

Exhibit HJ
NWR's Financial Statements

DEPARTMENT OF CORPORATIONS
APR 12 2006
SACRAMENTO OFFICE

DEPARTMENT OF CORPORATIONS
APR 04 2006
SACRAMENTO OFFICE

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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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 January 3, 2006 and December 28, 2004, and the related consolidated statements of operations, changes in stockholders' equity (deficit) and cash flows for each of the three years in the period ended January 3, 2006. 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. The Company is not required to have, nor were we engaged to perform an audit of its 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 also 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, 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 January 3, 2006 and December 28, 2004, and the results of their operations, and their cash flows for each of the three years in the period ended January 3, 2006, 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.

/s/ GRANT THORNTON LLP

Denver, Colorado

February 28, 2006

NEW WORLD RESTAURANT GROUP, INC.
CONSOLIDATED BALANCE SHEETS
AS OF JANUARY 3, 2006 AND DECEMBER 28, 2004
(in thousands, except share information)

	January 3, 2006	December 28, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,556	\$ 9,752
Restricted cash	2,554	1,269
Franchise and other receivables, net of allowance of \$480 and \$2,475	5,506	7,123
Inventories	5,072	4,941
Prepaid expenses and other current assets	4,506	1,643
Total current assets	19,194	24,728
Restricted cash long-term	595	2,526
Property, plant and equipment, net	33,359	41,855
Trademarks and other intangibles, net	67,717	77,219
Goodwill	4,875	4,875
Debt issuance costs and other assets	5,184	7,253
Total assets	\$ 130,924	\$ 158,456
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 5,848	\$ 8,243
Accrued expenses	24,789	34,836
Short term debt and current portion of long-term debt	280	295
Current portion of obligations under capital leases	19	16
Total current liabilities	30,936	43,390
Senior notes and other long-term debt	160,560	160,840
Obligations under capital leases	29	31
Other liabilities	8,610	9,678
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	257,135	270,939
Commitments and contingencies		
Stockholders' deficit:		
Common stock, \$.001 par value, 15,000,000 shares authorized, 10,065,072 and 9,848,713 shares issued and outstanding	10	10
Additional paid-in capital	176,018	175,797
Unamortized stock compensation	(68)	(137)
Accumulated deficit	(302,171)	(288,153)
Total stockholders' deficit	(126,211)	(112,483)
Total liabilities and stockholders' deficit	\$ 130,924	\$ 158,456

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

NEW WORLD RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED JANUARY 3, 2006, DECEMBER 28, 2004 AND DECEMBER 30, 2003
(in thousands, except earnings per share and related share information)

	January 3, 2006	December 28, 2004	December 30, 2003
Revenues:			
Retail sales	\$ 363,044	\$ 347,786	\$ 356,225
Manufacturing revenues	20,118	20,122	21,457
Franchise and license related revenues	5,931	5,952	5,624
Total revenues	389,093	373,860	383,306
Cost of sales:			
Retail costs	296,610	288,736	297,934
Manufacturing costs	18,781	17,925	19,756
Total cost of sales	315,391	306,661	317,690
Gross profit	73,702	67,199	65,616
Operating expenses:			
General and administrative expenses	36,096	32,755	41,794
Depreciation and amortization	26,316	27,848	34,013
Loss (gain) on sale, disposal or abandonment of assets, net	314	1,557	(558)
Charges (adjustments) of integration and reorganization cost	5	(869)	2,132
Impairment charges and other related costs	1,603	450	5,292
Income (loss) from operations	9,368	5,458	(17,057)
Other expense (income):			
Interest expense, net	23,698	23,196	34,184
Cumulative change in the fair value of derivatives	—	—	(993)
Gain on investment in debt securities	—	—	(374)
Loss on exchange of Series F Preferred Stock	—	—	23,007
Other	(312)	(284)	(172)
Loss before income taxes	(14,018)	(17,454)	(72,709)
Provision (benefit) for state income taxes	—	(49)	812
Net loss	(14,018)	(17,405)	(73,521)
Dividends and accretion on Preferred Stock	—	—	(14,423)
Net loss available to common stockholders	\$ (14,018)	\$ (17,405)	\$ (87,944)
Net loss per common share—Basic and Diluted	\$ (1.42)	\$ (1.77)	\$ (22.71)
Weighted average number of common shares outstanding:			
Basic and Diluted	9,878,665	9,842,414	3,873,284

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

NEW WORLD RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED JANUARY 3, 2006, DECEMBER 28, 2004 AND DECEMBER 30, 2003
(in thousands, except share information)

	Common Stock		Additional Paid In Capital	Unamortized Stock Compensation	Accumulated Deficit Amount	Total
	Shares	Amount				
Balance, December 31, 2002	847,413	\$ 1	\$ 86,657	\$ —	\$ (182,804)	\$ (96,146)
Net loss	—	—	—	—	(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)
Balance, December 30, 2003	9,841,828	\$ 10	\$ 175,585	\$ —	\$ (270,748)	\$ (95,153)
Net loss	—	—	—	—	(17,405)	(17,405)
Common stock issued upon exercise of warrants	6,885	—	7	—	—	7
Stock compensation expense of options granted	—	—	205	(205)	—	—
Amortization of stock compensation expense	—	—	—	68	—	68
Balance, December 28, 2004	9,848,713	\$ 10	\$ 175,797	\$ (137)	\$ (288,153)	\$ (112,483)
Net loss	—	—	—	—	(14,018)	(14,018)
Common stock issued upon exercise of warrants	216,359	—	221	—	—	221
Amortization of stock compensation expense	—	—	—	69	—	69
Balance, January 3, 2006	<u>10,065,072</u>	<u>\$ 10</u>	<u>\$ 176,018</u>	<u>\$ (68)</u>	<u>\$ (302,171)</u>	<u>\$ (126,211)</u>

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

NEW WORLD RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JANUARY 3, 2006, DECEMBER 28, 2004 AND DECEMBER 30, 2003
(in thousands)

	January 3, 2006	December 28, 2004	December 30, 2003
OPERATING ACTIVITIES:			
Net loss	\$ (14,018)	\$ (17,405)	\$ (73,521)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	26,316	27,848	34,013
Stock based compensation expense	69	68	—
Loss, net of gains, on disposal of assets	314	1,557	(558)
Impairment charges and other related costs	1,603	450	5,292
Charges (adjustments) of integration and reorganization costs	5	(869)	2,132
Provision for (recovery of) losses on accounts receivable, net	(158)	177	1,815
Amortization of debt issuance and debt discount costs	1,848	1,849	3,138
Gain on investment in debt securities	—	—	(374)
Cumulative change in fair value in derivatives	—	—	(993)
Notes issued as paid-in-kind for interest on Bridge Loan	—	—	395
Issuance of standstill and step-up warrants	—	—	3,132
Greenlight interest	—	—	1,025
Loss on exchange of Series F Preferred Stock	—	—	23,007
Reduction in Bridge Loan	—	—	(500)
Changes in operating assets and liabilities:			
Franchise and other receivables	1,775	(1,593)	(1,688)
Accounts payable and accrued expenses	(12,565)	(2,112)	8,516
Other assets and liabilities	(3,114)	1,140	(2,816)
Net cash provided by operating activities	2,075	11,110	2,015
INVESTING ACTIVITIES:			
Purchase of property and equipment	(10,264)	(9,393)	(6,921)
Proceeds from the sale of equipment	180	543	558
Proceeds from investment in debt securities	—	—	374
Net cash used in investing activities	(10,084)	(8,850)	(5,989)
FINANCING ACTIVITIES:			
Proceeds from line of credit	5,455	18,120	6,020
Repayments of line of credit	(5,470)	(19,105)	(11,020)
Repayment of other borrowings	(312)	(1,105)	(1,131)
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	(81)	—	(8,571)
Proceeds upon warrant exercise	221	7	—
Net cash provided by (used in) financing activities	(187)	(2,083)	3,614
Net increase (decrease) in cash	(8,196)	177	(360)
Cash and cash equivalents, beginning of period	9,752	9,575	9,935
Cash and cash equivalents, end of period	\$ 1,556	\$ 9,752	\$ 9,575

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

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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 and 2003, which ended on December 28, 2004 and December 30, 2003, respectively, contained 52 weeks, while fiscal year 2005, which ended on January 3, 2006, contained 53 weeks.

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

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.

During fiscal year 2005, we began selling bagels through our manufacturing operations outside of the United States to a wholesaler and a distributor who take possession in the United States. As the product is shipped FOB domestic dock, there are no international risk of loss or foreign exchange currency issues. Approximately \$2.2 million of international sales are included in manufacturing revenues.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and highly liquid instruments with original maturities of three months or less when purchased. Amounts in-transit from credit card processors are also considered cash equivalents because they are both short-term and highly liquid in nature and are typically converted to cash within three days of the sales transaction.

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NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)

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 (SFAS) No. 144, Accounting for the Impairment or Disposal of Long Lived Assets (SFAS No. 144), 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 restaurant 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.

During fiscal 2005, we recorded approximately \$0.2 million in impairment charges related to company-owned stores and approximately \$0.1 million in exit costs from the decision to close one restaurant. During fiscal 2004, we recorded \$0.5 million 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 under-performing 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. SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), requires a two-step approach for testing impairment of goodwill. For goodwill, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, 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. For other indefinite lived intangibles, the fair value is compared to the carrying value. 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

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144.

During the second quarter of 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 the Chesapeake brand did not fit within our long-term business model. Accordingly, we performed an interim impairment analysis and determined that no impairment existed. We also performed a longevity analysis and determined that the brand had an estimated useful life of four years. The trademarks were previously treated as a non-amortizing intangible and were reclassified to an amortizing intangible at June 29, 2004. During the second quarter of fiscal 2005, we re-visited the long term strategic fit of Chesapeake utilizing the recommendations of a third party consultant previously engaged to present viable alternatives for the brand. Based upon the consultant's recommendations, we began forming an exit strategy that we believed could be completed within one year. Because there had been a change in circumstances, it was necessary to review the asset for impairment. The analysis indicated that the carrying amount of the Chesapeake trademarks was greater than its fair value and accordingly we recorded an impairment charge of \$1.2 million during the quarter ended June 28, 2005. As we continued to work with our remaining franchisees on an exit strategy, we also continued to review the carrying amount of the Chesapeake trademarks in relation to their fair value. We recorded an additional \$0.1 million in impairment charges related to the Chesapeake trademarks. As of January 3, 2006, there is no remaining value reflected in our consolidated financial statements related to the Chesapeake trademarks and we anticipate completion of our exit strategy during fiscal year 2006. Our ability to execute an exit strategy is dependent upon the agreement and cooperation of our franchisees and we cannot provide any assurance that we will be successful in fully completing an exit strategy.

For the fiscal years ended 2005, 2004 and 2003, we engaged an independent valuation expert to assist us in performing an impairment analysis of the goodwill and indefinite lived intangible assets related to our Einstein Bros. and Manhattan brands. At January 3, 2006 and December 28, 2004, there was no indication of impairment in our goodwill and indefinite lived intangible assets. At December 30, 2003, there was an indication that the carrying amounts of certain indefinite lived assets exceeded their fair values and accordingly we recorded an impairment charge of \$4.9 million 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 \$0.4 million.

Insurance Reserves

We are insured for losses related to health, general liability and workers' compensation under large deductible policies. The 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 on actuarial estimates, is discounted at 10% based upon a discrete analysis of actual claims and historical data 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

Prior to 2001, we would occasionally guarantee leases for the benefit of certain of our franchisees. None of the guarantees have been modified since their inception and we have since discontinued this

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

practice. 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 reducing 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 record a liability for our exposure under the guarantees in accordance with SFAS No. 5, "Accounting for Contingencies," following a probability related approach. In the event that trends change in the future, our financial results could be impacted. As of January 3, 2006, we had outstanding guarantees of indebtedness under certain leases of approximately \$600,000. Approximately \$90,000 is reflected in accrued expenses in our consolidated balance sheet at January 3, 2006.

Fair Value of Financial Instruments

As of January 3, 2006 and December 28, 2004, 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. As of January 3, 2006, the fair value of the \$160 Million Notes approximated \$176.5 million as the notes were traded at a premium. The fair value of the \$160 Million Notes approximated its carrying value at December 28, 2004 as the notes were traded at par in the market.

The Mandatorily Redeemable Series Z Preferred Stock (Series Z) is recorded in the accompanying consolidated balance sheets at its full face value of \$57.0 million, which represents the total required future cash payment. The current fair value of the Series Z, which was determined by using the remaining term of the Series Z and the effective dividend rate from the Certificate of Designation, is estimated to be \$33.2 million and \$28.5 million at January 3, 2006 and December 28, 2004, respectively.

Concentrations of Risk

We purchase a majority of our frozen bagel dough from Harlan Bakeries, Inc. (who utilizes our proprietary processes) and on 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 a limited number of 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, any 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 \$6.6 million, \$4.5 million and \$12.9 million for the fiscal years ended 2005, 2004 and 2003, respectively, and are included in retail costs of sales in the consolidated statements of operations.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)

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 in effect for the year differences are expected to be taxable or refunded. 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 January 3, 2006 and December 28, 2004, 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.

Net Loss per Common Share

In accordance with SFAS No. 128, "Earnings per 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 during the period (which includes warrants exercisable for a nominal price of \$0.01 per share on a pre-split basis prior to our equity recapitalization further described in Note 13).

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 (in thousands of dollars, except share and per share data):

	For the years ended:		
	January 3, 2006	December 28, 2004	December 30, 2003
Weighted average shares outstanding	9,878,665	9,842,414	3,873,284
Net loss available to common stockholders	\$ (14,018)	\$ (17,405)	\$ (87,944)
Basic and diluted net loss per share	\$ (1.42)	\$ (1.77)	\$ (22.71)
Shares contingently issuable included in the weighted average number of shares of common stock	—	—	604,298

Stock options and warrants to purchase an aggregate of 1,737,113, 1,764,372 and 1,832,679 shares of common stock were outstanding as of January 3, 2006, December 28, 2004 and December 30, 2003, respectively. These stock options and warrants were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)

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 (APB No. 25), and related interpretations, in accounting for our fixed award stock options to our associates. 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 SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) 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 associates been determined on the basis of fair value using the following assumptions, net loss and loss per share would have been increased to the following pro forma amounts (in thousands of dollars, except per share amounts):

	For the year ended:		
	January 3, 2006	December 28, 2004	December 30, 2003
Net loss, as reported	\$ (14,018)	\$ (17,405)	\$ (87,944)
Deduct: fair value based compensation expense	(1,164)	(544)	(10)
Pro forma net loss	\$ (15,182)	\$ (17,949)	\$ (87,954)
Basic and diluted loss per common share:			
As reported	\$ (4.42)	\$ (1.77)	\$ (22.71)
Pro forma	\$ (1.54)	\$ (1.82)	\$ (22.71)
Assumptions:			
Expected life of options from date of grant	4 years	4 years	4 years
Risk-free interest rate	3.55%	2.7 - 3.4%	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	\$ 1.85	\$ 2.21	\$ 2.84

Recent Accounting Pronouncements

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 No. 25 and generally would require instead that such transactions be accounted for using a fair-value-based method. This Statement is to be implemented at the beginning of the next fiscal year that begins after June 15, 2005. Based on options granted and various assumptions used to calculate stock based compensation expense as of January 3, 2006, we believe that the adoption will result in an increase in expense of approximately \$0.6 million and \$0.1 million during fiscal 2006 and 2007, respectively. If actual events differ from our assumptions used to calculate the expense or if we grant additional options, our financial results could be impacted.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Changes in Interim Financial Statements. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles were required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements.

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 consolidated financial statements.

3. RESTRICTED CASH

Restricted cash consisted of the following:

	January 3, 2006	December 28, 2004
	(in thousands of dollars:)	
Advertising Funds(a)	\$ 533	\$ 851
New Jersey Economic Development Authority(b)	950	1,307
Worker's Compensation Insurance Collateral(c)	—	1,600
Distributor Collateral(d)	1,500	—
Other(e)	166	37
	3,149	3,795
Less current portion of long-term restricted cash	2,554	1,269
Long-term restricted cash	\$ 595	\$ 2,526

(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 January 3, 2006 and December 28, 2004 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 had 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 did not reimburse them for claims paid on our behalf. In 2005, our bank no longer required the letter of credit to be cash collateralized.

(d) We have restricted cash held as collateral for a letter of credit issued to one of our distributors. Our distributor could access the letter of credit in the event that we fail to pay them for products delivered to our company-owned restaurants.

(e) We also have various restricted cash accounts for the benefit of taxing and other government authorities.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

4. FRANCHISE AND OTHER RECEIVABLES

The majority of our receivables are due from our franchisees, distributors and trade customers. 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:

	January 3 2006	December 28, 2004
	(in thousands of dollars)	
Trade receivables	\$ 2,296	\$ 1,725
Franchisee and licensee receivables	984	3,367
Vendor rebates(a)	2,130	3,196
Other	576	1,310
	5,986	9,598
Less allowance for doubtful accounts	480	2,475
Total receivables	\$ 5,506	\$ 7,123

(a) Vendor rebates represent a rebate earned at the time products are purchased and are not contingent upon any level of purchases or period of time. Vendor rebates are recorded as a reduction to cost of sales when products are sold.

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:

	January 3 2006	December 28, 2004
	(in thousands of dollars)	
Finished goods	\$ 4,558	\$ 4,545
Raw materials	514	396
Total inventories	\$ 5,072	\$ 4,941

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

6. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	January 3	December 28,
	2006	2004
	(in thousands of dollars)	
Leasehold improvements	\$ 49,744	\$ 49,186
Store and manufacturing equipment	66,810	61,373
Furniture and fixtures	1,193	1,095
Office and computer equipment	11,044	10,404
Vehicles	115	41
	128,906	122,099
Less accumulated depreciation	95,547	80,244
Property and equipment, net	\$ 33,359	\$ 41,855

Depreciation expense was \$18.1 million, \$19.6 million and \$26.2 million for the fiscal years ended January 3, 2006, December 28, 2004 and December 30, 2003, respectively.

As of January 3, 2006 and December 28, 2004, manufacturing equipment with a net book value of approximately \$4.4 million and \$5.1 million, respectively, was located at the plant of Harlan Bakeries, Inc., our frozen bagel dough supplier.

7. TRADEMARKS AND OTHER INTANGIBLES

Trademarks and other intangibles consist of the following as of:

	January 3,	December 28,
	2006	2004
	(in thousands of dollars)	
Amortizing intangibles:		
Trade secrets	\$ 5,385	\$ 5,385
Trademarks	1,082	2,400
Patents—manufacturing process	33,741	33,741
	40,208	41,526
Less accumulated amortization:		
Trade secrets	4,847	3,770
Trademarks	1,082	725
Patents—manufacturing process	30,368	23,618
	36,297	28,113
Total amortizing intangibles, net	\$ 3,911	\$ 13,413
Non-amortizing intangibles:		
Trademarks	63,806	63,806
Total trademarks and other intangibles, net	\$ 67,717	\$ 77,219

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 \$8.2 million, \$8.2 million and \$7.8 million for the fiscal years ended 2005, 2004 and 2003, respectively. The remaining aggregate amortization expense of \$3.9 million is to be fully amortized during fiscal year 2006.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

8. DEBT ISSUANCE COSTS AND OTHER ASSETS

Debt issuance costs and other assets consist of the following:

	January 3 2006	December 28, 2004
	(in thousands of dollars)	
Security deposits	\$ 993	\$ 1,296
Debt issuance costs, net of amortization(a)	4,110	5,957
Debt issuance costs(b)	81	—
Total debt issue costs and other assets	<u>\$ 5,184</u>	<u>\$ 7,253</u>

(a) This asset represents costs incurred related to our \$160 Million Notes and AmSouth Revolver.

(b) This asset represents costs incurred as of January 3, 2006 related to the issuance of \$170 million in new term loans and \$15 million new revolving credit facility in February 2006 as further described in Note 27. Upon closing of our new debt facility, we began amortizing these costs and the debt issuance costs related to our \$160 Million Notes and AmSouth Revolver were written-off. Direct costs incurred for the issuance of debt under the \$160 Million Notes have been capitalized and amortized using the effective interest method over the term of the debt. Debt issuance costs related to the AmSouth Revolver have been capitalized and amortized using the straight-line method over the term of the 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 \$1.8 million, \$1.8 million and \$3.1 million was recorded for the fiscal years ended 2005, 2004 and 2003, respectively.

9. ACCRUED EXPENSES

Accrued expenses consist of the following:

	January 3, 2006	December 28, 2004
Payroll and related bonuses	\$ 13,064	\$ 12,450
Interest	181	10,249
Integration and reorganization	—	21
Gift cards	2,745	2,476
Other	8,799	9,640
Total accrued expenses	<u>\$ 24,789</u>	<u>\$ 34,836</u>

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. SENIOR NOTES AND OTHER LONG-TERM DEBT

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

	January 3, 2006	December 28, 2004
\$160 Million Indenture	\$ 160,000	\$ 160,000
AmSouth Revolver	—	15
New Jersey Economic Development Authority Note Payable	840	1,120
	160,840	161,135
Less current portion of debt	280	295
Long-term debt	\$ 160,560	\$ 160,840

\$160 Million Notes

On July 8, 2003, we issued \$160 million 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 are 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. The covenants also preclude the declaration and payment of dividends or other distributions to holders of our common stock. 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 January 3, 2006, we were in compliance with all of the 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):

Commencing on July 1,	Percentage
2005	103.0%
2006	102.0%
2007	101.0%
2008 and thereafter	100.0%

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.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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. The covenants also preclude the declaration and payment of dividends or other distributions to holders of our common stock. 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 \$10.0 million. This debt also contains usual and customary default provisions. As of January 3, 2006, we are in compliance with all of the 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 January 3, 2006 and December 28, 2004, the interest rate on the borrowings outstanding under the AmSouth Revolver was 7.75% and 6.25%, 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 January 3, 2006, we had \$7.1 million in letters of credit outstanding. The letters of credit expire on various dates during 2006, 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 \$7.9 million at January 3, 2006.

New Jersey Economic Development Authority Note Payable

In December 1998, Manhattan entered into a note payable in the principal amount of \$2.8 million 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.

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 January 3, 2006 and December 28, 2004 consolidated balance sheets in accordance with the payment terms. This classification will continue until the note is fully paid from the escrow amount proceeds.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Our senior notes and other long-term debt obligations for the three years following January 3, 2006 are as follows:

Fiscal year (in thousands of dollars):

2006	\$ 280
2007	280
2008	160,280
	<u>\$ 160,840</u>

Debt Redemption and Refinancing

On February 28, 2006, we completed the refinancing of the AmSouth Revolver and the \$160 Million Notes. Our new financing consists of a:

- \$15 million revolving credit facility maturing on March 31, 2011;
- \$80 million first lien term loan maturing on March 31, 2011;
- \$65 million second lien term loan maturing on February 28, 2012; and,
- \$25 million subordinated term loan maturing on February 28, 2013.

Each of the loans requires the payment of interest in arrears on a quarterly basis commencing on March 31, 2006. Additionally, the \$80 million First Lien Term Loan requires quarterly scheduled minimum principal reductions commencing June 30, 2006. In the event that we have not extended the maturity date of the Series Z to a date that is on or after July 26, 2012 (July 26, 2013 for the Subordinated Term Loan) or redeemed the Series Z by various dates in 2008 and 2009, then each of the loans have various accelerated maturity dates beginning in December 2008. For an additional discussion regarding our new debt facility, see Note 27.

11. LEASES

Capital Leases

We lease certain equipment under capital leases. Included in property and equipment are the asset values of \$63,000 and \$51,000 and the related accumulated amortization of \$16,000 and \$5,000 at January 3, 2006 and December 28, 2004, respectively. 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 2005, 2004 and 2003 was approximately \$27.1 million, \$27.9 million and \$27.8 million, respectively. Contingent rent included in rent expense for fiscal 2005, 2004 and 2003 was approximately \$140,000, \$130,000 and \$130,000, respectively.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)

Future Minimum Lease Payments

As of January 3, 2006, future minimum lease payments under capital and operating leases were as follows (in thousands of dollars):

Fiscal year:	Capital Leases	Operating Leases
2006	\$ 23	\$ 23,973
2007	20	14,294
2008	10	8,011
2009	—	5,959
2010	—	3,766
2011 and thereafter	—	3,365
Total minimum lease payments	53	\$ 59,368
Less imputed interest (average rate of 4.75%)	5	
Present value of minimum lease payments	48	
Less current installments	19	
Future minimum rental payments, net	\$ 29	

12. OTHER LONG-TERM LIABILITIES

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

	January 3, 2006	December 28, 2004
Vendor contractual agreements (a)	\$ 7,175	\$ 7,804
Guaranteed franchisee debt (b)	42	394
Deferred rent	1,234	1,480
Other	159	—
	\$ 8,610	\$ 9,678

(a) A strategic supplier of ours provided advance funding in the amount of \$10.0 million 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 January 3, 2006 and December 28, 2004, 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.

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

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 Agreements, 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 (contingently-issuable warrants). We determined that the contingently-issuable warrants could not be classified within stockholders' equity based on the application of the criteria in EITF Issue 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," and accordingly classified those warrants as a liability in the balance sheet.

Furthermore, those warrants classified as a liability were subject to the provisions of SFAS No. 133, "Accounting for Derivative and Hedging Activities." The warrants were carried at fair value based upon the underlying fair value of the common stock to which they were indexed, the estimated probability of issuance and other pertinent factors and were adjusted to fair value at each measurement date. Changes in the fair value of derivatives were recognized in earnings. During fiscal year 2003, we recorded a cumulative change in the fair value of derivatives resulting in a \$1.0 million gain. 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. During the 2003, freestanding warrants that were issued based on the passage of time were valued based upon the underlying fair value of the common stock to which they were indexed and recorded in additional paid-in-capital with a charge to interest expense.

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 fiscal year 2003, we received proceeds of \$0.4 million 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 \$0.4 million.

The proceeds received of \$36.7 million relating to our investment in the Einstein Bonds were used to 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

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Increasing Rate 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%. Also on July 8, 2003, we entered into the AmSouth Revolver.

On June 26, 2003, our board of directors approved an equity restructuring agreement between us and the holders of all our preferred stock and a substantial portion of our fully diluted common stock. These entities included: Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., Greenlight Capital Offshore, Ltd., Brookwood New World Investors, L.L.C. and NWCI Holdings, LLC. These entities are collectively referred to as Greenlight in this filing. Additionally, we also agreed to the equity recapitalization with Halpern Denny Fund III, L.P. (Halpern Denny). Certain of these entities also held a portion of the Increasing Rate Notes.

On September 24, 2003, our stockholders approved the equity recapitalization, which included the following transactions:

- We issued Halpern Denny 57,000 shares of Series Z Preferred Stock, par value \$0.001 per share (Series Z) in exchange for 56,237.994 shares of Series F, par value \$0.001 per share, 23,264,107 shares of common stock and warrants to purchase 13,711,054 shares of common stock; and
- Each stockholder received 0.6610444 new shares of common stock for every share of common stock held by such stockholder pursuant to a 1.6610444-for-one forward stock split in order to effect the transaction contemplated by the equity recapitalization;
- The per share exercise price and the number of shares of common stock issuable upon the exercise of each outstanding option or warrant (other than warrants that were issued in connection with the Increasing Rate Notes pursuant to the Warrant Agreement dated June 19, 2001, as amended between the Bank of New York, as warrant agent and us) were adjusted to reflect the forward stock split;
- Immediately following the forward stock split, but before the one-for-one hundred reverse stock split discussed below, we issued Greenlight 938,084,289 shares of common stock in exchange for 61,706.237 shares of Series F. These shares of Series F included: i) shares originally issued as Series F, ii) shares converted into Series F from the \$10 million contribution plus accrued interest resulting from the Bond Purchase Agreement, and iii) shares converted into Series F from the Bridge Loan.

Following the closing of the equity recapitalization, Greenlight beneficially owned 92% of our common stock on a fully diluted basis and warrants issued pursuant to the Warrant Agreement represented approximately 4.3% of our common stock on a fully diluted basis. In addition to approving the equity recapitalization, our stockholders also approved the following amendments to our Restated Certificate of Incorporation:

- effect a one-for-one-hundred reverse stock split following the consummation of the transactions as contemplated by the equity recapitalization;
- reduce the number of shares of common stock authorized for issuance following the consummation of the effectiveness of the reverse stock split;
- eliminate the classification of our board of directors; and

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

- allow our stockholders to take action by written consent of the holders of 80% of our capital stock entitled to vote on such action. The 1.6610444-for-one forward stock split and the one-for-one hundred reverse stock split have been retroactively reflected in the accompanying consolidated financial statements and footnotes for all periods presented.

The exchange of the Halpern Denny interest for Series Z resulted in a reduction of our effective dividend rate to that required by the Series F and as a result of this and other factors, we accounted for this transaction as troubled debt restructuring as required by SFAS No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings. Since a portion of this exchange included the receipt of our common stock and warrants previously held by Halpern Denny, we did not recognize a gain from troubled debt restructuring. The exchange of the Greenlight interest into common shares was recorded at fair value (the closing price of our common stock on September 24, 2003). Because fair value exceeded the negotiated conversion price of the Greenlight conversion of Series F into our common stock, we recorded a loss on the exchange of approximately \$23.0 million.

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;
- an annual dividend rate equal to 250 basis points higher than the highest rate paid on our funded indebtedness is payable if 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 \$57.0 million as a result of the accounting under troubled debt restructuring as discussed in Note 13. The \$57.0 million represents the total cash payable upon liquidation.

NEW WORLD RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 January 3, 2006 and December 28, 2004, there were 10,065,072 and 9,848,713 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 Stockholder Protection Rights Plan discussed below. 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 January 3, 2006, options to purchase 17 shares of common stock at an exercise price of \$210.71 per share and a remaining contractual life of 1.48 years 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