ended July 1, 2008 differs from the statutory income tax rate primarily due to anticipated FICA tip credits, the non-deductibility of incentive stock option compensation until the time of a disqualifying disposition and the tax exempt nature of our interest income from our investments.

LIQUIDITY AND CAPITAL RESOURCES

The following tables set forth, for the periods indicated, a summary of our key liquidity measurements (dollar amounts in thousands):

	July 1, 2008	January 1, 2008
Cash and investments	$ 6,677	$ 52,717
Net working capital (deficit)	($ 13,225)	$ 33,502
Current ratio	0.7:1.0	1.8:1.0

	Twenty-Six Weeks Ended	
	July 1, 2008	July 3, 2007
Cash provided by operating activities	$ 26,255	$ 10,365
Capital expenditures	$ 40,298	$ 33,807

Our fundamental corporate finance philosophy is to maintain a conservative balance sheet in order to support our long-term restaurant expansion plan with sufficient financial flexibility; to provide the financial resources necessary to protect and enhance the competitiveness of our restaurant and brewing operations and to provide a prudent level of financial capacity to manage the risks and uncertainties of conducting our business operations on a larger scale. In the past, we have obtained capital resources from our ongoing operations, public stock and warrant offerings, employee stock option exercises and construction contributions from our landlords. As an additional source of liquidity, we also have a $45 million credit facility in place, of which $5 million was drawn upon as of July 1, 2008.

Our capital requirements are principally related to our restaurant expansion plans. While our ability to achieve our growth plans is dependent on a variety of factors, some of which are outside of our control, our primary growth objective is to achieve a 20% to 25% increase in total restaurant operating weeks during fiscal 2008 from the development and opening of new restaurants. Our base of established restaurant operations is not yet large enough to generate enough free cash flow from operations to totally fund our planned expansion indefinitely. Accordingly, we will continue to actively monitor overall conditions in the capital markets with respect to the potential sources and timing of additional financing for our planned future expansion. However, there can be no assurance that such financing will be available when required or available on terms acceptable to us.

Similar to many restaurant chains, we typically utilize operating lease arrangements (principally ground leases) for the majority of our restaurant locations. We believe our operating lease arrangements continue to provide appropriate leverage for our capital structure in a financially efficient manner. However, we are not limited to the use of lease arrangements as our only method of opening new restaurants. While our operating lease obligations are not currently required to be reflected as indebtedness on our consolidated balance sheets, the minimum rents and other related lease obligations, such as common area expenses, under our lease agreements must be satisfied by cash flows from our ongoing operations. Accordingly, our lease arrangements reduce, to some extent, our capacity to utilize funded indebtedness in our capital structure. We also require capital resources to maintain our existing base of restaurants and brewery operations and to further expand and strengthen the capabilities of our corporate and information technology infrastructures. Our requirement for working capital is not significant since our restaurant guests pay for their food and beverage purchases in cash or credit cards at the time of the sale. Thus, we are able to sell many of our inventory items before we have to pay our suppliers for such items.

We typically seek to lease our restaurant locations for primary periods of 15 to 20 years under operating lease arrangements. Our rent structures vary from lease to lease, but generally provide for the payment of both minimum and contingent (percentage) rent based on sales, as well as other expenses related to the leases (for example, our pro-rata share of common area maintenance, property tax and insurance expenses). In addition, many of our lease arrangements include the opportunity to secure landlord construction contributions (also known as tenant improvement allowances) to partially offset the cost of constructing the related restaurants. Generally, landlords recover the cost of such contributions from increased minimum rents. During fiscal 2008, we expect to receive approximately $15 million of landlord construction contributions. However, there can be no assurance such contributions will always continue to be available to support the construction of our future restaurants. From time to time, we may also decide to purchase the underlying land for a new restaurant if that is the only way to secure a highly desirable site. Currently, we own the land that underlies four of our restaurants, and we may determine at some future point to monetize those assets through a sale-leaseback or other financial transaction. The majority of our current restaurant locations have been free-standing buildings, however, in the future we intend to develop more in-line locations in shopping malls, lifestyle centers, office complexes, strip centers, entertainment centers and other real estate developments where greater amounts of landlord construction contributions are typically available to us. We disburse cash for certain site-related work, buildings, leasehold improvements, furnishings, fixtures and equipment to build our leased and owned premises. We own substantially all of the equipment, furniture and trade fixtures in our restaurants and currently plan to do so in the future.

Our cash flows from operating activities, as detailed in the consolidated statements of cash flows, provided $26.3 million of net cash during the twenty-six weeks ended July 1, 2008, representing a $15.9 million increase from the $10.4 million provided during the twenty-six week period of 2007. The increase in cash from operating activities for the twenty-six weeks ended July 1, 2008, in comparison to twenty-six weeks ended July 3, 2007, is primarily due to increased net income combined with higher depreciation expense due to more restaurants and receipt of tenant improvement allowances from our landlords, coupled with the timing of payments to vendors included in accounts payable and accrued expenses.

For the twenty-six weeks ended July 1, 2008, total capital expenditures were $40.3 million, of which expenditures for the acquisition of restaurant and brewery equipment and leasehold improvements to construct new restaurants were $35.2 million. These expenditures were primarily related to the construction of our new restaurants in Cincinnati, Ohio; Louisville, Kentucky; Orlando, Florida; Indianapolis, Indiana; Baton Rouge, Louisiana; and, Torrance, California which opened during the twenty-six weeks ended July 1, 2008, as well as expenditures related to additional restaurants expected to open in the third and fourth quarters of 2008. In addition, total capital expenditures related to the maintenance of existing restaurants and expenditures for restaurant and corporate systems were $4.8 million and $0.3 million, respectively.

On November 16, 2006, we sold 3,075,000 shares of common stock to major institutional investors in a PIPE (private investment in public equity) offering at a purchase price of $20.00 per share for $58.3 million (net of approximately $3.2 million in related fees and expenses); and, on March 11, 2005, we sold 2,750,000 shares of common stock at a purchase price of $15.50 per share for $40.3 million (net of approximately $2.2 million in related fees and expenses). These proceeds are being utilized to fund the expansion of our restaurant operations and general corporate purposes.

On October 17, 2007, we established a $25 million unsecured revolving line of credit with a major financial institution (the Line of Credit). The Line of Credit expires on September 30, 2012 and may be used for working capital and other general corporate purposes. The Line of Credit was increased to $45 million during the first quarter of 2008. We expect to utilize the Line of Credit principally for letters of credit that are required to support certain of our self insurance programs and for working capital and construction requirements. As of July 1, 2008, there were funded borrowings of $5 million outstanding under the Line of Credit; and, there were outstanding letters of credit totaling $2.9 million. Any borrowings under the Line of Credit will bear interest at the financial institution s prime rate or at LIBOR plus a percentage not to exceed 1.375% based on a Lease Adjusted Leverage Ratio as defined in the Line of Credit agreement. The Line of Credit agreement also requires a Fixed Charge Coverage Ratio. At July 1, 2008, we were in compliance with these covenants. Any interest on the Line of Credit will be payable quarterly and all related borrowings must be repaid on or before September 30, 2012. While we have the Line of Credit in place and it can be currently drawn upon, in the event that global credit market conditions further deteriorate, it is possible that creditors could place limitations or restrictions on the ability of borrowers in general to draw on existing credit facilities. At this time, however, we have no indication that any such limitations or restrictions are likely to occur.

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We currently plan to open as many as 15 new restaurants during fiscal 2008. As of August 1, 2008, ten of those restaurants have already opened, and the remaining five restaurants have signed leases and are under construction. Our capital requirements related to opening additional restaurants will continue to be significant. We currently anticipate our total capital expenditures for 2008, gross of any allowances we may receive from landlords, to be $70 million to $75 million related to the construction of new restaurants, the reinvestment in some of our older restaurants as well as normal maintenance capital expenditures and the investment in toolsets and infrastructure. We expect to fund our expected capital expenditures for 2008 with current cash and investment balances, cash flow from operations, landlord contributions and our Line of Credit. During fiscal 2008, we are currently expecting to obtain approximately $15 million of landlord construction contributions. Our future capital expenditure requirements will depend on many factors, including the pace of expansion, real estate markets, construction costs, the specific sites selected for new restaurants, the nature of the lease and associated financing arrangements negotiated with landlords, the availability of capital and the extent of any programs we may initiate to re-image and remodel certain of our older restaurants.

Many retailers and restaurant companies are reducing their short-term expansion plans in light of the current economic slowdown in the United States. Many retail project developers are also postponing or canceling their planned projects, including planned new lifestyle centers and additions/upgrades to existing retail projects. Although this slowdown may not necessarily reduce the absolute number of sites available to us over the longer term, it may impact the timing of our shorter-term decisions to move forward with the development of the sites based on (1) the ability of developers to physically deliver sites to us in a timely manner, and (2) the ability of developers to timely deliver the co-tenants that we require in the retail projects in which we desire to open. Having the right mix of co-tenants with us in a retail project is critically important to our success, as it is to most retailers and restaurants, because of the synergies that are collectively generated in terms of overall customer traffic and energy for the project. We generally attempt to avoid opening new restaurants in retail projects that are having difficulty in locating a sufficient number of anchor tenants, or that might open with less than half of their total project leased. In addition to the co-tenancy factor, there are some other retail projects for which we are interested in opening new restaurants that have been postponed in their entirety. As such, we will continue to closely monitor every potential site that is currently in our development pipeline for 2009 and 2010, as events and factors outside of our control may cause us to reconsider the ultimate timing of the development of some of the sites.

As of July 1, 2008, our investments consisted of auction rate securities (ARS) with a par or face value of $37.1 million. These auction rate securities, AAA rated when purchased, are long-term debt obligations secured by student loans, which loans are 97% guaranteed by the U.S. Government under the Federal Family Education Loan Program (FFELP). The recent uncertainties in the credit markets have affected our holdings in these ARS investments, since auctions for our investments in these securities have failed to settle on their respective settlement dates. Historically, the fair value of the ARS investments approximated par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments, these investments are not currently trading and, therefore, do not currently have a readily determinable market value. In accordance with FAS 157, we estimated the fair value of our auction rate securities investments using valuation models and methodologies provided by third parties, including our investment manager for the ARS. Based on these valuation models and methodologies, we have recognized a temporary decline in the fair value of our ARS investments of approximately $2.0 million as of July 1, 2008. In accordance with FAS 115, a temporary change in fair value results in an unrealized holding gain or loss being recorded in the other comprehensive income (loss) component of shareholders equity. Such an unrealized holding gain or loss does not affect net income for the applicable accounting period. Due to the current illiquidity of these investments and the uncertainty regarding the auction rate securities market, we have also reclassified these investments to non-current investments for the current reporting period at fair value. We currently anticipate holding these ARS investments until a recovery of the auction process or until maturity. We will continue to monitor the auction rate securities market and the liquidity and value of the securities we hold. Additional adjustments to the fair value may be required from quarter to quarter to reflect changes in market conditions.

We currently believe that our projected cash flow from operations, cash balances on hand, agreed-upon landlord construction contributions and our $45 million credit facility, should be sufficient, in the aggregate, to finance our planned capital expenditures and other operating activities through at least fiscal 2008. We currently believe that the current lack of liquidity of our auction rate securities investments will not have a material impact on our ability to fund our operations or continue our expansion through at least 2008. However, if current conditions in the auction rate securities market continue for a prolonged period, our longer-term financial flexibility could be impacted until

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other sources of capital are obtained. Our base of established restaurant operations is not yet large enough to generate enough free cash flow from operations to totally fund our planned expansion indefinitely. Accordingly, we will continue to actively monitor overall conditions in the capital markets with respect to the potential sources and timing of additional financing for our planned future expansion. However, there can be no assurance that such financing will be available when required or available on terms acceptable to us.

OFF-BALANCE SHEET ARRANGEMENTS

We do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or variable interest entities (VIEs), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow limited purposes. As of July 1, 2008, we are not involved in any off-balance sheet arrangements.

IMPACT OF INFLATION

Our profitability is dependent, among other things, on our ability to anticipate and react to changes in the costs of key operating resources, including food and other raw materials, labor, energy and other supplies and services. Substantial increases in costs and expenses could impact our operating results to the extent that such increases cannot be passed along to our restaurant guests. While we have taken steps to enter into agreements for some of the commodities used in our restaurant operations, there can be no assurance that future supplies and costs for such commodities will not fluctuate due to weather and other market conditions outside of our control. We are currently unable to contract for many of our fresh commodities such as produce and fluid dairy items for long periods of time, and due to the current pressures on many commodities there can be no guarantee that we will be able to obtain contracts for other commodities in the future. Consequently, such commodities can be subject to unforeseen supply and cost fluctuations. The impact of inflation on food, labor, energy and occupancy costs can significantly affect the profitability of our restaurant operations.

Many of our restaurant employees are paid hourly rates related to the federal minimum wage. In fiscal 2007, Congress enacted an increase in the federal minimum wage implemented in three phases, beginning in fiscal 2007 and concluding in fiscal 2009. In addition, numerous state and local governments increased the minimum wage within their jurisdictions, with further state minimum wage increases going into effect in fiscal 2008. Additionally, a general shortage in the availability of qualified restaurant management and hourly workers in certain geographical areas in which we operate has caused related increases in the costs of recruiting and compensating such employees. Certain operating costs, such as taxes, insurance and other outside services continue to increase with the general level of inflation or higher and may also be subject to other cost and supply fluctuations outside of our control.

While we have been able to partially offset inflation and other changes in the costs of key operating resources by gradually increasing prices for our menu items, coupled with more efficient purchasing practices, productivity improvements and greater economies of scale, there can be no assurance that we will be able to continue to do so in the future. From time to time, competitive conditions could limit our menu pricing flexibility. In addition, macroeconomic conditions that impact consumer discretionary spending for food away from home could make additional menu price increases imprudent. There can be no assurance that all of our future cost increases can be offset by higher menu prices, or that higher menu prices will be accepted by our restaurant guests without any resulting changes in their visit frequencies or purchasing patterns. Many of the leases for our restaurants provide for contingent rent obligations based on a percentage of sales. As a result, rent expense will absorb a proportionate share of any menu price increases in our restaurants. There can be no assurance that we will continue to generate increases in comparable restaurant sales in amounts sufficient to offset inflationary or other cost pressures.

SEASONALITY AND ADVERSE WEATHER

Our business is subject to seasonal fluctuations and adverse weather. Our results of operations have historically been impacted by seasonality, which directly impacts tourism at our coastal California locations. The summer months (June through August) have traditionally been higher sales volume periods than other periods of the year. Over the past 18 months we have opened restaurants in Florida, Ohio, Oklahoma, Kentucky, Indiana and Louisiana and accordingly, these restaurants will be impacted by weather and other seasonal factors that typically impact other restaurant operations in those states. Holidays, severe winter weather, hurricanes, thunderstorms and similar conditions may impact restaurant sales volumes seasonally in some of the markets where we operate. Additionally, the state of California (where 40 of our current 77 restaurants are located as of August 1, 2008) can experience earthquakes, wildfires, windstorms and other naturally-occurring conditions that can impact our restaurant operations in that state. Many of our restaurants are located in or near shopping centers and malls that typically experience seasonal fluctuations in sales. Quarterly results have been and will continue to be significantly impacted by the timing of new restaurant openings and their associated restaurant opening expenses. As a result of these and other factors, our financial results for any given quarter may not be indicative of the results that may be achieved for a full fiscal year.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies require the greatest amount of subjective or complex judgments by management and are important to portraying our financial condition and results of operations. Judgments or uncertainties regarding the application of these policies may result in materially different amounts being reported under different conditions or using different assumptions. We consider the following policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Property and Equipment

We record all property and equipment at cost. Property and equipment accounting requires estimates of the useful lives for the assets for depreciation purposes and selection of depreciation methods. We believe the useful lives reflect the actual economic life of the underlying assets. We have elected to use the straight-line method of depreciation over the estimated useful life of an asset or the primary lease term of the respective lease, whichever is shorter. Renewals and betterments that materially extend the useful life of an asset are capitalized while maintenance and repair costs are charged to operations as incurred. Judgment is often required in the decision to distinguish between an asset which qualifies for capitalization versus an expenditure which is for maintenance and repairs. When property and equipment are sold or otherwise disposed of, the asset account and related accumulated depreciation and amortization accounts are relieved, and any gain or loss is included in earnings. Additionally, interest capitalized for new restaurant construction is included in Property and equipment, net on the Consolidated Balance Sheets.

Impairment of Long-Lived Assets

We assess potential impairments of our long-lived assets whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Factors considered include, but are not limited to, significant underperformance relative to expected historical or projected future operating results; significant changes in the manner of use of the acquired assets or the strategy for the overall business; and, significant negative industry or economic trends. The recoverability is assessed in most cases by comparing the carrying value of the asset to the undiscounted cash flows expected to be generated by the asset. This assessment process requires the use of estimates and assumptions regarding future cash flows and estimated useful lives, which are subject to a significant degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets. As of July 1, 2008, no other than temporary impairment indicators have been identified.

Self Insurance Liability

We are self-insured for a portion of our employee workers compensation program and general liability insurance. We maintain coverage with a third party insurer to limit our total exposure for these programs. The accrued liability associated with these programs are based on our estimate of the ultimate costs to settle known claims as well as claims incurred but not yet reported to us (IBNR claims) as of the balance sheet date. Our estimated liability is not discounted and is based on information provided by our insurance broker and insurer, combined with our judgments regarding a number of assumptions and factors, including the frequency and severity of claims, our claims development history, case jurisdiction, related legislation, and our claims settlement practice. Significant judgment is required to estimate IBNR claims as parties have yet to assert such claims. If actual claims trends, including the severity or frequency of claims, differ from our estimates, our financial results could be significantly impacted.

Income Taxes

We provide for income taxes based on our estimate of federal and state tax liabilities. Our estimates include, but are not limited to, effective state and local income tax rates, allowable tax credits for items such as FICA taxes paid on reported tip income and estimates related to depreciation expense allowable for tax purposes. We usually file our income tax returns several months after our fiscal year-end. We file our tax returns with the advice and compilation of tax consultants. All tax returns are subject to audit by federal and state governments, usually years after the returns are filed, and could be subject to differing interpretation of the tax laws.

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Deferred tax accounting requires that we evaluate net deferred tax assets to determine if these assets will more likely than not be realized in the foreseeable future. This test requires projection of our taxable income into future years to determine if there will be taxable income sufficient to realize the tax assets (future tax deductions and FICA tax credit carryforwards). The preparation of the projections requires considerable judgment and is subject to change to reflect future events and changes in the tax laws.

As of January 3, 2007, we adopted FIN 48, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize the impact of a tax position in our financial statements if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The adoption of FIN 48 did not result in an adjustment to opening retained earnings. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of July 1, 2008, unrecognized tax benefits recorded was approximately $84,000.

Leases

We lease the majority of our restaurant locations. We account for our leases under the provisions of FASB Statement No. 13, *Accounting for Leases* (FAS 13), which require that our leases be evaluated and classified as operating or capital leases for financial reporting purposes. The term used for this evaluation includes renewal option periods only in instances in which the exercise of the renewal option can be reasonably assured and failure to exercise such option would result in an economic penalty. All of our restaurant leases are classified as operating leases pursuant to the requirements of FAS 13. We disburse cash for leasehold improvements, furniture and fixtures and equipment to build and equip our leased premises. We may also expend cash for permanent improvements that we make to leased premises that may be reimbursed to us by our landlords as construction contributions (also known as tenant improvement allowances) pursuant to agreed-upon terms in our leases. Landlord construction contributions can take the form of up-front cash, full or partial credits against minimum or percentage rents otherwise payable by us or a combination thereof. All tenant improvement allowances received by us are recorded as a deferred rent obligation and amortized over the term of the lease.

The lease term used for straight-line rent expense is calculated from the date we obtain possession of the leased premises through the lease termination date. In accordance with FASB Staff Position No. 13-1, *Accounting for Rental Costs Incurred During a Construction Period*, we expense rent from possession date through restaurant open date as pre-opening expense. Once a restaurant opens for business, we record straight-line rent over the lease term plus contingent rent to the extent it exceeded the minimum rent obligation per the lease agreement.

There is potential for variability in the rent holiday period, which begins on the possession date and ends on the restaurant open date, during which no cash rent payments are typically due under the terms of the lease. Factors that may affect the length of the rent holiday period generally relate to construction related delays. Extension of the rent holiday period due to delays in restaurant opening will result in greater pre-opening rent expense recognized during the rent holiday period and lesser occupancy expense during the rest of the lease term (post-opening).

For leases that contain rent escalations, we record the total rent payable during the lease term, as determined above, on the straight-line basis over the term of the lease (including the rent holiday period beginning upon our possession of the premises), and record the difference between the minimum rents paid and the straight-line rent as a lease obligation. Certain leases contain provisions that require additional rental payments based upon restaurant sales volume (contingent rentals). Contingent rentals are accrued each period as the liabilities are incurred, in addition to the straight-line rent expense noted above. This results in some variability in occupancy expense as a percentage of revenues over the term of the lease in restaurants where we pay contingent rent.

Management makes judgments regarding the probable term for each restaurant property lease, which can impact the classification and accounting for a lease as capital or operating, the rent holiday and/or escalations in payments that are taken into consideration when calculating straight-line rent and the term over which leasehold improvements for each restaurant are amortized. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

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Stock-based Compensation

We have two stock-based compensation plans the 2005 Equity Incentive Plan and the 1996 Stock Option Plan under which we may issue shares of our common stock to employees, officers, directors and consultants. Upon effectiveness of the 2005 Equity Incentive Plan, the 1996 Stock Option Plan was closed for purposes of new grants. Both of these plans have been approved by our shareholders. Under the 2005 Equity Incentive Plan, we have granted incentive stock options, non-qualified stock options, and restricted stock units.

Beginning in 2007, substantially all of our restaurant general managers, executive kitchen managers, culinary training managers and our area and regional restaurant directors become eligible to participate in a new equity-based incentive program called the BJ s Gold Standard Stock Ownership Program (the GSSOP) under our 2005 Equity Incentive Plan. In November 2007, we expanded our GSSOP eligibility to also include certain brewery personnel. The GSSOP is a longer-term equity incentive program that utilizes Company restricted stock units (RSUs). The GSSOP is dependent on each participant s extended service with us in their respective positions and their achievement of certain agreed-upon performance objectives during that service period (i.e., five years).

Beginning in 2008, we also began issuing RSUs as a component of the annual equity grant award to officers and other employees. Under our 2005 Equity Incentive Plan we have issued approximately 388,800 RSUs as of July 1, 2008. The fair value of the RSUs is the quoted market value of our common stock on the date of grant. The fair value of each RSU is expensed over the period during which its related restrictions are expected to lapse (i.e., generally five years). Stock options generally vest at 20% per year or cliff vest, either ratably in years three through five or 100% in year five and expire ten years from date of grant. RSUs generally cliff vest 100% after five years for GSSOP participants, and generally vest at 20% per year for other RSU grantees.

We account for these plans under the fair value recognition provisions of FAS 123(R) using the modified-prospective-transition method. Compensation expense recognized in the twenty-six weeks ended July 1, 2008 and July 3, 2007 include; (a) compensation expense for all share-based payments granted prior to, but not yet vested as of January 4, 2006 (adoption date of FAS 123 (R)), based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (b) compensation expense for all share-based payments granted subsequent to January 4, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123(R). FAS 123(R) requires us to make certain assumptions and judgments regarding the grant date fair value. These judgments include expected volatility, risk free interest rate, expected option life, dividend yield and vesting percentage. These estimations and judgments are determined by us using many different variables that, in many cases, are outside of our control. The changes in these variables or trends, including stock price volatility and risk free interest rate, may significantly impact the grant date fair value resulting in a significant impact to our financial results. FAS 123(R) requires the cash flow tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion of market risks contains forward-looking statements. Actual results may differ materially from the following discussion based on general conditions in the financial and commodity markets.

Our market risk exposures are related to cash and cash equivalents and investments. We invest our excess cash in highly liquid short-term investments with maturities of less than twelve months as of the date of purchase. These investments are not held for trading or other speculative purposes. Changes in interest rates affect the investment income we earn on our investments and, therefore, impact our cash flows and results of operations. For the twenty-six weeks ended July 1, 2008, the average interest rate earned on cash and cash equivalents and investments was approximately 4.3%. As of July 1, 2008, our investment portfolio consisted of highly rated investment-grade auction rate securities with a par or face value of approximately $37.1 million currently classified as non-current investments. These auction rate securities, AAA rated when purchased, are long-term debt obligations secured by student loans, which are generally 97% guaranteed by the U.S. Government under the FFELP. In addition to the U.S. Government guarantee on such student loans, many of the securities also have separate insurance policies guaranteeing both the principal and accrued interest. Liquidity for these securities has historically been provided by an auction process that resets the applicable interest rate at pre-determined intervals up to 35 days. The final maturity dates of these auction rate securities are between 2020 and 2047. The recent uncertainties in the credit markets have affected our holdings in auction rate securities investments, since auctions for these securities have failed to settle on their respective settlement dates. While we continue to earn interest on our auction rate securities investments, these investments are not currently trading and, therefore, do not currently have a readily determinable market value. Accordingly, the estimated fair value of these auction rate securities investments no longer approximates par or face value and we recognized a temporary decline in the fair value of our auction rate securities investments of approximately $2.0 million as of July 1, 2008.

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The fair market value of these securities is subject to further interest rate risk and could decline in value if market interest rates increased. If market interest rates were to increase immediately and uniformly by 10% from the levels existing as of July 1, 2008, the decline in the fair value of the portfolio would not be material to our financial position, results of operations and cash flows. However, if interest rates decreased and securities within our portfolio matured and were re-invested in securities with lower interest rates, interest income would decrease in the future. Additionally, the current illiquidity of our investments in auction rate securities and the uncertainty regarding the auction rate securities market has caused us to reclassify our investments in those securities to non-current assets, and there can be no guarantee that the markets supporting these investments will recover in the near future. If current conditions in the auction rate securities market continue for a prolonged period, our longer-term financial flexibility could be impacted until other sources of capital can be obtained. While we have a $45 million credit facility in place, in the event that global credit market conditions further deteriorate, it is possible that creditors could place limitations or restrictions on the ability of borrowers in general to draw on existing credit facilities. At this time, however, we have no indication that any such limitations or restrictions are likely to occur.

We purchase food and other commodities for use in our operations, based upon market prices established with our suppliers. Many of the commodities purchased by us can be subject to volatility due to market supply and demand factors outside of our control. To manage this risk in part, we attempt to enter into fixed price purchase commitments, with terms typically up to one year, for many of our commodity requirements. Dairy costs can also fluctuate due to government regulation. We believe that substantially all of our food and supplies are available from several sources, which helps to diversify our overall commodity cost risk. We also believe that we have some flexibility and ability to increase certain menu prices, or vary certain menu items offered, in response to food commodity price increases. Some of our commodity purchase arrangements may contain contractual features that limit the price paid by establishing certain price floors or caps. We do not use financial instruments to hedge commodity prices, since our purchase arrangements with suppliers, to the extent that we can enter into such arrangements, help control the ultimate cost that we pay.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934 as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There has not been any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our second fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are subject to a number of private lawsuits, administrative proceedings and claims that arise in the ordinary course of our business. These claims typically involve claims from guests, employees and others related to operational issues common to the foodservice industry. A number of these claims may exist at any given time. We believe that most of our guest claims will be covered by our general liability insurance, subject to certain deductibles and coverage limits. Punitive damages awards and employee unfair practice claims, however, are not covered by our general liability insurance. To date, we have not paid punitive damages with respect to any claims, but there can be no assurance that punitive damages will not be awarded with respect to any future claims, employee unfair practice claims or any other actions. We could be affected by adverse publicity resulting from allegations in lawsuits, claims and proceedings, regardless of whether these allegations are valid or whether we are ultimately determined to be

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liable. We currently believe that the final disposition of these types of lawsuits, proceedings and claims will not have a material adverse effect on our financial position, results of operations or liquidity. It is possible, however, that our future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to lawsuits, proceedings or claims.

The following paragraphs describe certain legal actions now pending:

Labor Related Matters

On February 5, 2004, a former employee of ours, on behalf of herself, and allegedly other employees, filed a class action complaint in Los Angeles County, California Superior Court, Case Number BC310146, and on March 16, 2004, filed an amended complaint, alleging causes of action for: (1) failure to pay reporting time minimum pay; (2) failure to allow meal breaks; (3) failure to allow rest breaks; (4) waiting time penalties; (5) civil penalties; (6) reimbursement for fraud and deceit; (7) punitive damages for fraud and deceit; and (8) disgorgement of illicit profits. On June 28, 2004, the plaintiff stipulated to dismiss her second, third, fourth and fifth causes of action. During September 2004, the plaintiff stipulated to binding arbitration of the action. On March 2, 2008, and on March 19, 2008, one of Plaintiff s attorneys filed a notice with the California Labor and Workforce Development Agency, alleging failure to keep adequate pay records and to pay Plaintiff minimum wage. To our knowledge, the Agency has not responded to either of these notices. The parties met for mediation and expect to have further discussions on a non-binding basis. The outcome of this matter cannot be ascertained at this time.

On February 16, 2006, a former employee filed a lawsuit in Orange County, California, Superior Court, Case Number 06CC00030, on behalf of herself and allegedly other employees, for alleged failure to provide rest periods and meal periods and violation of California Business and Professions Code Section 17200. We have answered the complaint, denying the allegations and raising various additional defenses. Discovery in this case has begun. The parties met for mediation and have had further discussions on a non-binding basis. In May 2008, the parties have agreed to settle this matter subject to final approval from the court. The terms of this proposed settlement is not material to our consolidated financial position.

Other Matters

On June 12, 2008, we filed an arbitration claim against the broker-dealer for our auction rate securities investments with the Financial Industry Regulatory Authority (FINRA). The broker-dealer has not yet responded to our claim.

Item 1A. RISK FACTORS

A discussion of the significant risks associated with investments in our securities are set forth in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 1, 2008. There have been no material changes in the risks related to us from those disclosed in such Annual Report. These cautionary statements are to be used as a reference in connection with any forward-looking statements. The factors, risks and uncertainties identified in these cautionary statements are in addition to those contained in any other cautionary statements, written or oral, which may be made or otherwise addressed in connection with a forward-looking statement or contained in any of our subsequent filings with the SEC.

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

On June 4, 2008, we held our Annual Meeting of Shareholders. Shareholders voted upon the election of directors and the ratification of Ernst & Young LLP as the Company s independent registered public accounting firm for the fiscal year ending December 30, 2008.

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Paul A. Motenko, Jeremiah J. Hennessy, Gerald W. Deitchle, Peter A. Bassi, Larry D. Bouts, Shann M. Brassfield, James A. Dal Pozzo, J. Roger King and John F. Grundhofer all of whom were directors prior to the Annual Meeting and were nominated for re-election, were re-elected at the meeting. The following votes were cast for each of the nominees:

Name	For	Authority Withheld
Paul A. Motenko	19,137,862	309,252
Jeremiah J. Hennessy	19,137,662	309,452
Gerald W. Deitchle	19,237,123	209,991
Peter A. Bassi	19,327,339	119,775
Larry D. Bouts	19,327,294	119,820
Shann M. Brassfield	19,326,228	120,886
James A. Dal Pozzo	18,974,631	472,483
J. Roger King	19,326,028	121,086
John F. Grundhofer	19,323,128	123,986

There were no abstentions or broker non-votes with respect to the election of directors.

The shareholders also approved the ratification of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending January 1, 2008. The following votes were cast on the ratification: 19,421,863 For; 22,177 Against; 3,074 Abstain. There were no broker non-votes.

Item 6. EXHIBITS

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of the Company, as amended, incorporated by reference to Exhibit 3.1 to the Registration Statement on Form SB-2 filed with the Securities and Exchange Commission on June 28, 1996, as amended by the Company s Registration Statement on Form SB-2/A filed with the Commission on August 1, 1996 and the Company s Registration Statement on Form SB-2A filed with the Commission on August 22, 1996 (File No. 3335182-LA) (as amended, the Registration Statement).
3.2	Amended and Restated Bylaws of the Company, incorporated by reference to Exhibits 3.1 of the Form 8-K filed on June 4, 2007.
3.3	Certificate of Amendment of Articles of Incorporation incorporated by reference to Exhibit 3.3 of the 2004 Annual Report on Form 10-K.
4.1	Specimen Common Stock Certificate of the Company, incorporated by reference to Exhibit 4.1 of the Registration Statement.
10.1	Employment Agreement dated July 1, 2008 between the Company and Matt Hood, employed as Chief Marketing Officer.
31	Section 302 Certifications of Chief Executive Officer and Chief Financial Officer.
32	Section 906 Certification of Chief Executive Officer and Chief Financial Officer.

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SIGNATURES

In accordance with 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.

	BJ S RESTAURANTS, INC. (Registrant)
August 4, 2008	By: /s/ GERALD W. DEITCHLE Gerald W. Deitchle Chairman, Chief Executive Officer and President
	By: /s/ GREGORY S. LEVIN Gregory S. Levin Executive Vice President and Chief Financial Officer

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