ERNST & YOUNG

Ernst & Young LLP
Suite 1000
18111 Von Karman Avenue
Irvine, CA 92612

Phone: (949) 794-2300
Fax: (949) 437-0590
www.ey.com

Report of Independent Auditors

Board of Directors and Stockholders
The Johnny Rockets Group, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of The Johnny Rockets Group, Inc. and Subsidiaries as of May 1, 2005 and May 2, 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Johnny Rockets Group, Inc. and Subsidiaries as of May 1, 2005 and May 2, 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its consolidated financial statements for the year ended May 2, 2004 and the beginning accumulated deficit as of April 27, 2003.

Ernst + Young LLP

June 16, 2005

The Johnny Rockets Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share and par value data)

	May 1, 2005	May 2, 2004 (restated)
Assets		
Current assets:		
Cash	**$ 6,872**	$ 4,681
Restricted cash	**209**	209
Franchise fees receivable	**441**	268
Inventories	**921**	957
Other receivables	**104**	144
Other current assets	**120**	693
Deferred taxes	**2,355**	–
Total current assets	**11,022**	6,952
Property and equipment, at cost:		
Furniture, fixtures and equipment	**8,457**	9,304
Leasehold improvements	**13,442**	13,012
	21,899	22,316
Less accumulated depreciation and amortization	**15,690**	16,064
Net property and equipment	**6,209**	6,252
Other assets:		
Goodwill	**4,858**	4,858
Other assets, net	**163**	232
Deferred taxes	**4,985**	–
	10,006	5,090
	$ 27,237	$ 18,294

	May 1, 2005	May 2, 2004 (restated)
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 1,157	$ 1,490
Accrued expenses	3,593	3,753
Accrued disposition reserves	769	861
Deferred franchise fees, current portion	626	744
Current portion of long-term debt	–	700
Total current liabilities	6,145	7,548
Long-term debt, net of current portion	–	2,450
Deferred franchise fees, net of current portion	1,840	1,758
Other long-term liabilities	4,786	2,888
Total liabilities	12,771	14,644
Minority interest	20	100
Commitments and contingencies *(Note 12)*		
Stockholders' equity:		
Series A convertible preferred stock, $0.001 par value, 15,000,000 shares authorized, 8,957,617 shares issued and outstanding, aggregate liquidation preference of $44,788	44,788	44,788
Series B convertible preferred stock, $0.001 par value, 5,000,000 shares authorized, 3,373,333 shares issued and outstanding, aggregate liquidation preference of $15,180	15,180	15,180
Series C convertible preferred stock, $0.001 par value, 3,200,000 shares authorized, issued and outstanding, aggregate liquidation preference of $7,200	7,200	7,200
Common stock, $0.001 par value, 31,800,000 shares authorized, 765,750 shares issued and outstanding	2,334	2,334
Treasury stock	(629)	(475)
Accumulated deficit	(54,427)	(65,477)
Total stockholders' equity	14,446	3,550
	$ 27,237	$ 18,294

See accompanying notes.

The Johnny Rockets Group, Inc. and Subsidiaries

Consolidated Statements of Income

(in thousands)

	May 1, 2005	May 2, 2004 (restated)
Revenues:		
Restaurant sales	$ 47,976	$ 46,643
Franchise fees and royalties	7,510	6,009
Total revenues	55,486	52,652
Operating expenses:		
Cost of sales	11,891	11,608
Labor costs	14,698	14,251
Other restaurant operating costs	6,683	6,696
Occupancy costs	7,809	7,464
General and administrative expenses	8,257	5,694
Depreciation and amortization	1,970	2,139
Impairment loss	136	1,037
Total operating expenses	51,444	48,889
Income from operations	4,042	3,763
Other expense (income):		
Interest expense	82	703
Other	(98)	10
Total other (income) expense	(16)	713
Income before minority interests and provision for income taxes	4,058	3,050
Income from limited partnerships allocated to minority interests	–	29
Income before provision for income taxes	4,058	3,021
(Benefit) provision for income taxes	(6,992)	150
Net income	$ 11,050	$ 2,871

See accompanying notes.

The Johnny Rockets Group, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity

May 1, 2005 and May 2, 2004 (restated)

(in thousands)

	Series A Convertible Preferred Stock	Series B Convertible Preferred Stock	Series C Convertible Preferred Stock	Common Stock	Treasury Stock	Accumulated Deficit	Total
Balance at April 27, 2003, restated	$ 44,788	$ 15,180	$ 7,200	$ 2,334	$ (475)	$ (68,348)	$ 679
Net income	–	–	–	–	–	2,871	2,871
Balance at May 2, 2004, restated	44,788	15,180	7,200	2,334	(475)	(65,477)	3,550
Repurchase of stock	–	–	–	–	(154)	–	(154)
Net income	–	–	–	–	–	11,050	11,050
Balance at May 1, 2005	$ 44,788	$ 15,180	$ 7,200	$ 2,334	$ (629)	$ (54,427)	$ 14,446

See accompanying notes.

The Johnny Rockets Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(in thousands)

	Fiscal year ended May 1, 2005	Fiscal year ended May 2, 2004 (restated)
Operating activities		
Net income	$ 11,050	$ 2,871
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,970	2,139
Impairment loss	136	1,037
(Gain) loss on sale of property and equipment	(139)	13
Income from limited partnership allocated to minority interests	–	29
Deferred taxes	(7,340)	–
Net change in operating assets and liabilities:		
Franchise fees receivable, net	(173)	(23)
Inventories	(12)	(16)
Other receivables	40	(39)
Other assets	589	(528)
Accounts payable	(333)	132
Accrued expenses	1,695	(299)
Accrued disposition reserves	(92)	(537)
Deferred franchise fees	(36)	317
Net cash provided by operating activities	7,355	5,096
Investing activities		
Purchases of property and equipment	(2,318)	(787)
Acquisition of franchise	–	(452)
Proceeds from sale of property and equipment	538	–
Net cash used in investing activities	(1,780)	(1,239)
Financing activities		
Repayment of long-term debt	(3,150)	(7,943)
Borrowings under credit agreement	–	3,500
Repurchase of preferred and common stock	(154)	–
Purchase of partners' shares in limited partnership	(80)	–
Net cash used in financing activities	(3,384)	(4,443)
Net increase (decrease) in cash	2,191	(586)
Cash, beginning of year	4,681	5,267
Cash, end of year	$ 6,872	$ 4,681
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 79	$ 524
Cash paid for income taxes	$ 293	$ 30

See accompanying notes.

The Johnny Rockets Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

May 1, 2005 and May 2, 2004 (restated)

(Dollar amounts in thousands)

1. Company Background and Operations

The Johnny Rockets Group, Inc., a Delaware corporation, and its subsidiaries (collectively, the "Company" or "JRG") develop, operate and franchise restaurants under the name "Johnny Rockets, The Original Hamburger." The restaurants are casual-themed, 1940s – 1950s style diners that primarily serve hamburgers, malts and American fries. At May 1, 2005 and May 2, 2004, there were 42 and 43 Company-owned restaurants, respectively, and 131 and 107 franchised restaurants, respectively. Company-owned restaurants are located in California, Florida, Illinois, Indiana, Michigan, Nevada, New Jersey, New York, Ohio, Virginia and Washington, D.C. Franchised restaurants are located throughout the United States and in Canada, Dubai, Kuwait, Mexico and Qatar.

2. Restatement of Previously Issued Consolidated Financial Statements

The Company began a review of its lease accounting policies following announcements in December 2004 that several restaurant companies were revising their accounting practices for leases. As a result of the review, the Company changed its accounting for leases in 2005 and restated its historical consolidated financial statements to reflect revised lease accounting policies. The restatement adjustments are noncash and had no impact on revenues or net cash flows.

The changes to the lease accounting policies fall into the following:

Rent Holiday

Historically, the Company calculated and recognized straight-line rent expense (normalized rent) from the rent commencement date, pursuant to the lease agreement, through the end of the initial lease term. The Company has revised its policy to include the rent holiday period, which is defined as the date when the Company took possession of the property (generally, the date the tenant improvements begin) until the stated rent commencement date pursuant to the lease agreement. Normalized rent recorded from date of possession through the date the restaurant opens for operations has been capitalized and amortized over the life of the lease. Once the restaurant has opened, the Company records the normalized rent over the lease term, plus contingent rent to the extent it exceeded minimum cash rent pursuant to the lease agreement.

(Dollar amounts in thousands)

2. Restatement of Previously Issued Consolidated Financial Statements (continued)

Tenant Improvement Allowances

The Company has reclassified tenant improvement allowances from a contra asset in property and equipment, net to a lease obligation in the consolidated balance sheets. The impact of this reclassification of tenant improvement allowances has been an increase in depreciation and amortization expense and an offsetting reduction of occupancy costs in the consolidated statements of income. Finally, tenant improvement allowances have been reclassified in the consolidated statements of cash flows by increasing capital expenditures and increasing cash provided by operating activities.

In addition, the Company restated preferred stock and accumulated deficit at April 27, 2003 to accrete preferred stock to its liquidation value. As a result, preferred stock increased and accumulated deficit increased by $223 at April 27, 2003.

The Company restated its consolidated balance sheet as of May 2, 2004 and its consolidated statements of income, stockholders' equity and cash flows for the year ended May 2, 2004. The adjustments associated with the above corrections decreased net income by $776 and increased accumulated deficit by $999 for the year ended May 2, 2004.

The impacts of these restatements on the consolidated financial statements are summarized below:

Fiscal Year 2004:	**Previously Reported**	**Adjustments**	**As Restated**
Balance sheet data			
Leasehold improvements	$ 10,988	$ 2,024	$ 13,012
Accumulated depreciation and amortization	(15,013)	(1,051)	(16,064)
Net property and equipment	5,279	973	6,252
Total assets	17,321	973	18,294
Accrued expenses	4,892	(1,139)	3,753
Total current liabilities	8,687	(1,139)	7,548
Other long-term liabilities	–	2,888	2,888
Total liabilities	12,895	1,749	14,644
Preferred stock	22,157	223	22,380
Accumulated deficit	(64,478)	(999)	(65,477)
Total stockholders' equity	4,326	(776)	3,550
Total liabilities and stockholders' equity	17,321	973	18,294

(Dollar amounts in thousands)

2. Restatement of Previously Issued Consolidated Financial Statements (continued)

Tenant Improvement Allowances (continued)

Fiscal Year 2004:	**Previously Reported**	**Adjustments**	**As Restated**
Statement of income data			
Occupancy costs	$ 7,775	$ (311)	$ 7,464
Depreciation and amortization	1,828	311	2,139
Provision for impairment loss	261	776	1,037
Total operating expenses	48,113	776	48,889
Income from operations	4,539	(776)	3,763
Net income	3,647	(776)	2,871
Statement of cash flows data			
Net income	3,647	(776)	2,871
Depreciation and amortization	1,828	311	2,139
Impairment loss	261	776	1,037
Accrued expenses	12	(311)	(299)

3. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of The Johnny Rockets Group, Inc. and three subsidiaries. The three subsidiaries consist of one limited partnership in which the Company exercises significant control; one wholly owned subsidiary and one majority owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash

The Company maintains cash balances at financial institutions that are in excess of FDIC insurance coverage limits.

3. Summary of Significant Accounting Policies (continued)

Restricted Cash

At May 1, 2005 and May 2, 2004, restricted cash represents amounts associated with a letter of credit securing a lease on the Company's closed Texas restaurant.

Inventories

Inventories, consisting principally of food, beverages and smallwares are stated at the lower of cost (first-in, first-out method) or market. Smallwares, including plates, glassware and silverware, are capitalized when a restaurant is opened and are not depreciated; subsequent replacements of smallwares are expensed. Periodically, the Company evaluates the reasonableness of the smallwares balance to determine that the carrying value approximates replacement cost.

Property and Equipment

Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

Furniture, fixtures, and equipment	5 to 7 years
Leasehold improvements	Lesser of the lease term or estimated useful life

Major renewals and betterments are capitalized while maintenance costs and repairs are expensed in the year incurred.

Goodwill

Goodwill represents the excess of purchase price over the fair value of net assets acquired from the acquisitions of Johnny Rockets International, Inc. ("JRI"), certain formerly franchised restaurants, and the repurchase of minority interests from a limited partnership. Goodwill is deemed to have an indefinite life and is therefore not amortized, but is rather subject to annual impairment tests.

3. Summary of Significant Accounting Policies (continued)

Goodwill (continued)

The carrying value of goodwill is reviewed at least annually and when facts and circumstances suggest that it may be impaired. Such review entails comparing the carrying value goodwill to the fair value. If the aggregate carrying value of goodwill exceeds the fair value, the goodwill is impaired to the extent of the difference between the fair value and the aggregate carrying value. The Company performed the required impairment tests of goodwill as of May 1, 2005 and May 2, 2004. As a result of such tests, management believes that no impairment exists relating to goodwill as of May 1, 2005 and May 2, 2004.

In fiscal 2004, the Company recorded the liability for the limited partnership put option of $100 as an adjustment to goodwill and minority interest (Note 12).

Preopening Costs

Preopening costs, which consist of payroll, supplies and other direct expenses incurred in connection with opening new restaurants, are expensed as incurred.

Fiscal Year-End

The Company's fiscal year is the 52 or 53 week period ending the last Sunday in April or the first Sunday in May. The Company's 2005 and 2004 fiscal years ended on May 1, 2005 and May 2, 2004, respectively. Fiscal 2005 included 52 weeks and fiscal 2004 included 53 weeks. Consolidated affiliated partnerships utilize these same accounting periods.

Revenue Recognition

The Company recognizes revenue on food and beverage sales as services are rendered.

In connection with its franchising activities, the Company receives franchise fees, area development fees and continuing royalties. The Company recognizes franchise fee and area development fee revenue when it has completed performance of substantially all obligations specified in the related underlying agreements, in accordance with SFAS No. 45, *Accounting For Franchise Fee Revenue*. Payments received from franchisees prior to the completion of these obligations are reflected as deferred franchise fees in the accompanying balance sheets. Royalties are generally contractually earned at amounts equal to 5% of franchised restaurant sales and are recognized as such sales occur.

3. Summary of Significant Accounting Policies (continued)

Long-Lived Assets

The Company reviews its long-lived assets, including any allocated intangible assets related to each restaurant to be held and used, annually for impairment. The Company uses projected operating results in its impairment evaluation. Based on the best information available, an impaired restaurant is written down to its estimated fair value, which becomes its new cost basis. Estimated fair value is generally measured by discounting the estimated future cash flows. In addition, when a closure decision is made, the restaurant is reviewed for impairment based on the resulting shortened useful life. The Company recorded a charge for impairment of $136 for seven restaurants and $1,037 for nine restaurants in fiscal 2005 and 2004, respectively, related to equipment and leasehold improvements.

Income Taxes

The Company provided for income taxes under the liability method. Accordingly, deferred income tax assets and liabilities are computed for differences between the consolidated financial statements and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the period in which the differences are expected to affect taxable income. A valuation allowance is recorded when it is more likely than not that deferred tax assets will not be realized.

Stock-Based Compensation

The Company measures compensation expense for its employees' stock-based compensation plans using the intrinsic value method and provides pro forma disclosures of net income as if a fair value method had been applied in measuring compensation expense in accordance with the requirements of SFAS Statement No. 123, *Accounting for Stock-Based Compensation* (Statement 123), as amended. Accordingly, compensation cost for stock awards is measured as the excess, if any, of the fair value for financial reporting purposes of the Company's common stock at the measurement date (generally the date of grant) over the amount an employee must pay to acquire the stock.

The fair value of each stock option granted during fiscal 2005 and 2004 to employees and officers is estimated using the Black-Scholes option-pricing model on the date of grant using the following assumptions: (i) no dividend yield, (ii) volatility of zero, (iii) weighted-average risk-free interest rates ranging from 3.91% to 4.44% in 2005 and 2.82% to 3.95% in 2004, and (iv) expected life of seven years. The options granted during fiscal 2005 and 2004 had a weighted-average fair value of $0.57 and $0.50, respectively.

3. Summary of Significant Accounting Policies (continued)

Stock-Based Compensation (continued)

The effects of applying the fair value method to the Company's option grants would decrease the Company's net income by approximately $61 and $74, in fiscal 2005 and 2004, respectively.

Performance Unit Plan

The Company measures compensation expense for its performance unit plan using the fair value method in accordance with Statement No. 123 and FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. The Company records compensation cost for the changes in the fair value of vested performance units based upon the underlying fair value of the Company, as determined by an independent valuation firm. The fair value of the performance unit plan is included in other long-term liabilities.

Advertising

The Company expenses advertising as incurred. Advertising costs of $800 and $662 are included in the statements of income for fiscal 2005 and 2004, respectively.

Franchise Repurchase

In fiscal 2004, the Company acquired property and equipment of $250 and refunded an area development fee of $202 in connection with the repurchase of a franchise.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("Statement No. 123R"). Statement No. 123R will require the Company to expense share-based payments, including employee stock options, based on their fair value. The Company is required to adopt the provisions of Statement No. 123R effective as of the beginning of its fiscal year 2007. Statement No. 123R provides alternative methods of adoption which include prospective application and a modified retroactive application. The Company is currently evaluating the financial impact, including the available alternatives of adoption, of Statement No. 123R.

(Dollar amounts in thousands)

3. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In June 2005, the FASB Emerging Issues Task Force (EITF) reached a consensus on EITF Issue 05-06, Determining the Amortization Period for Leasehold Improvements ("EITF 05-06"). EITF 05-06 requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of the lease should be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. The Company is required to apply EITF 05-06 prospectively in periods beginning after July 1, 2005.

4. Accrued Expenses

The following is a summary of the components of accrued expenses:

	May 1, 2005	May 2, 2004 (restated)
Accrued lease obligation	$ 309	$ 317
Accrued payroll and related costs	1,768	1,670
Other	1,516	1,766
	$ 3,593	$ 3,753

5. Accrued Disposition Reserves

	May 1, 2005	May 2, 2004
Disposition reserves at beginning of year	$ 861	$ 1,398
Reserves utilized	(92)	(537)
Disposition reserves at end of year	$ 769	$ 861

During fiscal 2005 and 2004, the Company is utilizing the reserves originally established during fiscal 2003, 2002 and 2001. The amounts remaining in the reserve relate to lease costs through 2011 on closed stores.

(Dollar amounts in thousands)

6. Long-Term Debt

Long-term debt consists of the following:

	May 1, 2005	May 2, 2004
Note payable bearing interest at a rate of 2.5% over LIBOR	$ –	$ 3,150
Less: current portion of long-term debt	–	700
Noncurrent portion of long-term debt, net of current portion	$ –	$ 2,450

On October 31, 2003 and as amended through January 4, 2005, the Company entered into a credit agreement (the "Credit Agreement") with Bank of the West ("BOW") that allowed the Company to borrow up to $7,500, which provided for $4,000 in expansion and working capital lines and a $3,500 term loan. Under the Credit Agreement, the Company borrowed $3,500 under a term loan in fiscal 2004, the proceeds of which and excess available cash were used to repay existing senior debt and an unsecured note payable to stockholders. The term loan was paid in full in December 2004.

The Company's obligations to BOW under the Credit Agreement are secured by all of the Company's assets, including the stock of each of its subsidiaries (each of which has guaranteed the Company's obligations under the agreement), as well as all intangible assets it owns, including the intellectual property and trademark assets that the Company and its subsidiaries own.

The Credit Agreement provides the Company with an initial expansion line of $1,500. Under the terms of the Credit Agreement, amounts borrowed under this line are set to convert to term loans with monthly principal amortization payments beginning November 30, 2004, and are required to be repaid in full by October 31, 2008. The Credit Agreement requires that the Company pay interest on any borrowings outstanding under this line on a monthly basis at an interest rate computed in the same manner as described above for this term loan. As of May 1, 2005, no amounts were borrowed under the initial expansion line.

The Credit Agreement also provides the Company with a deferred expansion line of $1,500 plus the unused initial expansion line. Amounts borrowed under this line are set to convert to a term loan with monthly principal amortization payments beginning November 30, 2005, and are required to be repaid in full by October 31, 2009. The Credit Agreement requires that the Company pay interest on any borrowings outstanding under this line on a monthly basis at an interest rate computed in the same manner as described above for this term loan. As of May 1, 2005, no amounts were borrowed under the deferred expansion line.

6. Long-Term Debt (continued)

Finally, the Credit Agreement provides the Company with a $1,000 working capital facility. Under the terms of the Credit Agreement, amounts borrowed under this line are required to be repaid in full by October 31, 2005. The Credit Agreement requires that the Company pay interest on any borrowings outstanding under this line on a monthly basis at an interest rate computed in the same manner as described above for this term loan. As of May 1, 2005, no amounts were borrowed under the working capital facility.

The Company is subject to a number of restrictions under the Credit Agreement and the second amendment to the Credit Agreement, including limitations on the Company's ability to sell assets, incur additional indebtedness, incur new liens upon the Company's assets, and pay dividends on or repurchase its common stock. The Company must also maintain compliance with agreed-upon financial covenants that limit the amount of indebtedness that it may have outstanding in relation to its tangible net worth, require the Company to maintain a specified minimum dollar value level of EBITDA for the trailing four fiscal quarters and require the Company to maintain a specified minimum level of profitability. At May 1, 2005, the Company was in compliance with its financial covenants.

7. Preferred Stock

In fiscal 2005 and 2004, the Company did not issue any additional preferred stock.

Each share of Series A and Series B preferred stock is convertible, at the holder's option, into approximately 1.1 shares of common stock and contains antidilution provisions and voting privileges. Upon liquidation, and in preference to the rights of common stockholders, Series A and Series B preferred stockholders are entitled to receive $5.00 and $4.50 per share, respectively, plus any declared but unpaid dividends. The rights of the Series B preferred stockholders are senior to the rights of the Series A preferred stockholders. For every four shares of Series B convertible preferred stock purchased, the Company also issued a warrant to purchase one share of Series B convertible preferred stock for $4.50 per share (Note 9).

Each share of Series C preferred stock is convertible, at the holder's option, into one share of common stock and contains antidilution provisions and voting privileges, as defined. Upon liquidation and in preference to rights of common stockholders and Series A and B preferred stockholders, Series C preferred stockholders may be entitled to receive an additional amount based on the fair market value of the stock at that date. The Series C preferred stock was issued at $2.25 per share.

(Dollar amounts in thousands except per share and warrant data)

8. Treasury Stock

In fiscal 2005, the Company had the following treasury stock transactions:

	Number of Shares	Amount
Treasury stock as of May 2, 2004	149,996	$ (475)
Repurchase of Series A convertible preferred stock	108,942	(131)
Repurchase of Series B convertible preferred stock	6,667	(18)
Repurchase of common stock	5,000	(5)
Treasury stock as of May 1, 2005	270,605	$ (629)

9. Warrants

In fiscal years 2005 and 2004, no warrants were issued or exercised.

In connection with its issuance of Series B preferred stock, the Company issued 832,222 warrants. The warrants expired unexercised in April 2004.

In connection with its initial capitalization and subsequent acquisitions, the Company issued warrants to certain investors to purchase 1,685,676 shares of its common stock at $5.00 per share. The outstanding warrants expire on October 19, 2005.

10. Stock Options

The Company's 1995 Stock Option/Stock Issuance Plan (the "Plan") provides incentives to employees and directors of the Company who provide significant services to the Company through the issuance of incentive stock options ("ISOs") and non-qualified stock options ("NQSOs"). Under the Plan 1,800,000 options are available. Options granted under the Plan generally have a 10-year life, vest over a period of three to four years and have exercise prices of up to $5.00 per share. All options granted have exercise prices equal to or in excess of the estimated fair market value of the Company's common stock at the date of grant. At May 1, 2005 and May 2, 2004, the weighted-average remaining contractual life of the options outstanding was approximately 82 and 92 months, respectively. At May 1, 2005 and May 2, 2004, options to purchase 367,675 and 284,270 shares of the Company's common stock were vested and exercisable, respectively; the weighted-average exercise price of these options was $2.36 and $2.40, respectively.

(Dollar amounts in thousands except per share and warrant data)

10. Stock Options (continued)

A summary of stock option (vested and non-vested) activity under the plan is as follows:

	Number of Shares	Weighted-Average Exercise Price
Outstanding as of April 27, 2003	1,166,218	$ 2.29
Granted	197,911	2.25
Forfeited	(761,634)	2.26
Outstanding as of May 2, 2004	602,495	2.32
Granted	60,400	2.25
Forfeited	(64,694)	2.25
Outstanding as of May 1, 2005	598,201	$ 2.32

11. Income Taxes

Significant components of the provision for income taxes for the years ended May 1, 2005 and May 2, 2004 are as follows:

	2005	2004
Current:		
Federal	$ 177	$ 47
State	171	103
Total current	348	150
Deferred:		
Federal	(6,130)	–
State	(1,210)	–
Total deferred	(7,340)	–
Income tax provision	$(6,992)	$ 150

The effective tax rate differs from the statutory tax rate due principally to the change in the valuation allowance, federal alternative minimum tax and state income taxes.

(Dollar amounts in thousands)

11. Income Taxes (continued)

Deferred income taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred income tax assets and liabilities are as follows:

	May 1, 2005	May 2, 2004
Deferred income tax assets:		
Operating loss carryforwards	$ 4,697	$ 8,330
Tax credit carryforwards	1,993	1,374
Other accrued expenses	2,084	673
Deferred rent and lease obligations	1,138	700
Impairment losses currently not deductible for income tax	2,749	2,855
Total deferred income tax assets	12,661	13,932
Deferred income tax liabilities:		
Basis differences in fixed assets	(1,360)	(1,323)
Basis differences in intangible assets	(208)	(154)
Partnership losses currently deductible for income tax purposes	(516)	(259)
Total deferred income tax liability	(2,084)	(1,736)
Net deferred tax assets	10,577	12,196
Valuation allowance	(3,237)	(12,196)
Net deferred taxes	$ (7,340)	$ –

At May 1, 2005, the Company had cumulative federal, state and Alternative Minimum Tax (AMT) net operating loss carryforwards totaling $13,500, $1,400 and $17,000, respectively, which expire at various dates from 2005 through 2023.

Due to the "change of ownership" provisions of the Tax Reform Act of 1986, utilization of the Company's net operating loss carryforwards may be subject to an annual limitation against taxable income in future periods. As a result of the annual limitation, a portion of these carryforwards may expire before ultimately becoming available to reduce future income tax liabilities.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future income

(Dollar amounts in thousands)

11. Income Taxes (continued)

during the periods in which those temporary differences become deductible. Based on the level of historical taxable income and projections of future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will not realize $3,237 of the benefits from the deductible differences.

12. Commitments and Contingencies

Lease Commitments

The Company leases its restaurant facilities, office space and certain equipment under noncancelable operating leases expiring at various dates through 2015. Certain leases provide for monthly rent expense equal to the greater of a fixed payment or a percentage of gross sales. Certain leases are subject to annual adjustments for inflation and contain renewal options. The Company's rent expense for the years ended May 1, 2005 and May 2, 2004 was approximately $4,963 and $4,819, respectively (including contingent rental amounts of approximately $315 and $250, respectively).

Future minimum lease payments under noncancelable operating leases at May 1, 2005 are as follows:

Fiscal Year ending	
2006	$ 5,047
2007	4,435
2008	3,733
2009	2,230
2010	1,416
Thereafter	2,254
	$ 19,115

12. Commitments and Contingencies (continued)

Limited Partner Put Options

Under the terms of the limited partnership agreement in which one of the Company's subsidiaries is the general partner, the limited partners may, at their option, require the general partner to purchase the limited partners' partnership units at any time after October 19, 1999. The minimum purchase price is $40 per unit, but may be higher if the partnership's restaurants achieve specified operating results. At May 1, 2005, there was one half of a limited partnership unit subject to the purchase option, exclusive of those limited partnership units owned by the Company.

During fiscal 2005, two limited partners holding two units exercised their respective put options for an aggregate purchase price of $80. In accordance with the limited partnership agreement, the Company determined the purchase price to be $40 per unit, which was included in accrued expenses at May 2, 2004.

Performance Unit Plan

Effective April 29, 2002 and as amended November 2004, the Company entered into a Performance Unit Plan whereby 200 performance units, representing approximately 5% of the equity value of the Company, were granted to participants. Performance units vest over a period of two to four years from the grant date. Upon a change of control or an initial public offering, the holders of the performance units are entitled to receive a cash payment, up to a maximum of .025% of the Company's equity value per unit. The cash payment is calculated pursuant to a defined formula, which is based in part upon the Company achieving certain financial performance targets. At May 1, 2005, the performance units were 75% vested and the Company had met all financial performance targets necessary for a full payout of .025% of the Company's equity value per unit. Based upon an independent valuation of the Company , it was determined that the Company's equity value as of May 1, 2005 was $60,000. Accordingly, pursuant to the terms of the amended agreement, the Company recorded compensation expense of $2,250 in fiscal 2005 to reflect the value of the vested performance units, which is included in general and administrative expenses on the Company's consolidated statement of income and included in other long-term liabilities on the balance sheet. Even though 50% of the performance units vested, no amount was accrued at May 2, 2004 due to the fact that the Company has no marketability for its stock and believed the value of the vested performance units, if any, was not significant at May 2, 2004.

12. Commitments and Contingencies (continued)

Legal

The Company and its subsidiaries are parties to various legal actions and proceedings incident to normal business activity. Management believes, after consultation with outside legal counsel, that any liability in the event of final adverse determination of any of these matters would not be material to the Company's consolidated financial position, liquidity or results of operations.

13. 401(k) Plan

During fiscal 2005 and 2004, employees were eligible to receive matching contributions of up to \$350 and \$300 per employee per calendar year 2005 and 2004, respectively. In order to be eligible to participate in the 401(k) plan, employees must have completed one year of service with the Company, have worked 1,000 hours in a 12-month period and be at least 21 years of age. The Company recorded \$26 in expense associated with the matching contributions under the plan during both fiscal 2005 and 2004.