

MORGANS FOODS INC
Form 10-Q
July 05, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 20, 2007

or

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

For the transition period from _____ to _____

Commission File Number 1-08395

Morgan s Foods, Inc.

(Exact name of registrant as specified in its charter)

Ohio

34-0562210

(State or other jurisdiction of incorporation or organization)

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

4829 Galaxy Parkway, Suite S, Cleveland, Ohio

44128

(Address of principal executive offices)

(Zip Code)

(216) 359-9000

(Registrant s telephone number, including area code)

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of July 5, 2007, the issuer had 2,880,995 shares of common stock outstanding.

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MORGAN S FOODS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Quarter Ended | |
|---|----------------------|---------------------|
| | May 20, 2007 | May 21, 2006 |
| Revenues | \$22,650,000 | \$21,101,000 |
| Cost of sales: | | |
| Food, paper and beverage | 6,939,000 | 6,640,000 |
| Labor and benefits | 6,051,000 | 5,495,000 |
| Restaurant operating expenses | 5,573,000 | 5,211,000 |
| Depreciation and amortization | 654,000 | 723,000 |
| General and administrative expenses | 1,380,000 | 1,135,000 |
| Gain on restaurant assets | (16,000) | (6,000) |
| Operating income | 2,069,000 | 1,903,000 |
| Interest expense: | | |
| Bank debt and notes payable | 847,000 | 919,000 |
| Capital leases | 29,000 | 27,000 |
| Other income and expense, net | (44,000) | (23,000) |
| Net income before income taxes | 1,237,000 | 980,000 |
| Provision for income taxes | 407,000 | 81,000 |
| Net income | \$ 830,000 | \$ 899,000 |
| Basic net income per common share | \$ 0.29 | \$ 0.33 |
| Diluted net income per common share | \$ 0.28 | \$ 0.32 |
| Basic weighted average number of shares outstanding | 2,880,995 | 2,718,495 |
| Diluted weighted average number of shares outstanding | 2,964,527 | 2,806,030 |

See notes to these consolidated financial statements.

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MORGAN S FOODS, INC.
CONSOLIDATED BALANCE SHEETS

| | May 20, 2007 (UNAUDITED) | February 25, 2007 (AUDITED) |
|--|---|--|
| ASSETS | | |
| Current assets: | | |
| Cash and equivalents | \$ 8,615,000 | \$ 7,829,000 |
| Receivables | 280,000 | 345,000 |
| Inventories | 741,000 | 684,000 |
| Prepaid expenses | 523,000 | 600,000 |
| | 10,159,000 | 9,458,000 |
| Property and equipment: | | |
| Land | 10,639,000 | 10,462,000 |
| Buildings and improvements | 20,821,000 | 20,200,000 |
| Property under capital leases | 1,433,000 | 1,433,000 |
| Leasehold improvements | 7,909,000 | 7,841,000 |
| Equipment, furniture and fixtures | 20,996,000 | 20,531,000 |
| Construction in progress | 451,000 | 1,107,000 |
| | 62,249,000 | 61,574,000 |
| Less accumulated depreciation and amortization | 31,666,000 | 31,104,000 |
| | 30,583,000 | 30,470,000 |
| Other assets | 800,000 | 824,000 |
| Franchise agreements | 1,487,000 | 1,519,000 |
| Deferred tax asset | 624,000 | 825,000 |
| Goodwill | 9,227,000 | 9,227,000 |
| | \$ 52,880,000 | \$ 52,323,000 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Long-term debt, current | \$ 2,901,000 | \$ 2,913,000 |
| Current maturities of capital lease obligations | 34,000 | 28,000 |
| Accounts payable | 4,759,000 | 4,291,000 |
| Accrued liabilities | 4,586,000 | 4,629,000 |
| | 12,280,000 | 11,861,000 |
| Long-term debt | 33,710,000 | 34,445,000 |
| Long-term capital lease obligations | 1,286,000 | 1,299,000 |
| Other long-term liabilities | 1,256,000 | 1,302,000 |
| Deferred tax liabilities | 1,679,000 | 1,577,000 |
| SHAREHOLDERS EQUITY | | |
| Preferred shares, 1,000,000 shares authorized, no shares outstanding | | |

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| | | |
|--|---------------|---------------|
| Common Stock, 25,000,000 shares authorized | | |
| Issued shares - 2,969,405 | 30,000 | 30,000 |
| Treasury shares - 88,410 | (131,000) | (131,000) |
| Capital in excess of stated value | 29,174,000 | 29,174,000 |
| Accumulated deficit | (26,404,000) | (27,234,000) |
| Total shareholders' equity | 2,669,000 | 1,839,000 |
| | \$ 52,880,000 | \$ 52,323,000 |

See notes to these consolidated financial statements.

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MORGAN S FOODS, INC.
 CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
 (UNAUDITED)

| | Common Shares | | Treasury Shares | | Capital in | Accumulated | Total |
|---------------------------------|----------------------|---------------|------------------------|---------------|---------------------|--------------------|---------------------|
| | Shares | Amount | Shares | Amount | excess of | Deficit | Shareholders |
| | | | | | stated value | | Equity |
| Balance February 25, 2007 | 2,969,405 | \$ 30,000 | 88,410 | \$(131,000) | \$29,174,000 | \$(27,234,000) | \$ 1,839,000 |
| Net income | | | | | | 830,000 | 830,000 |
| Balance May 20, 2007 | 2,969,405 | \$ 30,000 | 88,410 | \$(131,000) | \$29,174,000 | \$(26,404,000) | \$ 2,669,000 |

See notes to these consolidated financial statements

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MORGAN S FOODS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Twelve Weeks Ended | |
|--|---------------------------|---------------------|
| | May 20, 2007 | May 21, 2006 |
| OPERATING ACTIVITIES | | |
| Net income | \$ 830,000 | \$ 899,000 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation and amortization | 654,000 | 723,000 |
| Amortization of deferred financing costs | 24,000 | 26,000 |
| Amortization of supply agreement advances | (226,000) | (170,000) |
| Funding from supply agreements | 60,000 | 41,000 |
| Decrease in deferred tax assets | 201,000 | |
| Increase in tax liabilities | 102,000 | 66,000 |
| Gain on restaurant assets | (16,000) | (6,000) |
| Change in assets and liabilities: | | |
| Decrease in receivables | 65,000 | 4,000 |
| Increase in inventories | (57,000) | (74,000) |
| Decrease in prepaid expenses | 77,000 | 119,000 |
| Increase in accounts payable | 468,000 | 367,000 |
| Increase (Decrease) in accrued liabilities and other | 93,000 | (105,000) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 2,275,000 | 1,890,000 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | (735,000) | (362,000) |
| Purchase of franchise agreement | | (10,000) |
| NET CASH USED FOR INVESTING ACTIVITIES | (735,000) | (372,000) |
| FINANCING ACTIVITIES | | |
| Principal payments on long-term debt | (747,000) | (800,000) |
| Principal payments on capital lease obligations | (7,000) | (6,000) |
| NET CASH USED FOR FINANCING ACTIVITIES | (754,000) | (806,000) |
| NET CHANGE IN CASH AND EQUIVALENTS | 786,000 | 712,000 |
| Cash and equivalents, beginning balance | 7,829,000 | 6,415,000 |
| CASH AND EQUIVALENTS, ENDING BALANCE | \$8,615,000 | \$7,127,000 |

Interest paid was \$871,000 and \$946,000 in the first 12 weeks of fiscal 2008 and 2007 respectively
Cash payments for income taxes were \$123,000 and \$65,000 in the first 12 weeks of fiscal 2008 and 2007 respectively
See notes to these consolidated financial statements.

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MORGAN S FOODS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

The interim consolidated financial statements of Morgan s Foods, Inc. (the Company) have been prepared without audit. In the opinion of Company Management, all adjustments have been included. Unless otherwise disclosed, all adjustments consist only of normal recurring adjustments necessary for a fair statement of results of operations for the interim periods. These unaudited financial statements have been prepared using the same accounting principles that were used in preparation of the Company s annual report on Form 10-K for the year ended February 25, 2007. Certain prior period amounts have been reclassified to conform to current period presentations.

Effective February 26, 2007, we adopted FASB Interpretation 48 (FIN 48), Accounting for Uncertainty in Income Taxes An Interpretation of Statement of Financial Accounting Standards No. 109. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, we determined that the provisions of FIN 48 did not have a material effect on prior financial statements and therefore no change was made to the opening balance of retained earnings.

FIN 48 also requires that changes in judgment that result in subsequent recognition, derecognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs. This change will not impact the manner in which we record income taxes on an annual basis and did not significantly impact our recorded income tax provision in the quarter ended May 20, 2007.

It is the Company s policy to include any penalties and interest related to income taxes in its income tax provision, however, the Company currently has no penalties or interest related to income taxes. The earliest year that the Company is subject to examination is the fiscal year ended February 29, 2004.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 apply under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not believe that adoption of SFAS No. 157 will have a material impact on its financial position, results of operations or related disclosures.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal years beginning after November 15, 2007, the year beginning March 1, 2008 for the Company. We are currently reviewing the provisions of SFAS 159 to determine any impact for the Company.

NOTE 2 NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is based on the combined weighted average number of shares outstanding, which includes the assumed exercise, or conversion of options. In computing diluted net income per common share, the Company has utilized the treasury stock method.

NOTE 3 DEBT

The Company s debt arrangements require the maintenance of a consolidated fixed charge coverage ratio of 1.2 to 1 regarding all of the Company s mortgage loans and the maintenance of individual restaurant fixed charge coverage ratios of between 1.2 and 1.5 to 1 on certain of the Company s mortgage loans. Fixed charge coverage ratios are calculated by dividing the cash flow before rent and debt service for the previous 12 months by the debt service and rent due in the coming 12 months. The consolidated and individual coverage ratios are computed quarterly. At the end

of fiscal 2007 and as of the quarter ended May 20, 2007, the Company was in compliance with the consolidated fixed charge coverage ratio of 1.2. However, at the end of fiscal 2007 and as of the quarter ended May 20, 2007, the Company was not in compliance with the individual fixed charge coverage ratio on certain of its restaurant properties and has obtained waivers of these violations.

Table of Contents**NOTE 4 STOCK OPTIONS**

On April 2, 1999, the Board of Directors of the Company approved a Stock Option Plan for Executives and Managers. Under the plan 145,500 shares were reserved for the grant of options. The Stock Option Plan for Executives and Managers provides for grants to eligible participants of nonqualified stock options only. The exercise price for any option awarded under the Plan is required to be not less than 100% of the fair market value of the shares on the date that the option is granted. Options are granted by the Stock Option Committee of the Company. Options for the 145,500 shares were granted to executives and managers of the Company on April 2, 1999 at an exercise price of \$4.125. The plan provides that the options are exercisable after a waiting period of 6 months and that each option expires 10 years after its date of issue.

At the Company's annual meeting on June 25, 1999 the shareholders approved the Key Employees Stock Option Plan. This plan allows the granting of options covering 291,000 shares of stock and has essentially the same provisions as the Stock Option Plan for Executives and Managers which was discussed above. Options for 129,850 shares were granted to executives and managers of the Company on January 7, 2000 at an exercise price of \$3.00. Options for 11,500 shares were granted to executives on April 27, 2001 at an exercise price of \$.85. As of February 25, 2007 and May 20, 2007, options for a total of 150,000 shares were available for grant.

No options were granted during fiscal year 2007 and the twelve week period ended May 20, 2007. As of February 25, 2007 and May 20, 2007 there were 124,000 options outstanding, fully vested and exercisable at a weighted average exercise price of \$4.03 per share.

The following table summarizes information about stock options outstanding at May 20, 2007.

| Exercise Prices | Number Outstanding at May 20, 2007 | Average Remaining Life | Number Exercisable at May 20, 2007 |
|-----------------|------------------------------------|------------------------|------------------------------------|
| \$3.00 | 10,100 | 2.6 | 10,100 |
| \$4.13 | 113,900 | 1.9 | 113,900 |
| | 124,000 | 2.0 | 124,000 |

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

Description of Business. Morgan's Foods, Inc. (the Company) operates, through wholly-owned subsidiaries, KFC restaurants under franchises from KFC Corporation and Taco Bell restaurants under franchises from Taco Bell Corporation. As of July 5, 2007, the Company operates 71 KFC restaurants, 7 Taco Bell restaurants, 14 KFC/Taco Bell restaurants under franchises from KFC Corporation and franchises or licenses from Taco Bell Corporation, 3 Taco Bell/Pizza Hut Express restaurants operated under franchises from Taco Bell Corporation and licenses from Pizza Hut Corporation, 1 KFC/Pizza Hut Express restaurant operated under a franchise from KFC Corporation and a license from Pizza Hut Corporation and 1 KFC/A&W restaurant operated under a franchise from KFC Corporation and a license from A&W Restaurants, Inc. The Company's fiscal year is a 52-53 week year ending on the Sunday nearest the last day of February.

Summary of Expenses and Operating Income as a Percentage of Revenues

| | Quarter Ended | |
|-------------------------------------|----------------------|-----------------|
| | May 20, 2007 | May 21, 2006 |
| Cost of sales: | | |
| Food, paper and beverage | 30.6% | 31.5% |
| Labor and benefits | 26.7% | 26.0% |
| Restaurant operating expenses | 24.6% | 24.7% |
| Depreciation and amortization | 2.9% | 3.4% |
| General and administrative expenses | 6.1% | 5.4% |
| Operating income | 9.1% | 9.0% |

Revenues. Revenues for the quarter ended May 20, 2007 were \$22,650,000 compared to \$21,101,000 for the quarter ended May 21, 2006. This increase of \$1,549,000 was due mainly to an 8.4% increase in comparable restaurant revenues. The increase in comparable restaurant revenues was primarily the result of continuing effective product promotions by the franchisors during the current year quarter including the Variety Big Box at KFC and the Steak Grilled Taquito at Taco Bell.

Costs of Sales - Food, Paper and Beverages. Food, paper and beverage costs declined as a percentage of revenue to 30.6% for the quarter ended May 20, 2007 compared to 31.5% for the quarter ended May 21, 2006. The improvement in the current year quarter was primarily the result of improved operating efficiencies due to higher average restaurant volumes.

Cost of Sales - Labor and Benefits. Labor and benefits increased as a percentage of revenue for the quarter ended May 20, 2007 to 26.7% compared to 26.0% for the year earlier quarter. The increase was primarily due to increases in the minimum wage and slightly higher benefit costs.

Restaurant Operating Expenses. Restaurant operating expenses decreased slightly as a percentage of revenue to 24.6% in the first quarter of fiscal 2008 compared to 24.7% in the first quarter of fiscal 2007 primarily as a result of efficiencies generated from higher average restaurant volumes.

Depreciation and Amortization. Depreciation and amortization decreased to \$654,000 in the quarter ended May 20, 2007 compared to \$723,000 for the quarter ended May 21, 2006 primarily due to significant amounts of fixed assets reaching the end of their useful lives and no longer being depreciated.

General and Administrative Expenses. General and administrative expenses increased to \$1,380,000 in the first quarter of fiscal 2008 compared to \$1,135,000 in the first quarter of fiscal 2007. This increase was caused by a variety of factors including salary increases and personnel additions both at the corporate office and in field management, field operations bonuses and increases in insurance rates.

Gain on Restaurant Assets. The Company experienced a gain on restaurant assets of \$16,000 for the first quarter of fiscal 2008 compared to a gain of \$6,000 for the first quarter of fiscal 2007. These amounts were the result of deferred gains on a sale/leaseback location and reduction of the reserve for disposal of a sub-leased property.

Operating Income. Operating income in the first quarter of fiscal 2008 increased to \$2,069,000 or 9.1% of revenues compared to \$1,903,000 or 9.0% of revenues for the first quarter of fiscal 2007 primarily due to decreases in food,

paper and beverage costs and restaurant operating expenses, partially offset by increases in labor costs.
Interest Expense. Interest expense on bank debt decreased to \$847,000 in the first quarter of fiscal 2008 from \$919,000 in the first quarter of fiscal 2007 due to lower debt balances during the fiscal 2008 quarter.

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Other Income. Other income increased to \$44,000 for the first quarter of fiscal 2008 from \$23,000 for the first quarter of fiscal 2007. The increase was primarily due to revenue from various sub-leased properties and increased earnings on cash balances.

Provision for Income Taxes. The provision for income taxes increased to \$407,000 for the first quarter of fiscal 2008 compared to \$81,000 for the first quarter of fiscal 2007. The provision for income taxes is recorded at the Company's projected annual effective tax rate. The increase was primarily due to the Company having recognized during fiscal 2007 the benefits of its remaining net operating loss carryforwards therefore requiring a provision for taxes in the current year period which was offset by the use of net operating loss carryforwards in the prior year period. This change did not affect the Company's cash balances or cashflow for the period as the provision related to deferred taxes.

Liquidity and Capital Resources. Cash flow activity for the first twelve weeks of fiscal 2008 and fiscal 2007 is presented in the Consolidated Statements of Cash Flows. Cash provided by operating activities was \$2,275,000 for the twelve weeks ended May 20, 2007 compared to \$1,890,000 for the twelve weeks ended May 21, 2006. The increase in operating cash flow resulted primarily from a decrease in the deferred tax asset and increases in accounts payable and accrued liabilities primarily caused by more favorable vendor payment terms. The Company paid scheduled long-term bank and capitalized lease debt of \$754,000 in the first twelve weeks of fiscal 2008 compared to payments of \$806,000 for the same period in fiscal 2007. Capital expenditures in the twelve weeks ended May 20, 2007 were \$735,000, compared to \$362,000 for the same period in fiscal 2007.

The Company's debt arrangements require the maintenance of a consolidated fixed charge coverage ratio of 1.2 to 1 regarding all of the Company's mortgage loans and the maintenance of individual restaurant fixed charge coverage ratios of between 1.2 and 1.5 to 1 on certain of the Company's mortgage loans. Fixed charge coverage ratios are calculated by dividing the cash flow before rent and debt service for the previous 12 months by the debt service and rent due in the coming 12 months. The consolidated and individual coverage ratios are computed quarterly. At the end of fiscal 2007 and as of the quarter ended May 20, 2007, the Company was in compliance with the consolidated fixed charge coverage ratio of 1.2. However, at the end of fiscal 2007 and as of the quarter ended May 20, 2007, the Company was not in compliance with the individual fixed charge coverage ratio on certain of its restaurant properties and has obtained waivers of these violations.

New Accounting Pronouncements. Effective February 26, 2007, we adopted FASB Interpretation 48 (FIN 48), Accounting for Uncertainty in Income Taxes—An Interpretation of Statement of Financial Accounting Standards No. 109. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, we determined that the provisions of FIN 48 did not have a material effect on prior financial statements and therefore no change was made to the opening balance of retained earnings.

FIN 48 also requires that changes in judgment that result in subsequent recognition, derecognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs. This change will not impact the manner in which we record income taxes on an annual basis and did not significantly impact our recorded income tax provision in the quarter ended May 20, 2007.

It is the Company's policy to include any penalties and interest related to income taxes in its income tax provision, however, the Company currently has no penalties or interest related to income taxes. The earliest year that the Company is subject to examination is the fiscal year ended February 29, 2004.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 apply under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not believe that adoption of SFAS No. 157 will have a material impact on its financial position, results of operations or related disclosures.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal years beginning after November 15, 2007, the year beginning March 1, 2008 for the Company. We are currently reviewing the provisions of SFAS 159 to determine any impact for the Company.

Seasonality. The operations of the Company are affected by seasonal fluctuations. Historically, the Company's revenues and income have been highest during the summer months with the fourth fiscal quarter representing the slowest period. This seasonality is primarily attributable to weather conditions in the Company's marketplace, which consists of portions of Ohio, Pennsylvania, Missouri, Illinois, West Virginia and New York.

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Safe Harbor Statements. This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The statements include those identified by such words as may, will, expect, anticipate, believe, plan and other similar terminology. The forward-looking statements reflect the Company's current expectations and are based upon data available at the time of the statements. Actual results involve risks and uncertainties, including both those specific to the Company and general economic and industry factors. Factors specific to the Company include, but are not limited to, its debt covenant compliance, actions that lenders may take with respect to any debt covenant violations, its ability to obtain waivers of any debt covenant violations and its ability to pay all of its current and long-term obligations. Economic and industry risks and uncertainties include, but are not limited to, franchisor promotions, business and economic conditions, legislation and governmental regulation, competition, success of operating initiatives and advertising and promotional efforts, volatility of commodity costs and increases in minimum wage and other operating costs, availability and cost of land and construction, consumer preferences, spending patterns and demographic trends.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's existing borrowings are at fixed interest rates, and accordingly the Company does not have market risk exposure for fluctuations in interest rates. The Company does not enter into derivative financial investments for trading or speculation purposes. Also, the Company is subject to volatility in food costs as a result of market risk and we manage that risk through the use of longer term purchasing contracts. Our ability to recover increased costs through higher pricing is, at times, limited by the competitive environment in which we operate. The Company believes that its market risk exposure is not material to the Company's financial position, liquidity or results of operations.

Item 4. Controls and Procedures.

The effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities Exchange Act of 1934) was evaluated as of the date of the financial statements. This evaluation was carried out under the supervision of and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer. Based on that evaluation, management concluded that as of May 20, 2007 the Company maintained effective internal controls over financial reporting. Management has concluded that the consolidated financial statements included in this Form 10-Q fairly present in all material respects the Company's financial condition as of May 20, 2007 and February 25, 2007 and the results of operations and cash flows for the quarters ended May 20, 2007 and May 21, 2006.

PART II OTHER INFORMATION**Item 1. Legal Proceedings**

The Company is a party to various legal proceedings and claims arising in the ordinary course of its business. The Company believes that the outcome of these matters will not have a material adverse effect on its consolidated financial position, results of operations or liquidity.

Item 1A. Risk Factors

The Company's annual report on form 10-K for the fiscal year ended February 25, 2007 discusses the risk factors facing the Company. There has been no material change in the risk factors facing our business since February 25, 2007.

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MORGAN S FOODS, INC.
INDEX TO EXHIBITS

| Exhibit Number | Exhibit Description |
|-------------------|--|
| 31.1 | Certification of the Chairman of the Board and Chief Executive Officer pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Senior Vice President, Chief Financial Officer and Secretary pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chairman of the Board and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of the Senior Vice President, Chief Financial Officer and Secretary pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

/s/ Kenneth L. Hignett
Senior Vice President,
Chief Financial Officer and Secretary
July 5, 2007
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