

RED ROBIN GOURMET BURGERS INC
Form 10-Q/A
May 19, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 2)

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended July 11, 2004

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 0-49916

RED ROBIN GOURMET BURGERS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of incorporation or organization)

84-1573084
(I.R.S. Employer Identification No.)

6312 S. Fiddler s Green Circle, Suite 200N

Greenwood Village, CO
(Address of principal executive offices)

80111
(Zip Code)

(303) 846-6000

(Registrant s telephone number, including area code)

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 10, 2004, there were 16,051,846 outstanding shares of the registrant s common stock.

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Explanatory Note

The purpose of this amendment on Form 10-Q/A to the Quarterly Report on Form 10-Q of Red Robin Gourmet Burgers, Inc. for the period ended July 11, 2004 is to restate our condensed consolidated financial statements as of July 11, 2004 and for the twelve and twenty-eight weeks ended July 11, 2004 and July 13, 2003, and related disclosures, as described in Note 2 to the condensed consolidated financial statements. Additional information about the decision to restate these financial statements can be found in our Current Report on Form 8-K, filed with the Securities and Exchange Commission (SEC) on March 1, 2005.

No attempt has been made in this Form 10-Q/A to update other disclosures presented in the original report on Form 10-Q, except as required to reflect the effects of the restatement. The Form 10-Q/A does not reflect events occurring after the filing of the Form 10-Q or modify or update those disclosures, including the exhibits to the Form 10-Q affected by subsequent events. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the SEC subsequent to the filing of the original Form 10-Q, including any amendments to those filings. The following items have been amended as a result of the restatement:

Part I - Item 1 - Financial Statements

Part I - Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Part I - Item 4 - Controls and Procedures

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RED ROBIN GOURMET BURGERS, INC.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****RED ROBIN GOURMET BURGERS, INC.****Condensed Consolidated Balance Sheets****(In thousands, except share amounts)****(unaudited)**

| | July 11, | December 28, |
|---|--------------------------|---------------------|
| | 2004 | 2003 |
| | <u>(As Restated, See</u> | |
| | <u>Note 2)</u> | |
| Assets: | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 4,040 | \$ 4,871 |
| Accounts receivable, net | 1,359 | 1,146 |
| Inventories | 4,820 | 4,357 |
| Prepaid expenses and other current assets | 2,117 | 3,977 |
| Income tax refund receivable | | 1,172 |
| Deferred tax asset | 757 | 757 |
| Restricted current assets – marketing funds | 1,380 | 959 |
| | <u>14,473</u> | <u>17,239</u> |
| Total current assets | | |
| Property and equipment, at cost, net | 184,344 | 154,410 |
| Deferred tax asset | 6,143 | 5,848 |
| Goodwill, net | 25,720 | 25,720 |
| Other intangible assets, net | 7,847 | 8,118 |
| Other assets, net | 2,778 | 3,047 |
| | <u>\$ 241,305</u> | <u>\$ 214,382</u> |
| Total assets | | |
| Liabilities and Stockholders' Equity: | | |
| Current Liabilities: | | |
| Trade accounts payable | \$ 13,175 | \$ 9,139 |
| Accrued payroll and payroll related liabilities | 13,887 | 12,161 |
| Unredeemed gift certificates | 2,609 | 3,997 |
| Accrued liabilities | 9,945 | 5,913 |
| Accrued liabilities – marketing funds | 1,380 | 959 |
| Current portion of long-term debt and capital lease obligations | 1,474 | 1,422 |
| | <u>42,470</u> | <u>33,591</u> |
| Total current liabilities | | |
| Deferred rent payable | 12,757 | 10,655 |

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| | | |
|---|-------------------|-------------------|
| Long-term debt and capital lease obligations | 39,846 | 36,206 |
| Other non-current liabilities | 1,897 | 1,544 |
| Commitments and contingencies | | |
| Stockholders' Equity: | | |
| Common stock; \$.001 par value: 30,000,000 shares authorized; 16,051,796 and 15,969,723 shares issued and outstanding as of July 11, 2004 and December 28, 2003, respectively | 16 | 16 |
| Preferred stock; \$.001 par value: 3,000,000 shares authorized; no shares issued and outstanding | | |
| Additional paid-in capital | 123,533 | 122,184 |
| Deferred stock compensation | (90) | (130) |
| Receivables from stockholders/officers | (6,526) | (6,432) |
| Accumulated other comprehensive loss, net of tax benefit | (43) | (108) |
| Retained earnings | 27,445 | 16,856 |
| | <u> </u> | <u> </u> |
| Total stockholders' equity | 144,335 | 132,386 |
| | <u> </u> | <u> </u> |
| Total liabilities and stockholders' equity | \$ 241,305 | \$ 214,382 |
| | <u> </u> | <u> </u> |

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****Condensed Consolidated Statements of Income****(In thousands, except per share data)****(Unaudited)**

| | Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|------------------------------------|---|--|---|--|
| | July 11, 2004 (As Restated, See Note 2) | July 13, 2003 (As Restated, See Note 2) | July 11, 2004 (As Restated, See Note 2) | July 13, 2003 (As Restated, See Note 2) |
| Revenues: | | | | |
| Restaurant | \$ 90,896 | \$ 73,329 | \$ 204,179 | \$ 163,546 |
| Franchise royalties and fees | 2,811 | 2,166 | 6,121 | 4,752 |
| Rent revenue | 61 | 97 | 197 | 186 |
| Total revenues | 93,768 | 75,592 | 210,497 | 168,484 |
| Costs and Expenses: | | | | |
| Restaurant operating costs: | | | | |
| Cost of sales | 21,322 | 17,290 | 48,115 | 38,309 |
| Labor | 31,597 | 25,858 | 71,706 | 57,707 |
| Operating | 13,096 | 10,853 | 29,629 | 24,820 |
| Occupancy | 5,648 | 4,853 | 12,929 | 11,060 |
| Depreciation and amortization | 4,817 | 3,625 | 10,715 | 8,258 |
| General and administrative | 6,522 | 5,419 | 14,690 | 12,317 |
| Franchise development | 629 | 324 | 2,954 | 1,721 |
| Pre-opening costs | 1,127 | 790 | 2,575 | 1,787 |
| Total costs and expenses | 84,758 | 69,012 | 193,313 | 155,979 |
| Income from operations | 9,010 | 6,580 | 17,184 | 12,505 |
| Other (income) expense: | | | | |
| Interest expense | 579 | 650 | 1,411 | 1,589 |
| Interest income | (74) | (71) | (173) | (167) |
| Loss on extinguishment of debt | | 106 | | 106 |
| Gain on sale of property | (257) | | (257) | |
| Other | 50 | (15) | 88 | (34) |
| Total other expenses | 298 | 670 | 1,069 | 1,494 |
| Income before income taxes | 8,712 | 5,910 | 16,115 | 11,011 |
| Provision for income taxes | 3,033 | 1,955 | 5,526 | 3,639 |
| Net income | \$ 5,679 | \$ 3,955 | \$ 10,589 | \$ 7,372 |

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| | | | | |
|---|---------|---------|---------|---------|
| Earnings per share: | | | | |
| Basic | \$ 0.35 | \$ 0.26 | \$ 0.66 | \$ 0.49 |
| Diluted | \$ 0.35 | \$ 0.26 | \$ 0.65 | \$ 0.48 |
| Weighted average shares outstanding: | | | | |
| Basic | 16,007 | 15,115 | 15,985 | 15,062 |
| Diluted | 16,302 | 15,352 | 16,301 | 15,273 |

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****Condensed Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

| | Twenty-eight Weeks Ended | |
|--|--|--------------------------------------|
| | July 11, 2004 | July 13, 2003 |
| | (As Restated, See Note 2) | (As Restated, See Note 2) |
| Cash Flows From Operating Activities: | | |
| Net income | \$ 10,589 | \$ 7,372 |
| Non-cash adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,715 | 8,258 |
| Other, net | 79 | 218 |
| Changes in operating assets and liabilities | 11,749 | 6,112 |
| Net cash flows provided by operating activities | 33,132 | 21,960 |
| Cash Flows From Investing Activities: | | |
| Proceeds from sales of property and equipment | 1,102 | 90 |
| Purchases of property and equipment | (39,722) | (28,392) |
| Net cash flows used in investing activities | (38,620) | (28,302) |
| Cash Flows From Financing Activities: | | |
| Borrowings of long-term debt | 8,849 | 15,052 |
| Payments of long-term debt and capital leases | (5,157) | (12,028) |
| Debt issuance costs | | (756) |
| Repayment of stockholders/officers notes | 53 | |
| Proceeds from exercise of stock options and employee stock purchase plan | 912 | 510 |
| Net cash flows provided by financing activities | 4,657 | 2,778 |
| Net decrease in cash and cash equivalents | (831) | (3,564) |
| Cash and cash equivalents, beginning of period | 4,871 | 4,797 |
| Cash and cash equivalents, end of period | \$ 4,040 | \$ 1,233 |
| Supplementary Disclosure of Cash Flow Information: | | |
| Income taxes paid | \$ 1,546 | \$ 2,601 |
| Interest paid, net of amounts capitalized | 1,176 | 1,482 |
| Capital lease obligations incurred for real estate and equipment purchases | | 105 |

| | |
|--|-------|
| Tenant improvement allowance paid directly by landlord to general contractor | 1,383 |
|--|-------|

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****Condensed Consolidated Statements of Stockholders' Equity**

(In thousands)

(Unaudited)

| | <u>Common Stock</u> | | Additional Paid-in Capital | Deferred Compensation | Receivables | Accumulated | Retained Earnings | Total |
|--|---------------------|--------|----------------------------------|--------------------------|-----------------------------------|---|----------------------|------------|
| | Shares | Amount | | | From Stockholders/ Officers | Other Comprehensive Loss, net of tax | | |
| Balance, December 28, 2003 | 15,970 | \$ 16 | \$ 122,184 | \$ (130) | \$ (6,432) | \$ (108) | \$ 16,856 | \$ 132,386 |
| Amortization of deferred compensation | | | | 40 | | | | 40 |
| Interest on notes from stockholders/officers | | | | | (164) | | | (164) |
| Repayment of stockholders/officers notes and related interest | | | | | 70 | | | 70 |
| Options exercised for common stock | 67 | | 616 | | | | | 616 |
| Tax benefit on exercise of stock options | | | 437 | | | | | 437 |
| Common stock issued through employee stock purchase plan | 15 | | 296 | | | | | 296 |
| Net income (As Restated, See Note 2) | | | | | | | 10,589 | 10,589 |
| Unrealized gain on cash flow hedge | | | | | | 65 | | 65 |
| Comprehensive income (As Restated, See Note 2) | | | | | | | | 10,654 |
| Balance, July 11, 2004 (As Restated, See Note 2) | 16,052 | \$ 16 | \$ 123,533 | \$ (90) | \$ (6,526) | \$ (43) | \$ 27,445 | \$ 144,335 |

See Notes to Condensed Consolidated Financial Statements.

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RED ROBIN GOURMET BURGERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description Of Business And Basis Of Presentation

Red Robin Gourmet Burgers, Inc., together with its subsidiaries (Red Robin or the Company), is a casual dining restaurant chain, which as of July 11, 2004 operated 125 company-owned restaurants located in 16 states. The Company also sells franchises and receives royalties from the operation of franchised Red Robin® restaurants. As of July 11, 2004, there were 113 additional restaurants operating under franchise or license agreements in 24 states and two Canadian provinces. Red Robin also owns and leases to third parties certain land, buildings and equipment.

The accompanying interim condensed consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair presentation of the results for such periods. The results of operations for any interim period are not necessarily indicative of results for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K.

The Company's quarter which ended July 11, 2004 is referred to as second quarter 2004 or the twelve weeks ended July 11, 2004, and its quarter which ended July 13, 2003 is referred to as second quarter 2003 or the twelve weeks ended July 13, 2003. The first quarter ended April 18, 2004, is referred to as first quarter 2004, and the first quarter ended April 20, 2003, is referred to as first quarter 2003. The first quarters for both years presented included 16 weeks, whereas the second quarters included 12 weeks. Together, the first and second quarter of each respective fiscal year are referred to as the twenty-eight weeks ended July 11, 2004, and July 13, 2003, respectively. Certain amounts in the 2003 consolidated interim financial statements have been reclassified to conform to the 2004 presentation.

The condensed consolidated financial statements include the accounts of Red Robin and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) equires 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates included in the preparation of the financial statements pertain to franchise receivables, allowances for doubtful accounts, fixed asset lives, valuation of long-lived assets, impairment of goodwill and other intangible assets, income taxes and self-insurance and workers' compensation reserves. Actual results could differ from those estimates.

2. Restatement of Previously Issued Financial Statements

On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission (SEC) issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating lease-related accounting issues and their application under GAAP. In light of this letter, the Company's management initiated a review of its lease accounting and determined that its previous

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methods of accounting for rent holidays and for leasehold improvements funded by landlord incentives or allowances under operating leases (tenant improvement allowances) were not in accordance with GAAP. As a result, the accompanying condensed consolidated financial statements as of July 11, 2004 and for the twelve and twenty-eight weeks ended July 11, 2004 and July 13, 2003 (financial statements), have been restated from the amounts previously reported.

Historically, when accounting for leases with renewal options, the Company recorded rent expense on a straight-line basis over the initial non-cancelable lease term, with the term commencing when rent payments began. In most instances, the period when rent payments began coincided with the date the Company's restaurants opened. This generally had the effect of excluding the build-out period for restaurants from the calculation of the period over which rent was expensed, though the point where the Company became legally obligated for future rent payments had been reached. The Company generally depreciated its buildings, leasehold improvements and other long-lived assets on those properties over a period that included both the initial non-cancelable lease term and all option periods provided for in the lease (or the useful life of the assets if shorter) up to a maximum period of twenty years. However, in certain instances the Company amortized leasehold improvements over only the initial non-cancelable lease term. Further, the Company's historical consolidated balance sheets had reflected the unamortized portion of tenant improvement allowances as a reduction of the related leasehold improvements and the subsequent amortization of those tenant improvement allowances as a reduction of depreciation and amortization

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RED ROBIN GOURMET BURGERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expense in its consolidated statements of income over the period that began when the allowances were received and ended at the end of the related lease term.

The Company has restated its financial statements to recognize rent expense on a straight-line basis over the expected lease term, including cancelable option periods where failure to exercise such options would result in an economic penalty. The lease term commences on the date that the Company becomes legally obligated for future rent payments, which coincides with the date on which the landlord delivers the property to the Company for development and the Company waives contract contingencies. The Company's restated financial statements include rental expenses in pre-opening costs for the period from inception through the date each restaurant opens. This had the effect of increasing pre-opening costs and decreasing restaurant occupancy costs.

The Company also has restated its financial statements to recognize tenant improvement allowances as deferred rent which is amortized over the lease term as a reduction of rent expense. This had the effect of increasing property and equipment, net and deferred rent payable in the condensed consolidated balance sheet and increasing depreciation and amortization expense and decreasing restaurant occupancy costs in the condensed consolidated statements of income. In addition, the Company has restated depreciation and amortization expenses in the financial statements to correct instances where the period of amortization of leasehold improvements did not match the lease term (or the useful life of the assets if shorter) up to a maximum period of twenty years. This led to an increase in property and equipment, net and a decrease in depreciation and amortization expense in the financial statements.

In addition, the Company's restated financial statements also reflect certain immaterial adjustments to reflect corrections to the condensed consolidated balance sheet classification of deferred tax assets and liabilities, accrued liabilities and other non-current liabilities and corrections to the condensed consolidated statements of income to reflect previously unrecorded activity related to a provision of the Company's fountain beverage agreement.

Finally, the Company's restated financial statements for the twelve and twenty-eight weeks ended July 11, 2004, include adjustments to increase depreciation and amortization expense and decrease property and equipment, net to correct errors for previously unrecorded depreciation that were identified by management during the fourth quarter of 2004.

The cumulative effect of this restatement resulted in a decrease in retained earnings of \$1.8 million as of July 11, 2004, and decreases in net income of \$254,000 and \$515,000 for the twelve and twenty-eight weeks ended July 11, 2004, respectively, and decreases in net income of \$80,000 and \$194,000 for the twelve and twenty-eight weeks ended July 13, 2003, respectively.

Following is a summary of the significant effects of the restatement on the Company's condensed consolidated balance sheet as of July 11, 2004 as well as the effects of these changes on the Company's condensed consolidated statements of income for the twelve and twenty-eight weeks ended July 11, 2004 and July 13, 2003 (in thousands, except per share data):

| | Condensed Consolidated Balance Sheets | | |
|---|--|--------------------|-----------------|
| | As | | As |
| | Previously Reported | Adjustments | Restated |
| July 11, 2004 | | | |
| Current deferred tax asset | \$ 1,075 | \$ (318) | \$ 757 |
| Property and equipment, net | 180,167 | 4,177 | 184,344 |
| Non-current deferred tax asset | 4,669 | 1,474 | 6,143 |
| Total assets | 235,972 | 5,333 | 241,305 |
| Accrued payroll and payroll related-liabilities | 15,784 | (1,897) | 13,887 |
| Accrued liabilities | 9,937 | 8 | 9,945 |
| Deferred rent payable | 5,662 | 7,095 | 12,757 |
| Other non-current liabilities | | 1,897 | 1,897 |
| Retained earnings | 29,215 | (1,770) | 27,445 |
| Total stockholders' equity | 146,105 | (1,770) | 144,335 |
| Total liabilities and stockholders' equity | \$ 235,972 | \$ 5,333 | \$ 241,305 |

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| | Condensed Consolidated Statements of Income | | |
|---|--|-------------------|-------------------|
| | As | | As |
| | Previously Reported | Adjustments | Restated |
| Twelve Weeks Ended July 11, 2004 | | | |
| Cost of sales | \$ 21,351 | (29) | 21,322 |
| Occupancy | 5,683 | (35) | 5,648 |
| Depreciation and amortization | 4,515 | 302 | 4,817 |
| General and administrative | 6,596 | (74) | 6,522 |
| Pre-opening costs | 871 | 256 | 1,127 |
| Income from operations | 9,430 | (420) | 9,010 |
| Income before income taxes | 9,132 | (420) | 8,712 |
| Provision for income taxes | 3,199 | (166) | 3,033 |
| Net income | \$ 5,933 | \$ (254) | \$ 5,679 |
| | <u> </u> | <u> </u> | <u> </u> |
| Earnings per share Basic | \$ 0.37 | \$ (0.02) | \$ 0.35 |
| | <u> </u> | <u> </u> | <u> </u> |
| Earnings per share Diluted | \$ 0.36 | \$ (0.01) | \$ 0.35 |
| | <u> </u> | <u> </u> | <u> </u> |
| Twenty-eight Weeks Ended July 11, 2004 | | | |
| Cost of sales | \$ 48,181 | (66) | 48,115 |
| Occupancy | 13,029 | (100) | 12,929 |
| Depreciation and amortization | 10,208 | 507 | 10,715 |
| General and administrative | 14,659 | 31 | 14,690 |
| Pre-opening costs | 2,096 | 479 | 2,575 |
| Income from operations | 18,035 | (851) | 17,184 |
| Income before income taxes | 16,966 | (851) | 16,115 |
| Provision for income taxes | 5,862 | (336) | 5,526 |
| Net income | \$ 11,104 | \$ (515) | \$ 10,589 |
| | <u> </u> | <u> </u> | <u> </u> |
| Earnings per share Basic | \$ 0.69 | \$ (0.03) | \$ 0.66 |
| | <u> </u> | <u> </u> | <u> </u> |
| Earnings per share Diluted | \$ 0.68 | \$ (0.03) | \$ 0.65 |
| | <u> </u> | <u> </u> | <u> </u> |
| Twelve Weeks Ended July 13, 2003 | | | |
| Cost of sales | \$ 17,314 | (24) | 17,290 |
| Occupancy | 4,966 | (113) | 4,853 |
| Depreciation and amortization | 3,566 | 59 | 3,625 |
| General and administrative | 5,429 | (10) | 5,419 |
| Pre-opening costs | 571 | 219 | 790 |
| Income from operations | 6,711 | (131) | 6,580 |
| Income before income taxes | 6,041 | (131) | 5,910 |
| Provision for income taxes | 2,006 | (51) | 1,955 |
| Net income | \$ 4,035 | \$ (80) | \$ 3,955 |

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| | | | | |
|---|---------|-----------|-----------|----------|
| Earnings per share | Basic | \$ 0.27 | \$ (0.01) | \$ 0.26 |
| Earnings per share | Diluted | \$ 0.26 | \$ | \$ 0.26 |
| Twenty-eight Weeks Ended July 13, 2003 | | | | |
| Cost of sales | | \$ 38,365 | (56) | 38,309 |
| Occupancy | | 11,234 | (174) | 11,060 |
| Depreciation and amortization | | 8,126 | 132 | 8,258 |
| General and administrative | | 12,334 | (17) | 12,317 |
| Pre-opening costs | | 1,356 | 431 | 1,787 |
| Income from operations | | 12,821 | (316) | 12,505 |
| Income before income taxes | | 11,327 | (316) | 11,011 |
| Provision for income taxes | | 3,761 | (122) | 3,639 |
| Net income | | \$ 7,566 | \$ (194) | \$ 7,372 |
| Earnings per share | Basic | \$ 0.50 | \$ (0.01) | \$ 0.49 |
| Earnings per share | Diluted | \$ 0.50 | \$ (0.02) | \$ 0.48 |

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Stock Based Compensation**

Employee Stock Purchase Plan The Company maintains an Employee Stock Purchase Plan (2002 ESPP) under which eligible employees may voluntarily contribute up to 15% of their salary, subject to limitations, to purchase common stock at a price equal to 85% of the fair market value of a share of the Company's common stock on the first day of each offering period, or 85% of the fair market value of a share of the Company's common stock on the last day of each offering period, whichever amount is less. Generally, all of the Company's officers and employees who have been employed by the Company for at least one year and who are regularly scheduled to work more than twenty hours per week are eligible to participate in the 2002 ESPP. The 2002 ESPP operates in successive six-month periods, or offering periods, commencing on each January 1 and July 1, which began on January 1, 2003. A total of 300,000 shares of common stock were initially reserved for issuance under the plan. During the twelve and twenty-eight weeks ended July 11, 2004, respectively, a total of 6,965 and 15,089 shares of common stock were issued in connection with the 2002 ESPP. As of July 11, 2004, a total of 275,649 shares remained available for future issuance under the plan.

Employee Stock Incentive Plans During the twelve and twenty-eight weeks ended July 11, 2004, respectively, a total of 146,406 and 488,919, employee stock options were granted under the Company's 2002 Stock Incentive Plan (2002 Stock Plan) at an exercise price equal to the closing market price on the date of grant. The weighted-average exercise price of these options was \$27.20 and \$26.93, per share, respectively. The weighted average fair values of options at their grant date during the twelve and twenty eight weeks ended July 11, 2004, were \$11.50 and \$11.41, respectively. The fair value of stock options granted was estimated using the Black-Scholes multiple option-pricing model with the following weighted average assumptions:

| | Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|-------------------------------|-----------------------|------------------|-----------------------------|------------------|
| | July 11, 2004 | July 13, 2003 | July 11, 2004 | July 13, 2003 |
| Risk-free interest rate | 3.9% | 2.6% | 3.3% | 2.6% |
| Expected years until exercise | 5.5 | 5.5 | 5.5 | 5.5 |
| Expected stock volatility | 40.8% | 46.9% | 41.2% | 46.9% |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |

The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, an amendment of Financial Accounting Standards Board Statement No. 123. The Statement requires prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company accounts for stock-based compensation awards under the intrinsic method of Accounting Principles Board Opinion No. 25, which requires compensation cost to be recognized based on the excess, if any, between the quoted market price of the stock at the date of grant and the amount an employee must pay to acquire the stock. As a result, compensation expense was recognized during the each period presented for certain options granted during 2002 with intrinsic value on the date of grant. The following table illustrates the effect on net income and earnings per share if the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, had been applied (in thousands, except per share data):

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| | Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|--|--------------------|------------------|--------------------------|------------------|
| | July 11, 2004 | July 13, 2003 | July 11, 2004 | July 13, 2003 |
| Net income, as reported | \$ 5,679 | \$ 3,955 | \$ 10,589 | \$ 7,372 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax benefit | 12 | 12 | 24 | 25 |
| Deduct: Stock-based employee compensation costs based on fair value method, net of tax benefit | (531) | (229) | (1,104) | (431) |
| Pro forma net income | \$ 5,160 | \$ 3,738 | \$ 9,509 | \$ 6,966 |
| Earnings Per Share: | | | | |
| Basic - as reported | \$ 0.35 | \$ 0.26 | \$ 0.66 | \$ 0.49 |
| Basic - pro forma | \$ 0.32 | \$ 0.25 | \$ 0.59 | \$ 0.46 |
| Diluted - as reported | \$ 0.35 | \$ 0.26 | \$ 0.65 | \$ 0.48 |
| Diluted - pro forma | \$ 0.32 | \$ 0.24 | \$ 0.58 | \$ 0.46 |

Table of Contents**RED ROBIN GOURMET BURGERS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Borrowings**

Borrowings consist of the following (in thousands):

| | July 11, 2004 | December 28, 2003 |
|------------------------------|------------------|----------------------|
| Revolving credit agreement | \$ 24,500 | \$ 20,000 |
| Capital leases | 7,226 | 7,388 |
| Collateralized notes payable | 9,594 | 10,240 |
| | 41,320 | 37,628 |
| Current portion | (1,474) | (1,422) |
| Long-term debt | \$ 39,846 | \$ 36,206 |

As of July 11, 2004, borrowings outstanding under the revolving credit agreement bore interest at approximately 3.2%.

5. Franchise Operations

Results of franchise operations consist of the following (in thousands):

| | Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|------------------------------------|-----------------------|------------------|-----------------------------|------------------|
| | July 11, 2004 | July 13, 2003 | July 11, 2004 | July 13, 2003 |
| Franchise royalties and fees | | | | |
| Royalty income | \$ 2,651 | \$ 2,118 | \$ 5,719 | \$ 4,637 |
| Franchise fees | 160 | 48 | 402 | 115 |
| Total franchise royalties and fees | 2,811 | 2,166 | 6,121 | 4,752 |
| Franchise development costs | | | | |
| Payroll and employee benefit costs | 334 | 216 | 1,064 | 578 |

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| | | | | |
|--|-----------------|-----------------|-----------------|-----------------|
| General and administrative | 312 | 112 | 687 | 366 |
| Annual conference | (17) | (4) | 1,203 | 777 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total franchise development costs | 629 | 324 | 2,954 | 1,721 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Operating income from franchise operations | \$ 2,182 | \$ 1,842 | \$ 3,167 | \$ 3,031 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

6. Earnings Per Share

The Company presents both basic and diluted earnings per share amounts. Basic earnings per share amounts are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share amounts are calculated based upon the weighted-average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive shares are excluded from the computation in periods in which they have an anti-dilutive effect. Diluted earnings per share reflect the potential dilution that could occur if holders of options exercised their holdings into common stock. During the twelve and twenty-eight weeks ended July 11, 2004, respectively, a total of 73,800 and 74,300, weighted-average stock options outstanding were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented. During the twelve and twenty-eight weeks ended July 13, 2003, respectively, a total of 26,900 and 11,500, weighted-average stock options outstanding were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented. The Company uses the treasury stock method to calculate the impact of outstanding stock options. The computations for basic and diluted earnings per share are as follows (in thousands, except share data):

| | Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|---|--------------------|------------------|--------------------------|------------------|
| | July 11, 2004 | July 13, 2003 | July 11, 2004 | July 13, 2003 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net income | \$ 5,679 | \$ 3,955 | \$ 10,589 | \$ 7,372 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Basic weighted average shares outstanding | 16,007 | 15,115 | 15,985 | 15,062 |
| Dilutive effect of employee stock options | 295 | 237 | 316 | 211 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Diluted weighted average shares outstanding | 16,302 | 15,352 | 16,301 | 15,273 |
| Earnings per share: | | | | |
| Basic | \$ 0.35 | \$ 0.26 | \$ 0.66 | \$ 0.49 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Diluted | \$ 0.35 | \$ 0.26 | \$ 0.65 | \$ 0.48 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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RED ROBIN GOURMET BURGERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Unvested shares issued upon early exercise, as described in Note 7, are not considered outstanding for purposes of computing basic earnings per share because the employee is not entitled to the rewards of ownership. However, these unvested shares are included as potentially dilutive for purposes of estimating diluted net income per share. Unvested shares issued upon early exercise totaled 22,989 as of July 11, 2004, and 103,448 as of July 13, 2003.

7. Related Party Transactions

In April 2002, the Company's board of directors approved the early exercise of options to purchase up to 775,862 shares of common stock held by certain executive officers under the Company's 2000 Stock Plan and the exercise of options to purchase an additional 146,552 shares of the Company's common stock related to fully vested options held by certain executive officers under our 1990 and 1996 Stock Plans. These shares were issued in exchange for full recourse notes totaling \$5.4 million, bearing interest at 4.65% per annum with maturity dates ranging from June 26, 2006 to January 29, 2012, or earlier if employment terminates. Shares issued upon early exercise of options are subject to a right of repurchase by the Company at the lower of fair value or issuance price until vested. The notes are recorded as a reduction of stockholders' equity and interest income of \$60,300 and \$57,800 has been recognized in the twelve weeks ended July 11, 2004 and July 13, 2003, respectively, and interest income of \$141,500 and \$134,800 has been recognized in the twenty-eight weeks ended July 11, 2004 and July 13, 2003, respectively. As of July 11, 2004 and December 28, 2003, the number of fully vested early exercised options totaled 752,873 and 741,379, respectively, and unvested early exercise options totaled 22,989 and 34,483, respectively.

During the twelve and twenty-eight weeks ended July 11, 2004, the Company's chief financial officer repaid \$1,200 and \$52,600, respectively, of principal related to his \$600,000 full recourse note and \$5,300 and \$17,600, respectively, of accrued interest thereon. There have been no other repayments related to these officer notes since their inception. As a result, the outstanding principal balance of the remaining full recourse notes as of July 11, 2004 was \$5.3 million.

The Company's chief executive officer has two \$300,000 notes payable to the Company, collateralized by shares of the Company's common stock. The notes were issued in June 2000 and May 2001 in connection with an employment agreement, and bear interest, compounded annually, of 6.62% and 5.07%, respectively. The notes mature in May 2005, at which time all principal and interest becomes due and payable to the Company. These notes, and the related interest thereon, are recorded as a reduction of stockholders' equity. During the twelve weeks ended July 11, 2004 and July 13, 2003, the Company recognized interest income of \$9,900 and \$9,300, respectively, and during the twenty-eight weeks ended July 11, 2004 and July 13, 2003, the Company recognized interest income of \$23,000 and \$22,200, respectively, on these notes.

The Company's chief executive officer and its senior vice president of operations own 31.0% and 7.0%, respectively, of Mach Robin, LLC (Mach Robin), which operates Red Robin restaurants under a franchise agreement. The Company recognized royalty income from Mach Robin of \$215,100 and 217,500 in the twelve weeks ended July 11, 2004 and July 13, 2003, respectively, and \$495,400 and \$496,700 in the twenty-eight weeks ended July 11, 2004 and July 13, 2003, respectively. Prior to January 2004, an entity controlled by Mach Robin had a 40.0% ownership interest in, and a right to share up to 60.0% of the profits of Red Robin Restaurants of Canada, Ltd (RRRC), which operated Red Robin restaurants in two Canadian provinces under franchise agreements. The Company recognized royalty income from RRRC of \$207,500 and \$212,600 in the twelve weeks ended July 11, 2004 and July 13, 2003, respectively, and \$485,500 and \$448,300 in the twenty-eight weeks ended July 11, 2004 and July 13, 2003, respectively. In January 2004, an entity controlled by Mach Robin acquired the remaining 60% ownership interest in RRRC that it did not already hold after the Company rejected its right of first refusal. The franchise agreements held by RRRC remain in place and RRRC is now controlled entirely by Mach Robin, or its subsidiaries.

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RED ROBIN GOURMET BURGERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Recent Accounting Pronouncements

In December 2003, the FASB issued FASB Interpretation No. (FIN) 46R, Consolidation of Variable Interest Entities an Interpretation of ARB No. 51. This interpretation, which replaces FASB Interpretation No. 46, Consolidation of Variable Interest Entities, clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. This interpretation is required in financial statements for periods ending after March 15, 2004 for those companies that have yet to adopt the provisions of FIN 46. The Company has no variable interest in variable interest entities and, therefore, no entities were consolidated with the Company s financial statements as a result of adopting FIN 46R.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Organization of Information

Management's Discussion and Analysis of Financial Condition and Results of Operations provides a narrative on our financial performance and condition that should be read in conjunction with the accompanying condensed consolidated financial statements. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain risk factors including, but not limited to, those discussed in "Risk Factors" under Item 1 and elsewhere in our annual report on Form 10-K. This section includes the following discussions:

Restatement of Previously Issued Financial Statements

Overview

Unit Data and Comparable Restaurant Sales

Results of Operations

Second Quarter 2004 (Twelve Weeks) compared to Second Quarter 2003 (Twelve Weeks)

Twenty-eight Weeks Ended July 11, 2004 compared to Twenty-eight Weeks Ended July 13, 2003

Liquidity and Capital Resources

Inflation

Seasonality

Critical Accounting Policies and Estimates

Recent Accounting Pronouncements

Forward-Looking Statements

Restatement of Previously Issued Financial Statements

As discussed in Note 2, the condensed consolidated financial statements included in this quarterly report on Form 10-Q/A have been restated. The accompanying Management's Discussion and Analysis gives effect to the restatement.

Overview

Red Robin is a casual dining restaurant chain which operates company-owned restaurants throughout the United States. We also sell franchises and receive royalties from the operation of franchised Red Robin® restaurants. As of July 11, 2004, we operated company-owned restaurants in 16 states and our franchisees operated restaurants in 24 states and two Canadian provinces. Red Robin also owns and leases to third parties certain land, buildings and equipment.

Table of Contents**Unit Data and Comparable Restaurant Sales**

The following table details the number of restaurants opened during second quarter 2004 and the current fiscal year-to-date through July 11, 2004, as well as the total number of restaurants open as of July 11, 2004.

| | Second Quarter | Fiscal Year Through July 11, 2004 |
|---------------------------------------|---------------------------|--|
| | 2004 | 2004 |
| Company-owned: | | |
| Beginning of period | 122 | 115 |
| Opened during period | 3 | 10 |
| | <u>125</u> | <u>125</u> |
| Franchised: | | |
| Beginning of period | 110 | 103 |
| Opened during period | 5 | 12 |
| Closed during period | (2) | (2) |
| | <u>113</u> | <u>113</u> |
| End of period | 113 | 113 |
| Total Number of Red Robin Restaurants | <u>238</u> | <u>238</u> |

Since July 11, 2004 and through August 13, 2004, we have opened three additional company-owned restaurants and our franchisees have opened two additional restaurants. These openings bring our total restaurant count as of the date of this filing to 128 company-owned restaurants, 115 franchised restaurants and 243 total. We expect to open an additional nine company-owned restaurants and anticipate that our franchisees will open three to four additional restaurants during the remainder of 2004.

Our company-owned comparable restaurant sales increased 5.7% for second quarter 2004 and 7.2% for the twenty-eight weeks ended July 11, 2004, over second quarter 2003 and the twenty-eight weeks ended July 13, 2003, respectively. We reflect restaurants as comparable in the first period following five full quarters of operations.

Results of Operations

Our operating results for each period presented below are expressed as a percentage of total revenues, except for the components of restaurant operating costs, which are expressed as a percentage of restaurant revenues:

| Twelve Weeks Ended | | Twenty-eight Weeks Ended | |
|---------------------------|-----------------|---------------------------------|-----------------|
| July 11, | July 13, | July 11, | July 13, |

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| | <u>2004</u> | <u>2003</u> | <u>2004</u> | <u>2003</u> |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|
| Revenues: | | | | |
| Restaurant | 96.9% | 97.0% | 97.0% | 97.1% |
| Franchise royalties and fees | 3.0 | 2.9 | 2.9 | 2.8 |
| Rent revenue | 0.1 | 0.1 | 0.1 | 0.1 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Costs and Expenses: | | | | |
| Restaurant operating costs: | | | | |
| Cost of sales | 23.5 | 23.6 | 23.6 | 23.4 |
| Labor | 34.8 | 35.3 | 35.1 | 35.3 |
| Operating | 14.4 | 14.8 | 14.5 | 15.2 |
| Occupancy | 6.2 | 6.6 | 6.3 | 6.8 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total restaurant operating costs | 78.9 | 80.3 | 79.5 | 80.7 |
| Depreciation and amortization | 5.1 | 4.8 | 5.1 | 4.9 |
| General and administrative | 7.0 | 7.2 | 7.0 | 7.3 |
| Franchise development | 0.7 | 0.4 | 1.4 | 1.0 |
| Pre-opening costs | 1.2 | 1.0 | 1.2 | 1.1 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Income from operations | 9.6 | 8.7 | 8.2 | 7.4 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Other (Income) Expense: | | | | |
| Interest expense | 0.6 | 0.9 | 0.7 | 0.9 |
| Interest income | (0.1) | (0.1) | (0.1) | (0.1) |
| Loss on extinguishment of debt | | 0.1 | | 0.1 |
| Gain on sale of property | (0.2) | | (0.1) | |
| Other | 0.1 | | | |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total other expenses | 0.4 | 0.9 | 0.5 | 0.9 |
| Income before income taxes | 9.2 | 7.8 | 7.7 | 6.5 |
| Provision for income taxes | 3.2 | 2.6 | 2.6 | 2.1 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net income | 6.0% | 5.2% | 5.1% | 4.4% |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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Second Quarter 2004 (Twelve Weeks) compared to Second Quarter 2003 (Twelve Weeks)

Total revenues. Total revenues increased by \$18.2 million, or 24.0%, to \$93.8 million, from \$75.6 million, due primarily to a \$17.6 million increase in restaurant revenues. The increase in restaurant revenues was due to \$7.9 million in additional revenues from the non-comparable restaurants that we opened in 2003, \$5.8 million of revenues from ten new restaurants opened year-to-date during 2004 and \$3.9 million from comparable restaurant sales increases of 5.7%. The increase in comparable restaurant sales was driven by an increase in guest counts of 3.2% and an increase in the average guest check of 2.5%. The increase in the average guest check reflects moderate price increases taken in January and mid-June.

Franchise royalties and fees increased \$644,900, or 29.8%, to \$2.8 million from \$2.2 million. Franchise royalties increased \$532,900, or 25.2%, to \$2.7 million, from \$2.1 million, due primarily to an increase in royalties generated from the 22 franchise restaurants opened in 2003 and 2004. Overall, our franchisees reported that comparable sales for U.S. and Canadian franchise restaurants increased 5.0% and 3.0%, respectively. Franchise fees increased \$112,000 to \$159,900, from \$47,900, due primarily to the fact that our franchisees opened five restaurants in second quarter 2004 compared to two in second quarter 2003.

Cost of sales. Cost of sales increased by \$4.0 million, or 23.3%, to \$21.3 million, from \$17.3 million, due primarily to more restaurants being operated during second quarter 2004. Cost of sales as a percentage of restaurant revenues decreased 0.1%, to 23.5%, from 23.6%. The improvement as a percentage of restaurant revenues was attributable primarily to the moderate price increases taken during January and mid-June, offset by slightly higher commodity costs in most food categories.

Labor. Labor expenses increased by \$5.7 million, or 22.2%, to \$31.6 million, from \$25.9 million, due primarily to more restaurants being operated in second quarter 2004. Overall, labor expense as a percentage of restaurant revenues improved 0.5%, to 34.8%, from 35.3%. Labor as a percentage of restaurant revenues improved during second quarter 2004, due primarily to our 5.7% increase in comparable restaurant sales. Bonuses were 0.4% higher as a percentage of restaurant revenues due to improved comparable restaurant sales. Our workers' compensation expense improved to 0.5% of restaurant revenues during second quarter 2004 compared to 1.1% a year ago. The improvement in workers' compensation expense as a percentage of restaurant revenues was attributable to recent lower claims experience and per claim costs. In 2003, our workers' compensation costs had increased as a percentage of restaurant revenues and we cannot predict with certainty whether or not our workers' compensation expense will increase or decrease during the remainder of 2004.

Operating. Operating expenses increased by \$2.2 million, or 20.7%, to \$13.1 million, from \$10.9 million, due primarily to more restaurants being operated in second quarter 2004. Operating expenses as a percentage of restaurant revenues improved 0.4%, to 14.4%, from 14.8%. The improvement as a percentage of restaurant revenues was due primarily to leverage from our 5.7% increase in comparable restaurant sales.

Occupancy. Occupancy expenses increased by \$794,400, or 16.4%, to \$5.6 million, from \$4.9 million, due primarily to more restaurants being operated in second quarter 2004. Occupancy expense as a percentage of

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restaurant revenues improved 0.4%, to 6.2%, from 6.6%. Our occupancy expenses as a percentage of restaurant revenues improved as a result of our comparable restaurant sales increase. In addition, the percentage of free-standing restaurants that we own or have ground leases on has increased compared to a year ago, and free-standing units generally have lower occupancy costs than in-line units.

Depreciation and amortization. Depreciation and amortization increased \$1.2 million, or 32.9%, to \$4.8 million, from \$3.6 million. The increase was primarily due to the addition of 28 new restaurants opened in 2003 and 2004. Depreciation and amortization expense as a percentage of total revenues increased 0.3%, to 5.1% from 4.8%.

General and administrative. General and administrative expenses increased by \$1.1 million, or 20.4%, to \$6.5 million, from \$5.4 million, primarily due to additional headcount and related costs attributable to operating more company-owned restaurants. These increases were partially offset by lower marketing expenses. General and administrative expenses as a percentage of total revenues improved 0.2%, to 7.0%, from 7.2%, due primarily to leverage from our increase in total revenues.

Franchise development. Our franchisees opened five new restaurants in second quarter 2004 compared to two in second quarter 2003. Overall, franchise development expenses increased \$304,600, or 93.9%, to \$629,000, from \$324,400, due primarily to additional headcount and related costs attributable to franchise operations. Franchise development expenses as a percentage of total revenues increased 0.3%, to 0.7%, from 0.4%. We substantially increased the size of our franchise development and support teams during the second half of 2003.

Pre-opening costs. Pre-opening costs increased \$336,100, or 42.5%, to \$1.1 million, from \$790,400, due primarily to the fact that there were three company-owned restaurants opened during second quarter 2004, compared to two in the prior year period. Pre-opening costs as a percentage of total revenues increased 0.2%, to 1.2%, from 1.0%. Overall, pre-opening costs for the restaurants we opened in second quarter 2004 averaged \$197,300 per restaurant compared to an average of \$218,300 per restaurant in second quarter 2003. This improvement was due to the fact that we own one of the sites opened in the second quarter 2004, and as a result, rent costs recognized during the construction period were lower on average in second quarter 2004.

Interest expense. Interest expense decreased by \$70,800, or 10.9%, to \$579,000, from \$649,800. Our interest expense was lower in second quarter 2004 due to the early payoff of various real estate and equipment loans during 2003 that bore significantly higher interest rates than borrowings under our revolving credit agreement. These reductions were partially offset by higher interest expense on borrowings and loan amortization fees related to our revolving credit agreement.

Interest income. Interest income was \$73,700 in second quarter 2004, compared to \$70,100 in second quarter 2003. Primarily all of the interest income we recorded in both periods was attributable to related party receivables from officer/stockholder notes.

Loss on extinguishment of debt. We incurred legal fees, prepayment penalties, non-cash write-offs of unamortized debt issuance costs and other costs totaling \$106,500 during second quarter 2003 as a result of our exercise of purchase options to acquire properties previously under capital lease.

Gain on sale of property. During second quarter 2004 we sold a parcel of land for \$1.1 million, resulting in a pre-tax gain of \$256,900.

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Other. Other expense was \$50,400 in second quarter 2004, compared to other income of \$15,300 in second quarter 2003.

Income before income taxes. As a result of the above, income before income taxes increased \$2.8 million, or 47.4%, to \$8.7 million, from \$5.9 million.

Provision for income taxes. The provision for income taxes increased \$1.1 million, or 55.1%, to \$3.0 million, from \$2.0 million. The increase was due primarily to increased pre-tax earnings and an increase in our estimated effective income tax rate. Our effective income tax rate for second quarter 2004 was 34.8%, compared to 33.1% for second quarter 2003.

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Net income. As a result of the above, net income increased by \$1.7 million, or 43.6%, to \$5.7 million, from \$4.0 million.

Twenty-eight Weeks ended July 11, 2004 compared to Twenty-eight Weeks ended July 13, 2003

Total revenues. Total revenues increased by \$42.0 million, or 24.9%, to \$210.5 million, from \$168.5 million, due primarily to a \$40.6 million increase in restaurant revenues. The increase in restaurant revenues was due to \$20.2 million in additional revenues from the non-comparable restaurants that we opened in 2002 and 2003, \$11.0 million from comparable restaurant sales increases of 7.2%, \$8.8 million of revenues from ten new restaurants opened year-to-date during 2004, and \$682,000 of additional revenues from the restaurant we assumed operations of during April 2003. The increase in comparable restaurant sales was driven by an increase in guest counts of 5.4% and an increase in the average guest check of 1.8%. The increase in the average guest check reflects moderate price increase taken in January and mid-June.

Franchise royalties and fees increased \$1.4 million, or 28.8%, to \$6.1 million from \$4.8 million. Franchise royalties increased \$1.1 million, or 23.3%, to \$5.7 million, from \$4.6 million, due primarily to an increase in royalties generated from the 22 franchise restaurants opened in 2003 and 2004. Overall, our franchisees reported that comparable sales for U.S. and Canadian franchise restaurants increased 5.3% and 3.9%, respectively. Franchise fees increased \$286,800 to \$401,900, from \$115,100, due to the fact that our franchisees opened 12 restaurants in the twenty-eight weeks ended July 11, 2004 compared to four a year ago.

Cost of sales. Cost of sales increased by \$9.8 million, or 25.6%, to \$48.1 million, from \$38.3 million, due primarily to more restaurants being operated during the twenty-eight weeks ended July 11, 2004. Cost of sales as a percentage of restaurant revenues increased 0.2%, to 23.6%, from 23.4%. The increase as a percentage of restaurant revenues was attributable to increases in certain food costs that we experienced in the second half of 2003, offset in part by moderate price increases taken during January and mid-June.

Labor. Labor expenses increased by \$14.0 million, or 24.3%, to \$71.7 million, from \$57.7 million, due primarily to more restaurants being operated in the twenty-eight weeks ended July 11, 2004. Labor expense as a percentage of restaurant revenues improved 0.2%, to 35.1%, from 35.3%, due primarily to our 7.2% increase in comparable restaurant sales. Bonus and payroll tax expenses increased 0.5% and 0.4%, respectively. The increase in bonus expenses was primarily due to improved comparable restaurant sales. Workers' compensation expense was unchanged as a percentage of restaurant sales during the twenty-eight weeks ended July 11, 2004 compared to a year ago. In 2003, our workers' compensation costs had increased as a percentage of sales and we cannot predict with certainty whether or not our workers' compensation expense will increase or decrease during the remainder of 2004.

Operating. Operating expenses increased by \$4.8 million, or 19.4%, to \$29.6 million, from \$24.8 million, due primarily to more restaurants being operated in the twenty-eight weeks ended July 11, 2004. Operating expenses as a percentage of restaurant revenues improved 0.7%, to 14.5%, from 15.2%. The improvement as a percentage of restaurant revenues was due to our 7.2% increase in comparable restaurant sales and the discontinuance of one of our marketing funds midway through first quarter 2003, for which we had previously contributed 0.3% of restaurant revenues.

Occupancy. Occupancy expenses increased by \$1.9 million, or 16.9%, to \$12.9 million, from \$11.1 million, due primarily to more restaurants being operated in the twenty-eight weeks ended July 11, 2004. Occupancy expense as a percentage of restaurant revenues improved 0.5%, to 6.3%, from 6.8%. Our occupancy expenses as a percentage of restaurant revenues improved as a result of our comparable restaurant sales increase. In addition, the percentage of free-standing restaurants that we own or have ground leases on has increased compared to a year ago, and free-standing units generally have lower occupancy costs than in-line units.

Depreciation and amortization. Depreciation and amortization increased \$2.5 million, or 29.7%, to \$10.7 million, from \$8.3 million. The increase was primarily due to the addition of 28 new restaurants opened in 2003 and 2004. Depreciation and amortization expense as a percentage of total revenues increased 0.2%, to 5.1%, from 4.9%.

General and administrative. General and administrative expenses increased by \$2.4 million, or 19.3%, to \$14.7 million, from \$12.3 million, primarily due to additional headcount and related costs attributable to operating

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more company-owned restaurants. These increases were partially offset by lower marketing expenses. General and administrative expenses as a percentage of total revenues improved 0.3%, to 7.0%, from 7.3%. The improvement in general and administrative expenses as a percentage of total revenues was primarily attributable to leverage from our increase in total revenues.

Franchise development. Franchise development expenses increased \$1.2 million, or 71.6%, to \$2.9 million, from \$1.7 million, due in part to additional headcount and related costs attributable to franchise operations. One third of this increase was attributable to our annual conference. Costs for the 2004 conference were higher than a year ago due to the fact that there were more attendees and because we held the 2004 conference in a more expensive location. Franchise development expenses as a percentage of total revenues increased 0.4%, to 1.4%, from 1.0%. We substantially increased the size of our franchise development and support teams during the second half of 2003 in order to support 2004 franchisee new restaurant openings and the existing franchisee restaurant base. Our franchisees have opened 12 new restaurants in the twenty-eight weeks ended July 11, 2004 compared to four in the prior year period.

Pre-opening costs. Pre-opening costs increased \$787,800, or 44.1%, to \$2.6 million, from \$1.8 million, due primarily to the fact that there were ten company-owned restaurants opened during the twenty-eight weeks ended July 11, 2004, compared to seven in the prior year period. Pre-opening costs as a percentage of total revenues increased 0.1%, to 1.2%, from 1.1%. Overall, pre-opening costs for the restaurants we opened in the twenty-eight weeks ended July 11, 2004 averaged \$211,300 per restaurant compared to an average of \$210,600 per restaurant in twenty-eight weeks ended July 13, 2003.

Interest expense. Interest expense decreased by \$177,600, or 11.2%, to \$1.4 million, from \$1.6 million. Our interest expense was lower in the twenty-eight weeks ended July 11, 2004 due to the early payoff of various real estate and equipment loans during 2003 that bore significantly higher interest rates than borrowings under our revolving credit agreement. These reductions were partially offset by higher interest expense on borrowings and loan amortization fees related to our revolving credit agreement.

Interest income. Interest income was \$173,000 in the twenty-eight weeks ended July 11, 2004, compared to \$166,400 in the twenty-eight weeks ended July 13, 2003. Primarily all of the interest income we recorded in both periods was attributable to related party receivables from officer/stockholder notes.

Loss on extinguishment of debt. We incurred legal fees, prepayment penalties, non-cash write-offs of unamortized debt issuance costs and other costs totaling \$106,500 during second quarter 2003 as a result of our exercise of purchase options to acquire properties previously under capital lease.

Gain on sale of property. During second quarter 2004 we sold a parcel of land for \$1.1 million, resulting in a pre-tax gain of \$256,900.

Other. Other expense was \$88,300 in the twenty-eight weeks ended July 11, 2004, compared to other income of \$33,900 in the twenty-eight weeks ended July 13, 2003. Results for the twenty-eight weeks ended July 13, 2003 included a one-time gain of \$34,300, which offset various other expenses.

Income before income taxes. As a result of the above, income before income taxes increased \$5.1 million, or 46.4%, to \$16.1 million, from \$11.0 million.

Provision for income taxes. The provision for income taxes increased \$1.9 million, or 51.9%, to \$5.5 million, from \$3.6 million. The increase was due primarily to increased pre-tax earnings and an increase in our estimated effective income tax rate. Our effective income tax rate for the twenty-eight weeks ended July 11, 2004 was 34.3%, compared to 33.0% for the twenty-eight weeks ended July 13, 2003.

Net income. As a result of the above, net income increased by \$3.2 million, or 43.6%, to \$10.6 million, from \$7.4 million.

Table of Contents**Liquidity and Capital Resources**

Cash and cash equivalents were \$4.0 million as of July 11, 2004, compared to \$4.9 million at the end of fiscal 2003. We attempt to keep only enough cash on hand to satisfy our working capital requirements, which can vary substantially as a result of seasonality, construction and other corporate needs. All available cash in excess of our estimated working capital needs is generally used to repay borrowings under our revolving credit agreement.

The change in cash and cash equivalents were as follows (in thousands):

| | Twenty-eight Weeks Ended | |
|---------------------------------------|---------------------------------|--------------------------|
| | July 11, 2004 | July 13, 2003 |
| Cash provided by operating activities | \$ 33,132 | \$ 21,960 |
| Cash used by investing activities | (38,620) | (28,302) |
| Cash provided by financing activities | 4,657 | 2,778 |
| Decrease in cash and cash equivalents | \$ (831) | \$ (3,564) |

Operating Activities

Cash provided by operations in the twenty-eight weeks ended July 11, 2004 increased \$11.2 million, or 50.9%, to \$33.1 million, compared to \$22.0 million in the twenty-eight weeks ended July 13, 2003, reflecting increased cash flow from restaurant and franchise operations, lower cash payments for taxes and interest, and increased cash flow from changes in operating assets and liabilities. These improvements were offset in part by increased non-cash adjustments to net income.

Investing Activities

Cash used in investing activities during the twenty-eight weeks ended July 11, 2004 increased \$10.3 million, or 36.5%, to \$38.6 million, compared to \$28.3 million in the twenty-eight weeks ended July 13, 2003. Our investing activities consist primarily of purchases of property and equipment related to the construction of new restaurants and remodels and capital improvements of our existing company-owned restaurants. Our cash inflows from investing activities generally relate to proceeds from the sale of property and equipment.

Capital Expenditures. In the twenty-eight weeks ended July 11, 2004, we spent \$39.7 million for new restaurant construction, remodels, capital improvements and various corporate initiatives. During the twenty-eight weeks ended July 13, 2003, we spent \$28.4 million for new restaurant construction, remodels, capital improvements, corporate initiatives and a lease buy-out on a property previously under capital lease.

During 2004, we expect to open 22 new company-owned restaurants for a total cost of \$50.0 million to \$52.0 million and we plan to spend \$6.3 million to \$6.6 million on restaurant remodels and capital improvements of our existing restaurants. In addition, we expect to invest \$2.7 million to \$2.8 million for corporate initiatives, including information systems, computer equipment and our corporate headquarters relocation that occurred in March 2004.

Proceeds from Investing Activities. Proceeds of \$1.1 million were generated during second quarter 2004 as a result of the sale of a parcel of land. During the twenty-eight weeks ended July 13, 2003 proceeds of \$90,200 were generated primarily from the sale of property.

Financing Activities

Cash provided by financing activities during the twenty-eight weeks ended July 11, 2004 increased \$1.9 million. Our financing activities consist primarily of borrowings used to fund restaurant construction and other corporate needs in excess of cash provided by operations and proceeds we receive from sales of common stock. Cash used in financing activities is primarily related to the repayment of various borrowings. During the remainder of

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2004, we expect our primary source of cash provided by financing activities will be obtained from additional borrowings under our revolving credit agreement.

Proceeds from the Issuance of Stock. During the twenty-eight weeks ended July 11, 2004, proceeds of \$616,300 were received as a result of the exercise of employee stock options and \$296,200 of proceeds were received as a result of sales of common stock to participants of our employee stock purchase plan.

Borrowings. We maintain an \$85.0 million amended revolving credit agreement that will expire in May 2006, which is in place to fund the construction and acquisition of new restaurants, to refinance existing indebtedness and for general corporate purposes, including working capital.

The amended revolving credit agreement is secured by a first priority pledge of all of the outstanding capital stock of our subsidiaries and a first priority lien on substantially all of our tangible and intangible assets. Borrowings under our revolving credit facility bear interest at one of the following rates we select: an Alternate Base Rate (ABR), which is based on the Prime Rate plus 1.0% to 1.75%, or a London Interbank Offered Rate (LIBOR), which is based on the relevant one, two, three or six month LIBOR, at our discretion, plus 2.0% to 2.75%. The spread, or margin, for ABR and LIBOR loans is adjusted quarterly based on our then current leverage ratio. Interest payments on ABR loans are due the last day of each March, June, September and December and on the maturity date. Interest payments on LIBOR loans having an interest period of three months or less are due the last day of such interest period. Interest payments on LIBOR loans having an interest period longer than three months are due every three months after the first day of the interest period and the last day of such interest period. In addition, we may borrow up to \$3.0 million under a swingline loan subfacility if the sum of the outstanding ABR and LIBOR loans, swingline loans and letters of credit do not exceed \$85.0 million. Swingline loans bear interest at a per annum rate equal to the prime rate plus 1.0% to 1.75%. As of July 11, 2004, borrowings outstanding under our revolving credit agreement bore interest at approximately 3.2%.

During the twenty-eight weeks ended July 11, 2004, our borrowings of long-term debt totaled \$8.8 million and our payments of long-term debt and capital lease obligations totaled \$5.2 million. Debt outstanding during the twenty-eight weeks ended July 11, 2004 had stated interest rates ranging from 2.1% to 13.4% and maturities ranging from 2005 through 2021. We do not plan to early prepay any capital lease or collateralized notes payable during 2004. Our borrowing activity in the twenty-eight weeks ended July 11, 2004 was as follows (in thousands):

| | <u>Additions</u> | <u>Payments</u> | <u>Total</u> |
|---|------------------|-------------------|-----------------|
| Revolving credit agreement | \$ 8,849 | \$ (4,349) | \$ 4,500 |
| Other repayments of capital leases and collateralized notes payable | | (808) | (808) |
| Total | \$ 8,849 | \$ (5,157) | \$ 3,692 |

An irrevocable letter of credit issued under our revolving credit agreement in the amount of \$2,041,000 is being maintained to back our self-insured workers compensation program and reduces the amount of borrowings available on our revolving credit agreement. Our total committed borrowing capacity, capacity used and unused borrowing capacity as of July 11, 2004 were as follows (in thousands):

| <u>Committed Capacity</u> | <u>Capacity Used</u> | <u>Unused Capacity</u> |
|-------------------------------|--------------------------|----------------------------|
|-------------------------------|--------------------------|----------------------------|

| | | | |
|----------------------------|-----------|-----------|-----------|
| Revolving credit agreement | \$ 85,000 | \$ 26,541 | \$ 58,549 |
|----------------------------|-----------|-----------|-----------|

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The revolving credit agreement requires that capital expenditures, as defined, will not exceed specified amounts for each fiscal year as set forth in the following table (in thousands). However, to the extent we do not exceed the annual limitations, any unused amount up to \$10.0 million in any fiscal year will be carried forward to the following fiscal year and will increase the limit in the succeeding year by such carry-forward amount. We carried forward \$1.7 million from 2003, in accordance with the agreement, which has been reflected in the table below.

| | Amount |
|------|---------------|
| 2004 | \$ 64,700 |
| 2005 | 75,000 |
| 2006 | 75,000 |

The revolving credit agreement prohibits us from entering into or assuming any obligations for the payment of rent under operating leases which, with respect to all new restaurants opened in each fiscal year in the aggregate, would exceed \$2.5 million in each of 2004, 2005 and 2006. In addition, the revolving credit agreement prohibits us from entering into obligations with respect to operating leases that would allow for an annual increase, on a year-to-year basis, of more than 20%.

The revolving credit agreement restricts our ability to, among other things, engage in mergers, acquisitions, joint ventures and sale-leaseback transactions, and to sell assets, incur indebtedness, make investments, create liens and pay dividends. We are currently in compliance with all covenants related to the revolving credit facility.

As of July 11, 2004, we had \$9.5 million outstanding under various real estate and equipment loans with GE Capital. These loans bear interest at the 30-day commercial paper rate plus 3.0% to 3.5%, mature from 2005 to 2016, and are secured by buildings, equipment and improvements on certain properties. In addition, we had \$7.3 million outstanding under various real estate and equipment loans with other lenders. These loans bear interest at rates ranging from 2.1% to 13.4% and mature from 2006 to 2021. The GE Capital loans, together with certain of our other loans, require that we maintain a maximum debt to net worth ratio, a minimum debt coverage ratio, a minimum EBITDA ratio and a maximum funded indebtedness ratio. As of July 11, 2004, we were in compliance with all of these financial ratios.

Capital Resources. We believe that anticipated cash flows from operations and funds available from our existing revolving credit agreement, together with cash on hand, will provide sufficient funds to finance our expansion plans and corporate initiatives through the remaining term of our revolving credit agreement. Changes in our operating plans, acceleration of our expansion plans, lower than anticipated sales, increased expenses or other events may make it necessary for us to seek additional debt or equity financing in future periods. There can be no guarantee that financing will be available on acceptable terms, or at all, and our failure to raise capital when needed could negatively impact our growth plans and our financial condition and results of operations. Additional equity financing may be dilutive to the holders of our common stock and debt financing, if available, may involve significant cash payment obligations and covenants and/or financial ratios that restrict our ability to operate our business.

Inflation

The primary inflationary factors affecting our operations are food and labor costs. A large number of our restaurant personnel are paid at rates based on the applicable minimum wage, and increases in the minimum wage directly affect our labor costs. Many of our leases require us to pay taxes, maintenance, repairs, insurance and utilities, all of which are generally subject to inflationary increases. We believe inflation had a modest impact on our results of operations in the twenty-eight weeks ended July 11, 2004 primarily due to rising commodity prices for certain foods we purchase at market rates. However, we cannot quantify this impact. In addition, we are also experiencing rising construction costs for materials

and labor related to construction of our new restaurants. Uncertainties related to future commodity prices, the supply of labor and construction materials make it difficult to predict what impact, if any, inflation may have during the remainder of 2004 and beyond.

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Seasonality

Our business is subject to seasonal fluctuations. Historically, sales in most of our restaurants have been higher during the summer months and winter holiday season. As a result, our quarterly and annual operating results and comparable restaurant sales may fluctuate significantly as a result of seasonality and other factors. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year and comparable restaurant sales for any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors. In that event, the price of our common stock would likely decrease.

Critical Accounting Policies and Estimates

In the ordinary course of business, management has made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our most critical accounting policies, the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions.

Property and Equipment. Property and equipment is recorded at cost. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life for owned assets and the shorter of the estimated useful life or the term of the underlying lease for leased assets. Changes in circumstances such as changes to our business model or changes in our capital strategy can result in the actual useful lives differing from our estimates. In those cases where management determines that the useful life of property and equipment should be shortened, we would depreciate the net book value over its revised remaining useful life thereby increasing depreciation and amortization expense. Factors such as changes in the planned use of fixtures or closing of facilities could also result in shortened useful lives.

Our accounting policies regarding property and equipment include judgments by management regarding the estimated useful lives of these assets, the expected lease term for assets related to properties under lease and the determination as to what constitutes enhancing the value of or increasing the life of existing assets. These judgments and estimates may produce materially different amounts of depreciation and amortization expense than would be reported if different assumptions were used. As discussed further below, these judgments may also impact management's need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized.

Impairment of Long-Lived Assets. Long-lived assets, including restaurant sites, leasehold improvements, other fixed assets, intangibles and goodwill are reviewed at least annually for impairment or sooner if events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. Expected cash flows associated with an asset is the key factor in determining the recoverability of the asset. Identifiable cash flows are generally measured at the restaurant level. The estimate of cash flows is based upon, among other things, certain assumptions about expected future operating performance. Management's estimates of undiscounted cash flows may differ from actual cash flow due to, among other things, changes in economic conditions, changes to our business model or changes in operating performance. If the sum of the undiscounted cash flows is less than the carrying value of the asset, we recognize an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the asset.

Judgments made by management related to the expected useful lives of long-lived assets and our ability to realize undiscounted cash flows in excess of the carrying amounts of such assets are affected by factors such as the ongoing maintenance and improvements of the assets, changes in economic conditions, and changes in operating performance. As the ongoing expected cash flows and carrying amounts of long-lived assets

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are assessed, these factors could cause us to realize a material impairment charge. There were no asset impairment charges during the twenty-eight weeks ended July 11, 2004 or July 11, 2003.

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We completed our most recent goodwill and other intangible assets impairment tests in December 2003 and determined that there were no impairment losses related to goodwill and other intangible assets. We completed our most recent property and equipment impairment tests in July 2004 and determined that there were no impairment losses related to property and equipment.

Lease Accounting. We are obligated under various lease agreements for certain land, restaurant facilities and office space. For operating leases, we recognize rent expense on a straight-line basis over the expected lease term. Capital leases are recorded as an asset and a liability at an amount equal to the present value of the future minimum lease payments during the lease term.

Under the provisions of certain of our leases, there are rent holidays and/or escalations in payments over the base lease term, as well as renewal periods. The effects of rent holidays and escalations have been reflected in rent costs on a straight-line basis over the expected lease term, which includes cancelable option periods when it is deemed to be reasonably assured that we will exercise such option periods due to the fact that we would incur an economic penalty for not doing so. The lease term commences on the date when we become legally obligated for the rent payments which generally coincides with the time when the landlord delivers the property for us to develop and we waive contract contingencies. Under generally accepted accounting principles, there are two acceptable methods for recognizing rent costs during a period of construction; the capitalization method and the expense method. Historically, we have used the expense method. Under the expense method, all rent costs recognized during construction periods are expensed immediately as pre-opening expenses. Using the expense method results in substantially higher current period costs compared to using the capitalization method because the construction period for our free-standing restaurants is typically 130-150 days, and as a result, the amount of rent costs that we recognize during construction periods is significant. Other companies in our industry may present their financial statements using the capitalization method and, as a result, our financial statements may not necessarily be comparable to other companies in our industry.

Leasehold improvements and property held under capital leases for each restaurant facility are amortized on the straight-line method over the shorter of the estimated life of the asset or the same expected lease term used for lease accounting purposes commencing when the restaurant opens. For each restaurant facility, the consolidated financial statements generally reflect the same lease term for amortizing leasehold improvements as management uses to determine capital versus operating lease classifications and in calculating straight-line rent expense. Percentage rent expense is generally based upon adjusted restaurant sales levels and is accrued at the point in time when we determine that it is probable that such adjusted restaurant sales levels will be achieved. Leasehold improvements paid for by the landlord are recorded as leasehold improvements and deferred rent.

Judgments made by management related to the probable term for each lease affect the classification and accounting for a lease as capital or operating; the rent holidays and/or escalations in payments that are taken into consideration when calculating straight-line rent; and the term over which leasehold improvements for each restaurant facility are amortized. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

Insurance/Self-Insurance Liabilities. We are self-insured for certain losses related to health, general liability and workers' compensation and we maintain stop loss coverage with third party insurers to limit our total exposure. The self-insurance liability represents an estimate of the ultimate cost of claims incurred and unpaid as of the balance sheet date. The estimated liability is not discounted and is established based upon analysis of historical data and actuarial estimates, and is closely monitored and adjusted when warranted by changing circumstances. Should a greater amount of claims occur compared to what was estimated or medical costs increase beyond what was expected, reserves might not be sufficient and additional expense may be recorded. Actual claims experience could also be more favorable than estimated, resulting in expense reductions. Unanticipated changes may produce materially different amounts of expense than that reported under these programs.

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Recent Accounting Pronouncements

In December 2003, the FASB issued FASB Interpretation No. (FIN) 46R, Consolidation of Variable Interest Entities an Interpretation of ARB No. 51. This interpretation, which replaces FASB Interpretation No. 46, Consolidation of Variable Interest Entities, clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. This interpretation is required in financial statements for periods ending after March 15, 2004 for those companies that have yet to adopt the provisions of FIN 46. The Company has no variable interest in variable interest entities and, therefore, no entities were consolidated with our financial statements as a result of adopting FIN 46R.

Forward-Looking Statements

Certain information contained in this Form 10-Q/A includes forward-looking statements. Forward-looking statements include statements regarding our expectations, beliefs, intentions, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts. These statements may be identified, without limitation, by the use of forward looking terminology such as may , will , anticipates , expects , believes , intends , should or comparable terms or the negative thereof. All forward-looking statements included in this Form 10-Q/A are based on information available to us on the date hereof. Such statements speak only as of the date hereof. These statements involve risks and uncertainties that could cause actual results to differ materially from those described in the statements. These risks and uncertainties include, but are not limited to, the following:

our ability to achieve and manage our planned expansion;

our ability to raise capital in the future;

the ability of our franchisees to open and manage new restaurants;

our franchisees adherence to our practices, policies and procedures;

changes in the availability and costs of food;

potential fluctuation in our quarterly operating results due to seasonality and other factors;

the continued service of key management personnel;

the concentration of our restaurants in the Western United States;

our ability to protect our name and logo and other proprietary information;

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changes in consumer preferences, general economic conditions or consumer discretionary spending;

health concerns about our food products and food preparation;

our ability to attract, motivate and retain qualified team members;

the impact of federal, state or local government regulations relating to our team members or the sale of food or alcoholic beverages;

the impact of litigation;

the effect of competition in the restaurant industry;

cost and availability of capital;

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additional costs associated with compliance, including the Sarbanes-Oxley Act and related regulations and requirements;

the effectiveness of our internal controls over financial reporting;

future changes in financial accounting standards; and

other risk factors described from time to time in SEC reports filed by Red Robin.

Other risks, uncertainties and factors, including those discussed under **Risk Factors** and elsewhere in our annual report on Form 10-K, could cause our actual results to differ materially from those projected in any forward-looking statements we make. The list of factors that may affect future performance and the accuracy of forward-looking statements is illustrative, but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with the understanding of their inherent uncertainty.

We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk exposures for our assets are related to cash, cash equivalents and investments. We invest our excess cash in highly liquid short-term investments with maturities of less than one year. These investments are not held for trading or other speculative purposes. Changes in interest rates affect the investment income we earn on our investments and, therefore, impact our cash flows and results of operations.

Under our amended revolving credit agreement, we are exposed to market risk from changes in interest rates on borrowings, which bear interest at one of the following rates we select: an ABR, based on the Prime Rate plus 1.0% to 1.75%, or a LIBOR, based on the relevant one, two, three or six-month LIBOR, at our discretion, plus 2.0% to 2.75%. The spread, or margin, for ABR and LIBOR loans under the revolving credit agreement are subject to quarterly adjustment based on our then current leverage ratio, as defined by the agreement.

Our objective in managing exposure to interest rate changes is to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve this objective, we may use interest rate swaps and caps to manage our net exposure to interest rate changes related to our borrowings. As appropriate, on the date derivative contracts are entered into, we designate derivatives as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge).

We are a party to a variable-to-fixed interest rate swap agreement that became effective in January 2003 and expires in January 2006. The agreement has been designated as a cash flow hedge under which we pay interest on \$10.0 million of notional amount at a fixed rate and receive interest on \$10.0 million of notional amount at a variable rate. The variable rate interest received by us resets according to the then current 1-month LIBOR rate determined two banking days prior to the first day of each monthly calculation period. This hedge is highly effective as defined by Statement of Financial Accounting Standards No. 133, and there were no gains or losses recognized in earnings during the twenty-eight weeks ended July 11, 2004 or July 13, 2003. At the end of the twenty-eight weeks ended July 11, 2004, the unrealized loss on derivative instruments designated and qualifying as cash flow hedging instruments that are reported in comprehensive income totaled \$42,750, net of tax of \$26,480, compared to \$108,100, net of tax of \$67,700 at the end of fiscal 2003.

Our variable rate based loans with GE Capital bear interest at the 30-day commercial paper rate plus a fixed percentage of 3.0% to 3.5%.

As of July 11, 2004, we had \$23.7 million of borrowings subject to variable interest rates, and a 1.0% change in the effective interest rate applied to these loans would have resulted in pre-tax interest expense fluctuating \$237,000 on an annualized basis.

Primarily all of our transactions are conducted, and our accounts are denominated, in United States dollars. Accordingly, we are not exposed to foreign currency risk. Many of the food products purchased by us are affected by changes in weather, production, availability, seasonality and other factors outside our control. In an effort to control some of this risk, we have entered into some fixed price purchase commitments with terms of no more than a year. In addition, we believe that almost all of our food and supplies are available from several sources, which helps to control food commodity risks.

Item 4. Controls and Procedures

Restatement of Previously Issued Financial Statements

On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission (SEC) issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating lease-related accounting issues and their application under accounting principles generally accepted in the United States of America (GAAP). In light of this letter, management initiated a review of the Company s lease accounting and determined that its previous methods of accounting for rent holidays and for leasehold improvements funded by landlord incentives or allowances under operating leases (tenant improvement allowances) were not in

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accordance with GAAP. As a result, the Company has restated its condensed consolidated financial statements as of July 11, 2004 and for the twelve and twenty-eight weeks ended July 11, 2004 and July 13, 2003.

See Note 2 to the condensed consolidated financial statements of this Quarterly Report on Form 10-Q/A for a summary of the effects of restatements of the Company's condensed consolidated financial statements.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our chief executive and chief financial officers, as appropriate, to allow timely decisions regarding required disclosure based on the definition of disclosure controls and procedures in Rule 13a-15(e) promulgated under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply judgment in evaluating our controls and procedures.

Our management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. In performing this evaluation, management reviewed the Company's lease accounting practices. As a result of this review, we concluded that our previously established lease accounting practices were not appropriate under GAAP. Accordingly, as described above, management has restated its condensed consolidated financial statements as of July 11, 2004 and for the twelve and twenty-eight weeks ended July 11, 2004 and July 13, 2003, to reflect the correction of these errors. These errors were attributed to deficiencies in the Company's controls relative to the selection, monitoring, and review of assumptions and factors affecting lease accounting practices as of July 11, 2004, resulting from errors in the Company's interpretation of GAAP. Based on the aforementioned evaluation, management, under the supervision and with the participation of our chief executive officer and chief financial officer, concluded that the Company's disclosure controls and procedures were not effective as of July 11, 2004.

Changes in Internal Controls over Financial Reporting

No change in internal controls over financial reporting occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

To remediate the material weakness in the Company's internal control over financial reporting, the Company has implemented additional review procedures over the selection and monitoring of appropriate assumptions and factors affecting lease accounting and leasehold depreciation practices.

Table of Contents**PART II - OTHER INFORMATION****Item 5. Submission of Matters to a Vote of Security Holders**

The following matters were submitted to a vote of security holders during the Company's annual meeting of shareholders held on June 2, 2004.

| Description of Matter | Number of Shares | | | |
|--|------------------|-----------|-----------|---------|
| | Voted | Votes | Voted | Abstain |
| | For | Withheld | Against | |
| 1. Election of Class II Directors | | | | |
| Edward T. Harvey | 14,626,12 | 634,259 | | |
| Gary J. Singer | 11,557,322 | 3,703,119 | | |
| 2. Approval of 2004 Performance Incentive Plan | 10,368,244 | | 3,755,542 | 2,943 |
| 3. Ratification of Appointment of Independent Auditors | 14,988,920 | | 268,485 | 3,036 |

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

Exhibit

| Number | Description |
|--------|--|
| 31.1 | Rule 13a-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a) Certification of Chief Financial Officer |
| 32.1 | Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer |

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Red Robin Gourmet Burgers, Inc.

May 19, 2005
(Date)

/s/ James P. McCloskey
James P. McCloskey
Chief Financial Officer

