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ELMERS RESTAURANTS INC

Form 10-K

June 18, 2002

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED APRIL 1, 2002 OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER 0-14837

ELMER'S RESTAURANTS, INC.

(Exact name of registrant as specified in its charter)

OREGON

93-0836824

(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

11802 S.E. Stark St.  
Portland, Oregon

97216

(503) 252-1485

(ADDRESS OF PRINCIPAL  
EXECUTIVE OFFICES) (ZIP CODE)

(REGISTRANT'S TELEPHONE NUMBER,  
INCLUDING AREA CODE)

Securities registered pursuant to Section 12(b) of the Act:  
None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, no par value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. \_\_\_\_\_

Aggregate market value of Common Stock held by nonaffiliates of the Registrant at June 5, 2002: \$8.9 million. For purposes of this calculation, officers and directors are considered affiliates.

Number of shares of Common Stock outstanding at June 5, 2002: 2,058,034

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Document	Part of Form 10-K into which incorporated
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Proxy Statement for 2002	Part III
Annual Meeting of Shareholders	

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

The Company, located in Portland, Oregon, is a franchisor and operator of full-service, family oriented restaurants under the names "ELMER'S. Breakfast. Lunch. Dinner" and "Mitzel's American Kitchen", and operates delicatessen restaurants under the names "Ashley's Cafe" and "Richard's Deli and Pub." The Company is an Oregon corporation and was incorporated in 1983. Walter Elmer opened the first Elmer's restaurant in Portland, Oregon in 1960, and the first franchised restaurant opened in 1966. The Company acquired the Elmer's franchising operation in January 1984 from the Elmer family. The Company now owns and operates ten Elmer's restaurants, five Mitzel's American Kitchen restaurants and franchises 22 Elmer's restaurants in six western states. The Company reports on a fiscal year, which ends on the Monday nearest March 31st.

#### BUSINESS SEGMENT

The Company primarily operates in two business segments: restaurant operations and restaurant franchisor. Information as to revenue, operating profit, identifiable assets, depreciation and amortization expense and capital expenditures for the Company's business segment for fiscal 2002, 2001 and 2000 is contained herein by reference to the Company's consolidated financial statements.

The ten Company-owned Elmer's restaurants are located in: the Delta Park section of Portland, Beaverton, Hillsboro, Albany and Springfield, Oregon; Palm Springs, California; Boise, Idaho; and Vancouver, Tacoma and Lynnwood, Washington. The Company operates five Mitzel's restaurants, located in Oak Harbor, Kent, Fife, Poulsbo and Everett, Washington. The Company acquired five Ashley's restaurants on February 18, 1999 and opened a sixth in January, 2000. Two Ashley's restaurants are located in Bend, Oregon; two are in Springfield Oregon; one is in Eugene, Oregon; and one is in Redmond, Oregon. The Company acquired four Richard's Deli and Pub restaurants on March 31, 1999. Richard's restaurants are located in Tigard, Aloha and two in Hillsboro, Oregon.

#### RECENT ACQUISITIONS AND DEVELOPMENTS

On May 7, 2002 the Company sold three Elmer's restaurants located in Grants Pass, Medford and Roseburg, Oregon to a buyer who signed 25-year franchise agreements for the three restaurants and agreed to open two new units under a development agreement. This transaction is further described in Note 15 to the financial statements.

On April 15, 2002 the Company acquired an Elmer's restaurant in Vancouver Washington from franchisee and former board member, Paul Welch. The Company paid total consideration of approximately \$250,000 and entered into a long-term occupancy lease with an unaffiliated landlord.

On April 12, 2001 the Company acquired the Sandpiper Restaurant in Roseburg, Oregon for \$164,000 in cash and assumed liabilities. The Company entered into a long-term occupancy lease. The Company has since sold the location and assigned the occupancy lease to the buyer in the May 7, 2002 transaction listed above.

On December 13, 2000, the Company purchased the assets of six Mitzel's American Kitchen restaurants in Washington for \$975,000 and 130,000 shares of Elmer's common stock. As part of the terms of the purchase agreement, the

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Company immediately closed the competing Tacoma Mitzel's restaurant.

On August 1, 2000 the Company acquired the assets of the Hodgepodge restaurant and Trackstirs Sports Bar located in Springfield, Oregon for \$325,000 and entered into a long-term occupancy lease. The Company finished the remodel of the restaurant property and re-opened it as an Elmer's restaurant in November 2000.

The Company intends to focus future growth primarily through new and existing franchisees, with an emphasis on experienced single and multi-unit operators and locations in the western states where the Company has an established presence. The Company will pursue strategic acquisitions, new restaurant openings and other growth opportunities where they support the Company's strategic focus. From time to time, the Company may refranchise, sell or otherwise dispose of restaurants.

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### ELMER'S. BREAKFAST. LUNCH. DINNER

The Company franchises or operates a total of 32 full-service, family-oriented Elmer's restaurants. These restaurants have a warm, friendly atmosphere and comfortable furnishings. Most of the restaurants are decorated in a home style with fireplaces in the dining rooms. They are free standing buildings, ranging in size from 4,600 to approximately 9,000 square feet with seating capacities ranging from 120 to 220 people. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. 22 of the restaurants have a lounge with seating capacities ranging from 15 to 75 people. The normal hours of operation are from 6 a.m. to 10 or 11 p.m. and to midnight on weekends in some restaurants with lounges.

Each restaurant offers full service, with a host or hostess to seat guests and handle payments, wait staff to take and serve orders, and additional personnel to clear and reset tables.

The menu offers an extensive selection of items for breakfast, lunch and dinner. The Elmer's breakfast menu, which is available all day, contains a wide variety of selections with particular emphasis on pancakes, waffles, omelets, crepes, country platters and other popular breakfast items. Each Elmer's restaurant makes batters and other key menu items from scratch and prepares its fruit sauces with fresh fruits when in season. The lunch menu includes soups made from scratch, salads, hamburgers and hot and cold sandwiches. Guests at dinner may choose from steak, seafood, chicken, and a variety of home-style items such as pot roast and turkey. A special children's menu and a full senior menu is offered in all restaurants.

### MITZEL'S AMERICAN KITCHEN

The Company owns and operates five full-service, family-style restaurants located in the Puget Sound region of Washington State. Home-style comfort food is served in a warm atmosphere with friendly service. Most of the restaurants are decorated in a home-style with fireplaces in the dining areas. They are free standing buildings, ranging in size from 5,400 to 6,250 square feet with seating capacities from 166 to 203 people. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. Two of the restaurants have a lounge with a seating capacity of 20 to 30. The normal hours of operation are 6:00 a.m. to 10:00 or 11:00 p.m. and to midnight on weekends in restaurants with lounges.

Each restaurant offers full service, with a host or hostess to seat guests, wait staff to take and serve orders and handle payments, and additional

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personnel to clear and reset tables.

The menu offers an extensive selection of items for breakfast, lunch and dinner. The Mitzel's breakfast menu contains a wide variety of selections from pancakes to schnitzels. The lunch/dinner menu includes soups, hamburgers, sandwiches, steak, seafood, pot roast, chicken and a variety of home-style, fresh rotisserie items such as prime rib and turkey. A special children's menu and a limited senior menu is offered in all restaurants.

### ASHLEY'S AND RICHARD'S DELI AND PUB

The Company operates a total of six Ashley's restaurants and four Richard's Delis and Pubs. They are substantially similar in design, size and menu. Eight of the ten units are located in retail strip mall locations, one is in a food court in a major indoor mall, and one is a free standing building. They range in size from 1,000 to 2,200 square feet with seating capacities ranging from 15 to 30 people. A portion of the dining room is also used for the sale of Oregon lottery games. The normal hours of operation are from 7 a.m. to 10 p.m. and up to 2 a.m. for some restaurants on weekends.

Each restaurant offers deli-style hot and cold sandwiches, soups, salads, and desserts and has a catering department. The restaurants are approved retailers with the Oregon lottery and offer all lottery games. Meal selections generally range in price from \$2.95 to \$6.95. The catering operation offers small to medium size food service and event support for business meetings, outdoor barbecues, and special events.

The above brands provide a vehicle for market penetration and unit growth, leveraging off the concept of broad appeal, quick-turn meals and emphasis on service. In a typical market, Ashley's restaurants and Richard's Delis and Pubs experience competition from either other moderately-priced, casual dining and walk-through restaurants or economy sandwich outlets. Ashley's and Richard's differentiate themselves from economy deli competitors by their full table and beer and wine service, attentive wait staff, lottery games, entertaining atmosphere, distinctive decor and consistently high-quality meals.

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### FRANCHISE OPERATIONS

In addition to the acquisition and development of additional Company operated restaurants, the Company encourages the strategic development of franchised restaurants in its existing markets as well as other western states. The primary criteria considered by the Company in the selection, review and approval of prospective franchisees is the availability of adequate capital and prior experience in operating full-service restaurants. Under a franchise agreement, a franchisor grants to a franchisee the right to operate a business in a manner developed by the franchisor. The franchisee owns the franchised operation independently from the franchisor and, in effect, pays a fee for the right to use the franchisor's name, format, and operational procedures. Franchisees benefit from a common identification, standardized products, and the business reputation and services that a franchisor may provide, such as group advertising, management services, product enhancements, and group buying programs. The franchisee is able to capitalize on a business concept without, in many cases, having to invest substantial capital to develop name recognition, menu items, logos and the like. The franchisor is able to expand its business without having to invest substantial capital in property, buildings and equipment.

EXISTING FRANCHISEES. The Company's 22 existing franchise agreements generally grant to franchisees the right to operate an Elmer's restaurant in one specific location for 25 years, renewable generally for an additional 25-year

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period. When they entered into franchising agreements, the existing franchisees paid initial franchise fees of up to \$25,000 plus additional fees of up to \$10,000 if the restaurant had a lounge serving alcoholic beverages. Franchisees pay monthly franchise royalty fees based on the gross revenues of their restaurants. All but one restaurant must contribute up to one percent of gross revenues to a common advertising pool. From time to time, franchised and Company-owned restaurants have agreed to increase advertising pool contributions to one and one-half percent. The Company may terminate a franchise agreement for several reasons including the franchisee's bankruptcy or insolvency, default in the payment of indebtedness to the Company or suppliers, failure to maintain standards set forth in the franchise agreement or operations manual, continued material violation of any safety, health or sanitation law, ordinance or governmental rule or regulation or cessation of business.

**PROSPECTIVE FRANCHISEES.** Prospective new franchisees will generally pay an initial franchise fee of \$35,000. Initial franchise fees are generally payable in cash at the execution of the franchise agreement. Existing franchisees opening new franchised restaurants may pay a lower initial franchise fee than new franchisees. For new franchisees, the monthly franchise royalty fee is expected to be four percent of the gross revenues of the restaurant, subject to a minimum monthly fee of \$750. The standard franchising agreement calls for a monthly advertising contribution equal to one percent of the gross revenues of the restaurant. See "Services to Franchisees" below.

A prospective franchisee who assumes operation of a previously franchised restaurant may be offered a reduced initial franchise fee, deferred payment of the franchise fee, or other concessions. Pursuant to certain area franchise agreements, the Company will receive reduced initial franchise fees and monthly royalty fees from additional restaurants that may be opened in the areas covered by those agreements. See "Area Franchise Agreements" below. In connection with the acquisition of the Elmer's franchising operation in 1984, the Company also granted Dale Elmer, a former director of the Company, and members of the Elmer family the right to operate a total of three additional restaurants at a franchise royalty fee of two percent. No restaurants are being operated on this basis.

The Company estimates that construction costs for the standard free-standing building will range from approximately \$700,000 to \$900,000, with actual costs dependent upon local building requirements and construction conditions, and further based on configuration and parking requirements.

The cost of the land may vary considerably depending upon the quality and size of the site, surrounding population density and other factors. The cost of kitchen equipment, furniture, and trade fixtures, is estimated by the Company to range from approximately \$250,000 to \$400,000. Inventory and miscellaneous items such as paper goods, food, janitorial supplies, and other small wares are estimated initially to cost between approximately \$68,000 and \$108,000.

There is no typical elapsed time from the signing of a franchise agreement until a restaurant is open for business, although it normally takes 120 days from the receipt of the building permits to construct a new restaurant facility. Most restaurants have opened within 12 months of the date of the signing of the franchise agreement. Franchisees bear all costs associated with the development and construction of their restaurants. Although the Company has established criteria to evaluate prospective franchisees, there can be no assurance that franchisees will have the business abilities or access to financial resources necessary to open the restaurants or that the franchisees will successfully develop or operate restaurants in their franchise areas in a manner consistent with the Company's concepts and standards.

**AREA FRANCHISE AGREEMENTS.** Under previous management, the Elmer's franchising operation granted exclusive area franchise agreements, whereby

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independent entities obtained the exclusive rights to develop Elmer's restaurants within their

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respective areas. All exclusive area franchise agreements have expired or lapsed, except for Clackamas County, Oregon. The area franchise agreements require the area franchisee to share with the Company the initial fees and the franchise royalty fees for each new restaurant in the area. The Company's share of the initial fees ranges from \$2,500 to \$12,500 per restaurant. There are two restaurants covered by area franchise agreements. Under the area franchise agreements, the Company reserves the right to approve each new restaurant franchisee. The area franchise agreements grant the franchisees the right to use the Company's name in the particular area and preclude the Company from opening Company-owned or franchised restaurants in the areas covered by the agreements. The Company does not intend to enter into similar agreements in the future.

SERVICES TO FRANCHISEES. The Company makes available to its franchisees various programs and materials. The Company provides several manuals to assist franchisees in ongoing operations, including a comprehensive operations manual describing kitchen operations, floor operations, personnel management, job descriptions, and other matters. The Company has prepared a recipe book for franchisees. All system restaurants use the same menu. Prices are adjusted according to local conditions. The Company has developed and maintains a menu cost-control program and a labor cost-control program at each of its Company-owned restaurants and has developed and implemented a training manual and programs for all positions within the restaurant.

The Company provides both formal and informal ongoing training for franchisees. At least one two or three-day meeting is scheduled each year. At the meetings, franchisees attend lectures by Company personnel and guest speakers from the industry, as well as participate in group workshops discussing such topics as cost control, promotion and food presentation.

The Company provides each franchisee with specifications for menu items. The Company, however, sells no food items or like products to franchisees, except for certain minor supplies such as gift certificates. The Company coordinates franchisees' purchases to obtain volume discounts. Franchisees bear all cost involved in the operation of their restaurants.

Periodic on-site inspections and audits are conducted to ensure compliance with Company standards and to aid franchisees in improving their sales and profitability.

### COMPANY-OWNED RESTAURANTS

The Company owns and operates 10 Elmer's restaurants, which it acquired or built from 1984 to 2001, five Ashley's restaurants acquired February 18, 1999, four Richard's Deli and Pub restaurants acquired March 31, 1999, one additional Ashley's unit opened January 3, 2001, and five Mitzel's American Kitchen restaurants purchased December 13, 2000.

The Company has owned and operated an Elmer's restaurant located in the Delta Park section of Portland, Oregon since January 1984. In August 1986, the Company opened a restaurant in Tacoma, Washington. In January 1987, the Company began operation of a restaurant in Lynnwood, Washington and assumed operation of an Elmer's restaurant in Grants Pass, Oregon. In fiscal 1988, the Company acquired from former franchisees restaurants in Gresham, Albany, and Medford, Oregon; and Boise, Idaho. In fiscal 1989, the Company purchased the land and buildings for the Boise and Gresham restaurants and also purchased, from a former franchisee, an additional restaurant in Hillsboro, Oregon. In May 1989, the Company acquired a franchised Elmer's restaurant in Palm Springs, California. In July 1991, the Company acquired a franchised Elmer's restaurant

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in Beaverton, Oregon. In November 2000, the Company sold and entered into a long-term franchise agreement and occupancy lease for the Gresham Elmer's restaurant. Also in 2000 the Company purchased the assets and remodeled the Springfield Elmer's restaurant. In April 2001 the Company purchased and remodeled the Roseburg Elmer's restaurant. The Company purchased an Elmer's restaurant located in Vancouver, Washington in April 2002. Of the 10 Elmer's restaurants, seven operate on leased property and three on property owned by the Company.

The Company owns and operates five Mitzel's American Kitchen restaurants, which were acquired on December 13, 2000. The first Mitzel's restaurant opened in Everett, Washington in August of 1984. In July of 1985, a restaurant was opened in Poulsbo, Washington. In 1987, restaurants were opened in Oak Harbor and Kent, Washington. In August of 1992, a restaurant was opened in Fife, Washington. All the restaurants operate on leased property.

Five Ashley's restaurants were acquired in a merger with CBW, Inc. on February 18, 1999. One restaurant in Springfield, Oregon was opened in 1994 and the other four were opened in 1995. The four Richard's Delis and Pubs were acquired in a purchase of the outstanding stock of Grass Valley Ltd., Inc. on March 31, 1999. All the restaurants operate on leased property.

The Company and its franchisees coordinate the purchase of their food, beverages and supplies from Company-approved and other suppliers. Management monitors the quality of the food, beverages and supplies provided to the restaurants. The Company believes that its continued efforts over time have achieved cost savings, improved food quality and consistency

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and helped decrease volatility of food and supply costs for the restaurants. All essential food and beverage products are available or, upon short notice, could be made available from alternate qualified suppliers. Therefore, management believes that the loss of any one supplier would not have a material adverse effect on the Company.

### EMPLOYEES

As of April 1, 2002, the Company employed 248 persons on a full-time basis, of whom 20 were corporate office personnel and 228 were restaurant personnel. At that date, the Company also employed 547 part-time restaurant and 2 part-time corporate personnel. Of 22 corporate employees, 8 are in upper management positions and the remainder are professional and administrative employees. Employees of franchised Elmer's restaurants are not included in these figures. None of the Company's employees are covered by collective bargaining agreements. The Company considers its employee relations to be good. Most employees, other than management and corporate personnel, are paid on an hourly basis. Many restaurant personnel also receive tips. The Company believes that it provides working conditions and wages that compare favorably with those of its competition.

Each Company-operated restaurant employs an average of 45 hourly employees, many of whom work part time on various shifts. The management staff of a typical restaurant operated by the Company consists of a general manager, one kitchen manager, one assistant manager and two shift managers. The Company has an incentive compensation program for restaurant managers that provides for quarterly bonuses based upon the achievement of certain defined goals.

### EXECUTIVE OFFICERS OF THE REGISTRANT

As of June 5, 2002, the executive officers and other key personnel of the Company were as set forth below.



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Name	Age	Position
-----	---	-----
Bruce Davis	41	President
William Service	41	Chief Executive Officer
Jerry Scott	48	Vice President, Operations
Dennis Miller	53	Secretary

### EXECUTIVE OFFICERS

Bruce Davis has served as President and Chairman of Board of Directors since August 1998. For more than five years prior to joining the Company, Mr. Davis was President of three companies engaged in the restaurant business: Jaspers Food Management, Inc. (1993-present), CBW, Inc. (1995-1999), and Oregon Food Management, Inc. (1996-present).

William Service has served as Chief Executive Officer and Director since August 1998. For more than five years prior to joining the Company, Mr. Service was the Chief Executive Officer of three companies engaged in the restaurant business: Jaspers Food Management, Inc. (1993-present), CBW, Inc. (1995-1999), and Oregon Food Management, Inc. (1996-present).

### KEY PERSONNEL

Jerry Scott has served as Vice President, Operations since August 1998, and has more than 30 years experience in restaurant operations. For more than five years prior to joining the Company, Mr. Scott served as Vice President of Operations for Jaspers Food Management, Inc. He served from November 1994 to November 1995 as Regional Director of Operations of Macheezmo Mouse Restaurants, Inc.

Dennis Miller has served as Secretary since April 2002 and Corporate Controller since December 2000 when the Company purchased the six Mitzel's Restaurants. Prior to that, and since September 1994, Mr. Miller was Corporate Controller for Mercer Restaurant Services, which owned and managed restaurants in the Puget Sound Area including the Mitzel's Restaurant chain. Prior to joining the restaurant industry, he had over 22 years in hotel finance positions, including 11 years with Westin Hotels.

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### TRADEMARKS AND SERVICE MARKS

The Company believes its trademarks and service marks have significant value and are important to its business. The Company has registered the trademarks and service marks "Elmer's Pancake & Steak House" and "Elmer's Colonial Pancake & Steak House" and the Elmer's logo with the U.S. Patent and Trademark Office. The service mark "Elmer's Breakfast. Lunch. Dinner" has also been registered in certain states. It is the Company's policy to pursue registration of its marks whenever possible and to actively protect its marks against infringement.

The Company grants to each of its Elmer's restaurant franchisees a nonexclusive right to use the trademarks and service marks in connection with and at each franchise location during the term of the franchise agreement.

### ADVERTISING AND MARKETING

Word-of-mouth advertising, new restaurant openings, and the on-premises sale of promotional products have historically been the primary methods of restaurant advertising. The Company employs an advertising consultant to assist

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in projecting the Elmer's restaurant concept to the general public in the Western states, primarily through magazines, newspapers, and radio and television commercials. The Company maintains a common advertising pool with its franchisees to advertise Elmer's restaurants. After production costs for the advertising campaign have been paid out of the common pool, the remaining money is used for advertising in the various local areas of the franchised restaurants. The Company-owned Elmer's restaurants and all but one of the franchised restaurants are required to participate by contributing one percent of monthly gross revenues. The Company promotes the Mitzel's restaurants with a frequent guest program and local store marketing initiatives. At the present time, the Company relies principally on word-of-mouth advertising and catering exposure for advertising of Ashley's and Richard's.

Generally, ongoing consumer research is employed on a limited basis to track attitudes, brand awareness and market share of not only the Company's customers, but also of its major competitors' customers as well. This is vital in creating a better understanding of the Company's short and long term marketing strategies.

### COMPETITION

The restaurant industry is highly competitive with respect to price, concept, quality and speed of service, location, attractiveness of facilities, customer recognition, convenience, food quality and variety, and is often affected by changes in the tastes and eating habits of the public, including changes in local, regional or national economic conditions affecting consumer spending habits, demographic trends and traffic patterns, increases in the number, type and location of competing restaurants, local and national economic conditions affecting spending habits, and by population and traffic patterns. The Company competes for potential franchisees with franchisors of other restaurants, Company-owned restaurants, chains and others. The Company-owned Elmer's restaurants and the franchised Elmer's restaurants compete for customers with restaurants from national and regional chains as well as local establishments. Some of the Company's competitors are much larger than the Company and have greater capital resources that can be devoted to advertising, product development and restaurant development and greater abilities to withstand adverse business conditions. Increased competition, discounting and changes in marketing strategies by one or more of these competitors could have an adverse effect on the Company's sales and earnings in the affected markets. In general, there is active competition for management personnel, capital and attractive commercial real estate sites suitable for restaurants.

The Company believes that the principal competitive factors in its favor for attracting both restaurant franchisees and restaurant customers are Elmer's extensive menu, quality of food, service, reasonable prices, and brand awareness.

### GOVERNMENT REGULATIONS

The restaurant industry generally, and each Company-operated and franchised restaurant specifically, are subject to numerous federal, state and local government regulations, including those relating to the preparation and sale of food and those relating to building, zoning, health, accommodations for disabled members of the public, sanitation, safety, fire, environmental and land use requirements; and, in some cases, state and local licensing of the sale of alcoholic beverages and the state licensing of gaming. The Company and its franchisees are also subject to federal and state laws governing their relationship with employees, including minimum wage requirements, accommodation for disabilities, overtime, working and safety conditions and citizenship/residency requirements. Federal and state environmental regulations have not had a major effect on the Company's operations to date. The Company has no material contracts with the United States government or any of its agencies.

The Company is subject to a number of state laws regulating franchise operations and sales. For the most part, those laws impose registration and disclosure requirements on the Company in the offer and sale of franchises but, in certain cases, also apply substantive standards to the relationship between the Company and the franchisees, including limitations on noncompetition provisions and on provisions concerning the termination or nonrenewal of a franchise. Some states require that certain franchise offering materials be registered before franchises can be offered or sold in that state. The Company is also subject to Federal Trade Commission regulations covering disclosure requirements and sales of franchises.

## ITEM 2. PROPERTIES

### HEADQUARTERS

The Company's corporate offices are located in Portland, Oregon and consist of an office facility of approximately 5,000 square feet. Lease payments totaled approximately \$35,000 for fiscal 2002. The lease expires November 30, 2006.

### COMPANY-OWNED RESTAURANTS

COMPANY-OWNED PROPERTIES. The Company owns the real property upon which the following three Company-owned restaurants are located. All of the properties are subject to mortgages in favor of lending institutions.

Location -----	Approximate Area	
	Site -----	Restaurant -----
Tacoma, Washington	1.3 acres	6,660 sq. ft.
Lynnwood, Washington	1 acre	6,500 sq. ft.
Boise, Idaho	1.3 acres	5,430 sq. ft.

LEASED PROPERTIES. The Company leases the property upon which the following 25 Corporate-owned restaurants are located. Each lease contains specific terms relating to calculation of lease payment, renewal, purchase options, if any, and other matters.

Elmer's Locations -----	Approximate Area	
	Restaurant Sq. ft. -----	Expiration -----
Grants Pass, Oregon (Sublet - May, 2002)	6,350	December, 2006
Hillsboro, Oregon	6,350	January, 2011
Medford, Oregon (Assigned - May, 2002)	6,300	May, 2008
Albany, Oregon	5,460	February, 2008
Roseburg, Oregon (Assigned - May, 2002)	8,800	February, 2018
Springfield, Oregon	9,000	June, 2011
Palm Springs, California	5,500	April, 2007
Portland, Oregon (Delta Park)	6,350	July, 2006
Vancouver, Washington (Acquired April, 2002)	5,900	February, 2004
Beaverton, Oregon	5,322	August, 2006
Mitzel's Locations -----		
Everett, Washington	6,200	December, 2005
Fife, Washington	5,900	September, 2004
Kent, Washington	5,100	April, 2005
Oak Harbor, Washington	5,200	April, 2005
Poulsbo, Washington	6,500	December, 2004

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### Ashley's Locations

-----		
Bend, Oregon (North)	1,000	December, 2005
Bend, Oregon (South)	1,400	August, 2003
Redmond, Oregon	1,200	June, 2003
Eugene, Oregon	1,700	September, 2003
Springfield, Oregon (Gateway)	921	January, 2004
Springfield, Oregon (Thurston)	1,200	June, 2002

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### Richard's Locations

-----		
Aloha, Oregon	1,727	November, 2002
Hillsboro, Oregon (North)	1,092	August, 2004
Hillsboro, Oregon (South)	2,510	June, 2002
Tigard, Oregon	1,743	December, 2002

The Company believes that its facilities are generally in good condition and that they are suitable for their current uses. The Company engages periodically in remodeling and other capital improvement projects designed to expand and improve the efficiency of its facilities.

#### ITEM 3. LEGAL PROCEEDINGS

The Company is periodically involved in litigation relating to claims arising in the normal course of business. The Company maintains insurance coverage against potential claims in amounts that it believes to be adequate. Management believes that it is not presently a party to any litigation, the outcome of which could have a material adverse effect on the Company's business or operations

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

## PART II

#### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the NASDAQ SmallCap Market under the symbol "ELMS."

The following table sets forth the high and low reported sales prices of the Common Stock in the NASDAQ SmallCap Market for the fiscal year quarters indicated

	Fiscal Year Ended			
	April 1, 2002		April 2, 2001	
	High	Low	High	Low
1st Quarter	4.86	4.52	5.63	4.30
2nd Quarter	4.76	4.31	6.13	4.87
3rd Quarter	5.43	4.40	5.42	4.17
4th Quarter	5.20	4.33	5.48	4.32

Although the Common Stock is traded on the NASDAQ SmallCap Market, there is a relatively low trading volume.

The Company has not paid or declared cash dividends on its Common Stock. In November 1999, the Company declared a five-percent stock dividend, in August 2000 a ten-percent stock dividend and in March 2002 a five-percent stock

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dividend. The Company intends to retain any future earnings to finance growth and does not presently intend to pay dividends or make distributions in cash other than the payment of cash in lieu of functional shares in connection with stock splits, if any, to the holders of Common Stock. Any future dividends will be determined by the Board of Directors based on the Company's earnings, financial condition, capital requirements, debt covenants or other relevant factors.

As of May 28, 2002, the Company had 187 shareholders of record. The Company estimates there are approximately 425 beneficial shareholders.

### UNREGISTERED SALES OF STOCK

Sales of unregistered Common Stock made by the Company in the last three fiscal years are as follows:

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The Company issued 130,000 shares as part of the consideration paid for the purchase of the six Mitzel's American Kitchen restaurants in December 2000.

### ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data relating to the Company should be read in conjunction with the Company's consolidated financial statements and the related notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations," other financial information included herein, and Elmer's Restaurants, Inc. consolidated financial statements. The selected financial data set forth below for the Company as of April 1, 2002 and April 2, 2001 and for each of the three years in the period ended April 1, 2002 are derived from the audited financial statements included elsewhere herein. The selected financial data set forth below for the Company as of March 31, 2000, 1999 and 1998 are derived from the consolidated financial statements not included elsewhere herein.

#### ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES SELECTED FINANCIAL DATA

For the fiscal years ended -----	April 1, 2002 -----	April 2, 2001 -----	March 31, 2000 -----	March 31, 1999 -----
Revenues	\$33,775,648	\$25,852,336	\$22,179,574	\$11,952,728
Net income	1,065,856	956,006	939,549	290,512
Net income per share	0.52	0.48	0.49	0.29
Total assets	16,685,283	16,374,147	13,847,208	13,046,684
Long-term notes payable, less current portion	5,366,050	5,798,769	5,124,130	5,703,539
Total liabilities	8,396,191	9,129,937	8,209,004	8,348,029
Total shareholder's equity	8,289,092	7,244,210	5,638,204	4,698,655

On August 25, 1998, CBW, Inc. ("CBW") acquired a controlling interest in the then outstanding stock of Elmer's. On February 18, 1999, CBW merged with and into Elmer's. These transactions have been accounted for as a purchase of Elmer's by CBW and, accordingly a new basis of accounting, based on fair values, was established for the assets and liabilities of Elmer's. Subsequent to the acquisition on August 25, 1998, the Company's financial statements reflect the combined results of operations and financial position of CBW and Elmer's based on the new basis of accounting for Elmer's and the historical cost basis of CBW. The results of operations for the year ended March 31, 1999 also reflect a minority interest in the earnings of the Company representing the 46.2% separate

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public ownership in Elmer's from August 25, 1998 through February 17, 1999. The financial position at March 31, 1999 also reflects the acquisition of Grass Valley Ltd. on that date. Prior to August 25, 1998, the financial statements of the Company include only the results of operations, financial position and cash flows of CBW, which began operations on June 16, 1995.

The following table presents summarized quarterly results.

	Quarter 1 -----	Quarter 2 -----	Quarter 3 -----	Quarter 4 -----
FISCAL 2002				
Revenues	\$10,267,510	\$ 8,193,871	\$ 7,905,618	\$ 7,408,649
Operating Income	628,475	503,955	479,760	422,191
Net Income	314,787	256,305	242,942	251,822
Net Income per share	\$ 0.15	\$ 0.13	\$ 0.12	\$ 0.12
	=====	=====	=====	=====
FISCAL 2001				
Revenues	\$ 7,231,139	\$ 5,458,374	\$ 5,809,505	\$ 7,353,318
Operating Income	605,355	513,710	363,927	386,064
Net Income	308,117	279,589	182,058	186,242
Net Income per share	\$ 0.16	\$ 0.14	\$ 0.09	\$ 0.09
	=====	=====	=====	=====

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### NEW ACCOUNTING PRONOUNCEMENTS

The effects of new accounting pronouncements are discussed in Note 1 of Notes to Consolidated Financial Statements.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the "Selected Historical Financial Data" and the financial statements of the Company and the accompanying notes thereto included elsewhere herein. Certain information discussed below may constitute forward-looking statements within the meaning of the federal securities laws. Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, it can give no assurance that its expectations will be achieved. Forward-looking information is subject to certain risks, trends and uncertainties that could cause actual results to differ materially from projected results. Among those risks, trends and uncertainties are the general economic climate, costs of food and labor, consumer demand, interest rate levels, restrictions imposed by the Company's debt covenants, management control, availability of supplies, the availability of financing and other risks associated with the acquisition, development and operation of new and existing restaurants. This list of risks and uncertainties is not exhaustive.

### CRITICAL ACCOUNTING POLICIES

The Company's reported results are affected by the application of certain accounting policies that require subjective or complex judgements. These judgements involve estimates that are inherently uncertain and may have a significant impact on our quarterly or annual results of operations and financial condition. Changes in these estimates and judgements could have significant effects on the Company's results of operations and financial condition in future years. We believe the Company's most critical accounting policies cover accounting for long-lived assets - specifically property, buildings and equipment depreciation thereon and the valuation of intangible assets. Additional critical accounting policies govern revenue recognition and

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accounting for stock options.

### Property, Buildings and Equipment

When the Company purchases fixed assets, those assets are recorded at cost. However, when the Company acquires an operating restaurant or business, the Company must allocate the purchase price between the fair market value of the tangible assets acquired and any excess to goodwill. The fair market value of restaurant equipment fixtures and furnishings in an operating restaurant is difficult to separate from the going concern value of the restaurant. Most of the value of the equipment is due to the fact that it is in the restaurant and working. The Company values in place equipment with reference to replacement cost, age and condition, and utility in its intended use.

### Depreciation

Property, buildings and equipment are depreciated using the straight-line method over their estimated useful lives. Leasehold improvements are amortized on a straight-line method over their estimated useful lives or the term of the related lease, whichever is shorter. Differences between the realized lives and the estimated lives could result in changes to the Company's results from operations in future years, as well as changes in the rate of recurring capital expenditures.

### Intangible Assets

The Company reviews the carrying value of the Company's intangible assets for impairment annually in accordance with FAS 142. These tests are primarily based on the cashflow of the underlying business units and the value of those cashflows in the marketplace. Changes in those cashflows or in the "multiples" assigned by the marketplace could result in the impairment of those assets and a subsequent writedown of goodwill.

### Revenue Recognition

The Company's revenue is primarily from cash and credit card transactions. As such, restaurant revenue is generally recognized upon receipt of cash or credit cards receipts. Franchise fees based upon a percent of the franchisees gross sales are recognized as the franchisees' sales occur. Revenue from the lottery, which includes traditional ticket based games and video poker games is recorded on a commission basis, that is net of state regulated payouts. Expenses are record using accrual accounting based upon when goods and services are used.

### Stock Options

The Company accounts for its stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Based on

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this methodology the company has not recorded any compensation costs related to its stock options since all options have been issued at an exercise price equal to or greater than the market value of the company's stock at the time of issuance. Included in note 14 of the Company's financial statements is the pro forma effect on the Company's net income and earnings per share if compensation had been determined based on the estimated fair value of the options at the date of grant consistent with the provisions of SFAS No. 123.

### HIGHLIGHTS OF HISTORICAL RESULTS

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The Company reported record net income of approximately \$1,066,000, or \$.52 basic earnings per share for the year ended April 1, 2002, on sales of approximately \$33,776,000. The Company reported net income of approximately \$956,000, or \$.48 per share for the year ended April 2, 2001. For the year ended March 31, 2000, the Company reported net income of approximately \$939,500 or \$.49 per share.

During the year ended April 1, 2002, total assets increased approximately \$311,000 to \$16.7 million. Increases in cash and marketable securities were largely offset by reductions in fixed assets due to the sale of the real estate in Gresham, Oregon to the franchisee. During the year ended April 1, 2002, total shareholders' equity increased approximately \$1.1 million to \$8.3 million, primarily as a result of current year net income.

### COMPARISON OF FISCAL YEAR 2002 RESULTS TO HISTORICAL RESULTS OF OPERATIONS

Dollar amounts in thousands except per share data

	For the Year Ended				
	April 1, 2002		April 2, 2001		Ma
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amou
Revenue	\$ 33,776	100.0%	\$ 25,852	100.0%	\$ 22
Restaurant costs and expenses	23,106	68.4	17,733	68.6	15
General and administrative expenses	8,635	25.6	6,251	24.2	5
Operating income	2,034	6.0	1,869	7.2	1
Non operating income (expense)	(469)	(1.4)	(425)	(1.6)	
Net income	1,066	3.2	956	3.7	
Earnings per share	\$ .52		\$ .48		\$
Weighted average shares outstanding	2,058,955		1,977,227		1,923

### REVENUE

	For the Year Ended				
	April 1, 2002		April 2, 2001		M
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amou
Restaurant operations:					
Restaurant sales	\$ 29,147	86.3%	\$ 21,720	84.0%	\$ 18
Lottery	3,412	10.1	3,292	12.7	2
	32,559	96.4	25,012	99.8	21
Franchise operations	1,217	3.6	840	3.2	
Total revenue	\$ 33,776	100.0%	\$ 25,852	100.0%	\$ 22

REVENUES. Revenues for the year ended April 1, 2002 were 30.7% greater than for the comparable period in 2001 reflecting the operations of the five Mitzel's units for the full year as well as two additional Company-owned Elmer's units. Same restaurant sales decreased 0.4% and franchise and administrative



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services revenues increased 43.3% due to the sale of two franchise agreements and the administrative services agreement with the Yankee Grills which commenced December, 2000. Lottery revenues, as a percentage of total revenues, fell from 12.7% to 10.1%. Revenues for the year ended April 2, 2001 were 16.6% greater than the comparable period in 2000, driven primarily by the December, 2000 acquisition of the five Mitzel's units.

**RESTAURANT COSTS AND EXPENSES.** As a percent of total revenue, food, beverage and supply costs were 28.6% in 2002 compared to 2001 and 2000 of 27.5% and 28.4% respectively. Labor was 31.2% of total revenue in 2002 compared to results in 2001 and 2000 of 31.4% and 31.9% respectively. Occupancy, depreciation, amortization and restaurant opening/closing expenses totaled 8.6% of revenue in 2002 compared to 2001 and results in 2000 of 9.6% and 8.5% respectively. In the first six months of the year, the Company saw a shift in sales to lower margin items, resulting in an increase in food beverage and supply costs as a percentage of revenues. This seems to have stabilized in the second half of the year. The decrease in labor as a percentage of revenue in 2002 over fiscal year 2001 is driven by improved operating efficiencies, partly offset by an increase in minimum wages rates in Washington and California. Washington state minimum wage is now indexed to inflation and will be adjusted annually. The decrease in occupancy, depreciation, amortization and restaurant opening/closing expenses as a percentage of revenues in 2002 over 2001 is primarily due to lower restaurant opening/closing expenses and the cessation of amortization under FAS 142, which the Company adopted in the first quarter of the fiscal year.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses were 25.6% of total revenue in fiscal 2002 compared 24.2% and 22.6% in fiscal 2001 and 2000 respectively. The increase in general and administrative costs as a percentage of revenues reflects the impact of integration expenses related to the Mitzel's restaurant acquisition and increased marketing expenditures for those restaurants as well as an increase in resources devoted to franchise operations.

**NON OPERATING INCOME (EXPENSES).** This primarily reflects net interest expenses that were 1.4% of total revenues in 2002 compared to 1.6% and 2.2% in fiscal 2001 and 2000 respectively. The reduction in net interest expense as a percentage of revenues is primarily the result of increased revenues.

### LIQUIDITY AND CAPITAL RESOURCES

As of April 1, 2002, the Company had cash and equivalents of approximately \$654,000 representing a decrease of approximately \$487,000 during the fiscal year. The decrease resulted from cash provided by operations totaling approximately \$1.69 million, less cash used in investing activities of approximately \$1.12 million and less cash used in financing activities of approximately \$1.06 million. Cash used in investing activities includes net additions to available for sale securities of \$1.17 million. In addition to the regular replacement of depreciating restaurant assets, cash used in investing activities included the acquisition and subsequent conversion to the Elmer's concept of the Roseburg location. Cash used in financing activities includes early retirement of the mortgage debt on the Gresham property of approximately \$435,000, as well as \$303,000 contributed to a sinking fund for the Company's convertible debt.

The Company's primary liquidity needs arise from debt service, operating lease requirements and the funding of capital expenditures. As of April 1, 2002, the Company had outstanding indebtedness of \$2.7 million under term loan facilities with GE Capital, \$1.7 million in real estate loan facilities with Wells Fargo Bank and \$1.3 million in convertible notes issued in a private placement.

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The GE Capital loan was originated in June 2001 with proceeds used to retire (without penalty) approximately \$1.55 million in Wells Fargo term debt and \$1.25 million in a term loan facility with Eagles View Management. The GE Capital loan fully amortizes over ten years, \$1.70 million of the loan has a fixed interest rate of 8.95%. Interest is variable at 385 basis points over 30 day commercial paper (currently approximately 5.6%) on the remaining \$1.00 million portion of the note. The variable portion of the note can be fixed (385 basis points above five year treasuries) without penalty within the first two years. The loan is collateralized by substantially all of the assets owned by Elmer's Restaurants, Inc. (except for real estate assets).

The remaining Wells Fargo real estate debt has a weighted-average maturity of 7.8 years, bears interest at an average of 8.2%, requires monthly payments of principal and interest, and is collateralized by three real estate assets.

The \$1.3 million of convertible notes have a remaining maturity of approximately six years, bear interest at 10%, require monthly interest-only payments, payments into a Company-held sinking fund, and are subordinated to other Company funded debt. The notes include a convertible feature that permits the holder to convert the principal of the note into common

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stock at any time at \$6.19 per share. The Company can redeem the notes after December 1, 2003 by paying a premium of 5% or less depending on the years remaining to maturity.

Certain of the Company's debt agreements require compliance with debt covenants. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.25 to 1.0, and a ratio of cash generation (defined as net income before taxes, interest expense, depreciation and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.25 to 1.0. Management believes that the Company is in compliance with such requirements.

Elmer's Restaurants, Inc., like most restaurant businesses, is able to operate with nominal or deficit working capital because sales are for cash and inventory turnover is rapid. Renovation and/or remodeling of existing restaurants is either funded directly from available cash or, in some instances, is financed through outside lenders. Construction or acquisition of new restaurants is generally, although not always, financed by outside lenders.

The Company believes that it will continue to be able to obtain adequate financing on acceptable terms for new restaurant construction and acquisitions and that cash generated from operations will be adequate to meet its financial needs and to pay operating expenses for the foreseeable future, although no assurances can be given.

### CONTRACTUAL OBLIGATIONS

The Company makes a range of contractual commitments in the ordinary course of business and in conjunction with the acquisition and sale of restaurants. The following table shows the Company's contractual obligations:

	Total amount committed	Commitment expiration period			
		1 year or less	1-3 years	4-5 years	5 years or more
Term debt	\$ 4,343,383	\$ 277,333	\$ 629,734	\$ 866,857	\$ 2,569,459

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Convertible debt	1,300,000				1,300,000
Operating Leases	6,577,654	1,202,994	2,310,424	1,501,209	1,563,027
Guarantees	2,607,900	243,000	537,250	586,950	1,240,700
-----					
Totals	\$14,828,937	\$ 1,723,327	\$ 3,477,408	\$ 2,955,016	\$ 6,673,186
	=====	=====	=====	=====	=====

The covenants to the Company's term debt require the company to maintain certain leverage and cash flow ratios (discusses in detail in the footnotes to the financial statements.) The Company believes it is in compliance with all debt covenants as of the fiscal year ended April 1, 2002, and the Company expects it will continue to be in compliance. However, in the event the company were out of compliance with the debt covenants, the terms of the loan agreements generally provide for the acceleration of repayment.

The Company has issued promissory notes, convertible at the option of the Holder, into common stock at \$6.19 per share. The likelihood of conversion increases with any increase in the market price of the Company's common stock above \$6.19.

The Company has signed long term occupancy leases for all but three of its restaurant locations. These leases are recorded as operating leases, and costs are expensed as they become due.

Under the terms of lease assignment agreements, the Company has guaranteed certain franchisee occupancy leases five years. In one case the guarantee could be extended for up to 16 years. In all cases these guarantees are in turn, personally guaranteed by the franchisee. In the event the franchisee defaulted on the occupancy lease, the Company could be required to pay all rent and other amounts due under the terms of the lease for the remainder of the guarantee term. In the event of default, the Company expects it would exercise its right to reoccupy and continue to operate the restaurants as Elmer's Breakfast. Lunch. Dinner(TM) These guarantees are further discussed in Note 15 of the financial statements.

### INFLATION

Certain of the Company's operating costs are subject to inflationary pressures, of which the most significant are food and labor costs. As of April 1, 2002, a significant percentage of the Company's employees were paid wages equal to or based on the state minimum hourly wage rates. Economic growth that would reduce unemployment or make more jobs available in higher paying industries could directly affect the Company's labor costs. The Company believes that inflation has not had a material impact on its results of operations for fiscal 2002, fiscal 2001 or fiscal 2000. Substantial increases in costs could

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have a significant impact on the Company and the industry. If operating expenses increase, management believes it can recover increased costs by increasing prices to the extent deemed advisable considering competition.

### SEASONALITY

The seasonality of restaurant sales due to consumer spending habits can be significantly affected by the timing of advertising, competitive market conditions and weather-related events. While restaurant sales for certain quarters can be stronger, or weaker, there is no predominant pattern.

### ITEM 7(A). QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS:

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Certain statements in this Form 10-K under "Item 1. Business," "Item 7. Management's discussion and analysis of financial condition and results of operations" and elsewhere in this Form 10-K constitute "forward-looking statements" within the meaning of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance, or achievements of Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; the impact of competitive products and pricing; success of operating initiatives; development and operating costs; advertising and promotional efforts; adverse publicity; acceptance of new product offerings; consumer trial and frequency; availability, locations, and terms of sites for restaurant development; changes in business strategy or development plans; quality of management; availability, terms and deployment of capital; the results of financing efforts; business abilities and judgment of personnel; availability of qualified personnel; food, labor and employee benefit costs; changes in, or the failure to comply with, government regulations; continued NASDAQ listing; weather conditions; construction schedules; and other factors referenced in this Form 10-K.

The Company holds no financial instruments of any kind for trading purposes. Certain of the Company's outstanding financial instruments are subject to market risks, including interest rate risk. Such financial instruments are not currently subject to foreign currency risk or commodity price risk. The Company's major market risk exposure is potential loss arising from changing interest rates and the impact of such changes on its long-term debt and marketable securities. Of the Company's long-term debt outstanding at April 1, 2002, \$951,000 was accruing interest at a variable rate of 3.85% over 30-day commercial paper. The Companies marketable securities are largely invested in mutual funds whose underlying assets are interest paying debt with a maturity of less than five years. A rise in prevailing interest rates could have adverse effects on the Company's financial condition and results of operations.

### PRINCIPAL AMOUNT BY EXPECTED MATURITY (\$ in thousands)

Fiscal Year	2003	2004	2005	2006	Thereafter	Total	Fair Value
-----	-----	-----	-----	-----	-----	-----	-----
Variable rate debt	\$73.3	\$79.1	\$85.0	\$92.4	\$620.9	\$950.7	\$950.7
Average interest rate (3.85% over 30-day Commercial Paper)	5.6%	5.6%	5.6%	5.6%	5.6%		

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The response to this item is submitted as a separate section of this Form 10-K. See Item 14.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On April 17, 2001, the Board of Directors dismissed PricewaterhouseCoopers LLP as the Company's independent accountants and appointed Moss Adams LLP for the fiscal year ended April 2, 2001. The decision to change accountants was recommended by the Company's Audit Committee and approved by the Board of Directors.

PricewaterhouseCoopers LLP 's reports on the financial statements for the years ended April 2, 2001 and March 31, 2000 contained no adverse opinion nor disclaimer of opinion, nor were such reports qualified or modified as to

uncertainty, audit scope, or accounting principles. During the fiscal years ended April 2, 2001 and March 31, 2000, and during the interim period between April 1, 2000, and April 17, 2001, there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction PricewaterhouseCoopers LLP, would have caused it to make a reference to the subject matter of the disagreements in connection with its reports.

### PART III

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to directors of the Company is included under the caption "Election of Directors" in the Company's definitive proxy statement (the "2002 Proxy Statement") for its 2002 Annual Meeting of Shareholders filed or to be filed not later than 120 days after the end of the fiscal year covered by this Report and is incorporated herein by reference. Information with respect to executive officers of the Company is included under Item 4(a) of Part I of this Report. Information with respect to compliance with Section 16(a) of the Securities Exchange Act is included under "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2002 Proxy Statement.

#### ITEM 11. EXECUTIVE COMPENSATION

Information with respect to executive compensation is included under the caption "Executive Compensation" in the 2002 Proxy Statement is incorporated herein by reference.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information with respect to security ownership of certain beneficial owners and management is included under the caption "Voting Securities and Principal Shareholders" and "Election of Directors" in the 2002 Proxy Statement incorporated herein by reference.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information with respect to certain relationships and related transactions with management is included under the caption "Certain Transactions" in the 2002 Proxy Statement and is incorporated herein by reference.

### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 10-K

The Financial Statements listed in the accompanying index on page F-1 are filed as part of this Report.

(a) (1)	Financial Statements and Schedules	Page in this Report -----
	Auditors' Reports.....	F-1
	Consolidated Balance Sheets at April 1, 2002 and April 2, 2001.....	F-3
	Consolidated Statements of Operations for the years ended	

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April 1, 2002, April 2, 2001 and March 31, 2000.....F-4

Consolidated Statements of Changes in Shareholders' Equity for  
the years ended April 1, 2002, April 2, 2001 and March 31, 2000.....F-5

Consolidated Statements of Cash Flows for the years ended  
April 1, 2002, April 2, 2001 and March 31, 2000.....F-6

Notes to Consolidated Financial Statements.....F-7

No other schedules are included because the required information is inapplicable or is presented in the financial statements or related notes thereto.

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### SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Elmer's Restaurants, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Elmer's Restaurants, Inc.

By: WILLIAM W. SERVICE

-----  
William W. Service  
Chief Executive Officer

Dated: June 14, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Elmer's Restaurants, Inc., in the capacities and on the dates indicated.

SIGNATURE -----	TITLE -----	DATE ----
/s/ Bruce N. Davis ----- Bruce N. Davis	Chairman of the Board & President	June 14, 2002
/s/ William W. Service ----- William W. Service	Chief Executive Officer & Director (Principal Executive & Financial Officer)	June 14, 2002
/s/ Thomas C. Connor ----- Thomas C. Connor	Director	June 14, 2002
/s/ Corydon H. Jensen ----- Corydon H. Jensen	Director	June 14, 2002
/s/ Richard Williams	Director	June 14, 2002

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-----  
Richard Williams

/s/ Donald Woolley

Director

June 14, 2002

-----  
Donald Woolley

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders  
Elmer's Restaurants, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Elmer's Restaurants, Inc. and Subsidiaries (the Company) as of April 1, 2002, and April 2, 2001, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 Elmer's Restaurants, Inc. and Subsidiaries as of April 1, 2002, and April 2, 2001, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Portland, Oregon  
May 22, 2002

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders

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Elmer's Restaurants, Inc.

In our opinion, the consolidated statements of income, of changes in shareholders' equity (deficit) and of cash flows for the year ended March 31, 2000 (included in the Elmer's Restaurants, Inc. Form 10-K for the fiscal year ended April 1, 2002) present fairly, in all material respects, the results of operations and cash flows of Elmer's Restaurants, Inc. and Subsidiaries for the year ended March 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Portland, Oregon  
May 23, 2000

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

	April 1, 2002	April 1, 2000
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 654,211	\$ 1,149,171
Marketable securities	1,149,171	315,063
Accounts and franchise fees receivable	315,063	372,712
Notes receivable - related parties, current portion	372,712	411,008
Inventories	411,008	133,424
Prepaid expenses and other	133,424	114,117
Income taxes receivable	114,117	
	-----	-----
Total current assets	3,149,706	2,000,000
Notes receivable - related parties, net of current portion	203,045	
Property, buildings, and equipment, net	7,654,097	8,000,000
Goodwill	4,699,164	4,000,000
Intangible assets	602,709	
Principal debt service account for convertible debt	305,019	
Other assets	274,588	
	-----	-----



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Total assets	\$ 16,685,283	\$ 16,685,283
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable, current portion	\$ 277,333	\$ 277,333
Accounts payable	1,483,823	1,483,823
Accrued expenses	174,120	174,120
Accrued payroll and related taxes	403,141	403,141
	-----	-----
Total current liabilities	2,338,417	2,338,417
Notes payable, net of current portion	5,366,050	5,366,050
Deferred income taxes	691,724	691,724
	-----	-----
Total liabilities	8,396,191	8,396,191
	-----	-----
COMMITMENTS AND CONTINGENCIES (Note 8)		
SHAREHOLDERS' EQUITY		
Common stock, no par value, 10,000,000 shares authorized; 2,058,034 and 1,962,032 shares issued and outstanding at April 1, 2002, and April 2, 2001, respectively	7,371,400	6,371,400
Retained earnings	929,266	929,266
Accumulated other comprehensive loss, net of taxes	(11,574)	(11,574)
	-----	-----
Total shareholders' equity	8,289,092	8,289,092
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 16,685,283	\$ 16,685,283
	=====	=====

See accompanying notes.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME

	For The Years Ended	
	April 1, 2002	April 2, 2001
	-----	-----
REVENUES	\$ 33,775,648	\$ 25,852,336
	-----	-----
COSTS AND EXPENSES		
Cost of restaurant sales:		
Food and beverage	9,672,077	7,121,428
Labor and related	10,526,212	8,126,818
Occupancy costs	2,067,785	1,598,805
Depreciation and amortization	786,593	745,744
Restaurant opening/closing expenses	53,382	139,909
General and administrative expenses	8,635,218	6,250,576

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	-----	-----
Total costs and expenses	31,741,267	23,983,280
	-----	-----
INCOME FROM OPERATIONS	2,034,381	1,869,056
OTHER INCOME (EXPENSE)		
Interest income	109,444	138,845
Interest expense	(572,210)	(591,311)
(Loss) gain on disposition of assets	(5,759)	27,528
	-----	-----
Income before provision for income taxes	1,565,856	1,444,118
Income tax provision	(500,000)	(488,112)
	-----	-----
NET INCOME	\$ 1,065,856	\$ 956,006
	=====	=====
PER SHARE DATA:		
Net income per share - basic	\$ 0.52	\$ 0.48
	=====	=====
Weighted average number of common shares outstanding - basic	2,058,955	1,977,227
	=====	=====
Net income per share - diluted	\$ 0.51	\$ 0.48
	=====	=====
Weighted average number of common shares outstanding - diluted	2,074,073	2,013,832
	=====	=====

See accompanying notes.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

	Common Stock		Retained Earnings
	Shares	Amount	(Accumulated Deficit)
	-----	-----	-----
BALANCE, March 31, 1999	1,586,229	\$ 4,746,520	\$ (47,865)
5% stock dividend (November 30, 1999)	79,319	495,744	(495,744)
Net income	--	--	939,549
	-----	-----	-----
BALANCE, March 31, 2000	1,665,548	5,242,264	395,940
10% stock dividend (August 18, 2000)	166,484	978,926	(978,926)
Issuance of common stock in conjunction with acquisition of Mitzel's American Kitchen			

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restaurants (December 13, 2000)	130,000	650,000	--
Net income	--	--	956,006
	-----	-----	-----
BALANCE, April 2, 2001	1,962,032	6,871,190	373,020
Stock repurchase			
(October 3, 2001)	(2,000)	(9,400)	--
5% stock dividend			
(March 7, 2002)	98,002	509,610	(509,610)
Comprehensive income:			
Net income	--	--	1,065,856
Change in net unrealized loss			
on securities available-for-			
sale, net of taxes	--	--	--
Total comprehensive income	--	--	--
	-----	-----	-----
BALANCE, April 1, 2002	2,058,034	\$ 7,371,400	\$ 929,266
	=====	=====	=====

See accompanying notes.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended	
	April 1, 2002	April 2, 2001
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,065,856	\$ 956,006
Adjustments to reconcile net income to net cash		
from operating activities:		
Depreciation and amortization	786,593	745,744
Deferred income taxes	(73,000)	(21,000)
Loss (gain) on disposition of assets	5,759	(27,521)
Changes in assets and liabilities:		
Accounts and franchise fees receivable, inventories,		
and prepaids	(68,806)	(127,281)
Other assets	(43,582)	(14,700)
Accounts payable	94,628	25,140
Accrued expenses	(23,385)	550,130
Income taxes	(52,492)	(341,390)
	-----	-----
Net cash from operating activities	1,691,571	1,719,974
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, buildings, and equipment	(793,520)	(1,142,010)
Purchases of available-for-sale securities	(1,476,353)	--
Proceeds from the sale of available-for-sale securities	305,904	--
Business acquisition	(128,000)	(1,507,470)
Issuance of notes receivable - related parties	(75,508)	(275,000)
Principal collected on notes receivable - related parties	148,473	33,740

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Proceeds from sale of assets	912,938	1,10
Repurchase of common stock	(9,400)	--
	-----	-----
Net cash from investing activities	(1,115,466)	(2,890,74
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of 10% convertible notes	1,300,000	--
Payments on notes payable	(760,319)	(628,43
Contribution to principal debt service account	(302,591)	--
	-----	-----
Net cash from financing activities	(1,062,910)	671,56
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(486,805)	(499,19
CASH AND CASH EQUIVALENTS, beginning of year	1,141,016	1,640,21
	-----	-----
CASH AND CASH EQUIVALENTS, end of year	\$ 654,211	\$ 1,141,01
	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	\$ 572,210	\$ 591,31
	=====	=====
Income taxes	\$ 667,300	\$ 850,50
	=====	=====
SUPPLEMENTAL DISCLOSURES OF NONCASH TRANSACTIONS		
Sale of property and equipment for notes receivable	\$ --	\$ 142,00
	=====	=====
Shares issued in conjunction with Mitzel's acquisition	\$ --	\$ 650,00
	=====	=====
Stock dividends declared	\$ 509,610	\$ 988,91
	=====	=====
Change in unrealized loss on available-for-sale securities, net of taxes	\$ 11,574	\$ --
	=====	=====
Note payable issued in conjunction with acquisition of certain assets and goodwill of a company	\$ 35,606	\$ --
	=====	=====
Accrued interest classified as note receivable	\$ 10,182	\$ --
	=====	=====
Note receivable issued for franchise fee receivable	\$ 31,500	\$ --
	=====	=====

See accompanying notes.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION - As of April 1, 2002, Elmer's Restaurants, Inc., an Oregon

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corporation, and Subsidiaries (the Company) owned and operated 12 Elmer's Restaurants, six Ashley's Deli restaurants, five Mitzel's American Kitchen restaurants, four Richard's Deli and Pub restaurants, and sells franchises that give franchisees the right to operate under the name Elmer's Breakfast. Lunch. Dinner™ for a specific restaurant or region. Franchises and Company-owned restaurants are located throughout the western United States.

**PRINCIPLES OF CONSOLIDATION** - The consolidated financial statements include the accounts of Elmer's Restaurants, Inc. and its wholly-owned subsidiaries, CBW, Inc., CBW Food Company LLC, Grass Valley Ltd., Inc., and Elmer's Pancake & Steak House, Inc. All material intercompany accounts and transactions have been eliminated.

**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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates and assumptions.

**CHANGE IN REPORTING PERIODS** - Effective April 1, 2000, the Company changed its quarterly reporting periods from three-month quarters ending on the last day of the third month, to a "4-3-3-3" accounting cycle whereby each quarter ends on the last Monday of the respective quarter. This change in reporting periods does not have a material effect on comparability of the consolidated financial statements. Fiscal year 2002 ended April 1, 2002, and fiscal year 2001 ended April 2, 2001.

**DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS** - The carrying amounts of financial instruments including cash and cash equivalents and accounts receivable approximated fair value as of April 1, 2002 and April 2, 2001, because of the relatively short maturity of these instruments. The carrying value of notes receivable approximated fair value as of April 1, 2002, and April 2, 2001, based upon interest rates and terms available for similar investments. The carrying value of notes payable approximated fair value as of April 1, 2002, and April 2, 2001, based upon interest rates and terms available for the same or similar loans.

**CASH AND CASH EQUIVALENTS** - For purposes of the statements of cash flows, the Company considers all short-term, highly liquid investments, with a maturity of three months or less, to be cash equivalents.

The Company's cash equivalents consist of interest-bearing deposits with major banks and money market accounts. Management routinely reviews these investments in order to limit the amount of credit exposure to any one financial institution.

**INVESTMENTS** - The Company classifies its marketable securities as "available-for-sale." Securities classified as available-for-sale are carried in the financial statements at fair value based on quoted market prices. Realized gains and losses, determined using the first-in, first-out (FIFO) method, are included in earnings; unrealized holding gains and losses are reported in other comprehensive income.

**CONCENTRATIONS OF CREDIT RISK** - Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash deposits, marketable securities, and accounts receivable. The Company places its cash deposits with federally insured financial institutions. As of April 1, 2002, the Company's deposits were in excess of the federal insurance limits of \$100,000. The Company maintained investment accounts with combined balances of \$1,399,465. The funds in these

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ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING  
POLICIES - (continued)

accounts were invested in mutual funds, corporate bonds, and equity securities. Future changes in market prices may make such investments less valuable. Accounts receivable balances consist primarily of franchise fees receivable, which are deemed fully collectible by the Company.

INVENTORIES - Inventories of food, beverages, and restaurant supplies are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

PROPERTY, BUILDINGS, AND EQUIPMENT - Property, buildings, and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Lives used for calculating depreciation and amortization rates for the principal asset classifications are as follows: buildings - 35 years; automobiles, furniture, fixtures, and equipment - 3 to 7 years; leasehold improvements - life of lease or applicable shorter period. Maintenance and repairs are expensed as incurred; renewals and improvements are capitalized. Upon disposal of assets subject to depreciation, the related costs and accumulated depreciation are removed and resulting gains and losses are reflected in the consolidated statements of income.

RECOVERABILITY OF LONG-LIVED ASSETS - Management of the Company reviews the carrying value of capitalized tangible and intangible assets on a regular basis to reach a judgment concerning possible permanent impairment of value. These reviews consider, among other factors: (1) the net realizable value of each major classification of assets; (2) the cash flow associated with the assets; and (3) significant changes in the extent or manner in which major assets are used. Management believes the carrying value of assets are less than the estimated fair value.

ADVERTISING - Advertising and promotional costs are expensed as incurred. Advertising and promotional expenses were \$318,081, \$406,987, and \$274,675 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively. Company-owned and franchise restaurants contribute 1% of gross sales to a common advertising fund maintained by the Company.

DERIVATIVE FINANCIAL INSTRUMENTS - In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 also requires that changes in the derivative instrument's fair value be recognized currently in results of operations unless specific hedge accounting criteria are met. SFAS No. 133, as amended by SFAS No. 137, is effective for fiscal years beginning after June 15, 2000. The Company entered into an interest rate swap agreement with a bank to reduce the impact of changes in interest rates on a portion of its floating rate long-term debt. The agreement effectively changed the Company's interest rate exposure on the covered portion to a fixed percentage. The interest rate swap agreement expired on March 1, 2002.

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REVENUE RECOGNITION - Initial license fees from individual and area franchise sales are recognized as revenue when substantially all of the terms and conditions of the franchise agreement are met. The terms of the franchise agreements are generally 25 years. Continuing franchise fees (based on a percentage of sales) are recognized as revenue each month based on the franchisees' monthly sales activity. Lottery revenues are recognized net of prizes and the State of Oregon's share of proceeds. Net lottery revenues were \$3,412,000, \$3,292,000, and \$2,906,000 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively.

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### ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued)

INCOME TAXES - Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized.

Income tax expense is the tax payable for the year, and the change during the year, in net deferred income tax assets and liabilities.

STOCK OPTIONS - SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, defines a fair value based method of accounting for employee stock options and similar equity instruments, and encourages all entities to adopt that method of accounting for all of their employee stock compensation plans. It encourages, but does not require, companies to record compensation costs for stock-based employee compensation plans at fair value. The Company has chosen to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related interpretations.

NET INCOME PER SHARE - Basic earnings per share (EPS) is computed using the weighted-average number of shares of common stock outstanding for the period. Diluted EPS is computed using the weighted-average number of shares of common stock and dilutive common stock equivalents outstanding during the period, if any. Common equivalent shares, if any, are excluded from the computation when their effect is antidilutive.

All references to share and per share information have been adjusted to give effect to stock dividends.

RECLASSIFICATION - A reclassification has been made to the financial statements for the year ended March 31, 2000, to transfer the fair value of shares issued in the November 30, 1999 5% stock dividend from retained earnings to common stock. The effect of the reclassification was to decrease retained earnings and increase common stock as of March 31, 2000 by \$495,744. This reclassification has no effect on previously reported net income or earnings per share.

Certain other amounts in the 2001 and 2000 consolidated financial statements have been reclassified to conform to the 2002 presentation. Net income and cash flows were not affected by the reclassifications.

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IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS - In June 2001, the FASB issued SFAS No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS. SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of a long-lived asset, except for certain obligations of lessees. As used in SFAS No. 143, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or a written or oral contract, or by legal construction for a contract under the doctrine of promissory estoppel. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002, although earlier application is encouraged. The Company does not expect that application of the provisions of this statement will have a material impact on the Company's financial statements.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued)

In October 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. SFAS No. 144 establishes a single accounting model, based on the framework established in SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, for long-lived assets to be disposed of by sale, and resolves significant implementation issues related to SFAS No. 121. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 2001, although earlier application is encouraged. The Company does not expect that application of the provisions of this statement will have a material impact on the Company's financial statements.

### NOTE 2 - MARKETABLE SECURITIES

Cost and fair value of available-for-sale marketable debt and equity securities at April 1, 2002, are as follows:

	Amortized Cost	Unrealized Gain	Gross Unrealized Losses	Gross Fair Value
Mutual funds	\$1,251,344	\$ 13,481	\$ 36,011	\$1,228,814
Corporate bonds	91,347	--	2,477	88,870
Equity securities	75,624	7,297	1,140	81,781
	-----	-----	-----	-----
	\$1,418,315	\$ 20,778	\$ 39,628	\$1,399,465
	=====	=====	=====	=====

These investments are classified on the balance sheet as follows:



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	Marketable Securities	Money Market	T
	-----	-----	-----
Marketable securities (current asset)	\$1,149,171	\$ --	\$1,1
Bond sinking fund (noncurrent asset)	250,294	54,725	3
	-----	-----	-----
	\$1,399,465	\$ 54,725	\$1,4
	=====	=====	=====

Net unrealized holding losses on available-for-sale securities in the amount of \$18,850 for the year-end April 1, 2002, have been included in accumulated other comprehensive income, net of income taxes of \$7,276. For the year ended April 1, 2002, realized losses on sales of available-for-sale securities were \$6,857 and are included in other income. There were no marketable securities held by the Company at April 2, 2001.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 3 - NOTES RECEIVABLE - RELATED PARTIES

Notes receivable - related parties consist of the following:

	April 1, 2002	A
	-----	-----
Notes receivable bearing interest at 10.5%, due on or before January 1, 2002, secured by a stock pledge agreement for 15,000 shares of Elmer's Restaurants Inc. common stock	\$ 154,889	\$
Note receivable bearing interest at 8%, due on or before October 15, 2002, secured by a franchise agreement and restaurant furniture, fixtures, and equipment	48,266	
Note receivable bearing interest at 10%, due on or before March 15, 2003, secured by a stock pledge agreement for 50,000 shares of Elmer's Restaurants Inc. common stock	135,460	
Notes receivable from franchisees, bearing interest from 12% to 14%, due on or before October 2002	34,097	
	-----	-----
Total notes receivable - related parties	372,712	
Less current portion	(372,712)	(
	-----	-----
Notes receivable - related parties, net of current portion	\$ --	\$
	=====	=====

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## NOTE 4 - PROPERTY, BUILDINGS, AND EQUIPMENT

	April 1, 2002	April 2, 2001
	-----	-----
Land	\$ 1,686,700	\$ 2,246,700
Buildings	1,551,378	1,911,903
Furniture, fixtures, and equipment	3,981,618	3,508,920
Leasehold improvements	2,505,232	2,117,301
Automobiles	55,814	23,409
	-----	-----
	9,780,742	9,808,233
Less accumulated depreciation and amortization	(2,126,645)	(1,366,366)
	-----	-----
	\$ 7,654,097	\$ 8,441,867
	=====	=====

Depreciation expense charged to operations was \$786,593, \$598,927, and \$484,204 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 4 - PROPERTY, BUILDINGS, AND EQUIPMENT - (continued)

In October 2001, the Company's Gresham, Oregon franchise exercised their option to purchase the land and building leased from the Company. Proceeds from the transaction and the carrying value of the assets were \$912,938 and \$918,697, respectively. The Company recognized a \$5,759 loss as a result of this transaction.

## NOTE 5 - INCOME TAXES

The provision for income taxes consisted of current and deferred income tax expense as follows:

	April 1, 2002	April 2, 2001	March 31, 2000
	-----	-----	-----
Current:			
Federal	\$ 487,000	\$ 419,112	\$ 400,000
State	86,000	90,000	60,000
	-----	-----	-----
	573,000	509,112	460,000
Deferred	(73,000)	(21,000)	20,000

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	-----	-----	-----
Income tax provision	\$ 500,000	\$ 488,112	\$ 480,000
	=====	=====	=====

A reconciliation of the federal income tax rate to the Company's effective income tax rate is as follows:

	April 1, 2002		April 2, 2001	
	-----		-----	
Federal income tax at statutory rate	\$ 534,000	34.0%	\$ 491,112	3
State income taxes, net of federal income tax benefit	56,000	3.6	52,000	
Nondeductible expenses	71,000	4.6	42,000	
Federal income tax credits	(161,000)	(10.2)	(97,000)	(
	-----	----	-----	----
	\$ 500,000	32.0%	\$ 488,112	3
	=====	=====	=====	=====

Deferred income taxes are the result of provisions in the tax laws that either require or permit certain items of income or expense to be reported for income tax purposes in different periods than they are reported for financial reporting. As of April 1, 2002, and April 2, 2001, the deferred tax liability of \$691,724 and \$772,000, respectively, primarily represents the difference between the book basis of property, buildings, and equipment and intangibles and the related tax basis of approximately \$2,056,000 and \$2,270,000, respectively.

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 6 - NOTES PAYABLE

Notes payable consist of the following:

	April 1, 2002	April 200
	-----	-----
Note payable to financing company, principal and interest due monthly at 8.95%, matures July 2011, secured by all assets of the Company	\$ 1,715,338	\$
Note payable to financing company, principal and interest due monthly, interest at average weekly yield of 30-day Commercial Paper, matures July 2011, secured by all assets of the Company	950,676	
Note payable to financial institution, payable in monthly principal installments of \$34,900 plus		

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interest at varying rates, refinanced in June 2001	--	1,61
Note payable to financial institution, principal and interest due monthly at 8.15%, repaid during 2002	--	44
Note payable to financial institution, principal and interest due monthly at 8.18%, matures January 2011, secured by real estate	1,150,590	1,19
Note payable to financial institution, principal and interest due monthly at 8.25%, matures February 2008, secured by real estate	526,779	55
Note payable to financing company, interest due monthly at 15%, subordinated, refinanced during 2002	--	1,25
Note payable to individual, principal and interest due monthly at 10%, repaid July 2001	--	
Convertible notes payable, interest payable monthly at 10%, principal due December 2007 (Note 7)	1,300,000	1,30
Total notes payable	5,643,383	6,36
Less current portion	(277,333)	(56)
Notes payable, net of current portion	\$ 5,366,050	\$ 5,79

Certain notes payable contain restrictive covenants pertaining to financial ratios and minimum cash flow coverage. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.25 to 1.0, and a ratio of cash generation (defined as net income before taxes, interest expense, depreciation, and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.25 to 1.0.

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ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - NOTES PAYABLE - (continued)

Future maturities of notes payable for the following fiscal years are:

Years ended April 1, 2003	\$ 277,333
2004	301,614
2005	328,120
2006	380,194
2007	486,663
Thereafter	3,869,459
	-----
	\$5,643,383
	=====

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All interest costs incurred during the years ended April 1, 2002, April 1, 2001, and March 31, 2000, have been expensed during the respective periods.

### NOTE 7 - CONVERTIBLE DEBT

The Company's outstanding convertible debt of \$1,300,000 at April 1, 2002, and April 2, 2001, is convertible into shares of the Company's common stock at a price of \$6.19 per share. The notes are subject to conversion, in whole but not in part, at any time following May 1, 2001, into unregistered shares of the Company's common stock, at the option of the holder. The notes also contain a call feature whereby the Company may call the notes for call prices designated at a percent of the stated conversion price as follows:

For the period:	Call Price -----
December 1, 2003 through November 30, 2004	105%
December 1, 2004 through November 30, 2005	103%
December 1, 2005 through November 30, 2005	101%
December 1, 2005 through the maturity date	100%

Under the terms of the convertible debt notes, the Company is required to make monthly payments (through December 2007) of principal in the amount of \$15,476 to a principal debt service account. The balance in the account was \$305,019 at April 1, 2002. There was no balance in the account at April 2, 2001.

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ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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### NOTE 8 - COMMITMENTS AND CONTINGENCIES

The Company leases certain facilities under operating lease agreements. Minimum fiscal year rental commitments for the year ending April 1, 2002, for property, buildings, and equipment with noncancellable terms of more than one year are:

Years ended April 1, 2003	\$1,202,994
2004	1,192,628
2005	1,117,796
2006	868,496
2007	632,713
Thereafter	1,563,027
	-----
	\$6,577,654
	=====

The leases generally provide for additional rentals based upon a specified percentage of sales and require the Company to pay certain other costs. Rental expense on operating leases amounted to approximately \$1,819,032, \$1,431,000, and \$884,000 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively.

From time to time the Company is involved in litigation relating to claims arising in the normal course of its business. The Company maintains insurance coverage against potential claims in amounts that it believes to be adequate. Management believes that it is not presently a party to any litigation, the

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outcome of which could have a material adverse effect on the Company's business or operations.

### NOTE 9 - RELATED-PARTY TRANSACTIONS

Jaspers Food Management, Inc. (JFMI), is a privately held restaurant management company. Certain officers and directors hold a majority interest in JFMI. Accounts payable and other liabilities due to the affiliate are due on demand and accrue interest at an annual rate of 10.5% based on the outstanding balance over 28 days. Under the terms of a management services agreement, the affiliate provides substantially all store labor, management, accounting, human resources, training, and other administrative services related to the operation of the six Ashley's Delis and four Richard's Deli and Pub restaurants. Labor and related expenses were \$842,000, \$930,000, and \$903,000 as of April 1, 2002, April 2, 2001, and March 31, 2000, respectively. Amounts outstanding with JFMI are as follows:

	April 1, 2002 -----	April 2, 2001 -----
Accounts (payable) receivable	\$ (7,231) =====	\$26,364 =====

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### ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 10 - RESTAURANT AND FRANCHISE OPERATIONS

The consolidated results of operations and other selected financial information, from restaurant and franchise operations, are presented after elimination of intercompany transactions:

	April 1, 2002 -----	April 2, 2001 -----	M -----
Revenues:			
Restaurant operations	\$32,558,606	\$25,011,807	\$21
Franchise operations	1,217,042	840,529	
	-----	-----	-----
Consolidated	\$33,775,648 =====	\$25,852,336 =====	\$22 =====
Income from operations:			
Restaurant operations	\$ 1,812,031	\$ 1,731,667	\$ 1
Franchise operations	222,350	137,389	
	-----	-----	-----
Consolidated	\$ 2,034,381 =====	\$ 1,869,056 =====	\$ 1 =====
Capital and intangible expenditures:			

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Restaurant operations	\$ 945,497	\$ 3,206,615	\$
Franchise operations	29,035	92,867	
	-----	-----	---
Consolidated	\$ 974,532	\$ 3,299,482	\$
	=====	=====	=====
Depreciation and amortization:			
Restaurant operations	\$ 739,293	\$ 692,755	\$
Franchise operations	47,300	52,989	
	-----	-----	---
Consolidated	\$ 786,593	\$ 745,744	\$
	=====	=====	=====
Assets:			
Restaurant operations	\$16,114,277	\$15,246,621	\$12
Franchise operations	571,006	1,127,526	1
	-----	-----	---
Consolidated	\$16,685,283	\$16,374,147	\$13
	=====	=====	=====

The number of Company-owned stores and operating franchises is as follows:

	April 1, 2002 ----	April 2, 2001 ----	March 31, 2000 ----
Company-owned stores	27	26	21
Operating franchises	20	19	18

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 11 - RESTAURANT ACQUISITIONS

ACQUISITION OF ROSEBURG RESTAURANT - On April 12, 2001, the Company executed an asset purchase agreement with Sandpiper Restaurants of Oregon, LLC, acquiring substantially all the assets of the Roseburg, Oregon, restaurant for \$128,000 in cash and a promissory note payable to seller for \$35,600. The acquisition cost of \$164,000 was allocated to the fair market value of the assets acquired (\$124,000) and the excess to goodwill (\$40,000). The Company converted the restaurant to the Elmer's concept, and opened in June 2001. As further described in Note 15, the Company sold and refranchised this location on May 7, 2002.

ACQUISITION OF SPRINGFIELD RESTAURANT - On August 1, 2000, the Company executed an asset purchase agreement with Hospitality Two LLC, acquiring substantially all the assets of the Springfield, Oregon, restaurant and lounge for \$325,000 in cash. The Company converted the restaurant to the Elmer's concept, and opened November of 2000. The acquisition cost of \$345,630 was allocated to the fair market value of the assets acquired (\$109,110) and the excess to goodwill (\$236,520).

ACQUISITION OF MITZEL'S RESTAURANTS - Effective December 13, 2000, the Company executed an asset purchase agreement with the owners of six Mitzel's American

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Kitchen restaurants, acquiring substantially all the assets of those locations for \$975,000 in cash and issuance of 130,000 shares of the Company's restricted common stock. These locations are wholly-owned and operated as a division of the Company. The acquisition was recorded as a purchase and the excess of the acquisition cost over fair value of the tangible assets acquired was allocated to goodwill. The total cost of the acquisition was as follows:

Cash	\$ 975,000
Value of 130,000 shares of common stock issued in conjunction with the transactions	650,000
Assumed liabilities, closing, and relocation expenses	122,245
Related legal and other transaction costs	65,009
	-----
	\$1,812,254
	=====

The acquisition cost of \$1,812,254 was allocated to the fair market value of the assets acquired (\$1,024,900) and the excess to goodwill (\$787,354).

### NOTE 12 - GOODWILL AND INTANGIBLE ASSETS

In July 2001, the FASB issued SFAS No. 141, BUSINESS COMBINATIONS and SFAS No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles have been evaluated against this new criteria and no changes were considered necessary to the previously recognized intangibles. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles (those deemed to have indefinite life) will be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles are determined to be more than their fair value.

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### ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 12 - GOODWILL AND INTANGIBLE ASSETS - (continued)

The Company adopted SFAS No. 142 effective April 3, 2001. The changes in the carrying amount of goodwill and intangible assets for the year ended April 1, 2002, are as follows:

	Goodwill -----	Intangibles -----
Balance as of April 3, 2001	\$4,642,152	\$ 602,709
Acquired during the year	57,012	--
	-----	-----
Balance as of April 1, 2002	\$4,699,164	\$ 602,709
	=====	=====

Components of goodwill are tested for impairment in the third quarter. The fair value of the reporting units as estimated using multiples of earnings before



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interest, taxes, depreciation, and amortization (EBITDA) resulted in no impairment of goodwill.

The pro forma effect of adjusted net income, basic and diluted earnings per share are as follows:

	April 1, 2002 -----	April 2, 2001 -----
Net income:		
Reported net income	\$ 1,065,856	\$ 956,006
Add back: Goodwill amortization, net of tax	--	97,715
Add back: Trademark amortization, net of tax	--	13,300
	-----	-----
Adjusted net income	\$ 1,065,856 =====	\$ 1,067,021 =====
Basic earnings per share:		
Reported net income	\$ 0.52	\$ 0.48
Add back: Goodwill amortization, net of tax	--	0.05
Add back: Trademark amortization, net of tax	--	0.01
	-----	-----
Adjusted net income	\$ 0.52 =====	\$ 0.54 =====
Diluted earnings per share		
Reported net income	\$ 0.51	\$ 0.48
Add back: Goodwill amortization, net of tax	--	0.05
Add back: Trademark amortization, net of tax	--	0.01
	-----	-----
Adjusted net income	\$ 0.51 =====	\$ 0.54 =====

All net income and per share amounts have been adjusted to reflect the March 7, 2002, 5% stock dividend.

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ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 13 - EMPLOYEE BENEFIT PLAN

The Company formed a 401(k) profit sharing plan on April 1, 2000, whereby eligible employees may contribute up to 20% of their regular earnings. Employees are eligible to participate after one year of half-time employment with the Company and attainment of 21 years of age. The plan provides that the Company

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can also make matching and other contributions to the plan. The Company contributed \$44,385 and \$29,200 to the plan for the years ended April 1, 2002, and April 2, 2001, respectively.

### NOTE 14 - STOCK OPTIONS

The Board of Directors adopted the 1999 Stock Option Plan (the Plan) in February 1999 which provides for the award of incentive stock options to key employees and the award of nonqualified stock options to employee and nonemployee directors. Under the terms of the Plan, the exercise price of the options are determined as the fair market value based on trading values of the Company's common stock at the time the option is granted. Under the Plan, 546,000 shares of common stock are authorized for issuance. Options are exercisable upon vesting. Options generally vest 20% annually and expire 10 to 15 years after the date of grant.

A summary of the Company's stock options and changes during the years ended April 1, 2002, April 2, 2001, and March 31, 2000, is presented below:

	Options Outstanding -----	Weighted- Average Exercise Price -----
Balance, March 31, 1999	197,072	\$ 3.91
Options granted	189,420	5.12
Options cancelled	(18,191)	3.91
	-----	
Balance, March 31, 2000	368,301	4.54
Options granted	94,500	4.69
Options cancelled	(21,945)	4.44
	-----	
Balance, April 2, 2001	440,856	4.58
Options granted	8,400	4.76
Options cancelled	(37,869)	4.44
	-----	
Balance, April 1, 2002	411,387 =====	\$ 4.59 =====

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### ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 14 - STOCK OPTIONS - (continued)

The following table summarizes information on stock options outstanding as of April 1, 2002:

Exercise	Number	Contractual	Weighted- Average Remaining Exercise	Weighted- Average Number	Weighted Average Exercise
----------	--------	-------------	---	--------------------------------	---------------------------------

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Price -----	Outstanding -----	Life - Years -----	Price -----	Exercisable -----	Price -----
\$ 3.92	148,565	9.74	\$ 3.92	89,139	\$ 3.92
4.52	57,750	8.70	4.52	30,450	4.52
4.76	8,400	14.92	4.76	--	4.76
5.00	25,725	10.52	5.00	5,145	5.00
5.09	49,671	8.81	5.09	23,334	5.09
5.15	121,276	12.05	5.15	121,276	5.15

There were 134,613 shares of common stock reserved for the grant of stock options under the Plan at April 1, 2002.

The Company complies with the disclosure-only provisions of SFAS No. 123 and thus no compensation cost has been recognized for the Plan. Had compensation cost for the stock-based compensation plan been determined based on the fair value of options at the date of grant consistent with the provisions of SFAS No. 123, the Company's pro forma net income and pro forma earnings per share would have been as follows:

	April 1, 2002 -----	April 2, 2001 -----	March 20 -----
Net income - as reported	\$ 1,065,856	\$ 956,006	\$ 93
Net income - pro forma	\$ 905,671	\$ 798,951	\$ 65
Diluted earnings per share - as reported	\$ 0.51	\$ 0.48	\$
Diluted earnings per share - pro forma	\$ 0.44	\$ 0.40	\$

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## ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 14 - STOCK OPTIONS - (continued)

For purposes of the above pro forma information, the fair value of each option grant was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	April 1, 2002 -----	April 2, 2001 -----	March 31, 2000 -----
Risk-free interest rate	5.28%	5.5%	6.0%
Expected life	10 years	10 years	10 years
Expected volatility	20%	26%	26%
Expected dividend yield	0%	0%	0%

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. The granting of additional stock options in future years is anticipated.

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### NOTE 15 - SUBSEQUENT EVENTS

Effective May 7, 2002, the Company executed asset purchase and franchise agreements with Southern Oregon Elmer's LLC (the Buyer), refranchising three of the Company's Elmer's restaurants located in Grants Pass, Medford, and Roseburg, Oregon. The Company has sold substantially all the assets of those locations in consideration for \$1,385,500 in cash and promissory notes valued at \$349,500. The Buyer has signed 25-year franchise agreements for each location and will operate the locations under the Elmer's Breakfast. Lunch. Dinner™ name.

The Buyer has also signed a development agreement to open two additional restaurants within seven years. The Buyer expects to open the first restaurant before December 2002.

As a result of this transaction, the Company will report a one-time gain of approximately \$475,000 (net of tax effect) in the Company's first quarter ending July 22, 2002.

The Company has agreed to provide a limited amount of seller financing. The Company accepted a \$270,000 note bearing interest at 9% per year, payable in 84 equal monthly payments; an approximately \$79,500 note bearing interest at 9%, payable in 24 equal monthly payments; and an approximately \$106,000 inventory note bearing interest at 12% and due in 90 days.

The Company has assigned its rights and obligations under the occupancy leases for the Medford and Roseburg locations. The Company remains a guarantor of the Medford lease until April 2007. The Company's guarantee of the Roseburg lease could extend until 2018 if the Buyer exercises its options in 2003, 2008, and 2013. The Company has subleased the Grants Pass location to the Buyer for five years under substantially the same terms and conditions as the underlying lease. Provided all parties are in good standing under the lease at the end of the sublease, the Grants Pass landlord has agreed to lease directly to the Buyer under substantially similar terms.

In an unrelated transaction, the Company has acquired an Elmer's restaurant located in Vancouver, Washington, from a franchisee and former Board member, for approximately \$250,000 in cash and assumed liabilities. The Company has entered into a long-term occupancy lease at the same location, and will continue to operate the location as an Elmer's restaurant. The Company expects to spend approximately \$100,000 on renovating this location.

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