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SHELLS SEAFOOD RESTAURANTS INC
Form 10-Q
May 16, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.
20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED APRIL 1, 2001

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NO. 0-28258

SHELLS SEAFOOD RESTAURANTS, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE

65-0427966

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

(IRS) EMPLOYER IDENTIFICATION NUMBER

16313 NORTH DALE MABRY HIGHWAY, SUITE 100, TAMPA, FL 33618

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(813) 961-0944

(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

CLASS

OUTSTANDING AT MAY 16, 2001

COMMON STOCK, \$.01 PAR VALUE

4,454,015

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
INDEX

PART I - FINANCIAL INFORMATION

PAGE NUMBER

ITEM 1 - FINANCIAL STATEMENTS

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| | |
|---|-----|
| CONSOLIDATED BALANCE SHEETS AS OF APRIL 1, 2001 (UNAUDITED) AND DECEMBER 31, 2000 | 3 |
| CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) FOR THE 13 WEEKS ENDED APRIL 1, 2001 AND APRIL 2, 2000 | 4 |
| CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) FOR THE 13 WEEKS ENDED APRIL 1, 2001 AND APRIL 2, 2000 | 5 |
| NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (UNAUDITED) | 6 |
| ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 7-9 |
| ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 10 |
| PART II - OTHER INFORMATION | 11 |
| SIGNATURES | 12 |

2

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

| | (UNAUDITED) APRIL 1, 2001 ----- | DECEMBER 31, 2000 ----- |
|---|---------------------------------------|----------------------------|
| ASSETS | | |
| Cash | \$ 371,373 | \$ 1,261,937 |
| Inventories | 940,848 | 1,007,520 |
| Other current assets | 892,305 | 495,506 |
| Receivables from related parties | 72,616 | 196,155 |
| Deferred tax asset, net | 638,000 | 638,000 |
| | ----- | ----- |
| Total current assets | 2,915,142 | 3,599,118 |
| Property and equipment, net | 12,442,912 | 14,165,527 |
| Prepaid rent | 160,522 | 173,122 |
| Other assets | 393,251 | 435,722 |
| Goodwill | 2,835,250 | 2,886,799 |
| Deferred tax asset, net | 85,441 | 200,223 |
| | ----- | ----- |
| TOTAL ASSETS | 18,832,518 ===== | 21,460,511 ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Accounts payable | \$ 3,340,212 | \$ 3,445,541 |
| Accrued expenses | 5,826,027 | 5,312,219 |
| Sales tax payable | 520,658 | 356,039 |
| Current portion of long-term debt | 1,969,522 | 1,985,447 |
| | ----- | ----- |
| Total current liabilities | 11,656,419 | 11,099,246 |
| Deferred rent | 1,799,965 | 1,783,994 |
| Long-term debt, less current portion | 3,539,491 | 3,714,316 |
| | ----- | ----- |
| Total liabilities | 16,995,875 | 16,597,556 |

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| | | |
|---|--------------|-------------|
| Minority partner interest | 442,718 | 449,011 |
| | ----- | ----- |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$0.01 par value; authorized 2,000,000 shares; none issued or outstanding | -- | -- |
| Common stock, \$.01 par value; authorized 20,000,000 shares; 4,454,015 shares issued and outstanding | 44,540 | 44,540 |
| Additional paid-in-capital | 14,161,010 | 14,161,010 |
| Retained earnings (deficit) | (12,811,625) | (9,791,606) |
| | ----- | ----- |
| Total stockholders' equity | 1,393,925 | 4,413,944 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | 18,832,518 | 21,460,511 |
| | ===== | ===== |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

3

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| | 13 WEEKS ENDED | |
|---|----------------|---------------|
| | APRIL 1, 2001 | APRIL 2, 2000 |
| | ----- | ----- |
| REVENUES | \$ 21,654,590 | \$ 25,850,919 |
| | ----- | ----- |
| COST AND EXPENSES: | | |
| Cost of revenues | 8,143,679 | 9,261,168 |
| Labor and other related expenses | 6,455,549 | 7,400,011 |
| Other restaurant operating expenses | 4,598,244 | 4,930,126 |
| General and administrative expenses | 1,694,154 | 1,812,437 |
| Depreciation and amortization | 536,022 | 676,549 |
| Provision for impairment of assets | 1,582,137 | -- |
| Provision for store closings | 1,333,271 | -- |
| | ----- | ----- |
| | 24,343,056 | 24,080,291 |
| | ----- | ----- |
| INCOME (LOSS) FROM OPERATIONS | (2,688,466) | 1,770,628 |
| | ----- | ----- |
| OTHER INCOME (EXPENSE): | | |
| Interest expense | (186,786) | (226,612) |
| Interest income | 1,247 | 35,497 |
| Other expense, net | (65,739) | (11,363) |
| | ----- | ----- |
| | (251,278) | (202,478) |
| | ----- | ----- |
| INCOME (LOSS) BEFORE ELIMINATION OF MINORITY PARTNER INTEREST AND INCOME TAXES | (2,939,744) | 1,568,150 |
| | ----- | ----- |
| ELIMINATION OF MINORITY PARTNER INTEREST | (78,707) | (95,963) |
| | ----- | ----- |

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| | | |
|--|----------------|------------|
| INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES | (3,018,451) | 1,472,187 |
| PROVISION FOR INCOME TAXES | -- | (486,000) |
| | ----- | ----- |
| NET INCOME (LOSS) | \$ (3,018,451) | \$ 986,187 |
| | ===== | ===== |
| BASIC NET INCOME (LOSS) PER SHARE OF COMMON STOCK | \$ (0.68) | \$ 0.22 |
| | ===== | ===== |
| BASIC WEIGHTED AVERAGE NUMBER OF SHARES OF COMMON STOCK OUTSTANDING | 4,454,015 | 4,454,015 |
| | ===== | ===== |
| DILUTED NET INCOME (LOSS) PER SHARE OF COMMON STOCK | \$ (0.68) | \$ 0.22 |
| | ===== | ===== |
| DILUTED WEIGHTED AVERAGE NUMBER OF SHARES OF COMMON STOCK OUTSTANDING | 4,454,015 | 4,454,083 |
| | ===== | ===== |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

4

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | 13 WEEKS ENDED | |
|--|----------------|---------------|
| | APRIL 1, 2001 | APRIL 2, 2001 |
| | ----- | ----- |
| OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (3,018,451) | \$ 986,187 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Provision for impairment of assets | 1,582,137 | -- |
| Depreciation and amortization | 536,022 | 676,549 |
| Minority partner interest | (6,293) | (19,037) |
| Changes in assets and liabilities: | | |
| Decrease (increase) in inventories | 66,672 | (75,307) |
| Decrease (increase) in receivables from related parties | 123,539 | (21,740) |
| Increase in other assets | (359,582) | (803,867) |
| Decrease in prepaid rent | 12,600 | 19,569 |
| Decrease in deferred tax asset | 114,782 | 484,290 |
| (Decrease) increase in accounts payable | (105,329) | 856,092 |
| Increase in accrued expenses | 513,808 | 256,616 |
| Increase in sales tax payable | 164,619 | 189,455 |
| Increase in deferred rent | 15,971 | 81,002 |
| | ----- | ----- |
| Total adjustments | 2,658,946 | 1,643,622 |
| | ----- | ----- |
| Net cash (used in) provided by operating activities | (359,505) | 2,629,809 |
| | ----- | ----- |
| INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (340,310) | (244,542) |

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| | | |
|---|--------------|--------------|
| Net cash used in investing activities | (340,310) | (244,542) |
| FINANCING ACTIVITIES: | | |
| Proceeds from debt financing | 227,636 | 245,432 |
| Repayment of debt | (418,385) | (260,539) |
| Net cash used in financing activities | (190,749) | (15,107) |
| Net (decrease) increase in cash | (890,564) | 2,370,160 |
| CASH AT BEGINNING OF PERIOD | 1,261,937 | 2,940,919 |
| CASH AT END OF PERIOD | \$ 371,373 | \$ 5,311,079 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 188,786 | \$ 224,451 |
| Cash (refunds received) paid for income taxes | \$ (114,781) | \$ 1,710 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

5

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, these statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all material adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The consolidated financial statements of Shells Seafood Restaurants, Inc. (the "Company") should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Form 10-K for the year ended December 31, 2000 filed with the Securities and Exchange Commission. Company management believes that the disclosures are sufficient for interim financial reporting purposes. Certain prior year amounts have been reclassified in the accompanying condensed consolidated financial statements to conform with the current year presentation.

2. EARNINGS PER SHARE

The following table represents the computation of basic and diluted earnings per share of common stock as required by Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share":

| 13 WEEKS ENDED | |
|----------------|---------------|
| APRIL 1, 2001 | APRIL 2, 2000 |
| ----- | ----- |

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| | | |
|---|---------------|------------|
| Net income (loss) applicable to common stock | \$(3,018,451) | \$ 986,187 |
| | ===== | ===== |
| Weighted common shares outstanding | 4,454,015 | 4,454,015 |
| Basic net income (loss) per share of common stock | \$ (0.68) | \$ 0.22 |
| Effect of dilutive securities: | | |
| Warrants | -- | -- |
| Stock options | -- | 68 |
| | ----- | ----- |
| Diluted weighted common shares outstanding | 4,454,015 | 4,454,083 |
| | ----- | ----- |
| Diluted net income per share of common stock | \$ (0.68) | \$ 0.22 |
| | ===== | ===== |

The earnings per share calculations excluded 1,411,425 options and warrants and 1,400,125 options and warrants during the first quarter of 2001 and 2000, respectively, as the exercise price of the options and warrants were greater than the average market price of the common shares.

3. NEW ACCOUNTING PRONOUNCEMENT

Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative (that is gains and losses) depends upon the intended use of the derivative and the resulting designation. SFAS No. 133, as amended, will be effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The adoption of SFAS No. 133 is not expected to materially affect the Company's consolidated financial statements.

6

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentages which the items in the Company's Consolidated Statements of Income bear to total revenues.

| | 13 WEEKS ENDED | |
|-------------------------------------|------------------------|------------------------|
| | ----- APRIL 1, 2001 | APRIL 2, 2000 ----- |
| REVENUES | 100.0% | 100.0% |
| COST AND EXPENSES: | | |
| Cost of revenues | 37.6% | 35.8% |
| Labor and other related expenses | 29.8% | 28.6% |
| Other restaurant operating expenses | 21.2% | 19.1% |
| | ----- | ----- |
| Total restaurant costs and expenses | 88.6% | 83.5% |
| | ----- | ----- |
| General and administrative expenses | 7.8% | 7.0% |
| Depreciation and amortization | 2.5% | 2.6% |

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| | | |
|--|---------|--------|
| Provision for impairment of assets | 7.3% | 0.0% |
| Provision for store closings | 6.2% | 0.0% |
| | ----- | ----- |
| Income (loss) from operations | (12.4)% | 6.8% |
| | ----- | ----- |
| Interest expense, net | (0.9)% | (0.7)% |
| Other expense, net | (0.3)% | 0.0% |
| Elimination of minority partner interest | (0.4)% | (0.4)% |
| | ----- | ----- |
| Income (loss) before provision for taxes | (14.0)% | 5.7% |
| Provision for income taxes | 0.0% | (1.9)% |
| | ----- | ----- |
| Net income (loss) | (14.0)% | 3.8% |
| | ===== | ===== |

7

13 WEEKS ENDED APRIL 1, 2001 AND APRIL 2, 2000

REVENUES. Total revenues for the first quarter of 2001 were \$21,655,000 as compared to \$25,851,000 for the first quarter of 2000. The \$4,196,000, or 16.2% decrease in revenues was due to the closing of four restaurants in the fourth quarter of 2000 and an additional six restaurants in the first quarter of 2001, and by a 5.4% decrease in comparable store sales. Comparisons of same store sales include only stores, which were open during the entire periods being compared and, due to the time needed for a restaurant to become established and fully operational, at least six months prior to the beginning of that period.

COST OF REVENUES. The cost of revenues as a percentage of revenues increased to 37.6% for the first quarter of 2001 from 35.8% for the first quarter of 2000. This increase primarily was due to rising shrimp costs coupled with menu changes and resulting shifts in customer preferences. The Company is continually anticipating and reacting to fluctuations in food costs by purchasing seafood directly from numerous suppliers, promoting certain alternative menu selections in response to price and availability of supply and adjusting its menu prices accordingly to help control the cost of revenues.

LABOR AND OTHER RELATED EXPENSES. Labor and other related expenses as a percentage of revenues increased to 29.8% during the first quarter of 2001 as compared to 28.6% for the first quarter of 2000. This increase was primarily attributable to labor inefficiencies in the Company's Midwest restaurants and general increases in hourly wage rates. Also included is a one-time nonrecurring charge of \$102,000 for severance pay primarily related to store closings in the Midwest.

OTHER RESTAURANT OPERATING EXPENSES. Other restaurant operating expenses as a percentage of revenues increased to 21.2% for the first quarter of 2001 as compared with 19.1% for the first quarter of 2000. The increase primarily was due to increased advertising costs mostly in the Florida markets and an increase in utility costs associated with fuel prices.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses as a percentage of revenues increased to 7.8% for the first quarter of 2001 as compared with 7.0% for the first quarter of 2000. The increase was due to increased salaries and wages and related travel costs resulting from the hiring of an additional director of operations for the Florida market in fiscal 2000. Also included is a one-time nonrecurring charge of \$150,000 for severance pay related to reorganization and downsizing of administrative and supervisory staff.

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DEPRECIATION AND AMORTIZATION. Depreciation and amortization expense as a percentage of revenues decreased to 2.5% for the first quarter of 2001 from 2.6% in the first quarter of 2000. The decrease primarily was due to the reduced basis of property and equipment resulting from the recognition of asset impairments in the third quarter of 2000.

PROVISION FOR IMPAIRMENT OF ASSETS. The Company recorded a \$1,582,000 charge relating to the write-down of impaired assets to their estimated fair value in accordance with Statement of Financial Accounting Standards No. 121. The asset impairment charge related to 14 restaurants, 13 restaurants in the Midwest and one restaurant in Florida. Eleven of the 14 restaurants had incurred previous write-downs in the third quarter of 2000. The Company subsequently decided to close most of these under-performing units in which six units were closed during the first quarter of 2001 and additional six units were closed during the second quarter of 2001. The Company is presently in negotiations with an unaffiliated entity to continue to operate the three remaining Midwest units as Shells restaurants under a licensing arrangement.

PROVISION FOR STORE CLOSINGS. The Company recorded a one-time charge of \$1,333,000 relating to store closing costs primarily related to restaurants in the Midwest. The Midwest restaurants were closed during the first and second quarters of 2001 due to poor operating results. Store closing costs consist primarily of real estate lease obligations incurred or anticipated to complete lease terminations or continuing costs while new tenants are located.

8

PROVISION FOR INCOME TAXES. A provision for income taxes of \$0 was recognized for the first quarter of 2001 as compared to \$486,000 during the same quarter in 2000. The decrease related to the net loss before the provision for income taxes incurred for the first quarter 2001.

INCOME (LOSS) FROM OPERATIONS AND NET INCOME (LOSS). As a result of the factors discussed above, the Company incurred a loss from operations of \$2,688,000 for the first quarter of 2001 as compared to income from operations of \$1,771,000 for the first quarter of 2000. The Company incurred a net loss of \$3,018,000 for the first quarter of 2001 compared to net income of \$986,000 for the first quarter of 2000. Exclusive of nonrecurring charges of \$3,167,000, first quarter 2001 net income was \$149,000.

LIQUIDITY AND CAPITAL RESOURCES

As of April 1, 2001, the Company's current liabilities of \$11,656,000 exceeded its current assets of \$2,915,000, resulting in a working capital deficiency of \$8,741,000. A decrease in revenues resulting from fewer restaurants in operation and a decrease in comparable store sales, coupled by increased operating costs and costs incurred to close six restaurants during the first quarter of 2001, negatively affected cash. Historically, the Company has generally operated with minimal or negative working capital as a result of the investing of current assets into non-current property and equipment as well as the turnover of restaurant inventory relative to more favorable vendor terms in accounts payable.

The Company continues to be negatively impacted by its Midwest locations. The Company is implementing its plan to divest itself of the Midwest restaurants. Such divestiture has had and, in the near term, will continue to have an adverse affect on the Company's cash position and operating results. The Company anticipates requiring additional outside financing during the second and third quarters of 2001. There can be no assurance that any such financing will be

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available to the Company on terms acceptable to the Company, or at all. In addition, in view of the closure of several restaurants and restructuring of the Company, as well as the present inability to supply adequate security for any borrowing, the Company's line of credit is not available to be drawn upon.

Cash used by operating activities for the first quarter of 2001 was \$360,000 as compared to cash provided by operating activities of \$2,630,000 for the first quarter of 2000. The net decrease of \$2,989,000 primarily was attributable to less favorable store operating results in first quarter 2001 in addition to costs incurred to close six restaurants.

The cash used in investing activities increased to \$340,000 for the first quarter of 2001 compared to \$245,000 for the first quarter of 2000. The increase of \$95,000 was due to the completion of remodeling of six Florida restaurants started in fourth quarter.

The cash used in financing activities was \$191,000 for the first quarter of 2001 compared to \$15,000 in the first quarter of 2000. The increase in cash used in financing activities primarily was due to debt repayments associated with stores closed in 2001 and 2000.

SEASONALITY

The restaurant industry in general is seasonal, depending on restaurant location and the type of food served. The Company has experienced fluctuations in its quarter-to-quarter operating results due primarily to its high concentration of restaurants in Florida. Business in Florida is influenced by seasonality due to various factors which include but are not limited to weather conditions in Florida relative to other areas of the U.S. and the health of Florida's economy in general and the tourism industry in particular. The Company's restaurant sales are generally highest from January through April and June through August, the peaks of the Florida tourism season, and generally lower from September through mid-December. In many cases, locations are in coastal cities, where sales are significantly dependent on tourism and its seasonality patterns.

9

In addition, quarterly results have been, and in the future could be, affected by the timing and conditions under which restaurants are closed both in and outside of Florida. Because of the seasonality of the Company's business and the impact of restaurant closures and openings, if applicable, results for any quarter are not generally indicative of the results that may be achieved for a full fiscal year on an annualized basis and cannot be used to indicate financial performance for the entire year.

ITEM 3. - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in interest rates on debt and changes in commodity prices. The Company's exposure to interest rate risk relates to its \$3,220,000 in outstanding debt with banks that is based on variable rates. Borrowings under the loan agreements bear interest at rates ranging from 50 basis points under the prime lending rate to 100 basis points over the prime lending rate. There is also one loan that is based on 225 basis points over the 30 day London Interbank Offered Rate.

10

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PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

None

Item 2 - Changes in Securities and Use of Proceeds

None

Item 3 - Defaults Upon Senior Securities

None

Item 4 - Submission of Matters to a Vote of Security Holders

None

Item 5 - Other Information

None

Item 6 - Exhibits and Reports on Form 8-K

None

11

SIGNATURES

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.

SHELLS SEAFOOD RESTAURANTS, INC.
(Registrant)

/s/ DAVID W. HEAD

Date May 16, 2001

David W. Head
President and Chief Executive Officer

/s/ WARREN R. NELSON

Date May 16, 2001

Warren R. Nelson
Executive Vice President and
Chief Financial Officer

12