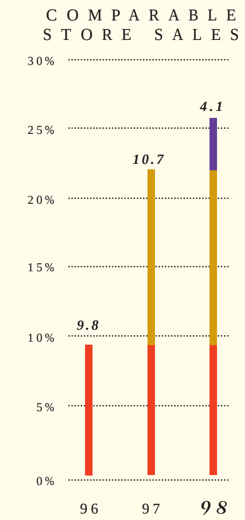
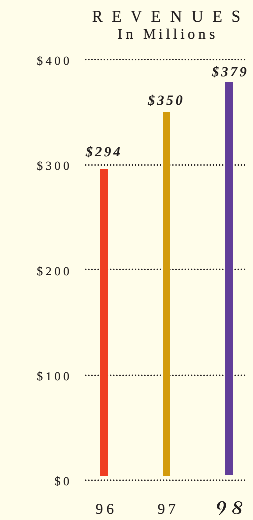
CEC ENTERTAINMENT, INC.

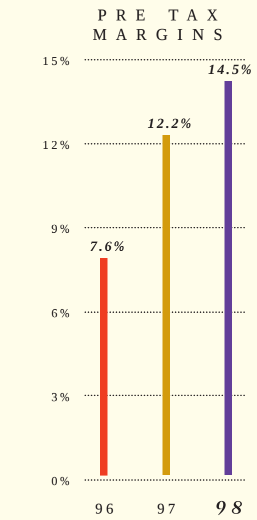
great YEAR great COMPANY

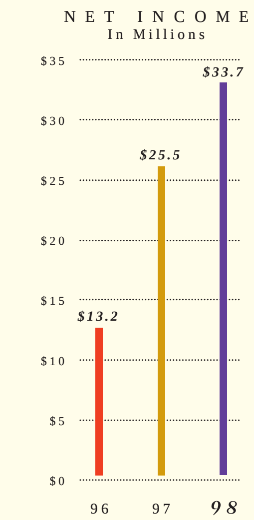
1998 Annual Report

Financial Highlights









(Dollars in thousands except per share amounts)	**1998**	1997	1996
OPERATING RESULTS:			
Revenues	**$ 379,427**	$ 350,267	$ 293,990
Income before income taxes	**55,032**	42,709	22,221
Net income	**33,730**	25,497	13,221
EARNINGS PER SHARE:			
Basic	**$ 1.85**	$ 1.37	$ 0.71
Diluted	**1.80**	1.34	0.70
OTHER INFORMATION:			
Total assets	**$ 252,228**	$ 226,368	$ 216,580
Long-term obligations (including current portion)	**31,911**	30,713	39,571
Shareholders' equity	**183,949**	155,938	141,476
INCREASE IN COMPARABLE STORE SALES:			
Company operated	**4.1%**	10.7%	9.8%
NUMBER OF RESTAURANTS AT YEAR END:			
Company operated	**271**	249	244
Franchise	**54**	63	70
Total	**325**	312	314

To Our Shareholders

1998 WAS A GREAT YEAR. WE RECORDED THE HIGHEST LEVELS OF REVENUES AND EARNINGS OF OUR HISTORY, AND SET NEW RECORDS FOR EARNINGS GROWTH IN EACH QUARTER OF 1998.

Comparable store sales grew for the third consecutive year and new store sales have significantly outperformed the average company store — reflecting the effectiveness of our repositioning initiatives and the durability of our concept.

For the year, revenues were $379.4 million, an 8.3 percent increase from $350.3 million in 1997. Net income improved to $33.7 million, a 32.2 percent gain from $25.5 million the previous year. Earnings per share grew 34.3 percent to $1.80, from $1.34 a year ago, even without the benefit of a high-volume 53rd week as happened in 1997. When results are adjusted to reflect the 52-week standard, 1998 revenues increased over 10 percent and earnings per share improved approximately 40 percent. We funded $66.7 million in capital expenditures entirely with cash from operations. We also purchased $10.6 million of our stock.

1998 also marked an important milestone — our tenth year as a public company. The anniversary gave us reason to reflect on our mission, our people and our performance. Our analysis validated the Company's leadership position and market relevance.

Since the company went public ten years ago, our earnings growth and stock price have appreciated on an annual compound basis of 42.8 percent and 32.3 percent, respectively. During this same time period, the Company has seen its market capitalization grow from $24 million to over one-half billion dollars. Our performance is a fitting tribute to those who believed in our concept, as well as our people's commitment and our capacity to make Chuck E. Cheese's the industry's gold standard. It also challenges us to improve upon our success.

In 1998 our company opened 14 new Chuck E. Cheese's restaurants and acquired 8 restaurants from franchisees. In 1999 we anticipate new unit openings and acquisitions to total 25 restaurants. The evolution of our concept is a work in progress that revitalizes our product and keeps us strong in an increasingly competitive marketplace. The success of our Phase II repositioning — which encompassed significant enhancements in games, rides, entertainment, prizes and merchandise, and brought guests in record numbers — demonstrates the importance of continual product improvement.

By year-end 1998 we had completed 224 Phase II remodels and plan to complete all remaining locations by year-end 1999. We continue to enlarge our highest-demand locations, with 20 expansions in 1998 and at least 15 more planned for 1999. A number of new product enhancements are being tested in the marketplace, including a laser play game and the addition of kids' karaoke to our Studio C concept. We continue to explore new opportunities within our marketplace, including product licensing. A number of food products were introduced in 1998, and a new line of Chuck E. Cheese's toy products will launch in 1999 — representing an exciting extension of our concept and a potentially significant revenue source over time.

We believe we are emerging as the great company that we always strived to be. We have a world-class concept with universal appeal and longevity. We have a proven record of performance that provides us with substantial financial resources and stability. And through our people — whom we regard as the best in the industry — we have the talent, commitment and vision to achieve even greater goals.

By all accounts, Chuck E. Cheese's is flourishing — and just in time to lead us into the next century. It's a journey about which we're excited and for which we have prepared well — and one that we look forward to sharing with you.

Sincerely,

Richard M. Frank

RICHARD M. FRANK (RIGHT)
Chairman and Chief Executive Officer

Michael H. Magusiak

MICHAEL H. MAGUSIAK (LEFT)
President

Great Concept

Great companies have great products. For CEC Entertainment, Inc. that product is a lovable, larger-than-life mouse named Chuck E. Cheese. Chuck E.'s venue is a network of 325 locations across the nation, and his guests are families with children.

The magic of Chuck E. Cheese's is the meticulous execution of a well designed entertainment and food package. To kids, Chuck E. Cheese's means playtime, prizes and pizza — an unbeatable trio for most youngsters. For parents, Chuck E. Cheese's is a rare combination of good times, good food and good value in a safe and caring environment. The end result is a highly regarded product brand with timeless appeal across demographic lines and generational boundaries.

Chuck E. Cheese's high visibility and viability translate into consistently high rankings as one of kids' most beloved characters. In 1998, Chuck E. ranked in the top five favorite brands among children aged six to eight. Chuck E.'s enduring popularity is also reflected in continued strong revenues and comparable store sales, which have increased 44 percent and 23 percent, respectively, since 1995. Our tremendous success has spawned a number of "me-too" entrants in the category, but our momentum, market presence and longevity (Chuck E. Cheese turned 21 in 1998) are hard to match.

Perhaps the best indication of the strength of our concept in the marketplace is to simply count our guests. Last year, Chuck E. Cheese's hosted 75 million visits from kids and their parents. And it's hard to disagree with happy customers — especially when they number more than 1,400,000 each week.

At the heart of the Company's success is a product concept that has both substance and staying power. Each week, more than 1.4 million kids and their parents visit Chuck E. Cheese's — as have generations of families since 1977 — for playtime, pizza and prizes.

Great Performance

Great companies produce great results. Yet the most successful organizations understand that performance is meaningful only when measured over time. CEC Entertainment's performance over the last decade provides positive proof of the vitality and direction of our business. It also positions us well to capitalize on exciting market opportunities that lie ahead.

In the ten-year period since our initial public offering, we have steadily improved in terms of growth, investment and return. Since 1988, annual revenues increased 151 percent. Operating income has increased from $444,000 to $55 million. Average weekly store sales rose 31 percent. In the last three years alone, we have invested more than $200 million in the Company, funded almost entirely by internally generated cash flow — including $167 million primarily for Phase I and II remodels, $25 million in stock repurchases, and $8 million in debt reduction.

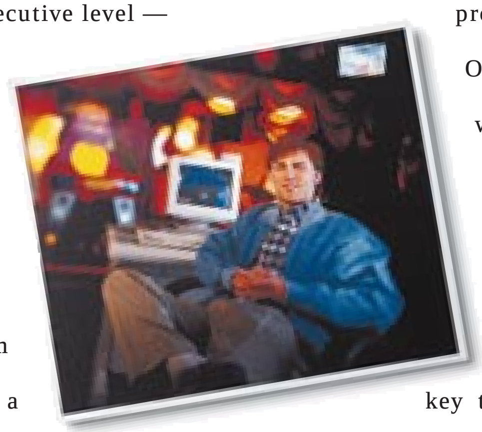
Our performance has not gone unnoticed. The compound annual appreciation in our stock price — perhaps the most objective measure of performance because it reflects the opinion of "outsiders" regarding shareholder value — increased 32 percent on an annual average in the ten years since our first listing. At the end of 1998, the Company's market capitalization exceeded the half-billion-dollar mark.

Today, on the merits of an outstanding concept and sustained positive financial performance, our business is at its strongest in the Company's history. Our financial position provides us a significant competitive advantage. With equal measures of financial stability and market confidence, we possess the ability and the agility to take our leadership position to new and higher levels. It's an opportunity for which we've long prepared.

Our ten-year earnings per share growth of 43 percent is proof of our commitment to creating long-term shareholder value. This commitment was further enhanced on July 9, 1998, when our stock began trading on the New York Stock Exchange under the symbol CEC.

Great People, Great Plans

Great people make great things happen. At CEC Entertainment, great things happen every day — because our people value excellence and know first-hand what it takes to be the best. As one of the longest-tenured management teams in the industry — with an average 9.5 years at the district level, 10.5 years at the regional level and 15 years at the executive level — the vast majority of our managers played a role in Chuck E. Cheese's rise to industry leader.



This considerable experience and collective wisdom provide the Company with a continuity and conviction that is both uncommon and refreshing. It also reflects the quality of the Company's values and culture, as well as the passion with which we pursue our mission: to be the premier growth company in the family entertainment and restaurant industry.

Evolving our concept is the cornerstone of our growth, particularly for core locations. Opening new locations in growth markets and expanding existing high-demand locations are equally vital. Dominant market presence and brand equity also afford us a prime opportunity to create new revenue streams through selective product licensing. A new line of toys and a video will be on retailers' shelves in 1999, complementing the food products we introduced in 1998. On-line merchandising via our website "www.chuckecheese.com" is yet another potential avenue for growth.

Outstanding performance is both our legacy and the key to our future, and we remain committed to excellence and improvement in all aspects of our business. Doing so not only creates value for guests and enhances value for shareholders, but also engenders enormous pride and extraordinary achievement among our people. Ultimately, it's the positive impact that Chuck E. Cheese's makes in the lives of real people that makes CEC Entertainment a truly great company.

Our people's experience and enthusiasm mark the Company for great days ahead. We expect continued strong growth through strategic initiatives that capitalize on our market position and brand equity, including new locations, expansions of existing high-demand locations and selective product licensing.

Company Mission

We dedicate ourselves, within the next five years, to become the premier growth company in the entertainment and restaurant industry by operating multiple concepts with each being the Number 1 brand in its segment.

Our Core Values

We believe in the inherent worth of the individual.

Our greatest asset is our people.

We demand of ourselves, and others we deal with, the highest level of integrity.

Teamwork is essential. Working together doesn't only bring out the best in all of us, it brings out the best in each of us.

Life is short. Have fun playing on a great team.

Our Culture

We recognize that first, and foremost, we are an operating company totally committed in achieving our operating mission: *Every guest leaves happy!*

We pride ourselves and dedicate our efforts to always have the best product in the marketplace, operated and supported by the best people in the industry.

We are focused with an uncompromising approach to excellent achievement of our goals and objectives.

Our management style is to provide crystal clear direction, support our people, foster autonomy, and promote two-way accountability.

Our primary measure of performance is sales; while recognizing our obligation to produce an excellent return on capital and maximize shareholder value.

Our concepts will be characterized by quality entertainment and food service, fun activities, while giving exceptional value and satisfaction to our guests.

August 1998

CEC Entertainment, Inc.

1998 Annual Report

Financial Review

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Selected Financial Data

(Thousands, except per share and store data)	**1998**	1997	1996	1995	1994
OPERATING RESULTS:(1)					
Revenues	**$379,427**	$350,267	$293,990	$263,783	$268,515
Costs and expenses	**324,395**	307,558	271,769	263,408	265,402
Income before income taxes	**55,032**	42,709	22,221	375	3,113
Income taxes:					
Current expense	**9,160**	3,417	2,855	701	869
Deferred expense (benefit)	**12,142**	13,795	6,145	(389)	1,568
	21,302	17,212	9,000	312	2,437
Net income	**$ 33,730**	$ 25,497	$ 13,221	$ 63	$ 676
PER SHARE:(2)					
Basic:					
Net income (loss)	**$ 1.85**	$ 1.37	$ .71	$ (.02)	$ .02
Weighted average shares outstanding	**18,062**	18,402	18,206	18,098	18,115
Diluted:					
Net income (loss)	**$ 1.80**	$ 1.34	$ .70	$ (.02)	$ .02
Weighted average shares outstanding	**18,540**	18,817	18,477	18,098	18,191
CASH FLOW DATA:					
Cash provided by operations	**$ 68,614**	$ 69,478	$ 48,362	$ 27,810	$ 30,819
Cash used in investing activities	**(65,622)**	(43,805)	(51,868)	(30,548)	(22,576)
Cash provided by (used in) financing activities	**(7,057)**	(21,800)	1,319	5,946	(10,373)
BALANCE SHEET DATA:					
Total assets	**$252,228**	$226,368	$216,580	$199,010	$188,308
Long-term obligations (including current portion and redeemable preferred stock)	**31,911**	30,713	39,571	39,244	33,223
Shareholders' equity	**183,949**	155,938	141,476	126,487	125,515
NUMBER OF RESTAURANTS AT YEAR END:					
Company operated	**271**	249	244	226	226
Franchise	**54**	63	70	93	106
	325	312	314	319	332

(1) Fiscal year 1997 was 53 weeks in length while all other fiscal years presented were 52 weeks in length.
(2) No cash dividends on common stock were paid in any of the years presented.

Quarterly Results of Operations

		Revenues	Income Before Income Taxes	Net Income	Earnings per Share Basic	Earnings per Share Diluted	ommon Share Prices High	ommon Share Prices Low
1998	1st Quarter	**$ 105,049**	**$ 19,215**	**$ 11,683**	**$ 0.64**	**$ 0.63**	**33 15/16**	**19⅞**
	2nd Quarter	**88,901**	**11,813**	**7,341**	**0.40**	**0.39**	**40 5/16**	**32⅞**
	3rd Quarter	**98,106**	**14,264**	**8,673**	**0.48**	**0.47**	**39 15/16**	**17⅞**
	4th Quarter	**87,371**	**9,740**	**6,033**	**0.33**	**0.33**	**30**	**19¼**
		$ 379,427	**$ 55,032**	**$ 33,730**	**$ 1.85**	**$ 1.80**		
1997	1st Quarter	$ 91,594	$ 13,333	$ 7,933	$ 0.43	$ 0.42	25	16½
	2nd Quarter	84,031	9,924	5,905	0.32	0.31	27⅜	17¼
	3rd Quarter	85,602	10,141	6,101	0.32	0.32	26¾	20½
	4th Quarter	89,040	9,311	5,558	0.30	0.30	24 15/16	17⅜
		$ 350,267	$ 42,709	$ 25,497	$ 1.37	$ 1.34		

Management's Discussion and Analysis

Results of Operations

A summary of the results of operations of the Company as a percentage of revenues for the last three fiscal years is shown below.

	1998	1997	1996
Revenues	**100.0%**	100.0%	100.0%
Costs and expenses:			
Cost of sales	**45.9%**	46.8%	48.7%
Selling, general and administrative	**14.9%**	15.1%	14.8%
Depreciation and amortization	**7.3%**	7.3%	8.5%
Interest expense	**.7%**	.8%	1.2%
Other operating expenses	**16.7%**	17.8%	19.2%
	85.5%	87.8%	92.4%
Income before income taxes	**14.5%**	12.2%	7.6%

1998 Compared to 1997 Revenues increased 8.3% to $379.4 million in 1998 from $350.3 million in 1997 primarily due to an increase of 4.1% in sales of the Company's Chuck E. Cheese's restaurants which were open during all of 1998 and 1997 ("comparable store sales"). In addition, the Company opened 14 new restaurants and purchased eight restaurants from franchisees and three restaurants from joint venture partners in 1998. Fiscal years 1998 and 1997 consisted of 52 and 53 weeks, respectively.

Income before income taxes increased to $55.0 million in 1998 from $42.7 million in 1997. A material portion of operating costs are fixed resulting in an improvement of operating margins at higher sales levels. Net income increased to $33.7 million in 1998 from $25.5 million in 1997. The Company's diluted earnings per share increased to $1.80 per share in 1998 compared to $1.34 per share in 1997.

Revenues Revenues increased to $379.4 million in 1998 from $350.3 million in 1997. Comparable store sales of Chuck E. Cheese's restaurants increased by 4.1% in 1998. In addition, the Company opened 14 new restaurants and acquired eight restaurants from franchisees and three restaurants from joint venture partners in 1998. Average annual revenues per restaurant increased to approximately $1,452,000 in 1998 from approximately $1,437,000 in 1997. Fiscal years 1998 and 1997 consisted of 52 and 53 weeks, respectively. Management believes that several factors contributed to the comparable store sales increase with the primary factor being sales increases at Phase II upgraded restaurants. Menu prices increased 1.8% between the two years.

Revenues from franchise fees and royalties were $3.3 million in 1998, an increase of 2.4% from 1997, primarily due to an increase in comparable franchise store sales of 0.7% in 1998 and higher sales volumes in new franchise restaurants. During 1998, three new franchise restaurants opened, four franchise restaurants closed and eight franchise restaurants were purchased by the Company.

Costs and Expenses Costs and expenses as a percentage of revenues decreased to 85.5% in 1998 from 87.8% in 1997.

Cost of sales as a percentage of revenues decreased to 45.9% in 1998 from 46.8% in 1997. Cost of food, beverage, prize and merchandise items as a percentage of restaurant sales decreased to 16.0% in 1998 from 16.5% in 1997 primarily due to an increase in game sales, reduced costs of certain food and beverage products and an increase in menu prices, partially offset by higher cheese costs. Restaurant labor expenses as a percentage of restaurant sales declined to 26.9% in 1998 from 27.5% in 1997 primarily due to an increase in comparable store sales and more effective utilization of hourly employees.

Selling, general and administrative expenses as a percentage of revenues decreased to 14.9% in 1998 from 15.1% in 1997 primarily due to a reduction in corporate overhead costs and advertising expense as a percentage of revenues, partially offset by an increase in preopening costs.

Depreciation and amortization expense as a percentage of revenues remained constant at 7.3% in both 1998 and 1997.

Other operating expenses decreased as a percentage of revenues to 16.7% in 1998 from 17.8% in 1997 primarily due to a decrease in insurance costs, including a reduction in prior year reserves, and a decrease in rent expense as a percentage of revenues.

Net Income The Company had net income of $33.7 million in 1998 compared to $25.5 million in 1997 due to the changes in revenues and expenses discussed above. The Company's diluted earnings per share increased to $1.80 per share in 1998 compared to $1.34 per share in 1997.

1997 Compared to 1996 Revenues increased 19.1% to $350.3 million in 1997 from $294.0 million in 1996 primarily due to an increase of 10.7% in comparable store sales. In addition, the Company purchased 19 restaurants from its largest franchisee in September 1996. Fiscal years 1997 and 1996 consisted of 53 and 52 weeks, respectively.

Income before income taxes increased to $42.7 million in 1997 from $22.2 million in 1996. A material portion of operating costs are fixed resulting in an improvement of operating margins at higher sales levels. Net income increased to $25.5 million in 1997 from $13.2 million in 1996. The Company's diluted earnings per share increased to $1.34 per share in 1997 compared to $.70 per share in 1996.

Revenues Revenues increased to $350.3 million in 1997 from $294.0 million in 1996. Comparable store sales of Chuck E. Cheese's restaurants increased by 10.7% in 1997. In addition, the Company purchased 19 restaurants from its largest franchisee in September 1996. Average annual sales per restaurant increased to approximately $1,437,000 in 1997 from approximately $1,286,000 in 1996. Fiscal years 1997 and 1996 consisted of 53 and 52 weeks, respectively. Management believes that several factors contributed to the comparable store sales increase with the primary factor being sales increases at repositioned restaurants. Menu prices increased 2.4% between the two years.

Revenues from franchise fees and royalties were $3.2 million in 1997, a decrease of 12.2% from 1996, primarily due to the Company's purchase of 19 franchise restaurants in September 1996. Comparable franchise store sales increased 9.1% in 1997. During 1997, one new franchise restaurant opened, six franchise restaurants closed and two franchise restaurants were purchased by the Company.

Costs and Expenses Costs and expenses as a percentage of revenues decreased to 87.8% in 1997 from 92.4% in 1996.

Cost of sales as a percentage of revenues decreased to 46.8% in 1997 from 48.7% in 1996. Cost of food, beverage, prize and merchandise items as a percentage of restaurant sales decreased to 16.5% in 1997 from 17.4% in 1996 primarily due to a 2.4% increase in menu prices and lower cheese costs in 1997. Restaurant labor expenses as a percentage of restaurant sales declined to 27.5% in 1997 from 28.7% in 1996 primarily due to labor efficiencies achieved at higher sales volumes.

Selling, general and administrative expenses as a percentage of revenues increased to 15.1% in 1997 from 14.8% in 1996 primarily due to start-up costs related to the outsourcing and evaluation of a toll-free birthday reservation system, management development expenses and stock offering costs incurred in 1997 for a secondary offering by the Company's largest shareholder.

Depreciation and amortization expense as a percentage of revenues decreased to 7.3% in 1997 from 8.5% in 1996 primarily due to the increase in comparable store sales, a change effected in the first quarter of 1997 in the estimated useful lives of certain fixed assets and the acquisition of restaurants in 1996 with lower depreciation expense than existing restaurants. Depreciation expense was reduced approximately $2.2 million in 1997 due to the change in the estimated useful lives of certain fixed assets based on a review of historical asset utilization.

Interest expense decreased to $2.9 million in 1997 from $3.5 million in 1996 primarily due to a decrease in the Company's outstanding debt between the two periods.

Other operating expenses decreased as a percentage of revenues to 17.8% in 1997 from 19.2% in 1996 primarily due to the increase in comparable store sales and the fact that a significant portion of operating costs such as rent, property taxes and insurance are fixed.

Net Income The Company had net income of $25.5 million in 1997 compared to $13.2 million in 1996 due to the changes in revenues and expenses discussed above. The Company's diluted earnings per share increased to $1.34 per share in 1997 compared to $.70 per share in 1996.

Inflation

The Company's costs of operations, including but not limited to labor, supplies, utilities, financing and rental costs, are significantly affected by inflationary factors. The Company pays most of its part-time employees rates that are related to federal and state mandated minimum wage requirements. Management anticipates that any increases in federally mandated minimum wage would result in higher costs to the Company, which the Company expects would be partially offset by menu price increases and increased efficiencies in operations.

Financial Condition, Liquidity and Capital Resources

Cash provided by operations decreased slightly to $68.6 million in 1998 from $69.5 million in 1997 primarily due to changes in working capital. Cash outflow from investing activities for 1998 was $65.6 million. Cash outflow from financing activities in 1998 was $7.1 million primarily related to the purchase of treasury stock. The Company's primary requirements for cash relate to planned capital expenditures, the repurchase of the Company's common stock and debt service. The Company expects that it will satisfy such requirements from cash provided by operations and, if necessary, funds available under its line of credit.

In 1999, the Company plans to add approximately 25 stores including new stores and acquisitions of existing stores from franchisees. The Company currently anticipates its cost of opening new stores to average approximately $1.5 million per store which will vary depending upon many factors including the size of the store and whether the store is an in-line or free-standing building. In addition to such new store openings, the Company plans to continue its strategy of expanding the customer area of stores. The Company also plans to complete Phase II upgrades in 25 stores in the first and second quarter of 1999 at an average cost of $150,000 to $160,000 per store. A Phase II upgrade generally includes a new game package, enhanced prize

and merchandise offerings and improved product presentation and service. During 1998, the Company opened 14 new restaurants, acquired eight restaurants from franchisees and three restaurants from joint venture partners, expanded the customer area of 20 restaurants and completed Phase II upgrades in 117 restaurants. The Company currently estimates that capital expenditures in 1999, including expenditures for remodeling existing stores, new store openings, existing store expansions and equipment investments, will be approximately $65 million. The Company plans to finance these expenditures through cash flow from operations and, if necessary, borrowings under the Company's line of credit.

In 1997, the Company announced that it planned to purchase shares of the Company's common stock at an aggregate purchase price of up to $20 million. In July 1998, the Company completed this plan and announced an additional plan to purchase shares of the Company's common stock at an aggregate purchase price of up to $15 million. As of January 3, 1999 the Company has purchased shares of its common stock under the $15 million plan at an aggregate purchase price of approximately $5.8 million.

In 1998, the Company's line of credit agreement was amended to provide borrowings of up to $30 million and extend the maturity date to June 2000. The Company's total credit facility of $53 million at January 3, 1999 consists of $23 million in term notes and the $30 million line of credit. Term notes totaling $18 million with annual principal payments of $6 million beginning in June 1999 and annual interest of 10.02% mature in 2001. Term notes totaling $5 million with quarterly principal payments of $833,000 and annual interest equal to LIBOR plus 3.5% mature in 2000. Interest under the $30 million line of credit is dependent on earnings and debt levels of the Company and ranges from prime minus 0.5% to plus 0.5% or, at the Company's option, LIBOR plus 1% to 2.5%. Currently, any borrowings under this line of credit would be at the prime rate minus 0.5% or LIBOR plus 1%. As of March 12, 1999, there were no borrowings under this line of credit. The Company is required to comply with certain financial ratio tests during the terms of the loan agreements.

In 1998, the Company purchased computer software and hardware which is Year 2000 compliant. The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. Current systems may be unable to accurately process certain date-based information. The cost of the new software and hardware has been recorded as an asset and is being amortized over its estimated useful life. Other maintenance or modification costs will be expensed as incurred. Accordingly, the Company does not expect the amounts required to be expensed over the next year to have a material effect on its financial position or results of operations or cash flows. The Company expects its Year 2000 date conversion project to be completed in 1999. The Company has initiated formal communication with significant vendors and suppliers to determine their efforts to remediate Year 2000 issues.

Certain statements in this report may constitute “forward-looking statements” which are subject to known and unknown risks and uncertainties including, among other things, certain economic conditions, competition, development factors and operating costs that may cause the actual results to differ materially from results implied by such forward-looking statements.

Consolidated Balance Sheets

(Thousands, except share data)	January 3, 1999	January 2, 1998
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 3,210**	$ 7,275
Accounts receivable, including receivables from related parties of $240 in 1997	**4,299**	2,996
Current portion of notes receivable, including receivables from related parties of $199 in 1997	**52**	259
Inventories	**5,842**	3,975
Prepaid expenses	**3,643**	3,550
Current portion of deferred tax asset	**720**	7,237
Total current assets	**17,766**	25,292
Investments in related parties		668
Property and equipment, net	**228,531**	187,433
Deferred tax asset	**1,036**	5,988
Notes receivable, less current portion, including receivables from related parties of $361 and $2,516, respectively	**363**	2,579
Other assets	**4,532**	4,408
	$252,228	$226,368
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	**$ 9,383**	$ 3,376
Accounts payable and accrued liabilities	**32,453**	35,665
Total current liabilities	**41,836**	39,041
Long-term debt, less current portion	**18,922**	23,826
Deferred rent	**3,915**	4,052
Other liabilities	**1,300**	1,300
Commitments and contingencies		
Redeemable preferred stock, $60 par value, redeemable for $2,974 in 2005	**2,306**	2,211
Shareholders' equity:		
Common stock, $.10 par value; authorized 100,000,000 shares; 22,265,303 and 21,912,277 shares issued, respectively	**2,227**	2,191
Capital in excess of par value	**163,105**	158,696
Retained earnings	**76,157**	42,768
Deferred compensation	**(1,520)**	(2,280)
Accumulated other comprehensive income	**6**	
Less treasury shares of 4,234,676 and 3,827,676, respectively, at cost	**(56,026)**	(45,437)
	183,949	155,938
	$252,228	$226,368

See notes to consolidated financial statements.

Consolidated Statements of Earnings and Comprehensive Income

Years Ended January 3, 1999, January 2, 1998 and December 27, 1996

(Thousands, except per share data)	1998	1997	1996
Food and beverage revenues	**$248,948**	$235,898	$202,624
Games and merchandise revenues	**126,612**	109,518	86,444
Franchise fees and royalties	**3,304**	3,227	3,675
Interest income, including related party income of $65, $244 and $246, respectively	**543**	1,095	1,051
Joint venture income	**20**	529	196
	379,427	350,267	293,990
Costs and expenses:			
Cost of sales	**173,890**	163,713	143,381
Selling, general and administrative expenses, including related party expenses of $31 and $125 in 1997 and 1996, respectively	**56,690**	53,037	43,534
Depreciation and amortization	**27,620**	25,524	25,057
Interest expense	**2,694**	2,866	3,476
Other operating expenses	**63,501**	62,418	56,321
	324,395	307,558	271,769
Income before income taxes	**55,032**	42,709	22,221
Income taxes:			
Current expense	**9,160**	3,417	2,855
Deferred expense	**12,142**	13,795	6,145
	21,302	17,212	9,000
Net income	**33,730**	25,497	13,221
Other comprehensive income, net of tax:			
Foreign currency translation	**6**		
Comprehensive income	**$ 33,736**	$ 25,497	$ 13,221
Earnings per share:			
Basic:			
Net income	**$ 1.85**	$ 1.37	$ .71
Weighted average shares outstanding	**18,062**	18,402	18,206
Diluted:			
Net income	**$ 1.80**	$ 1.34	$ .70
Weighted average shares outstanding	**18,540**	18,817	18,477

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years Ended January 3, 1999, January 2, 1998 and December 27, 1996 *(Thousands, except per share data)*	Amounts 1998	Amounts 1997	Amounts 1996	Shares 1998	Shares 1997	Shares 1996
Common stock and capital in excess of par value:						
Balance, beginning of year	**$160,887**	$155,947	$155,659	**21,912**	21,519	21,435
Stock options exercised	**2,573**	2,592	937	**349**	262	77
Tax benefit (expense) from exercise of stock options and stock grants	**1,775**	(14)	(655)			
Stock issued under 401(k) plan	**97**	59	52	**4**	3	8
Stock grant plan		2,293			128	
Stock split costs		10	(30)			
Cancellation of fractional shares			(16)			(1)
Balance, end of year	**165,332**	160,887	155,947	**22,265**	21,912	21,519
Retained earnings:						
Balance, beginning of year	**42,768**	17,613	4,733			
Net income	**33,730**	25,497	13,221			
Redeemable preferred stock accretion	**(103)**	(104)	(103)			
Redeemable preferred stock dividend, $4.80 per share	**(238)**	(238)	(238)			
Balance, end of year	**76,157**	42,768	17,613			
Deferred compensation:						
Balance, beginning of year	**(2,280)**	(1,821)	(3,642)			
Amortization of deferred compensation	**760**	1,821	1,821			
Stock grant plan		(2,280)				
Balance, end of year	**(1,520)**	(2,280)	(1,821)			
Accumulated other comprehensive income:						
Foreign currency translation	**6**					
Balance, end of year	**6**					
Treasury shares:						
Balance, beginning of year	**(45,437)**	(30,263)	(30,263)	**3,828**	3,109	3,109
Treasury stock acquired	**(10,589)**	(15,174)		**407**	719	
Balance, end of year	**(56,026)**	(45,437)	(30,263)	**4,235**	3,828	3,109
Total shareholders' equity	**$183,949**	$155,938	$141,476			

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended January 3, 1999, January 2, 1998 and December 27, 1996 *(Thousands)*	1998	1997	1996
Operating activities:			
Net income	**$ 33,730**	$ 25,497	$ 13,221
Adjustments to reconcile net income to cash provided by operations:			
Depreciation and amortization	**27,620**	25,524	25,057
Deferred income tax expense	**12,142**	13,795	6,145
Compensation expense under stock grant plan	**760**	1,821	1,821
Other	**(44)**	153	615
Net change in receivables, inventories, prepaids, payables and accrued liabilities	**(5,594)**	2,688	1,503
Cash provided by operations	**68,614**	69,478	48,362
Investing activities:			
Purchases of property and equipment	**(66,704)**	(48,451)	(51,719)
Payments received on notes receivable	**2,503**	7,376	3,534
Additions to notes receivable	**(690)**	(2,500)	(3,568)
Change in investments and other assets	**(731)**	(230)	(115)
Cash used in investing activities	**(65,622)**	(43,805)	(51,868)
Financing activities:			
Proceeds from debt and line of credit	**4,479**		7,600
Payments on debt and line of credit	**(3,376)**	(9,142)	(6,995)
Redeemable preferred stock dividends	**(238)**	(238)	(238)
Acquisition of treasury stock	**(10,589)**	(15,174)	
Exercise of stock options	**2,573**	2,592	937
Other	**94**	162	15
Cash provided by (used in) financing activities	**(7,057)**	(21,800)	1,319
Increase (decrease) in cash and cash equivalents	**(4,065)**	3,873	(2,187)
Cash and cash equivalents, beginning of year	**7,275**	3,402	5,589
Cash and cash equivalents, end of year	**$ 3,210**	$ 7,275	$ 3,402

See notes to consolidated financial statements.

1. Summary of significant accounting policies:

Operations: CEC Entertainment, Inc. (the "Company") operates and franchises family restaurant/entertainment centers as Chuck E. Cheese's restaurants.

Fiscal year: The Company's fiscal year is 52 or 53 weeks and ends on the Sunday nearest December 31. References to 1998, 1997 and 1996 are for the fiscal years ended January 3, 1999, January 2, 1998 and December 27, 1996, respectively. Fiscal years 1998 and 1996 were each 52 weeks in length, while fiscal year 1997 was 53 weeks in length.

Basis of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Foreign currency translation: The consolidated financial statements are presented in U.S. dollars. The assets and liabilities of the Company's Canadian subsidiary are translated to U.S. dollars at year-end exchange rates, while revenues and expenses are translated at average exchange rates during the year. Adjustments that result from translating amounts are reported as a component of other comprehensive income.

Cash and cash equivalents: Cash and cash equivalents of the Company are composed of demand deposits with banks and short-term cash investments with remaining maturities of three months or less from the date of purchase by the Company.

Inventories: Inventories of food, paper products and supplies are stated at the lower of cost or market on a first-in, first-out basis.

Property and equipment, depreciation and amortization: Property and equipment are stated at cost. Depreciation and amortization are provided by charges to operations over the estimated useful lives of the assets, or the lease term if less, by the straight-line method. All preopening costs are expensed as incurred.

Deferred charges and related amortization: Deferred charges are amortized over various periods of up to 16 years. All amortization is provided by the straight-line method, which approximates the interest method.

Franchise fees and royalties: The Company recognizes initial franchise fees upon fulfillment of all significant obligations to the franchisee. Royalties from franchisees are accrued as earned.

Impairment of intangibles and long-lived assets: Impairment losses are recognized if the future cash flows expected to be generated by the operations applicable to the intangibles and long-lived assets are less than the carrying value of the assets. The impairment loss is equal to the amount by which the carrying value of the assets exceeds the fair value of the assets.

Use of estimates and assumptions: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting for stock-based compensation: As permitted by Statement of Financial Accounting Standards No. 123 ("SFAS 123") "Accounting for Stock-Based Compensation," the Company applies the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees" and has disclosed the proforma effects of SFAS 123 (Note 17).

Recent accounting pronouncements: The Company has adopted Statement of Financial Accounting Standards No. 130 ("SFAS 130") "Reporting Comprehensive Income" which became effective for years beginning after December 15, 1997. Comprehensive income includes changes in equity from transactions and events from nonowner sources.

Statement of Financial Accounting Standards No. 131 ("SFAS 131") "Disclosures about Segments of an Enterprise and Related Information" became effective for years beginning after December 15, 1997. The Company is not engaged in multiple business or geographic segments requiring separate disclosure under SFAS 131.

2. Accounts receivable:

(Thousands)	**1998**	1997
Trade	**$1,358**	$1,112
Other	**2,954**	1,908
	4,312	3,020
Less allowance for doubtful collection	**(13)**	(24)
	$4,299	$2,996

3. Notes receivable:

The Company's notes receivable at January 3, 1999 and January 2, 1998 arose principally as a result of lines of credit established with the International Association of CEC Entertainment, Inc., a related party (Note 16), and advances to franchisees, joint ventures and managed properties. All obligors under the notes receivable are principally engaged in the restaurant industry. The notes have various terms, but most are payable in monthly installments of principal and interest through 2001, with interest rates ranging from 7.5% to 12.0%. The notes are generally collateralized by the related property and equipment. Balances of notes receivable are net of an allowance for doubtful collection of $84,000 at both January 3, 1999 and January 2, 1998.

4. Property and equipment:

	Estimated Lives (In years)	1998 (Thousands)	1997
Land		**$ 8,285**	$ 7,515
Leasehold improvements	4 - 20	**164,380**	150,565
Buildings	4 - 25	**10,788**	10,348
Furniture, fixtures and equipment	2 - 15	**172,028**	140,612
Property leased under capital leases (Note 6)	10 - 15	**449**	1,271
		355,930	310,311
Less accumulated depreciation and amortization		**(132,432)**	(124,640)
		223,498	185,671
Construction in progress		**5,033**	1,762
		$ 228,531	$ 187,433

5. Accounts payable and accrued liabilities:

(Thousands)	1998	1997
Accounts payable	**$ 13,810**	$ 13,162
Salaries and wages	**7,030**	6,591
Insurance	**4,167**	8,532
Taxes, other than income	**4,370**	4,096
Other	**3,076**	3,284
	$ 32,453	$ 35,665

6. Leases:

The Company leases certain restaurants and related property and equipment under operating and capital leases. All leases require the Company to pay property taxes, insurance and maintenance of the leased assets. The leases generally have initial terms of 7 to 30 years with various renewal options.

Following is a summary of property leased under capital leases:

(Thousands)	1998	1997
Buildings and improvements	**$ 449**	$ 1,271
Less accumulated depreciation	**(239)**	(1,031)
	$ 210	$ 240

Scheduled annual maturities of the obligations for capital and operating leases as of January 3, 1999, are as follows:

Years	Capital (Thousands)	Operating
1999	$ 184	$ 34,241
2000	187	33,091
2001	214	30,078
2002	214	22,447
2003	214	13,613
2004-2009 (aggregate payments)	409	30,947
Minimum future lease payments	1,422	$164,417
Less amounts representing interest	(595)	
Present value of future minimum lease payments	827	
Less current portion	(50)	
	$ 777	

Certain of the Company's real estate leases, both capital and operating, require payment of contingent rent in the event defined revenues exceed specified levels.

The Company's rent expense is comprised of the following:

(Thousands)	1998	1997	1996
Minimum	**$34,276**	$32,694	$30,484
Contingent	**365**	276	195
	$34,641	$32,970	$30,679

7. Long-term debt:

(Thousands)	1998	1997
Term loans, 10.02%, due June 2001	**$18,000**	$18,000
Term loans, LIBOR plus 3.5%, due June 2000	**5,000**	8,332
Revolving bank loan, prime minus 0.5% to plus 0.5% or LIBOR plus 1% to 2.5%, due June 2000	**4,478**	
Obligations under capital leases (Note 6)	**827**	870
	28,305	27,202
Less current portion	**(9,383)**	(3,376)
	$18,922	$23,826

In 1998, the Company's line of credit agreement was amended to provide the Company with available borrowings of up to $30 million expiring in June 2000. As of January 3, 1999, the Company's credit facility totals $53 million, which consists of $23 million in term notes and the $30 million line of credit. Interest on the term notes is payable quarterly. Interest under the line of credit is payable quarterly and dependent on earnings and debt levels of the Company. Currently, any borrowings under this line of credit would be at prime (7.25% at January 3, 1999) minus 0.5% or, at the Company's option, LIBOR (5.066% at January 3, 1999) plus 1%. At January 3, 1999, there was $4.5 million outstanding under the line of credit. A 3/8% commitment fee is payable on any unused credit line. The Company is required to comply with certain financial ratio tests during the terms of the loan agreements. The weighted average interest rate on long-term debt was 9.62% and 9.73% in 1998 and 1997, respectively.

As of January 3, 1999, scheduled annual maturities of all long-term debt (exclusive of obligations under capital leases) are as follows:

Years	Amount (Thousands)
1999	$ 9,333
2000	12,145
2001	6,000
	$27,478

8. Litigation:

From time to time the Company is involved in litigation, most of which is incidental to its business. In the Company's opinion, no litigation to which the Company currently is a party is likely to have a material adverse effect on the Company's results of operations, financial condition or cash flows.

9. Redeemable preferred stock:

As of January 3, 1999 and January 2, 1998, the Company had 49,441 and 49,570 shares, respectively, of its redeemable preferred stock authorized and outstanding. The stock pays dividends at $4.80 per year, subject to a minimum cash flow test. As of January 3, 1999, one quarterly dividend, totaling $59,329 or $1.20 per share, was accrued but not yet paid. The redeemable preferred stock has been recorded at the net present value of the redemption price and is being accreted on the straight-line basis. The Company's restated articles of incorporation provide for the redemption of such shares at $60 per share in 2005. During the continuation of any event of default by the Company, the preferred shareholders will be able to elect a majority of the directors of the Company.

10. Earnings per common share:

Earnings per common share ("EPS") are computed in accordance with SFAS 128. Under SFAS 128, basic and diluted EPS replaces primary and fully diluted EPS. Basic EPS is calculated by dividing earnings applicable to common shares by the weighted average number of common shares outstanding. Diluted EPS adjusts for the effect of potential common shares. Net income available per common share has been adjusted for the items indicated.

Earnings per common and potential common shares were computed as follows:

(Thousands, except per share data)	1998	1997	1996
Net income	**$33,730**	$25,497	$13,221
Accretion of redeemable preferred stock	**(103)**	(104)	(103)
Redeemable preferred stock dividends	**(238)**	(238)	(238)
Net income applicable to common shares	**$33,389**	$25,155	$12,880
Basic:			
Weighted average common shares outstanding	**18,062**	18,402	18,206
Earnings per common share	**$ 1.85**	$ 1.37	$ .71
Diluted:			
Weighted average common shares outstanding	**18,062**	18,402	18,206
Potential common shares for stock options and stock grants	**478**	415	271
Weighted average shares outstanding	**18,540**	18,817	18,477
Earnings per common and potential common shares	**$ 1.80**	$ 1.34	$ .70

11. Franchise fees and royalties:

At January 3, 1999, 54 Chuck E. Cheese's restaurants were operated by a total of 37 different franchisees. The standard franchise agreements grant to the franchisee the right to develop and operate a restaurant and use the associated trade names, trademarks and service marks within the standards and guidelines established by the Company.

Initial franchise fees included in revenues were $373,000, $172,000 and $274,000 in 1998, 1997 and 1996, respectively.

12. Cost of sales:

(Thousands)	1998	1997	1996
Food, beverage and related supplies	**$ 52,958**	$ 50,355	$ 45,681
Games and merchandise	**19,625**	18,339	14,816
Labor	**101,307**	95,019	82,884
	$173,890	$163,713	$143,381

13. Income taxes:

The significant components of income tax expense are as follows:

(Thousands)	1998	1997	1996
Current expense	**$ 9,160**	$ 3,417	$2,855
Deferred expense:			
Utilization of operating loss carryforwards		16,693	8,664
Utilization of tax credit carryforwards	**6,595**		(475)
Other	**5,547**	(2,898)	(2,044)
	$21,302	$17,212	$9,000

Deferred income taxes and benefits are provided for differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Temporary differences and the resulting deferred tax assets and liabilities at January 3, 1999 and January 2, 1998 are as follows:

(Thousands)	1998	1997
Deferred Tax Asset:		
Current:		
Deferred tax assets:		
Tax credit carryforwards		$ 6,595
Accrued vacation	**$ 404**	358
Unearned gift certificates	**115**	72
Other	**201**	212
Net current deferred tax asset	**720**	7,237
Non-Current:		
Deferred tax assets:		
Deferred gain		3,605
Deferred rent	**1,365**	1,411
Asset impairments	**412**	412
Unearned franchise fees	**165**	219
Other	**250**	705
	2,192	6,352
Deferred tax liabilities:		
Depreciation	**(1,156)**	(364)
Net non-current deferred tax asset	**1,036**	5,988
Net deferred tax asset	**$ 1,756**	$13,225

A reconciliation of the statutory rate to taxes provided is as follows:

(Thousands)	1998	1997	1996
Statutory rate	**35.0%**	35.0%	35.0%
State income taxes	**6.2%**	8.1%	9.0%
Tax credits earned			(2.1%)
Other	**(2.5%)**	(2.8%)	(1.4%)
Income taxes provided	**38.7%**	40.3%	40.5%

14. Fair value of financial instruments:

The Company has certain financial instruments consisting primarily of cash equivalents, notes receivable, notes payable and redeemable preferred stock. The carrying amount of cash equivalents approximates fair value because of the short maturity of those instruments. The carrying amount of the Company's notes receivable and long-term debt approximates fair value based on the interest rates charged on instruments with similar terms and risks. The estimated fair value of the Company's redeemable preferred stock is $3.0 million.

15. Supplemental cash flow information:

(Thousands)	1998	1997	1996
Cash paid during the year for:			
Interest	**$2,681**	$2,961	$3,429
Income taxes	**9,924**	2,753	2,222
Supplemental schedule of noncash investing and financing activities:			
Notes and accounts receivable canceled in connection with the acquisition of property and equipment	**834**		
Investment canceled in connection with the acquisition of property and equipment	**668**		

16. Related party transactions:

The Hallwood Group, Incorporated ("Hallwood") was the beneficial owner of approximately 2.6 million shares or 14.2% of the outstanding common stock of the Company prior to a secondary public offering in March 1997 in which Hallwood and certain of its affiliates sold all shares held. The directors of Hallwood had served as a majority of the directors of the Company, but resigned after the public offering. The Company did not receive any proceeds from the sale of shares by the selling stockholders. However, the Company paid $305,000 in expenses for the offering.

The Company made payments to Hallwood of $31,000 in 1997 and $125,000 in 1996 for consulting services. The consulting agreement terminated upon the closing of the public offering. In consideration for rent reductions resulting from Hallwood's negotiation of the Company's home office lease agreement in December 1990, the Company had assigned to Hallwood its sublease interest in the home office building with a fair value of approximately $120,000 per year.

The Company had advanced amounts to a joint venture in which the Company had a 50% interest or less. At January 2, 1998 approximately $610,000 was outstanding under this note. Principal and interest were payable in monthly installments, with interest at prime. The Company also had miscellaneous accounts receivable from the joint venture of approximately $229,000 at January 2, 1998. In January 1998, the Company acquired the interest of its joint venture partner for cash plus forgiveness of all receivables.

The Company has granted three separate operating lines of credit to the International Association of CEC Entertainment, Inc. (the "Association"). In December 1998, the lines were renewed to provide the Association with available borrowings of $1.7 million at 10.5% interest and are due December 31, 1999. The Association develops entertainment attractions and produces system wide advertising. Five officers of the Association are also officers of the Company. At January 3, 1999 and January 2, 1998, approximately $361,000 and $2,105,000, respectively, was outstanding under these lines of credit. The Company also had miscellaneous accounts receivable from the Association of $11,000 at January 2, 1998.

17. Employee benefit plans:

The Company has employee benefit plans that include: a) executive bonus compensation plans based on the performance of the Company; b) non-statutory stock option plans for its employees and non-employee directors; c) a stock grant plan and d) a retirement and savings plan.

The Company's common stock which could be issued under its initial employee stock option plan was 2,772,038 shares. Any shares granted under this plan had to be granted before December 31, 1998. In 1997, the Company adopted a new employee stock option plan under which an additional 925,000 shares may be granted before July 31, 2007. The exercise price for options granted under both plans may not be less than the fair market value of the Company's common stock at date of grant. Options may not be exercised until the employee has been continuously employed at least one year after the date of grant. Options which expire or terminate may be re-granted under the plan.

In 1995, the Company adopted a stock option plan for its non-employee directors. The number of shares of the Company's common stock that may be issued under this plan cannot exceed 150,000 shares and the exercise price for options granted may not be less than the fair market value of the Company's common stock at the date of grant.

At January 3, 1999, there were 562,623 shares available for grant. Stock option transactions are summarized as follows for all plans:

	Number of Shares			Weighted Average Exercise Price Per Share		
	1998	1997	1996	**1998**	1997	1996
Options outstanding, beginning of year	**1,586,298**	1,010,511	848,942	**$13.70**	$8.58	$ 9.08
Granted	**344,612**	944,715	276,734	**21.91**	17.87	8.39
Exercised	**(348,836)**	(261,445)	(77,495)	**7.37**	9.92	12.10
Terminated	**(47,758)**	(107,483)	(37,670)	**20.11**	11.36	11.01
Options outstanding, end of year	**1,534,316**	1,586,298	1,010,511	**16.79**	13.70	8.58

All stock options are granted at no less than fair market value of the common stock at the grant date. The estimated fair value of options granted was $7.54, $6.12 and $3.08 per share in 1998, 1997 and 1996, respectively. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 1998: risk free interest rate of 4.6%, 5.9% and 6.5% in 1998, 1997 and 1996, respectively; no dividend yield; expected lives of four years; and expected volatility of 30% in 1998 and 40% in 1997 and 1996. Stock options expire five and seven years from the grant date. Stock options vest over various periods ranging from one to four years. The number of stock option shares exercisable at January 3, 1999 was 504,564. These stock options have exercise prices ranging from $5.29 to $20.50 per share and have a weighted average exercise price of $12.84 per share. In January 1999, the Company granted 493,926 additional options at an exercise price of $26.25 per share.

The number of shares of the Company's common stock which may have been awarded to senior executives of the Company under the Stock Grant Plan was 1,718,637 shares. No further shares may be awarded under this plan after December 1998. In 1997, 128,500 shares were awarded in connection with an employment agreement effective January 1998. No grants were awarded in 1998 or 1996. Compensation expense recognized by the Company pursuant to this plan was $760,000 in 1998 and $1,821,000 per year in 1997 and 1996. All shares vest over periods ranging from three years to six years and are subject to forfeiture upon termination of the participant's employment by the Company. The shares are nontransferable during the vesting periods.

As a result of shares awarded to the Company's Chairman of the Board and Chief Executive Officer, the Company recognized deferred compensation of $12.0 million in 1993 and $2.3 million in 1997. The deferred compensation is amortized over the compensated periods of service.

The Company applies the provisions of APB Opinion 25 and related Interpretations in accounting for its employee benefit plans. Accordingly, no compensation cost has been recognized for its stock option plans. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards under those plans consistent with the method prescribed by SFAS 123, the Company's proforma net income would have been $31.6 million, $23.1 million and $12.8 million in 1998, 1997 and 1996, respectively. Proforma earnings per share assuming dilution would have been $1.71, $1.23 and $.67 per share in 1998, 1997 and 1996, respectively.

Notes to Consolidated Financial Statements
(continued)

The Company has adopted the CEC 401(k) Retirement and Savings Plan, to which it may, at its discretion, make an annual contribution out of its current or accumulated earnings. Contributions by the Company may be made in the form of its common stock or in cash. The Company made contributions of approximately $97,000 and $59,000 in common stock for the 1997 and 1996 plan years, respectively. The Company plans to contribute $138,000 in common stock for the 1998 plan year.

Independent Auditors' Report

Board of Directors and Shareholders
CEC Entertainment, Inc.
Irving, Texas

We have audited the accompanying consolidated balance sheets of CEC Entertainment, Inc. (formerly ShowBiz Pizza Time, Inc.) and subsidiaries as of January 3, 1999 and January 2, 1998, and the related consolidated statements of earnings and comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended January 3, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of CEC Entertainment, Inc. and subsidiaries as of January 3, 1999 and January 2, 1998, and the results of their operations and their cash flows for each of the three years in the period ended January 3, 1999, in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP
Dallas, Texas
March 8, 1999

Corporate Information

Board of Directors

INSIDE BOARD MEMBERS

Richard M. Frank
Chairman of the Board and Chief Executive Officer

Richard T. Huston
Executive Vice President

Michael H. Magusiak
President

OUTSIDE BOARD MEMBERS

Tim T. Morris
Partner, River Associates, LLC

Louis P. Neeb
Neeb Enterprises, Inc.

Cynthia I. Pharr
C. Pharr and Company

Walter Tyree
Chief Operating Officer, Boston Chicken Texas

Raymond E. Wooldridge
Vice Chairman, Southwest Securities

Officers

Richard M. Frank
Chairman of the Board and Chief Executive Officer

Michael H. Magusiak
President

Gene Cramm
Executive Vice President – Construction and Entertainment

Mark A. Flores
Executive Vice President and Director of Operations

Richard T. Huston
Executive Vice President – Marketing

Larry G. Page
Executive Vice President – Chief Financial Officer and Treasurer

Woodrow Berry
Senior Vice President – Southwest Region

John R. Cardinale
Senior Vice President – Purchasing & Real Estate

Dan Jouppi
Senior Vice President – Eastern Region

Bernard J. Yanelli
Senior Vice President – Franchise Operations

Marshall R. Fisco, Jr.
Vice President – Legal and Corporate Secretary

Randy Forsythe
Vice President – Southeast Region

James Mabry
Vice President – Controller

Ahmet Oner
Vice President – Management Information Systems

Jon Rice
Vice President – Marketing

Odom Sherman, Jr.
Vice President – Taxes and Assistant Treasurer

Jeff S. Smith
Vice President – Western Region

Gary Spring
Vice President – Midwest Region

Alice Winters
Assistant Treasurer and Assistant Secretary

EXECUTIVE OFFICES

4441 West Airport Freeway
P.O. Box 152077
Irving, Texas 75015
972/258-8507

ANNUAL SHAREHOLDER MEETING

June 24, 1999
9:00 AM
Harvey Hotel
4545 West John Carpenter Freeway
Irving, Texas

STOCK TRANSFER AGENT AND REGISTRAR

Boston EquiServe
46 Harvard Street
Westwood, Massachusetts 02909-2398

STOCK LISTING

The Company's common stock is traded on the New York Stock Exchange under the symbol "CEC."

INDEPENDENT AUDITORS

Deloitte & Touche LLP
2200 Ross Avenue
Suite 1600
Dallas, Texas 75201

10-K AVAILABILITY

The Company will furnish to any shareholder, without charge, a copy of the Company's annual report filed with the Securities and Exchange commission on Form 10-K for the 1998 fiscal year (including the financial statements and schedules thereto) upon written request from the shareholder addressed to:

Secretary
CEC Entertainment, Inc.
4441 West Airport Freeway
P.O. Box 152077
Irving, Texas 75015

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SQUIRES & COMPANY, DALLAS, TEXAS

CEC ENTERTAINMENT INC.
1998 ANNUAL REPORT

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