

# **Exhibit G**

## **NWR's Audited Financial Statements**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors  
New World Restaurant Group, Inc.

We have audited the accompanying consolidated balance sheets of New World Restaurant Group, Inc. and Subsidiaries as of December 28, 2004 and December 30, 2003, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 28, 2004. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits 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, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of New World Restaurant Group, Inc. and Subsidiaries as of December 28, 2004 and December 30, 2003, and the results of their operations, and their cash flows for each of the three years in the period ended December 28, 2004, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule II is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

As discussed in Note 2, the Company has restated their consolidated financial statements for the years ended December 30, 2003 and December 31, 2002, to record amortization expense on leasehold improvements in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Denver, Colorado  
February 21, 2005

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 28, 2004 AND DECEMBER 30, 2003**  
(in thousands, except share information)

	December 28, 2004	December 30, 2003 (Restated)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 9,752	\$ 9,575
Restricted cash	1,269	1,815
Franchise and other receivables, net of allowance of \$2,475 and \$3,310	7,123	5,842
Inventories	4,941	4,831
Prepaid expenses and other current assets	1,643	2,650
Total current assets	24,728	24,713
Restricted cash long-term	2,526	3,036
Property and equipment, net	41,855	54,513
Trademarks and other intangibles, net	77,219	85,431
Goodwill	4,875	4,875
Debt issuance costs and other assets	7,253	9,170
Total assets	\$ 158,456	\$ 181,738
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable	\$ 8,243	\$ 8,189
Accrued expenses	34,836	37,871
Short term debt and current portion of long-term debt	295	2,105
Current portion of obligations under capital leases	16	180
Total current liabilities	43,390	48,345
Senior notes and other long-term debt	160,840	161,120
Obligations under capital leases	31	29
Other liabilities	9,678	10,397
Mandatorily redeemable, Series Z Preferred Stock, \$.001 par value, \$1,000 per share liquidation value; 2,000,000 shares authorized; 57,000 shares issued and outstanding	57,000	57,000
Total liabilities	270,939	276,891
Stockholders' deficit:		
Common stock, \$.001 par value; 15,000,000 shares authorized; 9,848,713 and 9,841,828 shares issued and outstanding	10	10
Additional paid-in capital	175,797	175,585
Unamortized stock compensation	(137)	-
Accumulated deficit	(288,153)	(270,748)
Total stockholders' deficit	(112,483)	(95,153)
Total liabilities and stockholders' deficit	\$ 158,456	\$ 181,738

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

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 28, 2004, DECEMBER 30, 2003 AND DECEMBER 31, 2002**  
(in thousands, except earnings per share and related share information)

	<u>December 28, 2004</u>	<u>December 30, 2003</u> (Restated)	<u>December 31, 2002</u> (Restated)
Revenues:			
Retail sales	\$ 347,786	\$ 356,225	\$ 369,351
Manufacturing revenues	20,122	21,457	23,734
Franchise and license related revenues	5,952	5,624	5,565
<b>Total revenues</b>	<b>373,860</b>	<b>383,306</b>	<b>398,650</b>
Cost of sales:			
Retail costs	288,736	297,934	300,013
Manufacturing costs	17,925	19,756	21,493
<b>Total cost of sales</b>	<b>306,661</b>	<b>317,690</b>	<b>321,506</b>
<b>Gross profit</b>	<b>67,199</b>	<b>65,616</b>	<b>77,144</b>
Operating expenses:			
General and administrative expenses	32,755	41,794	42,640
Depreciation and amortization	27,848	34,013	35,047
Charges (adjustments) of integration and reorganization cost	(869)	2,132	4,194
Impairment charges and other related costs	450	5,292	-
<b>Income (loss) from operations</b>	<b>7,015</b>	<b>(17,615)</b>	<b>(4,737)</b>
Other expense (income):			
Interest expense, net	23,196	34,184	42,883
Cumulative change in the fair value of derivatives	-	(993)	(233)
Loss (gain) on sale, disposal or abandonment of assets, net	1,557	(558)	-
Gain on investment in debt securities	-	(374)	(2,537)
Loss on exchange of Series F Preferred Stock due to Equity Recap	-	23,007	-
Other	(284)	(172)	(322)
<b>Loss before income taxes</b>	<b>(17,454)</b>	<b>(72,709)</b>	<b>(44,528)</b>
Provision (benefit) for state income taxes	(49)	812	366
<b>Net loss</b>	<b>(17,405)</b>	<b>(73,521)</b>	<b>(44,894)</b>
Dividends and accretion on Preferred Stock	-	(14,423)	(27,594)
<b>Net loss available to common stockholders</b>	<b>\$ (17,405)</b>	<b>\$ (87,944)</b>	<b>\$ (72,488)</b>
<b>Net loss per common share – Basic and Diluted</b>	<b>\$ (1.77)</b>	<b>\$ (22.71)</b>	<b>\$ (55.18)</b>
Weighted average number of common shares outstanding:			
Basic and Diluted	9,842,414	3,873,284	1,313,760

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

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)**  
**FOR THE YEARS ENDED DECEMBER 28, 2004, DECEMBER 30, 2003 AND DECEMBER 31, 2002**  
(in thousands, except share information)

	Common Stock		Additional	Unamortized	Accumulated	Total
	Shares	Amount	Paid In Capital	Stock Compensation	Deficit Amount	
Balance, January 1, 2002 (as restated)	290,376	\$ -	\$ 80,220	\$ -	\$ (110,316)	\$ (30,096)
Net loss (as restated)	-	-	-	-	(44,894)	(44,894)
Issuance of common stock	557,037	1	116	-	-	117
Issuance of warrants in financing transactions	-	-	6,321	-	-	6,321
Dividends and accretion on preferred stock	-	-	-	-	(27,594)	(27,594)
<b>Balance, December 31, 2002 (as restated)</b>	<b>847,413</b>	<b>\$ 1</b>	<b>\$ 86,657</b>	<b>\$ -</b>	<b>\$ (182,804)</b>	<b>\$ (96,146)</b>
Net loss (as restated)	-	-	-	-	(73,521)	(73,521)
Conversion of Series F to common stock	9,380,843	9	84,704	-	-	84,713
Conversion of common stock and warrants to Series Z	(386,428)	-	(762)	-	-	(762)
Issuance of warrants in financing transactions	-	-	4,986	-	-	4,986
Dividends and accretion on preferred stock	-	-	-	-	(14,423)	(14,423)
<b>Balance, December 30, 2003 (as restated)</b>	<b>9,841,828</b>	<b>\$ 10</b>	<b>\$ 175,585</b>	<b>\$ -</b>	<b>\$ (270,748)</b>	<b>\$ (95,153)</b>
Net loss	-	-	-	-	(17,405)	(17,405)
Stock compensation expense of options granted	-	-	205	(205)	-	-
Amortization of stock compensation expense	-	-	-	68	-	68
Common stock issued upon warrant exercise	6,885	-	7	-	-	7
<b>Balance, December 28, 2004</b>	<b>9,848,713</b>	<b>\$ 10</b>	<b>\$ 175,797</b>	<b>\$ (137)</b>	<b>\$ (288,153)</b>	<b>\$ (112,483)</b>

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

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 28, 2004, DECEMBER 30, 2003 AND DECEMBER 31, 2002**  
(in thousands)

	<u>December 28, 2004</u>	<u>December 30, 2003 (Restated)</u>	<u>December 31, 2002 (Restated)</u>
<b>OPERATING ACTIVITIES:</b>			
Net loss	\$ (17,405)	\$ (73,521)	\$ (44,894)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	27,848	34,013	35,047
Stock based compensation expense	68	-	117
Loss, net of gains, on disposal of assets and impairment charges	1,872	4,734	
Gain on investment in debt securities	-	(374)	(2,537)
Charges (adjustments) of integration and reorganization	(869)	2,132	4,194
Provision for (recovery of) losses on accounts receivable	177	1,815	639
Cumulative change in fair value of derivatives	-	(993)	(233)
Amortization of debt issuance and debt discount costs	1,849	3,138	10,605
Notes issued as paid in kind for interest on Bridge Loan	-	395	3,526
Issuance of standstill and step-up warrants	-	3,132	-
Greenlight interest	-	1,025	1,784
Loss on exchange of Series F Preferred Stock due to Equity Recap	-	23,007	-
Reduction in Bridge Loan due to Equity Recap	-	(500)	-
Changes in operating assets and liabilities:			
Franchise and other receivables	(1,458)	(1,688)	3,394
Accounts payable and accrued expenses	(2,112)	8,516	(14,272)
Other assets and liabilities	1,140	(2,816)	(4,040)
Net cash provided by (used in) operating activities	<u>11,110</u>	<u>2,015</u>	<u>(6,670)</u>
<b>INVESTING ACTIVITIES:</b>			
Purchase of property and equipment	(9,393)	(6,921)	(5,172)
Proceeds from the sale of equipment	543	558	-
Proceeds from the sale of assets held for sale	-	-	1,397
Proceeds from investment in debt securities	-	374	36,711
Net cash provided by (used in) investing activities	<u>(8,850)</u>	<u>(5,989)</u>	<u>32,936</u>
<b>FINANCING ACTIVITIES:</b>			
Proceeds (repayments) of line of credit, net	(985)	(5,000)	6,000
Repayment of notes payable	(1,105)	(1,131)	(37,039)
Proceeds from issuance of \$160 Million Indenture	-	160,000	-
Repayment of \$140 Million Facility	-	(140,000)	-
Advance funding of NJEDA (restricted cash)	-	(1,684)	-
Debt issuance costs	-	(8,571)	-
Common stock issued upon warrant exercise	7	-	-
Net cash provided by (used in) financing activities	<u>(2,083)</u>	<u>3,614</u>	<u>(31,039)</u>
Net increase (decrease) in cash	177	(360)	(4,773)
Cash and cash equivalents, beginning of period	9,575	9,935	14,708
Cash and cash equivalents, end of period	<u>\$ 9,752</u>	<u>\$ 9,575</u>	<u>\$ 9,935</u>

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

## **NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### **1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

The consolidated financial statements of New World Restaurant Group, Inc. and its wholly-owned subsidiaries (collectively, the Company) have been prepared in conformity with accounting principles generally accepted in the United States of America. All inter-company accounts and transactions have been eliminated in consolidation. The Company owns, franchises or licenses various restaurant concepts under the brand names of Einstein Bros. Bagels and Einstein Bros. Café (collectively known as Einstein Bros.), Noah's New York Bagels (Noah's), Manhattan Bagel Company (Manhattan), Chesapeake Bagel Bakery (Chesapeake) and New World Coffee (New World).

We have a 52/53-week fiscal year ending on the Tuesday closest to December 31. Fiscal year 2004, 2003 and 2002 each contained 52 weeks and ended on December 28, 2004, December 30, 2003, and December 31, 2002, respectively.

Certain reclassifications have been made to conform previously reported data to the current presentation. These reclassifications have no effect on net income or financial position as previously reported.

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Restatement of Prior Financial Information**

It has been our longstanding historical accounting policy to amortize our leasehold improvements over a period that included both the noncancelable term of the lease and its option periods (or the useful life of the asset, if shorter). Concurrently, we used the noncancelable lease term in determining whether each of our leases was an operating lease or a capital lease and in calculating our straight-line rent expense. We believed that these accounting treatments were appropriate under generally accepted accounting principles. Furthermore, we believed that these accounting treatments were comparable to the practices of other public companies. However, we have since concluded that we should use the same lease term in amortizing leasehold improvements as we use in determining capital versus operating leases and in calculating straight-line rent expense. Accordingly, we have adopted the following policy: the depreciable lives for our leasehold improvements, which are subject to a lease, will be limited to the lesser of the useful life or the noncancelable lease term. In circumstances where we would incur an economic penalty by not exercising one or more option periods, as contemplated by Statement of Financial Accounting Standards (SFAS) No. 13 "Accounting for Leases," we may include one or more option periods when determining the depreciation period. In either circumstance, our policy requires consistency when calculating the depreciation period, in classifying the lease, and in computing straight-line rent expense.

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

As a result of this change, our financial statements have been restated as follows:

	2003		
	<u>As reported</u>	<u>Adjustments</u>	<u>Restated</u>
<b>Balance Sheet:</b>			
Property and equipment, net	\$ 67,800	\$ (13,287)	\$ 54,513
Total assets	195,025	(13,287)	181,738
Accumulated deficit	(257,461)	(13,287)	(270,748)
Total stockholders' deficit	(81,866)	(13,287)	(95,153)
<b>Statement of Operations:</b>			
Depreciation and amortization	28,200	5,813	34,013
Loss from operations	(11,802)	(5,813)	(17,615)
Loss before income taxes	(66,896)	(5,813)	(72,709)
Net loss	(67,708)	(5,813)	(73,521)
Net loss available to common stockholder	(82,131)	(5,813)	(87,944)
Net loss per common share, basic and diluted	\$ (21.20)	\$ (1.51)	\$ (22.71)
	2002		
	<u>As reported</u>	<u>Adjustments</u>	<u>Restated</u>
<b>Balance Sheet:</b>			
Property and equipment, net	\$ 81,254	\$ (7,474)	\$ 73,780
Total assets	210,648	(7,474)	203,174
Accumulated deficit	(175,330)	(7,474)	(182,804)
Total stockholders' deficit	(88,672)	(7,474)	(96,146)
<b>Statement of Operations:</b>			
Depreciation and amortization	30,626	4,421	35,047
Loss from operations	(316)	(4,421)	(4,737)
Loss before income taxes	(40,107)	(4,421)	(44,528)
Net loss	(40,473)	(4,421)	(44,894)
Net loss available to common stockholder	(68,067)	(4,421)	(72,488)
Net loss per common share, basic and diluted	\$ (51.81)	\$ (3.37)	\$ (55.18)



## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

Accumulated deficit at January 1, 2002 as reported was \$107,263. The impact of the restatement for fiscal year 2001 was \$3,053, which was recorded as an adjustment to opening stockholders' deficit at January 1, 2002. The adjustments had no effect on net cash flows from operating, investing and financing activities, cash position and revenues.

	2002					
	2001 Accumulated Deficit	Net Loss	Dividends/ Accretion on Preferred Stock	Net Loss Available to Common Stockholders	Net Loss per Common Share	2002 Accumulated Deficit
As reported	\$ (107,263)	\$ (40,473)	\$ (27,594)	(68,067)	\$ (51.81)	\$ (175,330)
Adjustments	<u>(3,053)</u>	<u>(4,421)</u>	-	<u>(4,421)</u>	<u>(3.37)</u>	<u>(7,474)</u>
As restated	<u>\$ (110,316)</u>	<u>\$ (44,894)</u>	<u>\$ (27,594)</u>	<u>(72,488)</u>	<u>\$ (55.18)</u>	<u>\$ (182,804)</u>

	2003					
	2002 Accumulated Deficit	Net Loss	Dividends/ Accretion on Preferred Stock	Net Loss Available to Common Stockholders	Net Loss per Common Share	2003 Accumulated Deficit
As reported	\$ (175,330)	\$ (67,708)	\$ (14,423)	(82,131)	\$ (21.20)	\$ (257,461)
Adjustments	<u>(7,474)</u>	<u>(5,813)</u>	-	<u>(5,813)</u>	<u>(1.51)</u>	<u>(13,287)</u>
As restated	<u>\$ (182,804)</u>	<u>\$ (73,521)</u>	<u>\$ (14,423)</u>	<u>\$ (87,944)</u>	<u>\$ (22.71)</u>	<u>\$ (270,748)</u>

#### Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues, costs and expenses during the reporting period. Actual results could differ from the estimates.

#### Revenue Recognition

We record revenue from the sale of food and beverage as products are sold. Our manufacturing revenues are recorded at the time of shipment to customers. Initial fees received from a franchisee or licensee to establish a new location are recognized as income when we have performed our obligations required to assist the franchisee or licensee in opening a new location, which is generally at the time the franchisee or licensee commences operations. Continuing royalties, which are a percentage of the net sales of franchised and licensed locations, are accrued as income each month. Proceeds from the sale of gift cards are recorded as deferred revenue and recognized as income when redeemed by the holder.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

#### Property and Equipment

Property and equipment is recorded at cost. Furniture and equipment are depreciated using the straight-line method over the estimated useful life of the asset, which ranges from 3 to 8 years. Leasehold improvements are amortized using the straight-line method. The depreciable lives for our leasehold improvements, which are subject to a lease, are limited to the lesser of the useful life or the noncancelable lease term. In circumstances where we would incur an economic penalty by not exercising one or more option periods, we include one or more option periods when determining the depreciation period. In either circumstance, our policy requires consistency when calculating the depreciation period, in classifying the lease, and in computing straight-line rent expense.

In accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets," impairment losses are recorded on long-lived assets on a restaurant-by-restaurant basis whenever impairment indicators are determined to be present. We consider a history of cash flow losses to be the primary indicator of potential impairment for individual restaurant locations. We determine whether a restaurant location is impaired based on expected undiscounted future cash flows, considering location, local competition, current store management performance, existing pricing structure and alternatives available for the site. If impairment exists, the amount of impairment is measured as the excess of the carrying amount of the asset over its fair value as determined utilizing the estimated discounted future cash flows or the expected proceeds, net of costs to sell, upon sale of the asset.

For the year ended December 28, 2004, we recorded \$450 in impairment charges for long-lived asset impairments and exit costs from the decision to close two restaurants and to write down the assets of five underperforming restaurants.

#### Goodwill, Trademarks and Other Intangibles

Intangible assets include both goodwill and identifiable intangibles arising from the allocation of the purchase prices of assets acquired. Goodwill represents the excess of cost over fair value of net assets acquired in the acquisition of Manhattan. Other intangibles consist mainly of trademarks, trade secrets and patents.

Goodwill and other intangible assets with indefinite lives are not subject to amortization but are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" requires a two-step approach for testing impairment. First, the estimated fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, then the second step of the impairment test is performed; the fair value of the reporting unit's goodwill is determined by allocating the unit's fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying amount over its fair value. Intangible assets not subject to amortization consist primarily of the Einstein Bros. and Manhattan trademarks.

Intangible assets with lives restricted by contractual, legal or other means are amortized over their useful lives and consist primarily of patents used in our manufacturing process. Amortization expense is calculated using the straight-line method over the estimated useful lives of approximately 5 years. Intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

During fiscal 2004, we began an evaluation of whether each of our brands should be a part of our overall strategic business plan. As a result of this evaluation, we determined that certain brands may no longer fit strategically. Accordingly, we performed an interim impairment analysis and determined that no impairment of these brands existed. We also performed a longevity analysis of certain brands and determined that certain trademarks had an estimated remaining useful life of 4 years. These trademarks were previously treated as a non-amortizing intangible and accordingly, were reclassified as an amortizing intangible at June 29, 2004.

For the fiscal years ended 2004 and 2003, we engaged an independent valuation expert to assist us in performing our impairment analyses. At December 28, 2004, there was no indication of impairment in our indefinite and definite lived intangible assets. At December 30, 2003, there was an indication that the carrying amounts of our indefinite lived assets exceeded their fair values and accordingly we recorded an impairment charge of \$4,878 related to our Manhattan and Chesapeake trademarks. The impairments for both Manhattan and Chesapeake were related to declining cash flows for those brands and our expectation that the trend of lower sales will continue in future years. In addition to the trademark impairment, we also wrote-off the value of previously reacquired Manhattan franchise territory rights of \$414.

#### **Self-Insurance**

We are self-insured for certain losses related to health, general liability and workers' compensation. We maintain stop loss coverage with third party insurers to limit our total exposure. The self-insurance liability represents an estimate of the ultimate cost of claims incurred and unpaid as of the balance sheet date. The estimated liability is established based upon analysis of historical data and actuarial estimates, is discounted at 10% and is reviewed on a quarterly basis to ensure that the liability is appropriate. The estimated liability is included in accrued expenses in our consolidated balance sheets.

#### **Guarantees**

We are liable for certain lease assignments and guarantees and we record a liability for our exposure under these lease assignments and guarantees when such exposure is probable and estimable. Current franchisees are the primary lessees under the vast majority of these leases. Under the lease guarantees, we may be required by the lessor to make all of the remaining monthly rental payments or property tax and common area maintenance payments if the franchisee does not make the required payments in a timely manner. However, we believe that most, if not all, of the franchised locations could be subleased to third parties minimizing our potential exposure. Additionally, we have indemnification agreements with our franchisees under which the franchisees would be obligated to reimburse us for any amounts paid under such guarantees. Historically, we have not been required to make such payments in significant amounts. We have recorded a liability where we believe our exposure is probable and estimable. As of December 28, 2004, our total exposure under these contingent liabilities was approximately \$2,300. Approximately \$425 has been recorded and is included in accrued expenses in our consolidated balance sheets.

We are also liable for certain debt guarantees we made in connection with our franchisees initial equipment purchases. When we have been required to make significant payments related to the debt guarantees, we have recorded a liability where we believe our exposure is probable and estimable. As of December 28, 2004, our total exposure under these contingent liabilities was approximately \$536. Approximately \$411 has been recorded and is included in accrued expenses in our consolidated balance sheets.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### Fair Value of Financial Instruments

As of December 28, 2004 and December 28, 2003, our financial instruments consist of cash equivalents, accounts receivable, accounts payable and debt. The fair value of accounts receivable and accounts payable approximate their carrying value, due to their short-term maturities. The fair value of debt and notes payable is estimated to approximate their carrying value by comparing the terms of existing instruments to the terms offered by lenders for similar borrowings with similar credit ratings. The fair value of the \$160 Million Notes approximates its carrying value at December 28, 2004 as the notes are traded at par in the market.

The Mandatorily Redeemable Series Z Preferred Stock (Series Z) is recorded in the accompanying balance sheet at its full face value of \$57,000, which represents the total required future cash payment. The current fair value of the Series Z, which was determined by using the useful life of the Series Z and the effective dividend rate from the Certificate of Designation, is estimated to be \$28,500 and \$24,400 at December 28, 2004 and December 30, 2003, respectively.

### Concentrations of Risk

We purchase a majority of our frozen bagel dough from one supplier who utilizes our proprietary processes, which we are dependent upon in the short-term. Additionally, we purchase all of our cream cheese from a single source. Though to date we have not experienced significant difficulties with our suppliers, our reliance on our suppliers subjects us to a number of risks, including possible delays or interruption in supplies, diminished control over quality and a potential lack of adequate raw material capacity. Any disruption in the supply or degradation in the quality of the materials provided by our suppliers could have a material adverse effect on our business, operating results and financial condition. In addition, such disruptions in supply or degradations in quality could have a long-term detrimental impact on our efforts to develop a strong brand identity and a loyal consumer base.

### Advertising Costs

We expense advertising costs as incurred. Advertising costs were \$4,500, \$12,900 and \$14,000 for the fiscal years ended 2004, 2003 and 2002, respectively, and are included in retail costs of sales in the consolidated statements of operations.

### Income Taxes

We record deferred tax assets and liabilities based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted statutory tax rate. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period. The recorded deferred tax assets are reviewed for impairment on a quarterly basis by reviewing our internal estimates for future net income. If we determine it to be more likely than not that the recovery of the asset is in question in the immediate, foreseeable future, we record a valuation allowance. On December 28, 2004 and December 30, 2003, we recorded a full valuation allowance against our net deferred tax asset. We will continue to record valuation allowances against additional deferred tax assets until such time that recoverability of such assets is demonstrated.

The provision (benefit) for income taxes reflected in our consolidated statements of operations represents minimum state taxes payable.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### Net Loss per Common Share

We compute basic net loss per common share by dividing the net loss for the period by the weighted average number of shares of common stock outstanding (which includes shares contingently issuable for little or no consideration) during the period.

Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock and potential common stock equivalents outstanding during the period, if dilutive. Potential common stock equivalents include incremental shares of common stock issuable upon the exercise of stock options and warrants. The effects of potential common stock equivalents have not been included in the computation of diluted net loss per share as their effect is anti-dilutive.

The following table summarizes the weighted average number of common shares outstanding, as well as sets forth the computation of basic and diluted net loss per common share for the periods indicated:

	For the years ended:		
	December 28, 2004	December 30, 2003 (restated)	December 31, 2002 (restated)
Weighted average shares outstanding	<u>9,842,414</u>	<u>3,873,284</u>	<u>1,313,760</u>
Net loss available to common stockholders (in thousands of dollars)	<u>\$ (17,405)</u>	<u>\$ (87,944)</u>	<u>\$ (72,488)</u>
Basic and diluted net loss per share	<u>\$ (1.77)</u>	<u>\$ (22.71)</u>	<u>\$ (55.18)</u>
Shares contingently issuable included in the weighted average number of shares of common stock	<u>-</u>	<u>604,298</u>	<u>942,347</u>
Outstanding options and warrants that were not included in the diluted calculation because their effect would be anti-dilutive	<u>1,764,372</u>	<u>1,832,679</u>	<u>102,380</u>

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

#### Stock-Based Compensation

We apply the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for our fixed award stock options to our employees. As such, compensation expense is recorded only if the current market price of the underlying common stock exceeded the exercise price of the option on the date of grant. We apply the fair value-basis of accounting as prescribed by Statements of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation" in accounting for our fixed award stock options to our consultants. Under SFAS No. 123, compensation expense is recognized based on the fair value of stock options granted. Had compensation cost for stock options granted to employees been determined on the basis of fair value as computed using the assumptions herein, net loss and loss per share would have been increased to the following pro forma amounts:

	For the years ended:		
	December 28, 2004	December 30, 2003 (restated)	December 31, 2002 (restated)
Net loss available to common stockholders, as reported	\$ (17,405)	\$ (87,944)	\$ (72,488)
Deduct: stock based compensation determined under the fair value method, net of related tax effects	(544)	(10)	(196)
Pro forma net loss available to common stockholders	\$ (17,949)	\$ (87,954)	\$ (72,684)
Basic and diluted loss per common share:			
As reported	\$ (1.77)	\$ (22.71)	\$ (55.18)
Pro forma	\$ (1.82)	\$ (22.71)	\$ (55.33)

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

Compensation cost of options granted for the SFAS No. 123 pro forma amounts disclosed above was estimated using the Black-Scholes option-pricing model with the following assumptions:

	For the years ended:		
	December 28, 2004	December 30, 2003	December 31, 2002
Expected life of options from date of grant (in years)	4.00	4.00	4.00
Risk-free interest rate	2.7 - 3.4%	3.0%	3.0%
Volatility	100.0%	100.0%	100.0%
Assumed dividend yield	0.0%	0.0%	0.0%
Weighted average fair value of options granted	\$ 2.21	\$ 2.84	\$ 6.47

#### Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs—an amendment of ARB No. 43, Chapter 4." SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) and amends Paragraph 5 of ARB 43, Chapter 4, by requiring that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed-production overhead be based on the normal capacity of the production facilities. This Statement is effective during fiscal years beginning after June 15, 2005. We do not believe the adoption of this Statement will have a material impact on our financial position and results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) entitled "Share-Based Payment" that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for a) equity instruments of the enterprise or b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The Statement eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees," and generally would require instead that such transactions be accounted for using a fair-value-based method. This Statement is effective as of the first interim or annual reporting period that begins after June 15, 2005. We have not fully completed our evaluation of the impact this Statement will have on our financial position and results of operations. Based on options granted and various assumptions used to calculate stock based compensation expense as of December 28, 2004, we anticipate that the impact of adoption would result in an increase in expenses of approximately \$471,000 for fiscal 2005. If actual events differ from our assumptions used to calculate the expense, our financial results could be impacted.

We have considered all other recently issued accounting pronouncements and do not believe that the adoption of such pronouncements will have a material impact on our financial statements.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 3. RESTRICTED CASH AND CASH EQUIVALENTS

Restricted cash and cash equivalents consist of the following:

	December 28, 2004	December 30, 2003
Advertising Funds(a)	\$ 851	\$ 667
New Jersey Economic Development Authority(b)	1,307	1,684
Worker's Compensation Insurance Collateral(c)	1,600	2,500
Other	37	-
	3,795	4,851
Less current portion of long-term restricted cash	1,269	1,815
Long-term restricted cash and cash equivalents	\$ 2,526	\$ 3,036

- (a) We act as custodian for certain funds paid by our franchisees that are earmarked as advertising fund contributions.
- (b) On July 3, 2003, we placed in escrow an advanced refunding of the New Jersey Economic Development Authority (NJEDA) note dated December 1, 1998 to enact a debt defeasance as allowed for in the agreement. The NJEDA funds are included in both current portion and long-term portion of restricted cash as of the December 28, 2004 and December 30, 2003 balance sheet dates in accordance with payment terms of the note. We anticipate this classification will continue until the NJEDA note is fully paid from the escrow amount proceeds. The NJEDA note has a maturity date of December 1, 2008. See Note 10 for additional information.
- (c) We also have restricted cash held as collateral for a letter of credit supporting our worker's compensation insurance claims. The insurance company could access this collateral in the event that we do not reimburse them for claims paid on our behalf.

### 4. FRANCHISE AND OTHER RECEIVABLES

The majority of our receivables are due from our franchisees and distributors. Credit is extended based on our evaluation of the customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 7-30 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. We determine our allowance by considering a number of factors, including the length of time trade accounts receivable are past due, our previous loss and payment history, the customer's current ability to pay its obligation to us, and the condition of the general economy and the industry as a whole. We write off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Franchise and other receivables consist of the following:

	December 28, 2004	December 30, 2003
Franchisee and licensee receivables	\$ 3,367	\$ 4,970
Vendor rebates	3,196	2,126
Other	3,035	2,056
	9,598	9,152
Less allowance for doubtful accounts	2,475	3,310
Total receivables	\$ 7,123	\$ 5,842



## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 5. INVENTORIES

Inventories, which consist of food, beverage, paper supplies and bagel ingredients, are stated at the lower of cost or market, with cost being determined by the first-in, first-out method. Inventories consist of the following:

	December 28, 2004	December 30, 2003
Finished goods	\$ 4,545	\$ 4,403
Raw materials	396	428
Total inventories	<u>\$ 4,941</u>	<u>\$ 4,831</u>

### 6. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	December 28, 2004	December 30, 2003 (restated)
Leasehold improvements	\$ 49,186	\$ 49,712
Store and manufacturing equipment	61,373	56,963
Furniture and fixtures	1,095	1,588
Office and computer equipment	10,445	9,574
	<u>122,099</u>	<u>117,837</u>
Less accumulated depreciation	<u>80,244</u>	<u>63,324</u>
Property and equipment, net	<u>\$ 41,855</u>	<u>\$ 54,513</u>

As of December 28, 2004 and December 30, 2003, manufacturing equipment with a net book value of approximately \$5,100 and \$10,100, respectively, was located at a major supplier's plant.

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

**7. TRADEMARKS AND OTHER INTANGIBLES**

Trademarks and other intangibles consist of the following as of:

	<u>December 28, 2004</u>	<u>December 30, 2003</u>
<b>Amortizing intangibles:</b>		
Trade secrets	\$ 5,385	\$ 5,385
Trademarks	2,062	-
Patents-manufacturing process	<u>33,741</u>	<u>33,741</u>
	41,188	39,126
<b>Less accumulated amortization:</b>		
Trade secrets	3,770	2,693
Trademarks	387	-
Patents-manufacturing process	<u>23,618</u>	<u>16,870</u>
	<u>27,775</u>	<u>19,563</u>
<b>Total amortizing intangibles, net</b>	<b><u>\$ 13,413</u></b>	<b><u>\$ 19,563</u></b>
<b>Non-amortizing intangibles:</b>		
Trademarks	<u>63,806</u>	<u>65,868</u>
<b>Total trademarks and other intangibles, net</b>	<b><u>\$ 77,219</u></b>	<b><u>\$ 85,431</u></b>

Certain trademarks were previously treated as a non-amortizing intangible and were reclassified as an amortizing intangible at June 29, 2004. See note 2 for additional information.

Intangible amortization expense totaled approximately \$8,200, \$7,800 and \$7,800 for the fiscal years ended 2004, 2003 and 2002, respectively. The estimated aggregate amortization expense for the following five fiscal years is as follows:

<u>Fiscal year:</u>	
2005	\$ 8,340
2006	4,428
2007	516
2008	129
2009	-
Thereafter	-
	<u>\$ 13,413</u>

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

**8. DEBT ISSUANCE COSTS AND OTHER ASSETS**

Debt issuance costs and other assets consist of the following:

	December 28, 2004	December 30, 2003
Security deposits	\$ 1,296	\$ 1,337
Debt issuance costs, net of amortization	5,957	7,802
Other	-	31
Total debt issue costs and other assets	<u>\$ 7,253</u>	<u>\$ 9,170</u>

Direct costs incurred for the issuance of debt are capitalized and amortized using the effective interest method over the term of the respective debt. In the event that the debt is retired prior to the maturity date, debt issuance costs will be expensed in the period that the debt is retired. The amortization of debt issuance costs is included in interest expense in the consolidated statements of operations. Amortization expense of approximately \$1,800, \$3,100 and \$10,600 was recorded for the fiscal years ended 2004, 2003 and 2002, respectively.

**9. ACCRUED EXPENSES**

Accrued expenses consist of the following:

	December 28, 2004	December 30, 2003
Payroll and related bonuses	\$ 12,450	\$ 11,664
Interest	10,249	10,039
Integration and reorganization	21	4,073
Gift cards	2,476	2,301
Other	9,640	9,794
Total accrued expenses	<u>\$ 34,836</u>	<u>\$ 37,871</u>

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

**10. SENIOR NOTES AND OTHER LONG-TERM DEBT**

Senior notes and other long-term debt consist of the following:

	December 28, 2004	December 30, 2003
\$160 Million Notes	\$ 160,000	\$ 160,000
AmSouth Revolver	15	1,000
Chesapeake Bagel Bakery Note Payable	-	825
New Jersey Economic Development Authority Note Payable	1,120	1,400
	<hr/>	<hr/>
	161,135	163,225
Less current portion of debt	295	2,105
	<hr/>	<hr/>
Long-term debt	\$ 160,840	\$ 161,120

**\$160 Million Notes**

On July 8, 2003, we issued \$160,000 of 13% senior secured notes maturing on July 1, 2008 (“\$160 Million Notes”) in a private placement.

The \$160 Million Notes are guaranteed, fully and unconditionally, jointly and severally, by us and all present and future subsidiaries of ours and is collateralized by substantially all of our assets in which we have an interest. Pursuant to an Intercreditor Agreement, the \$160 Million Notes are subordinate to the AmSouth Revolver as described below.

The \$160 Million Notes contain certain covenants, which, among others, include certain financial covenants such as limitations on capital expenditures and minimum EBITDA as defined in the agreement. These covenants are measured on a rolling twelve-month period and fiscal quarter basis, respectively. This debt contains usual and customary default provisions. As of December 28, 2004, we were in compliance with all our financial and operating covenants.

Interest payments under the \$160 Million Notes are payable in arrears at the rate of 13% per year on July 1 and January 1, commencing January 1, 2004. The notes are redeemable, at our option, in whole or in part at any time after July 1, 2004 at the following redemption prices (as expressed in percentages of the principal amount):

<u>Year</u>	<u>Percentage</u>
2004	104.0%
2005	103.0%
2006	102.0%
2007	101.0%
2008 and thereafter	100.0%

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

#### **AmSouth Revolver**

On July 8, 2003, we entered into a three-year, \$15 million senior secured revolving credit facility with AmSouth Bank ("AmSouth Revolver"). The AmSouth Revolver was subsequently amended to make technical corrections, clarify ambiguous terms and provide for increased limits with respect to letters of credit. On February 11, 2005, the AmSouth Revolver was amended again to increase our letter of credit sub-facility from \$5 million to \$7.5 million.

The AmSouth Revolver is collateralized by substantially all of our assets in which we have an interest and is senior to the \$160 Million Notes pursuant to an Intercreditor Agreement.

The AmSouth Revolver contains certain covenants, which, among others, include certain financial covenants such as limitations on capital expenditures, operating lease obligations, minimum EBITDA as defined in the agreement, operating cash flow coverage ratio and minimum net worth. These covenants are measured on a rolling twelve-month period at each fiscal quarter or annually at year-end. Additional covenant restrictions exist if the total borrowings, including outstanding letters of credit exceed \$10,000. This debt also contains usual and customary default provisions. As of December 28, 2004, we are in compliance with all of our financial and operating covenants.

Interest payments under the AmSouth Revolver are payable in arrears on the first of each month. The net borrowings under the AmSouth Revolver bear an interest rate equal to the base rate plus an applicable margin with the base rate being the AmSouth Bank "prime rate" and the applicable margin based on our fixed charge coverage ratio with a minimum and maximum applicable margin of 0.5% and 2.5%, respectively. As of December 28, 2004 and December 30, 2003, the interest rate on the borrowings outstanding under the AmSouth Revolver was 5.75% and 5.0%, respectively.

We are required to pay an unused credit line fee of 0.50% per annum on the average daily unused amount. The unused line fee is payable monthly in arrears. Additionally, we are required to pay a letter of credit fee, based on the average daily undrawn face amount for each letter of credit issued, of an applicable margin being based on our fixed charge coverage ratio with a minimum and maximum applicable margin of 2.0% and 4.5% respectively. Letters of credit reduce our availability under the AmSouth Revolver. At December 28, 2004, we had \$5,000 of letters of credit outstanding. The letters of credit expire on various dates during 2005, are automatically renewable for one additional year and are payable upon demand in the event that we fail to pay certain workers compensation claims. Our availability under the AmSouth Revolver was approximately \$10,000 at December 28, 2004.

#### **Chesapeake Bagel Bakery Note Payable**

As a part of the acquisition of the assets of Chesapeake, we entered into a note payable to the seller. The note provided for quarterly payments of interest only at 10%. The note was paid in full on August 31, 2004 according to its terms.

#### **New Jersey Economic Development Authority Note Payable**

In December 1998, Manhattan entered into a note payable in the principal amount of \$2,800 with the New Jersey Economic Development Authority (NJEDA) at an interest rate of 9% per annum. Principal is paid annually and interest is paid quarterly. The note matures on December 1, 2008 and is secured by the assets of Manhattan.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

On July 3, 2003, we placed an advanced funding of the note in escrow to enact a debt defeasance as allowed for in the agreement. This advanced funding is shown as restricted cash and the note is included in both current portion and long-term portion of debt in the December 28, 2004 and December 30, 2003 consolidated balance sheets in accordance with the payment terms. This classification will continue until the note is fully paid from the escrow amount proceeds.

Our senior notes and other long-term debt obligations for the five years following December 28, 2004 are as follows (in thousands of dollars):

<u>Fiscal year:</u>		
2005	\$	295
2006		280
2007		280
2008		160,280
2009		-
Thereafter		-
	\$	<u>161,135</u>

## 11. LEASES

### Capital Leases

We lease certain equipment under capital leases. Included in property and equipment are the asset values of \$51 and the related accumulated amortization of \$5 at December 28, 2004. Amortization of assets under capital leases is included in depreciation and amortization expense.

### Operating Leases

We lease office space, restaurant space and certain equipment under operating leases having terms that expire at various dates through fiscal 2017. Our restaurant leases have renewal clauses of 1 to 20 years at our option and, in some cases, have provisions for contingent rent based upon a percentage of gross sales, as defined in the leases. Rent expense for fiscal 2004, 2003 and 2002 was approximately \$31,400, \$31,200 and \$30,500, respectively. Contingent rent included in rent expense for fiscal 2004, 2003 and 2002 was approximately \$3,700, \$3,500 and \$2,900, respectively.

**NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

**Future Minimum Lease Payments**

As of December 28, 2004, future minimum lease payments under capital and operating leases were as follows (in thousands of dollars):

<u>Fiscal year:</u>	<u>Capital Leases</u>	<u>Operating Leases</u>
2005	\$ 18	\$ 26,358
2006	18	20,158
2007	14	10,734
2008	-	4,644
2009	-	2,705
2010 and thereafter	-	4,969
Total minimum lease payments	<u>50</u>	<u>\$ 69,568</u>
Less imputed interest (average rate of 4.75%)	<u>3</u>	
Present value of minimum lease payments	47	
Less current installments	<u>16</u>	
Future minimum rental payments, net	<u>\$ 31</u>	

**12. OTHER LONG-TERM LIABILITIES**

Other long-term liabilities consist of the following (in thousands of dollars):

	<u>December 28, 2004</u>	<u>December 30, 2003</u>
Vendor contractual agreements (a)	\$ 7,804	\$ 8,014
Guaranteed franchisee debt (b)	394	874
Deferred rent	<u>1,480</u>	<u>1,509</u>
	<u>\$ 9,678</u>	<u>\$ 10,397</u>

- (a) A strategic supplier of ours provided advance funding in the amount of \$10,000 to us in 1996 as part of a contract to continue buying products from the supplier. The contract terminates upon fulfillment of contractual purchase volumes. The accounting for this contract is to recognize a reduction of cost of goods sold based on the volume of purchases of the vendor's product.
- (b) In connection with our acquisition of Manhattan, we agreed to guarantee certain loans to franchisees made by two financial institutions. We evaluate the fair value of such liability at each balance sheet date. As of December 28, 2004 and December 30, 2003, the fair value of the liability reflected above is the probable and estimable loss related to such loans pursuant to agreements with the financial institutions regarding the established caps on our obligation. This represents our best estimate of future pay-outs we will make under these guarantees.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 13. 2003 DEBT REFINANCING AND EQUITY RECAPITALIZATION

During 2000 and 2001, we engaged in several financing transactions to acquire the bonds of Einstein/Noah Bagel Corp. (ENBC), which declared Chapter 11 bankruptcy on April 27, 2000. In 2001, we completed the acquisition of substantially all of the assets (the Einstein Acquisition) of ENBC and its majority-owned subsidiary, Einstein/Noah Bagel Partners, L.P. which operated 2 brands: Einstein Bros. Bagels and Noah's New York Bagels. The Einstein Acquisition in 2001 was accomplished by issuing a substantial amount of short-term debt and mandatorily redeemable preferred equity. The maturity date on the debt and the redemption date of certain preferred stock issuances ranged from one to three years. The debt and preferred stock agreements required the issuance of additional warrants and payment of dividends in the event that they were not redeemed within a certain period. Such debt and preferred stock and warrant agreements were referred to as the Increasing Rate Notes or \$140 Million Facility, the Standstill Agreement, the Bond Purchase Agreement, the Bridge Loan, and the Mandatorily Redeemable Series F Preferred Stock (Series F) and Warrant Agreements.

In connection with the aforementioned debt and preferred stock issuances, we issued freestanding warrants and rights to receive additional warrants based either on the passage of time or upon the occurrence (or non-occurrence) of certain contingent future events. The warrants were classified as a liability in the consolidated balance sheets, subject to the provisions of SFAS No. 133, "Accounting for Derivative and Hedging Activities," which required the warrants to be adjusted to fair value at each measurement date. Changes in the fair value of derivatives were recognized in earnings. During the years 2003 and 2002, we recorded a cumulative change in the fair value of derivatives of \$993 and \$233, respectively. As a result of the equity recapitalization as described below, we no longer have contingently issuable warrants and all warrants issued have been classified as permanent equity.

We previously held an investment in debt securities which included ENBC 7.25% Convertible Debentures due 2004 (Einstein Bonds). The Einstein Bonds were classified as available for sale and recorded at fair value with changes in fair value reported in stockholders' deficit. During the years ended 2003 and 2002, we received proceeds of \$374 and \$36,711, respectively, for the debentures from the bankruptcy court that exceeded the carrying value of the asset. Accordingly, we recorded a gain on our investment in debt securities of \$374 and \$2,537 in 2003 and 2002, respectively.

The proceeds received of \$36,711 relating to our investment in the Einstein Bonds were used repay a portion of the Bridge Loan, which bore interest at an initial rate of 14% per annum and increased by 0.35% on the fifteenth day of each month beginning July 15, 2002. The Bridge Loan was secured by the Einstein Bonds. We issued Series F to pay the remaining balance of the Bridge Loan. Additionally, we issued Series F to pay the Bond Purchase Agreement in full. The Bond Purchase Agreement provided for guaranteed accretion of 15% per year, increasing to 17% on January 17, 2002 and an additional 2% each six months thereafter. The Series F was entitled to an annual cash dividend equal to 17% per annum increasing 100 basis points per month until the Series F was redeemed. Warrants to purchase shares of our common stock were also issued in connection with this transaction and have since been reclassified as permanent equity as a result of the equity recapitalization.

On July 8, 2003, we issued \$160 million of 13% senior secured notes due 2008 as further explained in Note 10. We used the net proceeds, among other things, to refinance the Increasing Rate Notes. The Increasing Rates Notes bore interest at an initial rate of 13%, increasing 100 basis points each quarter commencing September 15, 2001 to a maximum rate of 18%. On that same date, we also entered into a three-year, \$15 million senior secured facility with AmSouth Bank.

In September 2003, we completed an equity recapitalization with our preferred stockholders, who held a substantial portion of our common stock. Among other things, our Mandatorily Redeemable Series F Preferred Stock (Series F) and its related dividends and accretion were eliminated. In exchange, we issued 57,000 shares of our Mandatorily Redeemable Series Z Preferred Stock (Series Z) to Halpern Denny Fund III, L.P. ("Halpern



## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

Denny”) and we issued 9,380,843 shares of our common stock to Greenlight Capital and affiliates (“Greenlight”).

The exchange of the Halpern Denny interest resulted in a reduction of our effective dividend rate and as a result of this and other factors, we accounted for this transaction as troubled debt restructuring. This exchange did not result in a gain from troubled debt restructuring. The exchange of the Greenlight interest into common shares was recorded at fair value, which resulted in a loss upon exchange of approximately \$23,000.

In connection with the equity recapitalization and because certain debt agreements were not redeemed within a certain period, we issued step-up warrants to prevent further dilution and entered into Standstill Agreements with holders of our Increasing Rate Notes. Under the terms of the Standstill Agreements, we agreed to issue additional warrants to purchase shares of our common stock. The Standstill Agreements prevented the call of the debt until such time as we completed the equity recapitalization. For the year ended December 30, 2003, we recorded \$3,132 in interest expense related to the standstill and step-up warrants representing the fair value of our stock on the date of issuance.

### 14. MANDATORILY REDEEMABLE SERIES Z PREFERRED STOCK

The major provisions of our Mandatorily Redeemable Series Z Preferred Stock (Series Z) are as follows:

- 2,000,000 shares authorized;
- par value of \$0.001 per share;
- mandatory redemption upon the earlier of (i) a merger or change of control or (ii) June 30, 2009;
- shares are non-voting (except for certain limited voting rights with respect to specified events);
- liquidation value is \$1,000 per share;
- dividends are not accrued or paid unless the shares are not redeemed by the redemption date; and
- shares may be redeemed in whole or in part at an earlier date at our discretion.

The Series Z is recorded in the accompanying consolidated balance sheets at its full face value of \$57,000 as a result of the accounting under troubled debt restructuring as discussed in Note 13. The \$57,000 represents the total cash payable upon liquidation.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 15. STOCKHOLDERS' EQUITY

#### Common Stock

We are authorized to issue up to 15 million shares of common stock, par value \$0.001 per share. As of December 28, 2004 and December 30, 2003, there were 9.849 million and 9.842 million shares outstanding, respectively.

#### Series A Junior Participating Preferred Stock

In June 1999, our board of directors authorized the issuance of a Series A junior participating preferred stock in the amount of 700,000 shares. This authorization was made in accordance with the Stockholders' Rights Plan. There are currently no issued shares.

#### Stockholder Protection Rights Plan

We maintain a Stockholder Protection Rights Plan (the Plan). Upon implementation of the Plan in June 1999, our Board declared a dividend distribution of one right on each outstanding share of common stock, as well as on each share later issued. Each right will allow stockholders to buy one one-hundredth of a share of Series A junior participating preferred stock at an exercise price of \$10.00. The rights become exercisable if an individual or group acquires 15% or more of common stock, or if an individual or group announces a tender offer for 15% or more of common stock. The Board can redeem the rights at \$0.001 per right at any time before any person acquires 15% or more of the outstanding common stock. In the event an individual (the "Acquiring Person") acquires 15% or more of the outstanding common stock, each right will entitle its holder to purchase, at the right's exercise price, one one-hundredth of a share of Series A junior participating preferred stock, which is convertible into common stock at one-half of the then value of the common stock, or to purchase such common stock directly if there are a sufficient number of Shares of common stock authorized. Our Board has the ability to exclude any Acquiring Person from the provision of the stockholders rights plan, resulting in such Acquiring Person's purchase of our common stock not triggering the plan. Rights held by the Acquiring Person are void and will not be exercisable to purchase shares at the bargain purchase price. If we are acquired in a merger or other business combination transaction, each right will entitle its holder to purchase, at the right's then-current exercise price, a number of the acquiring company's common shares having a market value at that time of twice the right's exercise price.

### 16. STOCK OPTION AND WARRANT PLANS

#### 1994 and 1995 Plans

Our 1994 Stock Plan (1994 Plan) provided for the granting to employees of incentive stock options and for the granting to employees and consultants of non-statutory stock options and stock purchase rights. On November 21, 2003, the board of directors terminated the authority to issue any additional options under the 1994 Plan. At December 28, 2004, 17 options with an exercise price of \$210.71 per share remained outstanding under this plan.

Our 1995 Directors' Stock Option Plan (Directors' Option Plan) provided for the automatic grant of non-statutory stock options to non-employee directors of the Company. On December 19, 2003, our board of directors terminated the authority to issue any additional options under the Directors' Option Plan. At December 28, 2004, 2,324 options with a weighted average exercise price of \$32.43 per share remained outstanding under this plan.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 2003 Executive Employee Incentive Plan

On November 21, 2003, our board of directors adopted the Executive Employee Incentive Plan, amended on December 19, 2003 (2003 Plan). The 2003 Plan provides for granting incentive stock options to employees and granting non-statutory stock options to employees and consultants. Unless terminated sooner, the 2003 Plan will terminate automatically in December 2013. The board of directors has the authority to amend, modify or terminate the 2003 Plan, subject to any required approval by our stockholders under applicable law or upon advice of counsel. No such action may affect any options previously granted under the 2003 Plan without the consent of the holders. The number of shares issuable pursuant to options granted under the 2003 Plan is 900,000. Options typically vest in part based upon the passage of time and, in part, upon our financial performance. Options that do not vest due to the failure to achieve specific financial performance criteria are forfeited. Options to purchase approximately 386,000 shares of our common stock, which are not yet exercisable, are subject to company performance. We expect that approximately one-half of the non-vested awards at December 28, 2004, will eventually vest based on company performance. As of December 28, 2004, there were 129,000 shares reserved for future issuance under the 2003 Plan.

### 2004 Stock Option Plan for Independent Directors

On December 19, 2003, our board of directors adopted the Stock Option Plan for Independent Directors, effective January 1, 2004, (2004 Directors' Plan). Our board of directors may amend, suspend, or terminate the 2004 Directors' Plan at any time, provided, however, that no such action may adversely affect any outstanding option without the option holders consent. A total of 200,000 shares of common stock have been reserved for issuance under the 2004 Directors' Plan. The 2004 Directors' Plan provides for the automatic grant of non-statutory stock options to independent directors on January 1 of each year. Options become exercisable six months after the grant date and are exercisable for 5 years from the date of grant unless earlier terminated. As of December 28, 2004, there were 170,000 shares reserved for future issuance under the 2004 Directors' Plan.

### Option Activity

Transactions during fiscal 2004, 2003 and 2002 were as follows:

	Number of Options			Weighted Average Exercise Price		
	2004	2003	2002	2004	2003	2002
Outstanding, beginning of year	878,345	86,647	47,582	\$ 4.12	\$ 17.46	\$ 97.53
Granted	45,000	877,495	84,219	3.25	4.05	15.61
Exercised	-	-	-	-	-	-
Forfeited	(120,004)	(85,797)	(45,154)	(3.00)	(16.89)	(98.68)
Outstanding, end of year	803,341	878,345	86,647	\$ 3.95	\$ 4.12	\$ 17.46
Exercisable, end of year	32,341	2,345	30,418	\$ 5.92	\$ 33.99	\$ 20.02

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

The following table summarizes information about stock options outstanding at December 28, 2004:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options	Wt. Avg. Remaining Life (Years)	Wt. Avg. Exercise Price	Number of Options	Wt. Avg. Exercise Price
\$2.25 - \$4.00	801,000	9.00	\$ 3.86	30,000	\$ 3.75
\$4.01 - \$31.00	1,826	8.42	12.20	1,826	12.20
\$31.01 - \$241.00	515	4.84	110.04	515	110.04
	<u>803,341</u>	<u>9.00</u>	<u>\$ 3.95</u>	<u>32,341</u>	<u>\$ 5.92</u>

### Warrants

As of December 28, 2004, we have 961,391 warrants outstanding and exercisable to purchase shares of our common stock. The warrants have exercise prices ranging from \$0.60 to \$663.00 per share, of which 950,933 are exercisable at \$1.00 or less per share, and have terms ranging from three to ten years. Such warrants were issued in connection with financings and certain other services. Transactions during fiscal 2004, 2003 and 2002 were as follows:

	2004	2003	2002
Outstanding at beginning of year	968,337	659,328	858,336
Issued	-	541,027	459,363
Exercised	(6,885)	-	(658,371)
Converted	-	(227,747)	-
Forfeited	(61)	(4,271)	-
Outstanding and exercisable at end of year	<u>961,391</u>	<u>968,337</u>	<u>659,328</u>

### 17. SAVINGS PLAN

We sponsor a qualified defined contribution retirement plan covering eligible employees of New World Restaurant Group. Employees, excluding officers, are eligible to participate in the plan if they meet certain compensation and eligibility requirements. The 401(k) plan allows participating employees to defer the receipt of a portion of their compensation and contribute such amount to one or more investment options. We have accrued a match of approximately 25% of the participants' elective contribution for 2004. Our contribution expense was \$250, \$203 and \$298 for 2004, 2003 and 2002, respectively. Our contributions vest at the rate of 100% after three years of service.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 18. INTEGRATION AND REORGANIZATION COSTS

#### 2001 Restructuring

During the quarter ended July 3, 2001, we implemented a plan to consolidate our two dough manufacturing facilities on the West Coast, eliminate duplicative labor lines of assembly, and terminate certain lease obligations inclusive of several restaurant and other locations. We initially recorded a restructuring accrual of approximately \$4,400 associated with this restructuring plan. Approximately \$1,000 of this charge represented a write-off of equipment and leasehold improvements that were either abandoned or deemed unusable by us. As of December 28, 2004, we anticipate the remaining lease liabilities to expire on or before October 2006.

The following table presents the activity and balances related to the 2001 restructuring accrual:

	Facility Consolidation Costs	Severance Costs	Contract Termination and Other Costs	Store Lease Termination	Total
Initial accrual	\$ 379	\$ 151	\$ 233	\$ 2,629	\$ 3,392
Application of costs against the accrual	-	-	(204)	(293)	(497)
Adjustments to the accrual	-	-	29	12	41
Balance at January 1, 2002	\$ 379	\$ 151	\$ 58	\$ 2,348	\$ 2,936
Application of costs against the accrual	(68)	(229)	(94)	(907)	(1,298)
Adjustments to the accrual	-	85	43	(702)	(574)
Balance at December 31, 2002	\$ 311	\$ 7	\$ 7	\$ 739	\$ 1,064
Application of costs against the accrual	(266)	-	(14)	(229)	(509)
Adjustments to the accrual	(32)	(7)	7	(181)	(213)
Balance at December 30, 2003	\$ 13	\$ -	\$ -	\$ 329	\$ 342
Application of costs against the accrual	(15)	-	-	(168)	(183)
Adjustments to the accrual	2	-	-	(140)	(138)
Balance at December 28, 2004	\$ -	\$ -	\$ -	\$ 21	\$ 21

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 2002 Restructuring

During the quarter ended October 1, 2002, we implemented a plan to shut down our dough manufacturing facilities on the East Coast. During the quarter ended December 31, 2002, we implemented a plan to terminate the lease obligation for the Eatontown location. We vacated the Eatontown location in the last week of 2002. When initiated, the restructuring plans were expected to take approximately one year to complete, subject to our ability to sublease the Eatontown facility. We ultimately recorded a \$4,800 charge associated with the restructuring plans in 2002. Approximately \$2,200 of this charge represented a write-off of equipment and leasehold improvements that were either abandoned or deemed unusable by us. In the fourth quarter of fiscal 2003, we became aware that the Eatontown facility was in the process of being sold and that the landlord had engaged a valuation expert to determine the total cost associated with our vacating the facility. Based upon the results of this study, we adjusted our initial charge to our estimate of the ultimate liability on the Eatontown facility. During April 2004, we reached an agreement with the landlord of the Eatontown facility to settle outstanding litigation. Previously recorded integration and reorganization estimates associated with closing this facility were adjusted to reflect a reduction of the prior year's accrued cost of \$700,000.

The following table presents the activity and balances related to the 2002 restructuring accrual:

	Facility Consolidation Costs	Severance Costs	Contract Termination and Other Costs	Total
Initial accrual	\$ 1,447	\$ 787	\$ 300	\$ 2,534
Application of costs against the accrual	-	(662)	(168)	(830)
Balance at December 31, 2002	\$ 1,447	\$ 125	\$ 132	\$ 1,704
Application of costs against the accrual	(160)	(90)	(68)	(318)
Adjustments to the accrual	2,413	(35)	(33)	2,345
Balance at December 30, 2003	\$ 3,700	\$ -	\$ 31	\$ 3,731
Application of costs against the accrual	(3,000)	-	-	(3,000)
Adjustments to the accrual	(700)	-	(31)	(731)
Balance at December 28, 2004	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

### 19. LOSS (GAIN) ON SALE, DISPOSAL OR ABANDONMENT OF ASSETS

During fiscal 2004, we recorded a loss on disposal or abandonment of assets of approximately \$120 due to the disposal of menu boards as a result of our new menu offerings and approximately \$1,500 due to the abandonment of leasehold improvements related to closed restaurants and our administrative facilities located in New Jersey. The loss on disposal or abandonment of assets was offset by a gain of approximately \$90 on the sale of the assets of Willoughby's as further described below.

### 20. SALE OF WILLOUGHBY'S COFFEE AND TEA

Effective October 6, 2004, we executed an Asset Purchase Agreement and sold the assets of Willoughby's to the original founders. The Willoughby's business consisted of a coffee roasting plant, three retail locations and an office space.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

Components of the asset sale included, but were not limited to:

- The "Willoughby's Coffee & Tea" trade name, trademark and logo,
- The "Serious Coffee" trademark,
- The willoughbyscoffee.com domain name and existing website,
- All property and equipment of Willoughby's, and
- Cash in drawer, accounts receivable, and inventory at all Willoughby's locations.

Under the terms of agreement, we sold the assets for a total sales price of approximately \$400, which was received in cash. In connection with the sale of Willoughby's, we also executed a two-year supply agreement to purchase coffee for our New World Coffee cafés from the buyer.

We have considered Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. We have determined that the revenues, cost of sales, other operating expenses and the net book value of the assets related to the sale of the coffee roasting plant and three retail locations included in the Willoughby's business were immaterial in relation to our Einstein Bros., Noah and Manhattan restaurants, as well as the financial statements taken as a whole. Accordingly, we have not presented discontinued operations in the accompanying consolidated statements of operations, nor have we reflected assets as held for sale in the accompanying consolidated balance sheets. We recognized a gain from the sale of approximately \$90 during the year ended December 28, 2004.

## 21. INCOME TAXES

The provision for income taxes consists of the following:

	2004	2003 (restated)	2002 (restated)
Current			
Federal	\$ -	\$ -	\$ -
State	(49)	812	366
Total current income tax expense (benefit)	(49)	812	366
Deferred			
Federal	(6,529)	(15,905)	(17,354)
State	(611)	(1,601)	(1,577)
Total deferred income tax benefit	(7,140)	(17,506)	(18,931)
Increase in valuation allowance	7,140	17,506	18,931
Total income tax benefit (expense)	\$ (49)	\$ 812	\$ 366

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

A reconciliation between the reported provision for income taxes and the amount computed by applying the statutory federal income tax rate of 35% to loss before income taxes is as follows:

	2004	2003 (restated)	2002 (restated)
Expected tax expense (benefit) at 35%	\$ (6,109)	\$ (25,448)	\$ (15,585)
State tax, net of federal benefit	(611)	(1,601)	(1,577)
Loss on extinguishment of debt	-	8,052	-
Other, net	(469)	2,303	(1,403)
Change in valuation allowance	7,140	17,506	18,931
Total provision (benefit) for taxes	\$ (49)	\$ 812	\$ 366

The income tax effects of temporary differences that give rise to significant portions of deferred tax assets as of December 28, 2004 and December 30, 2003 are as follows:

	2004	2003
Deferred tax assets		
Operating loss carryforwards	\$ 57,412	\$ 53,409
Capital loss carryforwards	1,237	-
Accrued expenses	2,424	4,563
Allowances for doubtful accounts	893	1,266
Other assets	32	-
Property, plant and equipment	12,016	7,636
Total gross deferred tax asset	74,014	66,874
Less valuation allowance	(74,014)	(66,874)
Total deferred tax asset	\$ -	\$ -

For income tax purposes, at December 28, 2004, we had net operating loss carryforwards of approximately \$150,000, expiring at various dates through 2024. The utilization of approximately \$69,000 of the aforementioned net operating loss carryforwards is subject to an annual limitation under the provisions of Section 382 of the Internal Revenue Code.

We believe it is more likely than not that our net deferred tax asset will not be realized. Accordingly, a valuation allowance has been recorded against the deferred tax asset at December 28, 2004 and December 30, 2003. Should we conclude that the deferred tax asset is, at least in part, realizable, the valuation allowance will be reversed to the extent of such expected realizability.



## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 22. SUPPLEMENTAL CASH FLOW INFORMATION

	2004	2003	2002
Cash paid during the period for (in thousands):			
Interest	\$ 21,166	\$ 17,284	\$ 24,874
Income taxes	\$ 667	\$ 630	\$ 366
 Non-cash investing and financing activities (in thousands):			
Non-cash dividends and accretion on preferred stock	\$ -	\$ 14,423	\$ 27,594
Conversion of Bridge Loan and Greenlight obligation to Mandatorily Redeemable Series F preferred stock	\$ -	\$ 18,588	\$ -
Conversion of Mandatorily Redeemable Series F to Mandatorily Redeemable Series Z preferred stock	\$ -	\$ 57,000	\$ -
Conversion of Mandatorily Redeemable Series F to common stock	\$ -	\$ 61,706	\$ -
Non-cash warrant issuance	\$ -	\$ 1,854	\$ 6,321
Non-cash option issuance	\$ 205	\$ -	\$ -

### 23. RELATED PARTY TRANSACTIONS

Several of our stockholders or former stockholders, including BET, Brookwood, Halpern Denny, Greenlight Capital, LLC and certain of their affiliates (Greenlight), have been involved in our financings, refinancings and have purchased our debt and equity securities. Below, we have summarized related party transactions involving these investors during 2004, 2003 and 2002 fiscal years.

E. Nelson Heumann is the chairman of our board of directors and is a current employee of Greenlight. Leonard Tannenbaum, a director, was the Managing Director of MYFM Capital LLC until July 2004. In July 2004, Mr. Tannenbaum founded Fifth Street Capital LLC and is the managing partner. He is also a limited partner and 10% owner in BET. His father-in-law is Bruce Toll, an affiliate of BET. John S. Clark II, a director, was employed by Greenlight until March 2004. Greenlight beneficially owns approximately 97 percent of our common stock.

Eve Trkla, a director of our company until August 16, 2003, is the Chief Financial Officer of Brookwood Financial Partners, L.P., a former affiliate of Brookwood. Brookwood designated Ms. Trkla as a director to serve for the period specified in the Stockholders Agreement (which was terminated as a result of the equity recapitalization).

William Nimmo, a director of our company until June 6, 2003, is a partner in Halpern, Denny and Co., an affiliate of Halpern Denny. Halpern Denny designated Mr. Nimmo as a director of our company.

On May 30, 2002, we entered into a Loan and Security Agreement (the facility) with BET, which provided for \$75,000 revolving loan facility at 11% interest. The facility was secured by substantially all of our assets. In connection with obtaining the facility, we paid MYFM Capital LLC a fee of \$75. In February 2003, we executed an amendment to the facility to extend the maturity of the facility from March 31, 2003 to June 1, 2003. From February 1, 2003 to June 1, 2003, the interest rate increased from 11% to 13% per annum. BET and MYFM

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

Capital LLC received an extension fee of \$188 in connection with the amendment, payable at maturity, and an additional \$113 because the facility was not paid in full by June 2, 2003. After June 1, 2003, the interest rate for borrowings under the facility was 15% per annum, and MYFM Capital LLC received a \$25 fee for entering into a standstill agreement with us. The facility was repaid with the proceeds of issuance of the \$160 Million Facility in July 2003, and BET received \$3 for reimbursement of legal fees and expenses.

In July 2003, Greenlight purchased all of the outstanding Einstein/Noah Bagel Corp. 7.25% Convertible Debentures due 2004 from Jefferies. Upon consummation of the equity recapitalization, we issued 4,337,481 shares of Series F to Greenlight in full payment of the outstanding Bridge Loan. The shares of Series F were converted into common stock in the equity recapitalization.

On June 25, 2003, we entered into the equity recapitalization with Halpern Denny and Greenlight, pursuant to which the parties agreed to a recapitalization of our equity structure. Pursuant to the equity recapitalization, we reimbursed Greenlight and Halpern Denny for legal fees and disbursements incurred in connection with their investment in our company and the equity restructuring in the respective amounts of \$226 and \$125.

Greenlight purchased \$35,000 and BET purchased \$7,500 of our \$160 Million Notes. Leonard Tannenbaum purchased an additional \$500 of our \$160 Million Notes in the market.

On December 8, 2003, we entered into a consulting agreement with Ms. Jill B. W. Sisson to provide legal, consulting and advisory services to us and to serve as General Counsel and Secretary. Pursuant to the Agreement, Ms. Sisson is paid \$16 per month and, on December 19, 2003, was granted options to purchase 75,000 shares of common stock pursuant to the 2003 Plan. The options vest in part, upon length of service and in part, upon the achievement of specified financial goals by us. In addition, Ms. Sisson is eligible to receive annual additional premium compensation based upon our performance and personal performance. Ms. Sisson will also be reimbursed for reasonable and necessary out-of-pocket expenses. The agreement provides for non-solicitation of our employees for a year after termination of the agreement, and can be terminated by either party upon 30 days notice.

During 2002, the holders involved in certain debt and preferred stock financings in 2000 and 2001 became entitled to receive additional warrants. See Note 13 for additional information.

#### 24. PURCHASE COMMITMENTS

We have obligations with certain of our major suppliers of raw materials (primarily frozen bagel dough and cream cheese) for minimum purchases both in terms of quantity and pricing on an annual basis. Furthermore, from time to time, we will commit to the purchase price of certain commodities that are related to the ingredients used for the production of our bagels. On a periodic basis, we review the relationship of these purchase commitments to our business plan, general market trends and our assumptions in our operating plans. If these commitments are deemed to be in excess of the market, we will expense the excess purchase commitment to cost of sales, in the period in which the shortfall is determined. The total of our future purchase obligations at December 28, 2004 was approximately \$18,468.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
(dollars in thousands, except share and per share amounts)

### 25. LITIGATION

We are subject to claims and legal actions in the ordinary course of our business, including claims by our franchisees, licensees and employees or former employees. We do not believe that an adverse outcome in any currently pending or threatened matter would have a material adverse effect on our business, results of operations or financial condition.

#### Employment Related

On July 31, 2002, Tristan Goldstein, a former store manager, and Valerie Bankhordar, a current store manager, filed a putative class action against Einstein and Noah Corp. ("ENC") in the Superior Court for the State of California, County of San Francisco. The plaintiffs alleged that ENC failed to pay overtime wages to managers and assistant managers of its California stores who were improperly designated as exempt employees. In April 2004, we reached an agreement in principle to settle the litigation, subject to court approval. Amounts representing our estimate to settle this litigation were previously recorded during fiscal 2003.

On March 31, 2003, Jerold E. Novack, our former Chief Financial Officer and Secretary, filed a complaint in the United States District Court for the District of New Jersey against us, Anthony D. Wedo, our former Chairman and Chief Executive Officer, and William J. Nimmo, a former member of our board of directors. On January 13, 2005, the parties resolved the litigation. The resolution of this issue did not have a material adverse effect on our consolidated financial condition or results of operations.

On June 4, 2003, R. Ramin Kamfar, our former Chairman of the Board and Chief Executive Officer, filed an action in the United States District Court for the Southern District of New York against us and Anthony D. Wedo, our former Chairman and Chief Executive Officer, alleging breach of contract, defamation, declaratory relief and punitive damages. On February 10, 2005, the case was dismissed with prejudice and the parties have resolved this litigation. The resolution of this issue did not have a material adverse effect on our consolidated financial condition or results of operations.

On September 14, 2004, Atlantic Mutual Insurance Company brought an action in the Superior Court of New Jersey Law Division: Morris County, Docket No. MRS-L-2463-04 against the Company, Wedo, Nimmo, Novack, Kamfar, Lexington Insurance Company, and XL Specialty Insurance Company seeking declaratory judgment on insurance coverage issues in the Novack litigation and the Kamfar litigation described above. The parties have filed answers and cross-claims, and Mr. Kamfar has filed a motion for partial summary judgment claiming advancement for expenses for which he claims the Company is required to indemnify him. At this time, we cannot predict the outcome of this matter and there can be no assurance that we will prevail in this matter, that a determination will be made that we have insurance coverage for expenses that we have already incurred, or that damages or other relief will not be awarded against us.

#### Investigations

On April 3, 2002, the Securities and Exchange Commission notified us that the Commission was conducting an investigation into the resignation of our former Chairman, R. Ramin Kamfar, and the termination for cause of our former Chief Financial Officer, Jerold Novack, and the delay in filing our Form 10-K for 2001. We have cooperated fully with the investigation as well as with a Department of Justice inquiry relating to these issues. Further, several of the former and present officers and directors have requested that, under applicable law and our by-laws, we advance reasonable legal expenses on their respective behalves to the extent any of them is or has been requested to provide information to the Commission in connection with its investigation. We have advanced certain expenses in connection with these claims. At this time, it is not possible to reasonably estimate the loss or range of loss, if any.

## NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (dollars in thousands, except share and per share amounts)

#### Other Litigation

On February 23, 2000, New World Coffee of Forest Hills, Inc., a franchisee, filed a demand for arbitration with the American Arbitration Association against us alleging fraudulent inducement and violations of New York General Business Law Article 33. In August 2004, this matter was resolved. The resolution of this issue did not have a material adverse effect on our consolidated financial condition or results of operations.

#### 26. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table summarizes the unaudited consolidated results of operations for fiscal 2004 and 2003:

	Fiscal year 2004, for the quarters ended:			
	March 30	June 29	Sept. 28	Dec. 28
Revenue	\$ 91,196	\$ 94,164	\$ 91,179	\$ 97,321
Income from operations (1)	\$ 1,654	\$ 1,300	\$ 456	\$ 3,605
Net loss (2)	\$ (4,130)	\$ (6,224)	\$ (4,952)	\$ (2,099)
Net loss available to common shareholders (3)	\$ (4,130)	\$ (6,224)	\$ (4,952)	\$ (2,099)
Basic and diluted loss per share	\$ (0.42)	\$ (0.63)	\$ (0.50)	\$ (0.21)

  

	Fiscal year 2003, for the quarters ended (restated):			
	April 1	July 1	Sept. 30	Dec. 30
Revenue	\$ 95,211	\$ 97,749	\$ 93,227	\$ 97,119
Income (loss) from operations (1)	\$ (1,655)	\$ (3,929)	\$ (3,714)	\$ (8,317)
Net loss (2)	\$ (9,154)	\$ (14,630)	\$ (35,711)	\$ (14,026)
Net loss available to common shareholders (3)	\$ (13,756)	\$ (24,451)	\$ (35,711)	\$ (14,026)
Basic and diluted loss per share	\$ (9.03)	\$ (15.22)	\$ (14.16)	\$ (1.43)

- (1) The loss from operations includes charges for integration and restructuring in the amounts of \$2,300 for the respective quarters ended September 30, 2003 and December 30, 2003. Charges for integration and restructuring are further discussed in footnote 18. The quarters ended December 28, 2004 and December 30, 2003 include impairment charges of \$500 and \$5,300, respectively, which is further discussed in footnote 2.
- (2) The net loss includes the following items:
  - Cumulative change in fair value of derivatives for the respective 2003 quarters ended April 1, July 1 and September 30 of \$700, (\$700) and \$1,100;
  - Loss (gain) on sale, disposal or abandonment of assets for the 2004 quarter ended June 29 of \$1,472;
  - Gain on investment in debt securities for the respective quarters ended December 30, 2003 of \$400; and,
  - Loss on exchange of Series F Preferred Stock due to equity recapitalization of \$23,000 for the quarter ended September 30, 2003.
- (3) The net loss available to common stockholders includes dividends and accretion on Preferred Stock for the respective 2003 quarters' ended April 1 and July 1 of \$4,600. In connection with the Equity Recap, the Series F and its related dividends and accretion, have been recapitalized and, as of the quarter ended September 30, 2003, we are no longer incurring these items.
- (4) The sum of basic and diluted earnings per share for the four quarters may differ from annual earnings per share due to the required method of computing the weighted average number of shares in interim periods.

**NEW WORLD RESTAURANT GROUP, INC.**

**Schedule II - Valuation and Qualifying Accounts**

(in thousands of dollars)

	<u>Balance at beginning of period</u>	<u>Additions (a)</u>	<u>Deductions (b)</u>	<u>Balance at end of period</u>
For the fiscal year ended December 31, 2002:				
Allowance for doubtful accounts	\$ 4,097	639	(125)	\$ 4,611
Restructuring reserve	\$ 2,936	3,107	(3,275)	\$ 2,768
Valuation allowance for deferred taxes	\$ 30,437	18,931	-	\$ 49,368
For the fiscal year ended December 30, 2003:				
Allowance for doubtful accounts	\$ 4,611	1,815	(3,116)	\$ 3,310
Restructuring reserve	\$ 2,768	2,420	(1,115)	\$ 4,073
Valuation allowance for deferred taxes	\$ 49,368	17,506	-	\$ 66,874
For the fiscal year ended December 28, 2004:				
Allowance for doubtful accounts	\$ 3,310	177	(1,012)	\$ 2,475
Restructuring reserve	\$ 4,073	(869)	(3,183)	\$ 21
Valuation allowance for deferred taxes	\$ 66,874	7,140	-	\$ 74,014

Notes:

- (a) Amounts charged to costs and expenses.
- (b) Bad debt write-offs and charges to reserves.

See accompanying report of independent registered public accounting firm