

PIZZA FACTORY, INC.
(A California S Corporation)
Oakhurst, California

FINANCIAL STATEMENTS

and

INDEPENDENT AUDITOR'S REPORT

For the year ended December 31, 2005

PIZZA FACTORY, INC.
FINANCIAL STATEMENTS
For the year ended December 31, 2005

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INDEPENDENT AUDITOR'S REPORT

January 25, 2006

To the Board of Directors and Stockholders
Pizza Factory, Inc.
Oakhurst, California.

We have audited the accompanying balance sheet of Pizza Factory, Inc. (an S Corporation) as of December 31, 2005, and the related statements of income, retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit provides reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pizza Factory, Inc. as of December 31, 2005, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Dunn, Jeffries, Hering & Wong LLP

Dunn, Jeffries, Hering & Wong, LLP
Certified Public Accountants

PIZZA FACTORY, INC.

Balance Sheet
December 31, 2005

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
<u>ASSETS</u>			
CURRENT ASSETS			
Cash	\$ 752,850	\$ 166,654	\$ 919,504
Accounts receivable	78,356	23,106	101,462
Current portion of notes receivable	134,128		134,128
Payroll taxes receivable	<u>12</u>		<u>12</u>
TOTAL CURRENT ASSETS	<u>965,346</u>	<u>189,760</u>	<u>1,155,106</u>
Notes receivable, less current portion	78,504	848	79,352
Property and equipment, net	<u>134,983</u>		<u>134,983</u>
	<u>213,487</u>	<u>848</u>	<u>214,335</u>
TOTAL ASSETS	<u>\$ 1,178,833</u>	<u>\$ 190,608</u>	<u>\$ 1,369,441</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>			
CURRENT LIABILITIES			
Accounts payable	28,956	22,498	51,454
Accounts payable – officer	32,858		32,858
Current maturities of long term debt	131,604		131,604
Unearned revenue		168,110	168,110
Sales tax payable	1,418		1,418
State taxes payable	<u>4,943</u>		<u>4,943</u>
TOTAL CURRENT LIABILITIES	<u>199,779</u>	<u>190,608</u>	<u>390,387</u>
LONG TERM DEBT, less current maturities	<u>32,134</u>		<u>32,134</u>
TOTAL LIABILITIES	<u>231,913</u>	<u>190,608</u>	<u>422,521</u>
STOCKHOLDERS' EQUITY			
Common stock, no par value, 1,000 shares authorized, 200 shares issued and outstanding	1,600		1,600
Retained Earnings	<u>945,320</u>		<u>945,320</u>
TOTAL STOCKHOLDERS' EQUITY	<u>946,920</u>		<u>946,920</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 1,178,833</u>	<u>\$ 190,608</u>	<u>\$ 1,369,441</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Income
For the year ended December 31, 2005

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Eliminations</u>	<u>Total</u>
INCOME:				
Franchise and royalties fees	\$ 2,230,780	\$	\$	\$ 2,230,780
Advertising assessment		859,817		859,817
Exclusivity contract income	145,053			145,053
Administrative fees	56,010		(56,010)	0
Market feasibility fees	27,500			27,500
Training fees	<u>55,000</u>			<u>55,000</u>
TOTAL INCOME	<u>2,514,343</u>	<u>859,817</u>	<u>(56,010)</u>	<u>3,318,150</u>
EXPENSES:				
Salaries – Officers	196,800			196,800
Salaries – Office	368,627			368,627
Payroll taxes	47,410			47,410
Administrative fees		56,010	(56,010)	0
Advertising and promotion	27,036	798,328		825,364
Bad debt	17,136	163		17,299
Bank Charges		18		18
Contributions	350			350
Depreciation	47,119			47,119
Dues and subscriptions	904			904
Insurance	69,335			69,335
Lease expense	6,976			6,976
Legal and accounting	86,520			86,520
Licenses and fees	10,249			10,249
Meals and entertainment	1,802			1,802
Meetings	17,396			17,396
Miscellaneous	19,598	1,312		20,910
Office expense	30,523			30,523
Outside service	159,876			159,876
Postage and shipping	19,257			19,257
Rent	42,000			42,000
Repairs and maintenance	31,488			31,488
Staff training	919			919
Storage	2,572	5,067		7,639
Supplies	5,175	149		5,324
Telephone	45,852			45,852
Travel and accommodation	71,182			71,182
Utilities	<u>5,468</u>			<u>5,468</u>
TOTAL EXPENSES	<u>1,331,570</u>	<u>861,047</u>	<u>(56,010)</u>	<u>2,136,607</u>
OTHER INCOME (EXPENSE):				
Gain on sale of assets	25,000			25,000
Other income	19,108	150		19,258
Interest income	17,271	1,080		18,351
Interest expense	<u>(10,740)</u>			<u>(10,740)</u>
INCOME BEFORE TAX	1,233,412			1,233,412
INCOME TAX PROVISION	<u>18,416</u>			<u>18,416</u>
NET INCOME	<u>\$ 1,214,996</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,214,996</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Retained Earnings
December 31, 2005

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Retained Earnings Prior to S status</u>	<u>Total</u>
RETAINED EARNINGS, BEGINNING OF YEAR	\$ 762,838	\$	\$ 74,861	\$ 837,699
NET INCOME	1,214,996			1,214,996
Distributions	<u>(1,107,375)</u>	_____	_____	<u>(1,107,375)</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ 870,459</u>	<u>\$</u>	<u>\$ 74,861</u>	<u>\$ 945,320</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Cash Flows
For the year ended December 31, 2005

	Franchise Operations	Advertising Trust	Total
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 1,214,996	\$ 0	\$ 1,214,996
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	47,119		47,119
(Increase) decrease in:			
Accounts receivable	(15,149)	(1,057)	(16,206)
Increase (decrease) in:			
Accounts payable	8,228	22,498	30,726
Accrued payroll and payroll taxes	(15)		(15)
Accrued income taxes	3,527		3,527
Sales tax payable	1,418		1,418
Unearned revenue		(155,934)	(155,934)
	<u>1,260,124</u>	<u>(134,493)</u>	<u>1,125,631</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES			
CASH FLOWS FROM INVESTING ACTIVITIES:			
Collections on notes receivable	37,139		37,139
Additions to notes receivable	(29,000)		(29,000)
Purchase of furniture and equipment	(81,722)		(81,722)
	<u>(73,583)</u>		<u>(73,583)</u>
NET CASH USED IN INVESTING ACTIVITIES			
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on line of credit	(9,583)		(9,583)
Proceeds from long term debt	42,426		42,426
Repayments of long term debt	(26,344)		(26,344)
Distributions	(1,107,375)		(1,107,375)
	<u>(1,100,876)</u>		<u>(1,100,876)</u>
NET CASH USED IN FINANCING ACTIVITIES			
INCREASE (DECREASE) IN CASH:	85,665	(134,493)	(48,828)
CASH AT BEGINNING OF YEAR	<u>667,185</u>	<u>301,147</u>	<u>968,332</u>
CASH AT END OF YEAR	<u>752,850</u>	<u>166,654</u>	<u>919,504</u>
Interest paid	<u>\$ 10,740</u>		<u>\$ 10,740</u>
Income taxes paid	<u>\$ 13,473</u>		<u>\$ 13,473</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

1 - DESCRIPTION OF ORGANIZATION

Pizza Factory, Inc. (hereinafter "the Company") is a California S corporation incorporated June 3, 1982 for the purpose of franchising pizza and pasta restaurants. There are Pizza Factory restaurants in multiple cities across ten states in the US, and internationally, in China.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's financial statements have been prepared on the accrual basis of accounting. The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

Revenue Recognition

In accordance with Statement of Financial Standards No. 45, "Accounting for Franchise Fee Revenue," the Company recognizes initial fees as income when substantially all significant services to be provided by the Company have been performed. Continuing service fee or royalties are recognized as income when earned.

In addition, each franchisee is assessed fees that are primarily used to cover advertising expenses on behalf of franchisees. These funds are accounted for separately, and have been designated as "Advertising Trust" activity on these financial statements. Assessments collected in excess of expenses incurred are classified as unearned revenue.

Bad debt expense is recorded using the reserve method, and is based on management's periodic assessment of the age of accounts, recent payment history, and other factors. Management believes no reserve is necessary at this time.

Property and Equipment and Depreciation

Property and equipment are stated at cost, with depreciation computed using the straight-line method over a five to seven year life. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Tax Status

The Company, with the consent of its shareholders, has elected, under the Internal Revenue Code, to be treated as an S Corporation. In lieu of federal income taxes, the shareholders of an S Corporation are taxed on their proportionate share of the Company's taxable income. Therefore, no provision for federal income taxes has been included in these financial statements. California law generally conforms to federal law except for a 1½% tax imposed on S-Corporation's earnings. The Company is subject to taxes in other states. Deferred income taxes have not been recognized in these financial statements, as the amount of deferred taxes is not considered material.

3 - NOTES RECEIVABLE

Notes receivable consists of:

6% secured promissory note with a franchisee, \$600 payable monthly, due January 15, 2007	\$ 7,039
6% promissory note with a franchisee, \$200 payable monthly, due March 2008	4,456
Non-interest bearing, secured promissory note with a franchisee, payable monthly, due on demand	7,805
Non-interest bearing, secured promissory note with a franchisee, to be repaid in three months, due March 31, 2006	4,000
8% secured promissory note with a franchisee, \$293 payable monthly, due June 15, 2009	30,397
10% secured promissory note with a franchisee, \$689 payable monthly, due May 1, 2006	3,352
5% secured promissory note with a franchisee, \$495 payable monthly, due December, 2006	<u>81,453</u>
Sub-total	138,502

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

3 - NOTES RECEIVABLE (cont.)

Balance carried forward:	\$ 138,502
6% secured promissory note with a franchisee, \$100 payable monthly, due August 15, 2007	3,759
Non-interest bearing, secured promissory note with a franchisee, \$200 payable monthly, due November 2007	7,000
6% secured promissory note with a franchisee, \$271 payable monthly, due December 15, 2006	11,312
6% secured promissory note with a franchisee, \$200 payable monthly, due September 15, 2007	23,915
6% secured promissory note with a franchisee, \$222 payable monthly, due November 2006	2,575
8% secured promissory note with a franchisee, \$125 payable monthly, due May 15, 2007	3,150
7% secured promissory note with a franchisee, \$200 payable monthly, due July 20, 2008	19,406
Promissory notes with franchisees, payable monthly, due on demand	<u>3,013</u>
	212,632
Less: current portion of notes receivable	<u>(134,128)</u>
Notes receivable, less current portion	<u>\$ 78,504</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

4 - PROPERTY AND EQUIPMENT

A summary of property and equipment is as follows. (Please refer to Note 2 regarding capitalization and depreciation).

	<u>Asset Lives</u>	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
Leasehold improvements		\$ 6,234	\$	\$ 6,234
Machinery and equipment	5-7 yrs	120,567	18,470	139,037
Furniture and fixtures	7 yrs	14,369		14,369
Vehicles	5 yrs	<u>265,075</u>		<u>265,075</u>
		406,245	<u>18,470</u>	424,715
Less: accumulated depreciation		<u>(271,263)</u>	<u>(18,470)</u>	<u>(289,733)</u>
		<u>\$ 134,982</u>	<u>\$ 0</u>	<u>\$ 134,982</u>

Depreciation charged to income was \$47,119 for the year ended December 31, 2005.

5 - INITIAL FRANCHISE FEES

Initial franchise, feasibility, and training fees recognized for the year ended December 31, 2005 total \$404,500.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

6 - LONG-TERM DEBT

Long-Term debt consists of the following:

6.25% \$300,000 line of credit with Yosemite Bank, expiring June 5, 2006	\$ 112,576
6.055% note payable to American Honda Finance, payable \$683 a month; due November 27, 2008	21,854
6% note payable to Yosemite Bank, payable \$351 a month; due October 15, 2009	14,394
6.75% note payable to Yosemite Bank, Payable \$394 a month; due February 15, 2008	9,514
3.59% note payable to Chase Manhattan, payable \$369 a month; due March 28, 2007	<u>5,400</u> 163,738
Less: current maturities	<u>(131,604)</u>
Long -term debt, less current maturities	<u>\$ 32,134</u>

Maturities of long term debt as of December 31, by year and in the aggregate, for debt obligations with initial or remaining terms in excess of one year are as follows:

2006	\$131,604
2007	16,772
2008	11,948
2009	<u>3,414</u>
	<u>\$163,738</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2005

7 - LEASES

The Company leases certain vehicles and equipment under non-cancelable operating leases that expire in 2006.

Future minimum lease payments as of December 31, 2005, by year and in the aggregate, under non-cancelable operating leases with initial or remaining terms in excess of one year are as follows:

2006	<u>\$ 3,799</u>
	<u>\$ 3,799</u>

Related rental expense for the operating leases for the twelve months ended December 31, 2005 was \$6,976.

8 - RELATED PARTY TRANSACTIONS

The Company leases its corporate office from its shareholders on a month to month basis. The Lessor is responsible for such executory costs as insurance, repairs and maintenance and taxes. Rent expense for the year ended December 31, 2005 was \$42,000.

As of December 31, 2005, the Company owed a shareholder \$32,858 for payments made on behalf of the Company for two vehicles.

9 - CONCENTRATION OF CREDIT RISK

The Company is subject to credit risks with respect to cash and cash investments held in financial institutions in amounts in excess of the federally insured limit. As of December 31, 2005, the Company held uninsured bank balances totaling approximately \$819,504.

PIZZA FACTORY, INC.
(A California S Corporation)
Oakhurst, California

FINANCIAL STATEMENTS

and

INDEPENDENT AUDITOR'S REPORT

For the year ended December 31, 2004

PIZZA FACTORY, INC.
FINANCIAL STATEMENTS
For the year ended December 31, 2004

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INDEPENDENT AUDITOR'S REPORT

January 25, 2005

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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pizza Factory, Inc. as of December 31, 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Dunn, Jeffries & Hering LLP

Dunn, Jeffries & Hering, LLP
Certified Public Accountants

PIZZA FACTORY, INC.

Balance Sheet
December 31, 2004

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
<u>ASSETS</u>			
CURRENT ASSETS			
Cash	\$ 667,185	\$ 301,147	\$ 968,332
Accounts receivable	63,207	22,049	85,256
Current portion of notes receivable	<u>46,075</u>	<u> </u>	<u>46,075</u>
TOTAL CURRENT ASSETS	<u>776,467</u>	<u>323,196</u>	<u>1,099,663</u>
Notes receivable, less current portion	174,696	848	175,544
Property and equipment, net	<u>100,380</u>	<u> </u>	<u>100,380</u>
	<u>275,076</u>	<u>848</u>	<u>275,924</u>
TOTAL ASSETS	<u>\$ 1,051,543</u>	<u>\$ 324,044</u>	<u>\$ 1,375,587</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>			
CURRENT LIABILITIES			
Accounts payable	20,731		20,731
Accounts payable – officer	32,858		32,858
Current maturities of long term debt	15,318		15,318
Unearned revenue		324,044	324,044
State taxes payable	<u>1,416</u>	<u> </u>	<u>1,416</u>
TOTAL CURRENT LIABILITIES	<u>70,323</u>	<u>324,044</u>	<u>394,367</u>
LONG TERM DEBT, less current maturities	<u>141,921</u>	<u> </u>	<u>141,921</u>
TOTAL LIABILITIES	<u>212,244</u>	<u>324,044</u>	<u>536,288</u>
STOCKHOLDERS' EQUITY			
Common stock, no par value, 1,000 shares authorized, 200 shares issued and outstanding	1,600		1,600
Retained Earnings	<u>837,699</u>	<u> </u>	<u>837,699</u>
TOTAL STOCKHOLDERS' EQUITY	<u>839,299</u>	<u> </u>	<u>839,299</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 1,051,543</u>	<u>\$ 324,044</u>	<u>\$ 1,375,587</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Income
For the year ended December 31, 2004

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Eliminations</u>	<u>Total</u>
INCOME:				
Franchise and royalties fees	\$ 1,882,115	\$	\$	\$ 1,882,115
Advertising assessment		554,877		554,877
Exclusivity contract income	133,346			133,346
Administrative fees	56,010		(56,010)	0
Market feasibility fees	80,000			80,000
Training fees	<u>49,250</u>			<u>49,250</u>
TOTAL INCOME	<u>2,200,721</u>	<u>554,877</u>	<u>(56,010)</u>	<u>2,699,588</u>
EXPENSES:				
Salaries – Officers	196,800			196,800
Salaries – Office	333,265			333,265
Payroll taxes	41,882			41,882
Administrative fees		56,010	(56,010)	0
Advertising and promotion	28,248	488,302		516,550
Bad debt	110,466	7,414		117,880
Contributions	900			900
Depreciation	52,870			52,870
Dues and subscriptions	489			489
Insurance	64,171			64,171
Lease expense	6,975			6,975
Legal and accounting	76,735			76,735
Licenses and fees	7,758			7,758
Meals and entertainment	4,561			4,561
Meetings	21,193			21,193
Miscellaneous	87,976			87,976
Office expense	32,472			32,472
Outside service	104,898			104,898
Postage and shipping	18,402			18,402
Rent	42,000			42,000
Repairs and maintenance	6,375			6,375
Staff training	4,236			4,236
Storage	2,383	4,125		6,508
Supplies	2,871	141		3,012
Telephone	43,909			43,909
Travel and accommodation	59,847			59,847
Utilities	<u>6,048</u>			<u>6,048</u>
TOTAL EXPENSES	<u>1,357,730</u>	<u>555,992</u>	<u>(56,010)</u>	<u>1,857,712</u>
OTHER INCOME (EXPENSE):				
Gain on sale of assets	7,168			7,168
Other income	615			615
Interest income	16,175	1,115		17,290
Interest expense	<u>(9,099)</u>			<u>(9,099)</u>
INCOME BEFORE TAX	857,850			857,850
INCOME TAX PROVISION	<u>13,036</u>			<u>13,036</u>
NET INCOME	<u>\$ 844,814</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 844,814</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Retained Earnings
December 31, 2004

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Retained Earnings Prior to S status</u>	<u>Total</u>
RETAINED EARNINGS, BEGINNING OF YEAR	\$ 868,024	\$	\$ 74,861	\$ 942,885
NET INCOME	844,814			844,814
Distributions	<u>(950,000)</u>	_____	_____	<u>(950,000)</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ 762,838</u>	<u>\$</u> _____	<u>\$ 74,861</u>	<u>\$ 837,699</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Cash Flows
For the year ended December 31, 2004

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 844,814	\$ 0	\$ 844,814
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	52,870		52,870
(Increase) decrease in:			
Accounts receivable	7,745	673	8,418
Prepaid taxes	1,519		1,519
Other assets	12,792		12,792
Increase (decrease) in:			
Accounts payable	3,961		3,961
Accounts payable – officer	17,939		17,939
Accrued payroll and payroll taxes	(88)		(88)
Accrued income taxes	1,416		1,416
Unearned revenue		5,821	5,821
NET CASH PROVIDED BY OPERATING ACTIVITIES	942,968	6,494	949,462
CASH FLOWS FROM INVESTING ACTIVITIES:			
Collections on notes receivable	119,345		119,345
Additions to notes receivable	(58,557)		(58,557)
Purchase of furniture and equipment	(61,735)		(61,735)
Sale of furniture and equipment	14,832		14,832
NET CASH USED IN INVESTING ACTIVITIES	13,885		13,885
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on line of credit	(11,171)		(11,171)
Proceeds from long term debt	12,638		12,638
Repayments of long term debt	(27,032)		(27,032)
Distributions	(950,000)		(950,000)
NET CASH USED IN FINANCING ACTIVITIES	(975,565)		(975,565)
INCREASE (DECREASE) IN CASH:	(18,712)	6,494	(12,218)
CASH AT BEGINNING OF YEAR	685,897	294,653	980,550
CASH AT END OF YEAR	667,185	301,147	968,332
Interest paid	\$ 9,099		\$ 9,099
Income taxes paid	\$ 10,102		\$ 10,102

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

1 - DESCRIPTION OF ORGANIZATION

Pizza Factory, Inc. (hereinafter "the Company") is a California S corporation incorporated June 3, 1982 for the purpose of franchising pizza and pasta restaurants. There are Pizza Factory restaurants in multiple cities across eight states in the US, and internationally, in China.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's financial statements have been prepared on the accrual basis of accounting. The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

Revenue Recognition

In accordance with Statement of Financial Standards No. 45, "Accounting for Franchise Fee Revenue," the Company recognizes initial fees as income when substantially all significant services to be provided by the Company have been performed. Continuing service fee or royalties are recognized as income when earned.

In addition, each franchisee is assessed fees that are primarily used to cover advertising expenses on behalf of franchisees. These funds are accounted for separately, and have been designated as "Advertising Trust" activity on these financial statements. Assessments collected in excess of expenses incurred are classified as unearned revenue.

Bad debt expense is recorded using the reserve method, and is based on management's periodic assessment of the age of accounts, recent payment history, and other factors. Management believes no reserve is necessary at this time.

Property and Equipment and Depreciation

Property and equipment are stated at cost, with depreciation computed using the straight-line method over a five to seven year life. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Tax Status

The Company, with the consent of its shareholders, has elected, under the Internal Revenue Code, to be treated as an S Corporation. In lieu of federal income taxes, the shareholders of an S Corporation are taxed on their proportionate share of the Company's taxable income. Therefore, no provision for federal income taxes has been included in these financial statements. California law generally conforms to federal law except for a 1½% tax imposed on S-Corporation's earnings. The Company is subject to taxes in other states. Deferred income taxes have not been recognized in these financial statements, as the amount of deferred taxes is not considered material.

3 - NOTES RECEIVABLE

Notes receivable consists of:

6% secured promissory note with a franchisee, \$600 payable monthly, due January 15, 2007	\$ 14,131
6% promissory note with a franchisee, \$200 payable monthly, due March 2008	6,520
Non-interest bearing, secured promissory note with a franchisee, payable monthly, due on demand	7,805
8% secured promissory note with a franchisee, \$251 payable monthly, due October 15, 2005	2,000
8% secured promissory note with a franchisee, \$293 payable monthly, due June 15, 2009	31,433
10% secured promissory note with a franchisee, \$689 payable monthly, due May 1, 2006	10,996
5% secured promissory note with a franchisee, \$495 payable monthly, due December, 2006	<u>83,271</u>
Sub-total	156,156

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

3 - NOTES RECEIVABLE (cont.)

Balance carried forward:	\$ 156,156
6% secured promissory note with a franchisee, \$100 payable monthly, due August 15, 2007	3,759
Non-interest bearing, secured promissory note with a franchisee, \$200 payable monthly, due November 2007	7,000
6% secured promissory note with a franchisee, \$271 payable monthly, due December 15, 2006	13,799
6% secured promissory note with a franchisee, \$200 payable monthly, due September 15, 2007	24,850
6% secured promissory note with a franchisee, \$222 payable monthly, due November 2006	4,803
8% secured promissory note with a franchisee, \$125 payable monthly, due May 15, 2007	4,345
Various promissory notes with franchisees, payable monthly, due on demand	<u>6,059</u>
	220,771
Less: current portion of notes receivable	<u>(46,075)</u>
Notes receivable, less current portion	<u>\$ 174,696</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

4 - PROPERTY AND EQUIPMENT

A summary of property and equipment is as follows. (Please refer to Note 2 regarding capitalization and depreciation).

	<u>Asset Lives</u>	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
Leasehold improvements		\$ 6,234	\$	\$ 6,234
Machinery and equipment	5-7 yrs	100,373	18,470	118,843
Furniture and fixtures	7 yrs	14,369		14,369
Vehicles	5 yrs	<u>225,150</u>		<u>225,150</u>
		346,126	- 18,470	364,596
Less: accumulated depreciation		<u>(245,746)</u>	<u>(18,470)</u>	<u>(264,216)</u>
		<u>\$ 100,380</u>	<u>\$ 0</u>	<u>\$ 100,380</u>

Depreciation charged to income was \$52,870 for the year ended December 31, 2004.

5 - INITIAL FRANCHISE FEES

Initial franchise fees recognized for the year ended December 31, 2004 total \$433,250.

6 - CORPORATE FRANCHISE

In 2003, the Company acquired the Fountain, Colorado franchise, held it for resale, and sold it in 2004.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

7- LONG-TERM DEBT

Long-Term debt consists of the following:

6.25% \$300,000 line of credit with Yosemite Bank, expiring June 5, 2006	\$ 122,159
5.9% note payable to Toyota Financial Services, payable \$902 a month; due September 28, 2005	7,925
6% note payable to Yosemite Bank, payable \$351 a month; due October 15, 2009	17,606
3.59% note payable to Chase Manhattan, payable \$369 a month; due March 28, 2007	<u>9,549</u>
	157,239
Less: current maturities	<u>(15,318)</u>
Long-term debt, less current maturities	<u>\$ 141,921</u>

Maturities of long term debt as of December 31, by year and in the aggregate, for debt obligations with initial or remaining terms in excess of one year are as follows:

2005	\$ 15,318
2006	129,902
2007	4,755
2008	3,881
2009	<u>3,383</u>
	<u>\$157,239</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2004

8 - LEASES

The Company leases certain vehicles and equipment under non-cancelable operating leases that expire in 2005 and 2006.

Future minimum lease payments as of December 31, 2004, by year and in the aggregate, under non-cancelable operating leases with initial or remaining terms in excess of one year are as follows:

2005	\$ 9,168
2006	<u>3,799</u>
	<u>\$ 12,967</u>

Related rental expense for the operating leases for the twelve months ended December 31, 2004 was \$6,975.

9 - RELATED PARTY TRANSACTIONS

The Company leases its corporate office from its shareholders on a month to month basis. The Lessor is responsible for such executory costs as insurance, repairs and maintenance and taxes. Rent expense for the year ended December 31, 2004 was \$42,000.

As of December 31, 2004, the Company owed a shareholder \$32,858 for payments made on behalf of the Company for two vehicles.

10 - CONCENTRATION OF CREDIT RISK

The Company is subject to credit risks with respect to cash and cash investments held in financial institutions in amounts in excess of the federally insured limit. As of December 31, 2004, the Company held uninsured bank balances totaling approximately \$868,332.

PIZZA FACTORY, INC.
(A California S Corporation)
Oakhurst, California

FINANCIAL STATEMENTS

and

INDEPENDENT AUDITOR'S REPORT

For the year ended December 31, 2003

PIZZA FACTORY, INC.
FINANCIAL STATEMENTS
For the year ended December 31, 2003

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DUNN, JEFFRIES & HERING, LLP

CERTIFIED PUBLIC ACCOUNTANTS
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

INDEPENDENT AUDITOR'S REPORT

January 21, 2004

To the Board of Directors and Stockholders
Pizza Factory, Inc.
Oakhurst, California.

We have audited the accompanying balance sheet of Pizza Factory, Inc. as of December 31, 2003, and the related statements of income, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit provides reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pizza Factory, Inc. as of December 31, 2003, and the results of operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Dunn, Jeffries & Hering LLP

Dunn, Jeffries & Hering
Certified Public Accountants

PIZZA FACTORY, INC.

Balance Sheet

December 31, 2003

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
<u>ASSETS</u>			
CURRENT ASSETS			
Cash	\$ 685,897	\$ 294,653	\$ 980,550
Accounts receivable	70,950	22,724	93,674
Current portion of notes receivable	82,543		82,543
Prepaid Taxes	<u>1,519</u>		<u>1,519</u>
TOTAL CURRENT ASSETS	<u>840,909</u>	<u>317,377</u>	<u>1,158,286</u>
Notes receivable, less current portion	199,021	845	199,866
Property and equipment, net	106,346		106,346
Fountain Colorado franchise	<u>12,792</u>		<u>12,792</u>
	<u>318,159</u>	<u>845</u>	<u>319,004</u>
TOTAL ASSETS	<u>\$ 1,159,068</u>	<u>\$ 318,222</u>	<u>\$ 1,477,290</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>			
CURRENT LIABILITIES			
Accounts payable	16,767		16,767
Accounts payable – officer	14,918		14,918
Current maturities of long term debt	18,116		18,116
Line of credit	133,330		133,330
Unearned revenue		318,222	318,222
Other liabilities	<u>91</u>		<u>91</u>
TOTAL CURRENT LIABILITIES	<u>183,222</u>	<u>318,222</u>	<u>501,444</u>
LONG TERM DEBT, less current maturities	<u>31,358</u>		<u>31,358</u>
TOTAL LIABILITIES	<u>214,580</u>	<u>318,222</u>	<u>532,802</u>
STOCKHOLDERS' EQUITY			
Common stock, no par value, 1,000 shares authorized, 200 shares issued and outstanding	1,600		1,600
Retained Earnings	<u>942,888</u>		<u>942,888</u>
TOTAL STOCKHOLDERS' EQUITY	<u>944,488</u>		<u>944,488</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 1,159,068</u>	<u>\$ 318,222</u>	<u>\$ 1,477,290</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Income
For the year ended December 31, 2003

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Eliminations</u>	<u>Total</u>
INCOME:				
Franchise and royalties fees	\$ 1,479,078	\$	\$	\$ 1,479,078
Advertising assessment		403,119		403,119
Exclusivity contract income	113,288			113,288
Administrative fees	56,010		(56,010)	0
Market feasibility fees	45,000			45,000
Training fees	16,500			16,500
TOTAL INCOME	<u>1,709,876</u>	<u>403,119</u>	<u>(56,010)</u>	<u>2,056,985</u>
EXPENSES:				
Salaries – Officers	213,770			213,770
Salaries – Office	262,333			262,333
Payroll taxes	35,660			35,660
Administrative fees		56,010	(56,010)	0
Advertising and promotion	23,153	338,685		361,838
Bad debt	35,354	5,783		41,137
Contributions	3,000			3,000
Depreciation	46,788	982		47,770
Dues and subscriptions	754			754
Insurance	30,982			30,982
Lease expense	6,986			6,986
Legal and accounting	65,604			65,604
Licenses and fees	11,055			11,055
Meals and entertainment	7,147			7,147
Meetings	7,169			7,169
Miscellaneous	5,886			5,886
Office expense	33,977			33,977
Outside service	83,243			83,243
Postage and shipping	14,122			14,122
Rent	42,000			42,000
Repairs and maintenance	7,856	179		8,035
Staff training	210			210
Storage	405	2,619		3,024
Supplies	2,822	203		3,025
Telephone	47,872			47,872
Travel and accommodation	55,945			55,945
Utilities	5,959			5,959
TOTAL EXPENSES	<u>1,050,052</u>	<u>404,461</u>	<u>(56,010)</u>	<u>1,398,503</u>
OTHER INCOME (EXPENSE):				
Other income	16,321			16,321
Interest income	15,141	1,342		16,483
Interest expense	(5,302)			(5,302)
INCOME BEFORE TAX	685,984			685,984
INCOME TAX PROVISION	<u>10,481</u>			<u>10,481</u>
NET INCOME	<u>\$ 675,503</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 675,503</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Retained Earnings
December 31, 2003

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Retained Earnings Prior to S status</u>	<u>Total</u>
RETAINED EARNINGS, BEGINNING OF YEAR	\$ 822,524	\$	\$ 74,861	\$ 897,385
NET INCOME	675,503			675,503
Distributions	<u>(630,000)</u>	_____	_____	<u>(630,000)</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ 868,027</u>	<u>\$</u>	<u>\$ 74,861</u>	<u>\$ 942,888</u>

The accompanying notes are an integral part of these financial statements.

PIZZA FACTORY, INC.
Statement of Cash Flows
For the year ended December 31, 2003

	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 675,503	\$ 0	\$ 675,503
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	46,788	982	47,770
(Increase) decrease in:			
Accounts receivable	8,046	1,393	9,439
Accounts receivable – officer	55,000		55,000
Inventory	2,194		2,194
Prepaid taxes	(1,519)		(1,519)
Intangible	17,000		17,000
Other assets	(6,675)		(6,675)
Increase (decrease) in:			
Accounts payable	6,783		6,783
Accrued payroll and payroll taxes	(2,849)		(2,849)
Accrued income taxes	(3,300)		(3,300)
Unearned revenue		50,738	50,738
Other accrued liabilities	(971)		(971)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>796,000</u>	<u>53,113</u>	<u>849,113</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Collections on notes receivable	42,507		42,507
Additions to notes receivable	(171,469)	(845)	(172,314)
Purchase of furniture and equipment	(16,449)		(16,449)
NET CASH USED IN INVESTING ACTIVITIES	<u>(145,411)</u>	<u>(845)</u>	<u>(146,256)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on line of credit	(5,432)		(5,432)
Proceeds from line of credit	85,000		85,000
Proceeds from long term debt	21,228		21,228
Repayments of long term debt	(15,056)		(15,056)
Distributions	(630,000)		(630,000)
NET CASH USED IN FINANCING ACTIVITIES	<u>(544,260)</u>		<u>(544,260)</u>
INCREASE IN CASH:	106,329	52,268	158,597
CASH AT BEGINNING OF YEAR	<u>579,568</u>	<u>242,385</u>	<u>821,953</u>
CASH AT END OF YEAR	<u>685,897</u>	<u>294,653</u>	<u>980,550</u>
Interest paid	<u>\$ 5,302</u>		<u>\$ 5,302</u>
Income taxes paid	<u>\$ 14,786</u>		<u>\$ 14,786</u>

The accompanying notes are an integral part of these financial statements:

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

1 - DESCRIPTION OF ORGANIZATION

Pizza Factory, Inc. (hereinafter "the Company") is a California S corporation incorporated June 3, 1982 for the purpose of franchising pizza and pasta restaurants. There are Pizza Factory restaurants in multiple cities across seven states in the US, and internationally, in China.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's financial statements have been prepared on the accrual basis of accounting. The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

Revenue Recognition

In accordance with Statement of Financial Standards No. 45, "Accounting for Franchise Fee Revenue," the Company recognizes initial fees as income when substantially all significant services to be provided by the Company have been performed. Continuing service fee or royalties are recognized as income when earned.

In addition, each franchisee is assessed fees that are primarily used to cover advertising expenses on behalf of franchisees. These funds are accounted for separately, and have been designated as "Advertising Trust" activity on these financial statements. Assessments collected in excess of expenses incurred are classified as unearned revenue.

Bad debt expense is recorded using the reserve method, and is based on management's periodic assessment of the age of accounts, recent payment history, and other factors. Management believes no reserve is necessary at this time.

Property and Equipment and Depreciation

Property and equipment are stated at cost, with depreciation computed using the straight-line method over a five to seven year life. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Tax Status

The Company, with the consent of its shareholders, has elected, under the Internal Revenue Code, to be treated as an S Corporation. In lieu of federal income taxes, the shareholders of an S Corporation are taxed on their proportionate share of the Company's taxable income. Therefore, no provision for federal income taxes has been included in these financial statements. California law generally conforms to federal law except for a 1½% tax imposed on S-Corporation's earnings. The Company is subject to taxes in other states. Deferred income taxes have not been recognized in these financial statements, as the amount of deferred taxes is not considered material.

3 - NOTES RECEIVABLE

Notes receivable consists of:

6% secured promissory note with a franchisee, \$600 payable monthly, due September 15, 2004	\$ 19,870
8% secured promissory note with a franchisee, \$480 payable monthly due March 15, 2008	56,286
6% promissory note with a franchisee, \$200 payable monthly, due March 2008	8,466
Non-interest bearing, secured promissory note with a franchisee, payable monthly, due on demand	7,805
8% secured promissory note with a franchisee, \$225 payable monthly, due October 15, 2005	7,621
3% secured promissory note with a franchisee, \$494 payable monthly, due October 15, 2004	5,358
8% secured promissory note with a franchisee, \$293 payable monthly, due November 30, 2013	<u>33,658</u>
Sub-total	139,064

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

3 - NOTES RECEIVABLE (cont.)

Balance carried forward:	\$ 139,064
10% secured promissory note with a franchisee, \$700 payable monthly, due March 1, 2006	17,628
6% promissory note with a franchisee, \$100 payable monthly, due December 20, 2004	4,075
5% secured promissory note with a franchisee, \$495 payable monthly, due December, 2006	85,000
Various promissory notes with franchisees, payable monthly, due on demand	<u>35,797</u>
	281,561
Less: current portion of notes receivable	<u>(82,543)</u>
Notes receivable, less current portion	<u>\$ 199,021</u>

4 - PROPERTY AND EQUIPMENT

A summary of property and equipment is as follows. (Please refer to Note 2 regarding capitalization and depreciation).

	<u>Asset Lives</u>	<u>Franchise Operations</u>	<u>Advertising Trust</u>	<u>Total</u>
Leasehold improvements		\$ 6,234	\$	\$ 6,234
Machinery and equipment	5-7 yrs	89,914	18,470	108,384
Furniture and fixtures	7 yrs	14,369		14,369
Vehicles	5 yrs	<u>209,140</u>		<u>209,140</u>
		319,657	<u>18,470</u>	338,127
Less: accumulated depreciation		<u>(213,311)</u>	<u>(18,470)</u>	<u>(231,781)</u>
		<u>\$ 106,346</u>	<u>\$ 0</u>	<u>\$ 106,346</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

Depreciation charged to income was \$46,788 and \$982 for Franchise Operations and Advertising Trust respectively for the year ended December 31, 2003.

5 - INITIAL FRANCHISE FEES

Initial franchise fees recognized for the year ended December 31, 2003 total \$226,500.

6 - CORPORATE FRANCHISE

In 2001, the Company acquired the Spring Creek Nevada franchise that was experiencing financial difficulty. In accordance with Statement of Financial Standards No. 45 "*Accounting for Franchise Fee Revenue*," this acquisition was accounted for as a business combination using the purchase method. The franchise was subsequently sold in January 2003.

In 2003, the Company acquired the Fountain Colorado franchise and was holding it for resale.

7 - LINE OF CREDIT

The Company has a \$300,000 revolving line of credit agreement with a bank, secured by property; current interest of 5%. The agreement expires March 5, 2004. As at December 31, 2003, the outstanding balance was \$133,330.

8 - LONG-TERM DEBT

Notes payable consist of the following:

5.9% note payable to Toyota Financial Services, payable \$902 a month; due September 28, 2005	\$ 17,963
4.9% note payable to Wells Fargo Bank, payable \$499 a month; due December 5, 2005	<u>10,848</u>
Sub-total	28,811

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

8 - LONG-TERM DEBT (cont.)

Balance carried forward:	28,811
6% note payable to Yosemite Bank, payable \$351 a month; due October 15, 2009	<u>20,663</u>
	49,474
Less: current maturities	<u>(18,116)</u>
Long-term debt, less current maturities	<u>\$ 31,358</u>

Maturities of long term debt as of December 31, by year and in the aggregate, for debt obligations with initial or remaining terms in excess of one year are as follows:

2004	\$ 18,116
2005	16,963
2006	3,443
2007	3,656
2008	3,881
2009	<u>3,415</u>
	<u>\$ 49,474</u>

9 - LEASES

The Company leases certain vehicles and equipment under non-cancelable operating leases that expire in various years through 2006.

Future minimum lease payments as of December 31, 2003, by year and in the aggregate, under non-cancelable operating leases with initial or remaining terms in excess of one year are as follows:

2004	\$ 9,530
2005	9,157
2006	<u>3,369</u>
	<u>\$ 22,056</u>

PIZZA FACTORY, INC.
Notes to Financial Statements
Year ended December 31, 2003

Related rental expense for the operating leases for the twelve months ended December 31, 2003 was \$6,985.

10 - RELATED PARTY TRANSACTIONS

The Company leases its corporate office from its shareholders on a month to month basis. The Lessor is responsible for such executory costs as insurance, repairs and maintenance and taxes. Rent expense for the year ended December 31, 2003 was \$42,000.

As at December 31, 2003, the Company owed a shareholder \$14,918 for a payment made on behalf of the Company for one of their vehicles.

11 - CONCENTRATION OF CREDIT RISK

The Company is subject to credit risks with respect to cash and cash investments held in financial institutions in amounts in excess of the federally insured limit. As at December 31, 2003, the Company held uninsured bank balances totaling approximately \$880,550.