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ELMERS RESTAURANTS INC  
Form 10-K  
July 02, 2001

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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED APRIL 2, 2001 OR

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

COMMISSION FILE NUMBER 0-14837

ELMER'S RESTAURANTS, INC.  
(Exact name of registrant as specified in its charter)

OREGON \_\_\_\_\_ 93-0836824  
(STATE OR OTHER JURISDICTION OF \_\_\_\_\_ (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NO.)

11802 S.E. Stark St. \_\_\_\_\_  
Portland, Oregon 97216 (503) 252-1485  
(ADDRESS OF PRINCIPAL (ZIP CODE (REGISTRANT'S TELEPHONE NUMBER,  
EXECUTIVE OFFICES) INCLUDING AREA CODE)

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

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

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

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

Aggregate market value of Common Stock held by nonaffiliates of the Registrant at June 23, 2001: \$7.6 million. For purposes of this calculation, officers and directors are considered affiliates.

Number of shares of Common Stock outstanding at June 20, 2001: 1,962,032

Document \_\_\_\_\_ Part of Form 10-K into which incorporated  
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Proxy Statement for 2001 Part III

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Annual Meeting of Shareholders  
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### ITEM 1. BUSINESS

#### GENERAL

The Company, located in Portland, Oregon, is a franchisor and operator of full-service, family oriented restaurants under the names "Elmer's Pancake & Steak House", "ELMER'S. Breakfast. Lunch. Dinner", and "Mitzel's American Kitchen" and operates delicatessen restaurants under the names "Ashley's Cafe" and "Richard's Deli and Pub." The Company is an Oregon corporation and was incorporated in 1983. Walter Elmer opened the first Elmer's restaurant in Portland, Oregon in 1960, and the first franchised restaurant opened in 1966. The Company acquired the Elmer's franchising operation in January 1984 from the Elmer family. The Company now owns and operates 12 Elmer's restaurants, five Mitzel's American Kitchen restaurants and franchises 19 Elmer's restaurants in six western states. The Company reports on a fiscal year which ends on the Monday nearest March 31st.

#### BUSINESS SEGMENT

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

Company-owned Elmer's restaurants are located in the Delta Park section of Portland, Oregon; Beaverton, Hillsboro, Medford, Albany, Springfield, Roseburg and Grants Pass, Oregon; Palm Springs, California; Boise, Idaho; and Tacoma and Lynnwood, Washington. The Company acquired six Mitzel's restaurants on December 13, 2000, located in Oak Harbor, Kent, Fife, Poulsbo and Everett, Washington. The Company acquired five Ashley's restaurants on February 18, 1999 and opened a sixth in January, 2000. Two Ashley's restaurants are located in Bend, Oregon; two are in Springfield Oregon; one is in Eugene, Oregon and the newest is in Redmond, Oregon. The Company acquired four Richard's Deli and Pub restaurants on March 31, 1999. Richard's restaurants are located in Tigard, Aloha and two in Hillsboro, Oregon.

#### RECENT ACQUISITIONS AND DEVELOPMENTS

On April 12, 2001 the Company purchased the assets of the Sandpiper restaurant located in Roseburg, Oregon and entered into a long-term occupancy lease. The Company intends to convert the restaurant to an Elmer's restaurant by the end of June 2001.

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

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

Effective March 31, 1999, the Company executed a stock exchange agreement ("GVL Acquisition") with Grass Valley Ltd., Inc. ("GVL"), a closely held Oregon corporation, in a transaction in which the Company acquired 100% of the outstanding stock of GVL in consideration for the payment by the Company of the sum of \$110,000 in cash and the issuance of 209,620 restricted shares of the Company's common stock to GVL's shareholders. The primary source of the cash portion of the purchase price was working capital. GVL is now a wholly owned

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subsidiary of the Company.

GVL owns and operates four restaurants in Hillsboro, Aloha, and Tigard, Oregon operating under the moniker of Richard's Deli and Pub. The first Richard's Deli and Pub was opened in August 1994 and all the restaurants are located in leased retail space. The Company plans to continue operations at all four locations in a substantially similar manner. The Company's management believes that it has realized significant synergies between the Richard's Deli and Pubs and Ashley's Deli operations while accruing significant savings from the consolidation of back office functions.

On February 18, 1999, the Company merged with its majority shareholder CBW, Inc. ('CBW'), a closely held Oregon corporation, in a transaction in which the Company was the surviving corporation. CBW was the operator of five restaurants in Eugene, Springfield, and Bend, Oregon. In consideration for the issuance by the Company of 770,500 new shares of the Company's restricted stock to the CBW shareholders and the assumption of approximately \$4 million in debt owed by CBW

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arising from CBW's acquisition of the controlling block of the Company's restricted common stock on August 25, 1998, the Company acquired all the stock and assets of CBW including CBW's wholly owned subsidiary, CBW Food Company, LLC (which by operation of merger is now the Company's wholly-owned subsidiary). The assets included five Ashley's Delis operated by CBW and an option to purchase four Richards' Delis operated by GVL.

Each CBW shareholder received 144.4507 shares of the Company's restricted common stock for every CBW share owned. The shares of Company stock previously acquired by CBW, a total of 705,000 shares, were concurrently transferred to the Company and canceled. The Company's primary source of financing for the acquisition consisted of \$3.08 million from its principal lender bank, Wells Fargo Bank, N.A. The proceeds were applied to pay down \$1.75 million of the assumed debt and approximately \$1.48 million in other outstanding debt of the Company. The debt financing is secured by a grant of various security interests in the Company's assets as well as the issuance of continuing guaranties by two subsidiaries of the Company. The Company also used approximately \$1,000,000 in working capital to pay down debt assumed in the transaction.

The CBW Merger and GVL Acquisition were accounted for under the purchase method of accounting. The CBW Merger transaction was accounted for as a reverse acquisition as the shareholders of CBW received the larger portion (53.8%) of the voting interests in the combined enterprise. (for more details see the Company's Consolidated Financial Statements incorporated herein). Accordingly, CBW was considered the acquirer for accounting purposes and therefore, the Company's assets and liabilities were recorded based upon their fair market values. The CBW Merger and GVL Acquisition created a company with over 20 restaurants, making it more competitive in the particular restaurant segments represented and allowing the crossover of product promotions, menu items, marketing strategies and restaurant images while generating likely opportunities for the development of several brands targeting different consumer segments. Management anticipates that the CBW Merger and GVL Acquisition will also allow the Company to achieve administrative and operational efficiencies which were previously not possible.

To the extent permitted by operating cash flow or external financing sources, the Company intends to focus future growth primarily in its existing markets through strategic acquisitions, new restaurant openings and other growth opportunities. The Company will also continue to seek to expand through existing and new franchisees. From time to time, the Company may refranchise, sell or

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otherwise dispose of restaurants.

ELMER'S. BREAKFAST. LUNCH. DINNER.

The Company franchises or operates a total of 31 full-service, family-oriented Elmer's restaurants. These restaurants have a warm, friendly atmosphere and comfortable furnishings. Most of the restaurants are decorated in a home style with fireplaces in the dining rooms. They are free standing buildings, ranging in size from 4,600 to approximately 9,000 square feet with seating capacities ranging from 120 to 220 people. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. Thirteen of the restaurants have a lounge with seating capacity ranging from 15 to 75 people. The normal hours of operation are from 6 a.m. to 10 or 11 p.m. and to 12 midnight on weekends in some restaurants with lounges.

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

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

While most menu selections are standard to all Elmer's restaurants, restaurants in different areas include on their menus selections that appeal to local preferences. A special children's menu and a full senior menu is offered in all restaurants.

MITZEL'S AMERICAN KITCHEN

The Company owns and operates five full-service, family-style restaurants located in the Puget Sound region of Washington State. Home-style, comfort food is served in a warm atmosphere with friendly service. Most of the restaurants are decorated in a home style with fireplaces in the dining areas. They are free standing buildings, ranging in size from 5,400 to 6,250

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square feet with seating capacities from 166 to 203 people. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. Two of the restaurants have a lounge with a seating capacity of 20 to 30. The normal hours of operation are 6:00 a.m. to 10:00 or 11:00 p.m. and to midnight on weekends in restaurants with lounges.

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

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

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and a limited senior menu is offered in all restaurants.

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

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

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

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

### FRANCHISE OPERATIONS

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

EXISTING FRANCHISEES. The Company's existing franchise agreements generally grant to franchisees the right to operate an Elmer's restaurant in one specific location for 25 years, renewable generally for an additional 25-year period. When they entered into franchising agreements, the existing franchisees paid initial franchise fees of up to \$25,000 plus additional fees of up to \$10,000 if the restaurant had a lounge serving alcoholic beverages. Franchisees pay monthly franchise royalty fees ranging from two to four percent of the gross revenues of their restaurants. All but one restaurant must contribute up to one percent of gross revenues to a common advertising pool. From time to time, franchised and Company-owned restaurants have agreed to increase advertising pool contributions to one and one-half percent. The Company may terminate a franchise agreement for several reasons including the franchisee's bankruptcy or insolvency, default in the payment of indebtedness to the Company or suppliers,

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failure to maintain standards set forth in the franchise agreement or operations manual, continued material violation of any safety, health or sanitation law, ordinance or governmental rule or regulation or cessation of business.

PROSPECTIVE FRANCHISEES. Prospective new franchisees will generally pay an initial franchise fee of \$35,000. Initial franchise fees are generally payable in cash at the execution of the franchise agreement. Existing franchisees opening new

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franchised restaurants may pay a lower initial franchise fee than new franchisees. For new franchisees, the monthly franchise royalty fee is expected to be four percent of the gross revenues of the restaurant, subject to a minimum monthly fee of \$750. The standard franchising agreement calls for a monthly advertising contribution equal to one percent of the gross revenues of the restaurant. See "Services to Franchisees" below.

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

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

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

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

AREA FRANCHISE AGREEMENTS. Under previous management, the Elmer's franchising operation granted exclusive area franchise agreements, whereby independent entities obtained the exclusive rights to develop Elmer's restaurants within their respective areas. Areas covered by these agreements are Clackamas County, Oregon and Vancouver, Washington. The agreement covering Ada and Canyon Counties, Idaho expired in 1998 and was not renewed. The area franchise agreements require the area franchisee to share with the Company the

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

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

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

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

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

### COMPANY-OWNED RESTAURANTS

The Company owns and operates 12 Elmer's restaurants, which it acquired or built from 1984 to 2001, five Ashley's restaurants acquired February 18, 1999, four Richard's Deli and Pub restaurants acquired March 31, 1999, one additional Ashley's unit opened January 3, 2001, and five Mitzel's American Kitchen restaurants purchased December 13, 2000. The Company has owned and operated an Elmer's restaurant located in the Delta Park section of Portland, Oregon since January 1984. In August 1986, the Company opened a restaurant in Tacoma, Washington. In January 1987, the Company began operation of a restaurant in Lynnwood, Washington and assumed operation of an Elmer's restaurant in Grants Pass, Oregon. In fiscal 1988, the Company acquired from former franchisees restaurants in Gresham, Albany, and Medford, Oregon; and Boise, Idaho. In fiscal 1989, the Company purchased the land and buildings for the Boise and Gresham restaurants and also purchased, from a former franchisee, an additional restaurant in Hillsboro, Oregon. In May 1989, the Company acquired a franchised Elmer's restaurant in Palm Springs, California. In July 1991, the Company acquired a franchised Elmer's restaurant in Beaverton, Oregon. In November 2000, the Company sold and entered into a long-term franchise agreement and occupancy lease for the Gresham Elmer's restaurant. Also in 2000 the Company purchased the assets and remodeled the Springfield Elmer's restaurant. In April 2001 the



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Company purchased and remodeled the Roseburg Elmer's restaurant. Of the 12 restaurants, nine operate on leased property and three on property owned by the Company.

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

As earlier discussed, five Ashley's restaurants were acquired in a merger with CBW, Inc. on February 18, 1999. One restaurant in Springfield, Oregon was opened in 1994 and the other four were opened in 1995. The four Richard's Delis and Pubs were acquired in a purchase of the outstanding stock of Grass Valley Ltd., Inc. on March 31, 1999 (as reported on a Current Report on Form 8-K filed April 15, 1999 and amended on June 14, 1999). All the restaurants operate on leased property.

The Company and its franchisees coordinate the purchase of their food, beverages and supplies from Company-approved and other suppliers. Management monitors the quality of the food, beverages and supplies provided to the restaurants. The Company believes that its continued efforts over time have achieved cost savings, improved food quality and consistency and helped decrease volatility of food and supply costs for the restaurants. All essential food and beverage products are available or, upon short notice, could be made available from alternate qualified suppliers. Therefore, management believes that the loss of any one supplier would not have a material adverse effect on the Company.

### EMPLOYEES

As of April 2, 2001, the Company employed 410 persons on a full-time basis, of whom 20 were corporate office personnel and 390 were restaurant personnel. At that date, the Company also employed 529 part-time restaurant and 2 part-time corporate personnel. Of 22 corporate employees, 8 are in upper management positions and the remainder are professional and administrative employees. Employees of franchised Elmer's restaurants are not included in these figures. None of the Company's employees are covered by collective bargaining agreements. The Company considers its employee relations to be good. Most employees, other than management and corporate personnel, are paid on an hourly basis. Many restaurant personnel also receive tips. The Company believes that it provides working conditions and wages that compare favorably with those of its competition.

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

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### EXECUTIVE OFFICERS OF THE REGISTRANT

As of June 20, 2001, the executive officers and other key personnel of the Company were as set forth below.

Name	Age	Position
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Bruce Davis	40	President
William Service	40	Chief Executive Officer
Jerry Scott	47	Vice President, Operations
Dennis Miller	52	Controller

### EXECUTIVE OFFICERS

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

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

### KEY PERSONNEL

Jerry Scott has served as Vice President, Operations since August 1998. For more than five years prior to joining the Company, Mr. Scott served as Vice President of Operations for Jaspers Food Management, Inc. He served from November 1994 to November 1995 as Regional Director of Operations of Macheezmo Mouse Restaurants, Inc. and from June 1993 to September 1994 as Director of Operations of Mission Investment Company.

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

### TRADEMARKS AND SERVICE MARKS

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

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

### ADVERTISING AND MARKETING

Word-of-mouth advertising, new restaurant openings, and the on-premises sale of promotional products have historically been the primary methods of restaurant advertising. The Company employs an advertising consultant to assist in projecting the Elmer's restaurant concept to the general public in the Western states, primarily through magazines, newspapers, and radio and television commercials. The Company maintains a common advertising pool with its franchisees to advertise Elmer's restaurants. After production costs for the advertising campaign have been paid out of the common pool, the remaining money is used for advertising in the various local areas of the franchised

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restaurants. The Company-owned Elmer's restaurants and all but one of the franchised restaurants are required to participate by contributing one percent of monthly gross revenues. At the present time, the Company relies principally on word-of-mouth advertising and catering exposure for advertising of Ashley's and Richard's.

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

### COMPETITION

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

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

### GOVERNMENT REGULATIONS

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

The Company is subject to a number of state laws regulating franchise operations and sales. For the most part, those laws impose registration and disclosure requirements on the Company in the offer and sale of franchises but,

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

The failure to obtain or retain food licenses or approvals to sell franchises, or an increase in the minimum wage rate, employee benefit costs (including costs associated with mandated health insurance coverage) or other costs associated with employees could adversely affect the Company and its franchisees. Some Company-owned and franchisee-owned restaurants offer lottery products and/or alcoholic beverages. The failure to obtain or renew lottery or liquor licenses could adversely affect those restaurants. Some restaurant employees are paid at or slightly above the minimum wage. Mandated increases in the minimum wage rate were implemented in 1999, 2000 and 2001 and have the effect of increasing labor costs.

### ITEM 2. PROPERTIES

#### HEADQUARTERS

The Company's corporate offices are located in Portland, Oregon and consist of an office facility of approximately 5,000 square feet. Lease payments totaled approximately \$35,000 for fiscal 2001. The lease expires November 30, 2001.

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#### COMPANY-OWNED RESTAURANTS

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

Location	Approximate Area	
	Site	Restaurant
Tacoma, Washington	1.3 acres	6,660 sq. ft.
Lynnwood, Washington	1 acre	6,500 sq. ft.
Gresham, Oregon (leased to franchisee)	1 acre	5,670 sq. ft.
Boise, Idaho	1.3 acres	5,430 sq. ft.

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

Elmer's Locations	Approximate Area	
	Restaurant Sq. ft.	Expiration
Grants Pass, Oregon	6,350	December, 2006
Hillsboro, Oregon	6,350	January, 2002
Medford, Oregon	6,300	May, 2008
Albany, Oregon	5,460	February, 2008
Roseburg, Oregon	8,800	February, 2018
Springfield, Oregon	9,000	June, 2011
Palm Springs, California	5,500	April, 2007
Portland, Oregon (Delta Park)	6,350	July, 2006

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Beaverton, Oregon	5,322	August, 2006
Mitzel's Locations		
-----		
Everett, Washington	6,200	December, 2005
Fife, Washington	5,900	September, 2004
Kent, Washington	5,100	April, 2005
Oak Harbor, Washington	5,200	April, 2005
Poulsbo, Washington	6,500	December, 2004
Ashley's Locations		
-----		
Bend, Oregon (North)	1,000	December, 2005
Bend, Oregon (South)	1,400	August, 2003
Redmond, Oregon	1,200	June, 2003
Eugene, Oregon	1,700	September, 2003
Springfield, Oregon (Gateway)	921	May, 2004
Springfield, Oregon (Thurston)	1,200	April, 2002
Richard's Locations		
-----		
Aloha, Oregon	1,727	November, 2002
Hillsboro, Oregon (North)	1,092	August, 2004
Hillsboro, Oregon (South)	2,510	October, 2001
Tigard, Oregon	1,743	December, 2002

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

ITEM 3. LEGAL PROCEEDINGS

Not applicable.

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

Not applicable.

PART II

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

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

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

	Fiscal Year Ended			
	April 2, 2001		March 31, 2000	
	High	Low	High	Low
1st Quarter	5.90	4.52	7.79	4.81
2nd Quarter	6.44	5.11	7.14	5.09
3rd Quarter	5.67	4.38	6.71	4.77
4th Quarter	5.75	4.53	6.53	4.31

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

The Company has not paid or declared cash dividends on its Common Stock. In November 1999, the Company declared a five-percent stock dividend, and in August 2000 the Company declared a ten-percent stock dividend. The Company intends to retain any future earnings to finance growth and does not presently intend to pay dividends or make distributions in cash other than the payment of cash in lieu of fractional shares in connection with stock splits, if any, to the holders of Common Stock. Any future dividends will be determined by the Board of Directors based on the Company's earnings, financial condition, capital requirements, debt covenants or other relevant factors.

As of June 15, 2001, the Company had 191 shareholders of record.

### UNREGISTERED SALES OF STOCK

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

CBW Inc. acquired 705,000 restricted shares of the Common Stock in the Company from Anita Goldberg and Rudolph Mazurosky on August 25, 1998. The consideration paid by CBW, Inc. for the Shares was \$4,504,950. The shareholders of CBW, Inc. that acquired the indirect beneficial ownership of the Company's Common Stock as part of this transaction were William W. Service, Bruce N. Davis, Thomas C. Connor, Corydon H. Jensen, Linda E. Bolton (as Trustee under a Restated Trust Agreement dated 6/8/98), Ken Boettcher, Karen Brooks, Gregory Wendt and Donald W. Woolley. The issuance was made pursuant to available exemptions from the registration provisions of the Securities Act of 1933, as amended (specifically, Section 4(2) of the Securities Act) and relevant Blue Sky statutes. The shares are subject to transfer restrictions and may only be transferred subject to compliance with applicable federal and state securities laws.

Effective February 18, 1999, the Company merged with its majority shareholder CBW Inc. ('CBW'), a closely held Oregon corporation, in a transaction in which the Company was the surviving corporation. In consideration for the issuance by the Company of 770,500 new shares of the Company's restricted Common Stock to the CBW shareholders and the assumption of approximately \$4 million in debt owed by CBW arising from CBW's acquisition of the controlling block of the Company's

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restricted common stock on August 25, 1998, the Company acquired all the stock and assets of CBW including CBW's wholly owned subsidiary, CBW Food Company, LLC (which by operation of merger is now the Company's wholly-owned subsidiary). Each CBW shareholder received 144.4507 shares of the Company's restricted Common Stock for every CBW share owned. The shares of Company stock previously acquired by CBW, a total of 705,000 shares, were concurrently transferred to the Company and were canceled upon receipt thereof. The issuances were made pursuant to available exemptions from the registration provisions of the Securities Act of 1933, as amended (specifically, Section 4(2) of the Securities Act) and relevant Blue Sky statutes. The shares are subject to transfer restrictions and may only be transferred subject to compliance with applicable federal and state securities laws.

Effective March 31, 1999, the Company paid the sum of \$110,000 in cash and issued 209,620 shares of Common Stock to the shareholders of GVL, namely Gary Weeks and Richard Buckley, as part of the GVL Acquisition (disclosed in Item 1 under the sub-caption "Recent Developments and Acquisitions"). The

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issuances were made pursuant to available exemptions from the registration provisions of the Securities Act of 1933, as amended (specifically, Section 4(2) of the Securities Act) and relevant Blue Sky statutes. The shares are subject to transfer restrictions and may only be transferred subject to compliance with applicable federal and state securities laws.

The Company issued 130,000 shares as part of the consideration paid for the purchase of the six Mitzel's American Kitchen restaurants in December 2000. The Company filed SEC Form 8-K in its fourth quarter disclosing the details of the transaction.

### ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data relating to the Company should be read in conjunction with the Company's consolidated financial statements and the related notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations," other financial information included herein, and Elmer's Restaurants, Inc. consolidated financial statements. The selected financial data set forth below for the Company as of April 2, 2001 and March 31, 2000 and for each of the three years in the period ended April 2, 2001 are derived from the audited financial statements included elsewhere herein. The selected financial data set forth below for the Company as of March 31, 1999, 1998 and for the years ended March 31, 1998 and 1997 are derived from the consolidated financial statements not included elsewhere herein.

Elmer's Restaurants, Inc. and Subsidiaries  
Selected Financial Data  
for the fiscal years ended March 31, and  
April 2,

	2001	2000	1999
Revenues	\$25,852,336	\$22,179,574	\$11,952,72
Net income (loss)	956,006	939,549	290,51
Net income (loss) per share	0.51	0.51	0.3
Total assets	16,374,147	13,847,208	13,046,68
Long-term notes payable, less current portion	5,798,769	5,124,130	5,703,53
Total liabilities	9,129,937	8,209,004	8,348,02
Total shareholder's equity (deficit)	7,244,210	5,638,204	4,698,65

On August 25, 1998, CBW, Inc. ("CBW") acquired a controlling interest in the then outstanding stock of Elmer's. On February 18, 1999, CBW merged with and into Elmer's. These transactions have been accounted for as a purchase of Elmer's by CBW and, accordingly a new basis of accounting, based on fair values, was established for the assets and liabilities of Elmer's. Subsequent to the acquisition on August 25, 1998, the Company's financial statements reflect the combined results of operations and financial position of CBW and Elmer's based on the new basis of accounting for Elmer's and the historical cost basis of CBW. The results of operations for the year ended March 31, 1999 also reflect a minority interest in the earnings of the Company representing the separate 46.2% separate public ownership in Elmer's from August 25, 1998 through February 17, 1999. The financial position at March 31, 1999 also reflects the acquisition of GVL on that date. Prior to August 25, 1998, the financial statements of the Company include only the results of operations, financial position and cash flows of CBW, which began operations on June 16, 1995.

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The following table presents summarized quarterly results.

FISCAL 2001	Quarter 1	Quarter 2	Quarter 3	Quarter 4
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Total revenues	7,231,139	5,458,374	5,809,505	7,353,318
Operating income	605,355	513,710	363,927	386,064
Net Income	308,117	279,589	182,058	186,242
Net income per share	\$ 0.17	\$ 0.15	\$ 0.10	\$ 0.09
	=====	=====	=====	=====
FISCAL 2000				
Total revenues	7,018,838	5,110,491	5,109,326	4,940,919
Operating income	570,043	454,258	476,214	396,954
Net Income	257,059	228,236	249,733	204,520
Net income per share	\$ 0.14	\$ 0.12	\$ 0.14	\$ 0.11
	-----	-----	-----	-----

### NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

#### OVERVIEW

On August 25, 1998, CBW, Inc. purchased 53.8% of Elmer's Restaurants, Inc. then outstanding common stock from its then president and chairman, Ms. Anita Goldberg, and her brother and director, Rudolph Mazurosky. On February 18, 1999, Elmer's Restaurants, Inc. merged with CBW, Inc.

In accordance with generally accepted accounting principles, these transactions have been accounted for as a purchase of Elmer's Restaurants, Inc. by CBW, Inc. and accordingly a new basis of accounting, based on fair values, was established for the assets and liabilities of Elmer's Restaurants, Inc. The consolidated financial statements include the accounts of CBW, Inc. for the years ended March 31, 1998 and 1997 (rather than the previously reported results of Elmer's) and include the accounts of CBW, Inc. for the year ended March 31, 1999 and of Elmer's Restaurants, Inc. for the period August 31, 1998 through March 31, 1999 (with a minority interest in the income through February 17, 1999 representing the 46.2 % separate public ownership), as well as the assets and liabilities of Grass Valley Ltd., Inc., which was acquired as of March 31, 1999.

Because of the significance of these transactions, the Company believes that a discussion and analysis of the Company's results of operations in fiscal year 2001 and 2000 to pro forma results of operations for 1999, which include results of operations of Elmer's Restaurants, Inc. and Grass Valley Ltd., Inc., provides a more meaningful comparison than the discussion and analysis of prior year actual results of operations which, prior to these transactions, only



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includes the results of operations of CBW, Inc. and supplements the following highlights of historical results.

### HIGHLIGHTS OF HISTORICAL RESULTS

The Company reported record net income of approximately \$956,000, or \$.51 basic earnings per share for the year ended April 2, 2001, on sales of approximately \$25,852,000. The Company reported net income of approximately \$939,500 or

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\$.51 per share for the year ended March 31, 2000. For the year ended March 31, 1999, the Company reported net income of approximately \$290,500 or \$.30 per share.

During the year ended April 2, 2001, total assets increased approximately \$2.6 million to \$16.4 million. This increase is due primarily to the acquisition of the Mitzel's units and the new Springfield Elmer's location. At April 2, 2001, total shareholders' equity increased approximately \$1.6 million as a result of current year net income and 130,000 shares issued in conjunction with the acquisition of Mitzel's.

### COMPARISON OF FISCAL YEAR 2001 ACTUAL RESULTS TO HISTORICAL PRO FORMA RESULTS OF OPERATIONS

As discussed above, the Company believes that discussion and analysis of the Company's fiscal year 2001 and 2000 results of operations compared to 1999 on a pro forma basis, which include CBW, Inc. and Grass Valley Ltd., Inc., provides a more meaningful comparison than the discussion and analysis of reported historical actual results of operations. The following discussion and analysis presents the Company's results of operations for the year ended April 2, 2001 and March 31, 2000 with the results of operations for the year ended March 31, 1999, as if the merger of CBW, Inc. and the acquisition of Grass Valley Ltd., Inc., had occurred at the beginning of the periods after giving effect to pro forma adjustments, including amortization of goodwill, depreciation, interest expense, and related income tax effects. The pro forma information is provided for illustrative purposes and is not necessarily indicative of the combined results of operations that would have actually occurred for such periods nor does it represent a forecast of results of operations for any future periods.

Dollar amounts in thousands except per share data

Years Ended

(pro forma information is unaudited)

	April 2, 2001		March 31, 2000		
	Amount	Percent of Revenues	Amount	Percent of Revenues	
	-----	-----	-----	-----	-----
Revenue	\$25,852	100.0%	\$22,180	100.0%	\$2
Restaurant costs and expenses	17,840	69.0	15,260	68.8.0	1
General and administrative expenses	6,143	23.8	5,023	22.6	
Operating income	1,869	7.2	1,897	8.6	
Non operating income (expense)	(425)	(1.6)	(478)	(2.2)	
Net income	956	3.7	940	4.2	

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Earnings per share	\$ .51	\$ .51	
Weighted average shares outstanding	1,883,074	1,832,032	1,832,032

REVENUE	For the year ended					
	April 2, 2001		March 31, 2000		March 31, 1999	
	Amount	Percent of Revenues	Amount	Percent of Revenues	PRO FORMA Amount	Percent of Revenues
Restaurant operations:						
Restaurant sales	\$21,720	84.0%	18,625	84.0%	\$18,255	86.0%
Lottery	3,292	12.7	2,906	13.1	2,354	11.1
	25,012	96.7	21,531	97.1	20,609	97.1
Franchise operations	840	3.3	649	2.9	623	2.9
Total pro forma revenue	\$25,852	100.0%	\$22,180	100.0%	\$21,232	100.0%

REVENUES. Revenues for the year ended April 2, 2001 were 16.6% greater than for the comparable period in 2000. Same restaurant sales increased 3.6% and franchise and administrative services revenues increased 29.4% due to the sale of two

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franchise agreements and the administrative services agreement with the Yankee Grills which commenced December, 2000. Lottery revenues, as a percentage of total revenues, fell from 13.1% to 12.7%. Revenues for the year ended March 31, 2000 were 4.5% greater than the pro forma comparable period in 1999. This was due to an increase in restaurant sales of 4.5%, franchise revenues increased 4.2% and lottery revenues increased 23.5%.

RESTAURANT COSTS AND EXPENSES. As a percent of total revenue, food, beverage and supply costs were 27.5% in 2001 compared to 2000 and pro forma 1999 of 28.4% and 28.5% respectively. Labor was 31.4% of total revenue in 2001 compared to results in 2000 and pro forma 1999 of 31.9% and 31.2% respectively. Occupancy, depreciation, amortization and restaurant opening/closing expenses totaled 10.0% of revenue in 2001 compared to 2000 and pro forma results in 1999 of 8.5% and 9.0% respectively. The decrease in food, beverage and supply cost as a percentage of revenue in 2001 over 2000 is principally a result of the introduction of the new menu and "outsert" items, an increase in customer check average, and in-restaurant training, promotions and development. The decrease in labor as a percentage of revenue in 2001 over fiscal year 2000 is driven by improved operating efficiencies, partly offset by an increase in minimum wages rates in Washington. The Company's slight increase in labor as a percentage of revenues in 2000 compared to pro forma 1999 was driven by an increase in the Company's average wage rate resulting from significant increases in both Oregon

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and Washington minimum wage rates. Washington's minimum wage rate increased 10.7% on January 1, 1999 from \$5.15 to \$5.70. Washington state minimum wage was increased another 14% on January 1, 2000 (matching Oregon's \$6.50 per hour rate). Washington state minimum wage is now indexed to inflation and will be adjusted annually. The increase in occupancy, depreciation, amortization and restaurant opening/closing expenses as a percentage of revenues in 2001 over 2000 is primarily due to the costs of opening the Springfield Elmer's, closing the Tacoma Mitzel's and incremental depreciation on the prior year's capital expenditures.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses were 23.9% of total revenue in 2001 compared to 2000 of 22.6% and pro forma results of 22.9% in 1999. The increase in general and administrative costs as a percentage of revenues reflects the impact of integration expenses related to the Mitzel's restaurant acquisition and increased marketing expenditures for those restaurants.

PRO FORMA NON OPERATING INCOME (EXPENSES). This primarily reflects net interest expenses that were 1.6% of total revenues in 2001 compared to fiscal year 2000 and pro forma results in 1999 of 2.2% and 2.4% respectively. The reduction in net interest expense as a percentage of pro forma revenues is the result of increased revenues and increased interest income.

### LIQUIDITY AND CAPITAL RESOURCES

As of April 2, 2001, the Company had cash and equivalents of approximately \$1,141,000 representing a decrease of approximately \$499,000. The decrease resulted from cash provided by operations totaling approximately \$1,720,000, cash provided by financing activities of approximately \$671,000 and less cash used in investing activities of approximately \$2.9 million. Cash provided by financing is \$1.3 million in new convertible notes less principal payments on term debt. Cash used in investing activities was the result of additions to property, buildings, equipment and intangibles. In addition to the regular replacement of depreciating restaurant assets, cash used in investing activities included the acquisition on the five Mitzel's units and the acquisition and remodel of the Springfield Elmer's.

December 2000 the Company issued \$1.3 million in convertible notes to finance the Mitzel's acquisition. The seven year notes bear interest at 10%, and are convertible to common stock after six months at \$6.50 per share. The Company may call the notes after 3 years at premiums of between one and five percent, depending on the remaining term. Interest-only payments are made to the holder and \$13,690 per month is paid into a sinking fund. The notes are unsecured and subordinate to the Company's senior secured debt held by Wells Fargo Bank.

The Company's primary liquidity needs arise from debt service on indebtedness incurred in connection with the merger of CBW, Inc., operating lease requirements and the funding of capital expenditures. As of April 2, 2001, the Company had outstanding indebtedness for borrowed money of \$1.6 million under a term loan facility and \$2.2 million in real estate loan facilities with Wells Fargo Bank and \$1.25 million under a term loan facility with Eagle's View Management, assumed at the time of the merger with CBW, Inc. The Wells Fargo loans have a weighted-average maturity of 9 years, bear interest at an average of 8.25%, require monthly payments of principal and interest, are collateralized by substantially all of the assets owned by Elmer's Restaurants, Inc. and impose certain financial restrictions and covenants, the most restrictive of which, require the Company to maintain a maximum of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 4.0 to 1.0. In addition, effective September 30, 1999, and thereafter on a trailing four quarter basis as of the end of each fiscal quarter, the Company will be required to maintain a ratio of cash generation (defined as net income before taxes, interest expense, depreciation and amortization) to total interest expense plus

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the prior period current maturities of long-term debt of at least 2.25 to 1.0. The Company was in compliance with this covenant at April 2, 2001. The Company has available a \$250,000 line of credit with Wells Fargo Bank through September 1, 2001, which is secured by substantially all assets of the Company

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excluding real estate. Interest on the unpaid balance accrues at a rate of prime plus 1%. The prime rate at April 2, 2001 was 8.25%. There was no amount outstanding at April 2, 2001.

The Eagle's View Management loan has a maturity of approximately three years, an interest rate of 15%, requires monthly payments of interest only, and is secured by a second position on substantially all the assets owned by Elmer's Restaurants, Inc. and does not impose financial covenants upon the Company. The Company plans to complete the early pay off of the \$1.6 million Wells Fargo term loan and the \$1.25 million Eagles View Management loan in the first quarter of fiscal year 2002. The Company anticipates financing the pay down with long term senior secured debt.

The Company's primary source of liquidity during the year was the operation of the restaurants, franchise fees earned from its franchisees, internal cash and borrowings as discussed above.

In the future, the Company's liquidity and capital resources will depend primarily on the operations of Elmer's Restaurants, Inc., CBW, Inc. and Grass Valley Ltd., Inc. which, under the provisions of the Company's loan agreements, would permit, under certain conditions, distributions and dividends to the Company's shareholders and early reduction of the Eagle's View Management indebtedness. Elmer's Restaurants, Inc., CBW, Inc. and Grass Valley Ltd., Inc., like most restaurant businesses, are able to operate with nominal or deficit working capital because sales are for cash and inventory turnover is rapid. Renovation and/or remodeling of existing restaurants is either funded directly from available cash or, in some instances, is financed through outside lenders. Construction or acquisition of new restaurants is generally, although not always, financed by outside lenders.

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

### INFLATION

Certain of the Company's operating costs are subject to inflationary pressures, of which the most significant are food and labor costs. As of April 2, 2001, a significant percentage of the Company's employees were paid wages equal to or based on the state minimum hourly wage rates. Economic growth that would reduce unemployment or make more jobs available in higher paying industries could directly affect the Company's labor costs. The Company believes that inflation has not had a material impact on its results of operations for fiscal 2001, fiscal 2000 or fiscal 1999. Substantial increases in costs could have a significant impact on the Company and the industry. If operating expenses increase, management believes it can recover increased costs by increasing prices to the extent deemed advisable considering competition.

### SEASONALITY

The seasonality of restaurant sales due to consumer spending habits can be significantly affected by the timing of advertising, competitive market conditions and weather-related events. While restaurant sales for certain

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quarters can be stronger, or weaker, there is no predominant pattern.

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

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

CERTAIN STATEMENTS IN THIS FORM 10-K UNDER "ITEM 1. BUSINESS," "ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" AND ELSEWHERE IN THIS FORM 10-K CONSTITUTE "FORWARD-LOOKING STATEMENTS" WHICH WE BELIEVE ARE WITHIN THE MEANING OF THE SECURITIES ACT OF 1933, AS AMENDED AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS, UNCERTAINTIES, AND OTHER FACTORS WHICH MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE, OR ACHIEVEMENTS OF ELMER'S RESTAURANTS, INC. (INDIVIDUALLY AND COLLECTIVELY WITH ITS SUBSIDIARIES, HEREIN THE "COMPANY") TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE, OR ACHIEVEMENTS EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. SUCH FACTORS INCLUDE, AMONG OTHERS, THE FOLLOWING: GENERAL ECONOMIC AND BUSINESS CONDITIONS; THE IMPACT OF COMPETITIVE PRODUCTS AND PRICING; SUCCESS OF OPERATING INITIATIVES; DEVELOPMENT AND OPERATING COSTS; ADVERTISING AND PROMOTIONAL EFFORTS; ADVERSE PUBLICITY; ACCEPTANCE OF NEW PRODUCT OFFERINGS; CONSUMER TRIAL AND FREQUENCY; AVAILABILITY, LOCATIONS, AND TERMS OF SITES FOR RESTAURANT DEVELOPMENT; CHANGES IN

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BUSINESS STRATEGY OR DEVELOPMENT PLANS; QUALITY OF MANAGEMENT; AVAILABILITY, TERMS AND DEPLOYMENT OF CAPITAL; THE RESULTS OF FINANCING EFFORTS; BUSINESS ABILITIES AND JUDGMENT OF PERSONNEL; AVAILABILITY OF QUALIFIED PERSONNEL; FOOD, LABOR AND EMPLOYEE BENEFIT COSTS; CHANGES IN, OR THE FAILURE TO COMPLY WITH, GOVERNMENT REGULATIONS; IMPACT OF YEAR 2001; CONTINUED NASDAQ LISTING; WEATHER CONDITIONS; CONSTRUCTION SCHEDULES; AND OTHER FACTORS REFERENCED IN THIS FORM 10-K.

The Company holds no financial instruments of any kind for trading purposes. Certain of the Company's outstanding financial instruments are subject to market risks, including interest rate risk. Such financial instruments are not currently subject to foreign currency risk or commodity price risk. The Company's major market risk exposure is potential loss arising from changing interest rates and the impact of such changes on its long-term debt. Of the Company's long-term debt outstanding at April 2, 2001, \$808,000 was accruing interest at a variable rate of LIBOR plus 2.25%. A rise in prevailing interest rates could have adverse effects on the Company's financial condition and results of operations.

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

Fiscal Year	2002	2003	2004	2005	Total	Fair Value
Variable rate debt	236.4	236.4	236.4	98.2	808.4	808.4
Average interest rate	7.25%	7.25%	7.25%	7.25%		
2.25% above LIBOR						

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

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

PricewaterhouseCoopers LLP 's reports on the financial statements for the years ended March 31, 2000 and 1999, contained no adverse opinion nor disclaimer of opinion, nor were such reports qualified or modified as to uncertainty, audit scope, or accounting principles. During the fiscal years ended March 31, 2000 and 1999, and during the interim period between April 1, 2000, and April 17, 2001, there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction PricewaterhouseCoopers LLP, would have caused it to make a reference to the subject matter of the disagreements in connection with its reports.

### PART III

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

Information with respect to directors of the Company is included under the caption "Election of Directors" in the Company's definitive proxy statement (the "2001 Proxy Statement") for its 2001 Annual Meeting of Shareholders filed or to be filed not later than 120 days after the end of the fiscal year covered by this Report and is incorporated herein by reference. Information with respect to executive officers of the Company is included under Item 4(a) of Part I of this Report. Information with respect to compliance with Section 16(a) of the Securities Exchange Act is included under "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2001 Proxy Statement.

#### ITEM 11. EXECUTIVE COMPENSATION

Information with respect to executive compensation is included under the caption "Executive Compensation" in the 2001 Proxy Statement is incorporated herein by reference.

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

Information with respect to security ownership of certain beneficial owners and management is included under the caption "Voting Securities and Principal Shareholders" and "Election of Directors" in the 2001 Proxy Statement incorporated herein by reference.

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

Information with respect to certain relationships and related transactions with management is included under the caption "Certain Transactions" in the 2001 Proxy Statement and is incorporated herein by reference.

### PART IV

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

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

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(a) (1) Financial Statements and Schedules	Page in this Report -----
Reports of Independent Accountants.....	F-1
Consolidated Balance Sheets at April 2, 2001 and March 31, 2000.....	F-3
Consolidated Statements of Operations for the years ended April 2, 2001, March 31, 2000 and 1999.....	F-4
Consolidated Statements of Changes in Shareholders' Equity for the years ended April 2, 2001, March 31, 2000 and 1999.....	F-5
Consolidated Statements of Cash Flows For the years ended April 2, 2001, March 31, 2000 and 1999.....	F-6
Notes to Consolidated Financial Statements.....	F-7

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

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SIGNATURES

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

Elmer's Restaurants, Inc.

By: WILLIAM W. SERVICE  
-----  
William W. Service  
Chief Executive Officer

Dated: June 29, 2001

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

SIGNATURE

TITLE

DATE

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----- /s/ Bruce N. Davis ----- Bruce N. Davis	----- Chairman of the Board & President	----- June 29, 2001
----- /s/ William W. Service ----- William W. Service	----- Chief Executive Officer & Director (Principal Executive & Financial Officer)	----- June 29, 2001
----- /s/ Thomas C. Connor ----- Thomas C. Connor	----- Director	----- June 29, 2001
----- /s/ Corydon H. Jensen ----- Corydon H. Jensen	----- Director	----- June 29, 2001
----- /s/ Richard Williams ----- Richard Williams	----- Director	----- June 29, 2001
----- /s/ Donald Woolley ----- Donald Woolley	----- Director	----- June 29, 2001

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REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of changes in shareholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of Elmer's Restaurants, Inc. and Subsidiaries (the Company) at March 31, 2000, and the results of their operations and their cash flows for the years ended March 31, 2000 and 1999 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



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PricewaterhouseCoopers LLP

Portland, Oregon  
May 23, 2000

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INDEPENDENT AUDITOR'S REPORT

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

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

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Elmer's Restaurants, Inc. and Subsidiaries as of April 2, 2001, and the results of their operations and their cash flows for the year then ended in conformity with generally accepted accounting principles.

MOSS ADAMS LLP

Portland, Oregon  
May 25, 2001

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ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
April 2, 2001 and March 31, 2000

	April 2, 2001	March 31, 2000
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,141,016	\$ 1,640,210
Accounts receivable	337,266	199,466

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Notes receivable - related parties, current portion	180,213	--
Inventories	368,059	339,654
Prepaid expenses and other	237,681	276,604
Income taxes receivable	61,625	--
	-----	-----
Total current assets	2,325,860	2,455,934
Notes receivable - related parties, net of current portion	203,045	--
Property, buildings and equipment, net	8,441,867	6,892,844
Intangible assets, net of accumulated amortization of \$362,244 and \$194,325	5,280,714	4,390,471
Other assets	122,661	107,959
	-----	-----
Total assets	\$ 16,374,147	\$ 13,847,208
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable, current portion	\$ 569,327	\$ 572,399
Accounts payable	1,389,195	772,174
Accrued expenses	209,821	448,803
Accrued payroll and related taxes	390,825	218,728
Accrued income taxes	--	279,770
	-----	-----
Total current liabilities	2,559,168	2,291,874
Notes payable, net of current portion	5,798,769	5,124,130
Deferred income taxes	772,000	793,000
	-----	-----
Total liabilities	9,129,937	8,209,004
	-----	-----
Commitments and contingencies (Note 6)		
Shareholders' equity		
Common stock, no par value; 10,000,000 shares authorized, 1,962,032 and 1,665,548 shares issued and outstanding at April 2, 2001 and March 31, 2000 respectively	6,871,190	5,242,264
Retained earnings	373,020	395,940
	-----	-----
Total shareholders' equity	7,244,210	5,638,204
	-----	-----
Total liabilities and shareholders' equity	\$ 16,374,147	\$ 13,847,208
	=====	=====

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

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ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
For the years ended April 2, 2001, March 31, 2000 and 1999

	FOR THE YEARS ENDED		
	APRIL 2, 2001	MARCH 31, 2000	MARCH 31, 1999
	-----	-----	-----
REVENUES	\$ 25,852,336	\$ 22,179,574	\$ 11,952,728
	-----	-----	-----

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### COSTS AND EXPENSES:

#### Cost of restaurant sales:

Food and beverage	7,121,428	6,298,727	3,406,602
Labor and related costs	8,126,818	7,082,100	3,735,043
Occupancy costs	1,706,692	1,248,224	741,078
Depreciation and amortization	745,744	630,089	341,170
Restaurant opening/closing expenses	139,909	--	--
General and administrative expenses	6,142,689	5,022,965	2,683,534

	23,983,280	20,282,105	10,907,427
--	------------	------------	------------

	1,869,056	1,897,469	1,045,301
--	-----------	-----------	-----------

### OTHER INCOME (EXPENSE):

Interest income	138,845	91,314	18,545
Interest expense	(591,311)	(570,334)	(458,804)
Gain on disposition of assets	27,528	1,100	6,477

	1,444,118	1,419,549	611,519
--	-----------	-----------	---------

Income tax provision	(488,112)	(480,000)	(185,000)
----------------------	-----------	-----------	-----------

	956,006	939,549	426,519
--	---------	---------	---------

Minority interest	--	--	(136,007)
-------------------	----	----	-----------

	\$ 956,006	\$ 939,549	\$ 290,512
--	------------	------------	------------

### PER SHARE DATA:

Net income per share - Basic	\$ 0.51	\$ 0.51	\$ 0.30
------------------------------	---------	---------	---------

Weighted average number of common shares outstanding - Basic	1,883,074	1,832,032	968,563
---	-----------	-----------	---------

Net income per share - Diluted	\$ 0.50	\$ 0.50	\$ 0.30
--------------------------------	---------	---------	---------

Weighted average number of common shares outstanding - Diluted	1,917,936	1,881,376	968,563
---	-----------	-----------	---------

### PRO FORMA INCOME TAX INFORMATION

Income before provision for income taxes	611,519
Provision for income taxes	(211,000)
Minority interest	(136,007)

	264,512
--	---------

	\$ 0.27
--	---------

	\$ 0.27
--	---------

Shares used in per share calculation Basic	968,563
---	---------

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Diluted

968,563

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

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ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY (DEFICIT)  
For the years ended April 2, 2001, March 31, 2000 and 1999

	Common Stock		Retained
	Shares	Amount	(accumulat
	-----	-----	-----
Balance March 31, 1998	770,500	\$ 295,020	\$ (29
Capital contributions		600,000	
Dividend distributions			(4
Issuance of common stock in conjunction with merger	606,109	2,803,000	
Issuance of common stock in conjunction with acquisition of Grass Valley Ltd., Inc.	209,620	1,048,500	
Net income	--	--	29
	-----	-----	-----
Balance, March 31, 1999	1,586,229	4,746,520	(4
5% stock dividend (November 30, 1999)	79,319	495,744	(49
Net income	--	--	93
	-----	-----	-----
Balance, March 31, 2000	1,665,548	5,242,264	39
10% stock dividend (August 18, 2000)	166,484	978,926	(97
Issuance of common stock in conjunction with acquisition of Mitzel's American Kitchen restaurants	130,000	650,000	
Net income	--	--	95
	-----	-----	-----
Balance, April 2, 2001	1,962,032	\$6,871,190	\$ 37
	=====	=====	=====

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

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ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the years ended April 2, 2001, March 31, 2000 and 1999

	FOR THE YEARS ENDED		
	APRIL 2, 2001	MARCH 31, 2000	MARCH 1999
Cash flows from operating activities:			
Net income	\$ 956,006	\$ 939,549	\$ 290,000
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	745,744	630,089	341,000
Deferred income taxes	(21,000)	20,000	(7,000)
Gain on disposition of assets	(27,528)	(1,100)	(6,000)
Minority Interest	136,007		
Changes in assets and liabilities:			
Current assets	(127,282)	5,016	162,000
Other assets	(14,702)	20,942	(41,000)
Accounts payable and accrued expenses	550,136	140,614	(51,000)
Income taxes	(341,395)	387,002	(130,000)
Net cash provided by operating activities	1,719,979	2,142,112	694,000
Cash flows from investing activities:			
Additions to property, buildings and equipment	(1,597,233)	(527,165)	(217,000)
Additions to intangible assets	(1,052,249)		
Business acquisition, net of cash acquired			(3,438)
Issuance of note receivable	(275,000)		
Principal collected on note receivables	33,742		
Proceeds from sale of assets		1,100	20,000
Net cash used in investing activities	(2,890,740)	(526,065)	(3,635,000)
Cash flows from financing activities:			
Proceeds from issuance of notes payable			7,092
Capital contribution			600
Issuance of 10% convertible notes	1,300,000		
Payments on notes payable	(628,433)	(579,409)	(4,145)
Distributions			(44,000)
Net cash provided by (used in) financing activities	671,567	(579,409)	3,502
Net increase (decrease) in cash and cash equivalents	(499,194)	1,036,638	561,000
Cash and cash equivalents, beginning of period	1,640,210	603,572	42,000

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Cash and cash equivalents, end of period	\$1,141,016	\$1,640,210	\$ 603
	=====	=====	=====
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	\$ 591,311	\$ 582,887	422
	=====	=====	=====
Income taxes	\$ 850,507	\$ 73,000	467
	=====	=====	=====
Supplemental disclosures of non-cash transactions:			
Sale of equipment for note receivable	\$ 142,000		
	=====		
Shares issued in conjunction with Mitzel's restaurants acquisition	650,000		
	=====		
Stock dividends declared	\$ 988,915	\$ 495,744	
	=====	=====	

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

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

#### 1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### THE COMPANY

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

On December 13, 2000, the Company acquired six Mitzel's American Kitchen restaurants for \$975,000 in cash and 130,000 shares of common stock. This transaction was accounted for by the purchase method of accounting.

On August 25, 1998, CBW, Inc. (CBW) acquired a controlling interest (705,000 shares representing 53.8% of the outstanding stock) of the then outstanding common stock of Elmer's Restaurants, Inc. (Elmer's) for \$4,500,000. On February 18, 1999, CBW merged with and into Elmer's. Pursuant to the terms of the merger, Elmer's Restaurants, Inc. and Subsidiaries was the surviving corporation. The merger was consummated by Elmer's issuance of 770,500 shares of Elmer's restricted common stock to CBW shareholders in exchange for the 705,000 shares previously acquired. In connection with the merger, Elmer's assumed approximately \$4 million in debt owed by CBW arising from CBW's acquisition of the controlling block of stock on August 25, 1998. These transactions were accounted for as a purchase of Elmer's by CBW, and accordingly a new basis of accounting, based on fair values, was established for the assets and liabilities of Elmer's. Elmer's entered into a new financing agreement whereby it borrowed funds to refinance existing debt and debt of CBW totaling approximately \$1,750,000. Elmer's also used existing cash to reduce debt by approximately \$1,000,000. Each CBW shareholder received 144.4507 shares of Elmer's restricted common stock for every CBW share owned.

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On March 31, 1999, the Company acquired Grass Valley Ltd., Inc. (GVL), which is the owner and operator of four delicatessen-style restaurants operating under the name of Richard's Deli and Pub located in Oregon (see Note 9).

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of CBW for the years ended April 2, 2001 and March 31, 2000 and 1999, Elmer's from August 31, 1998 (the results of operations of Elmer's from August 25, 1998 to August 31, 1998 is not material to the results of operations of the Company), and Grass Valley Ltd., Inc., Elmer's wholly-owned subsidiary, from March 31, 1999. All material intercompany accounts and transactions have been eliminated. The minority interest included in the 1999 consolidated financial statements represents the 46.2% separate public ownership in Elmer's from August 31, 1998 through February 17, 1999.

### USE OF ESTIMATES

The preparation of the consolidated financial statements in conformity with accounting

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

principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates and assumptions.

### CHANGE IN REPORTING PERIODS

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

### DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments including cash and cash equivalents and accounts receivable approximated fair value as of April 2, 2001 and March 31, 2000 because of the relatively short maturity of these instruments. The carrying value of notes receivable approximated fair value as of April 2, 2001 and March 31, 2000 based upon interest rates and terms available for similar investments. The carrying value of notes payable approximated fair value as of April 2, 2001 and March 31, 2000 based upon interest rates and terms available for the same or similar loans.

### CASH AND CASH EQUIVALENTS

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

The Company invests its excess cash in interest bearing deposits with major banks and in U.S. Treasury securities. These investments mature within 90 days and are therefore subject to minimal risk. Management routinely reviews these investments in order to limit the amount of credit exposure to any one financial institution.

### CONCENTRATIONS OF CREDIT RISK

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Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash deposits. The Company places its cash deposits with federally insured financial institutions. As of April 2, 2001, the Company's deposits were in excess of the federal insurance limits.

### INVENTORIES

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

### PROPERTY, BUILDINGS AND EQUIPMENT

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

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

subject to depreciation, the related costs and accumulated depreciation are removed and resulting gains and losses are reflected in the consolidated statements of operations.

### INTANGIBLE ASSETS

The excess of cost over fair value of net tangible assets of acquired companies (goodwill) and trademarks are amortized on a straight-line basis over 30 years.

### RECOVERABILITY OF LONG-LIVED ASSETS

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

### ADVERTISING

Advertising and promotion costs are expensed as incurred. Advertising and promotion expenses were \$406,987, \$274,675 and \$131,752 for the years ending April 2, 2001 and March 31, 2000 and 1999, respectively.

### INTEREST RATE SWAP AGREEMENT

The Company entered into an interest rate swap agreement with a bank to reduce the impact of changes in interest rates on a portion of its floating rate long-term debt. The agreement effectively changes the Company's interest rate exposure on the covered portion to a fixed percentage. The interest rate swap agreement expires on March 1, 2002.

### FRANCHISE OPERATIONS

Initial license fees from individual and area franchise sales are recognized as revenue when substantially all of the terms and conditions of the franchise agreement are met. Elmer's has sold area franchises to several restaurant operators in various western states. The terms of the agreements entered into with each franchisee protect the territory for the operator and provide standard building blueprints, recipes, formulas and methods of food preparation. The term of the franchise is generally 25 years. Continuing franchise fees (based on a



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percentage of sales) are recognized as revenue when earned.

### INCOME TAXES

CBW was treated for federal income tax purposes as an S corporation under Subchapter S of the Internal Revenue Code of 1986, as amended and comparable state tax laws from May 22, 1997 through February 17, 1999. During that period, CBW's earnings were taxed directly to CBW's shareholders, at their individual federal and state income tax rates, rather than to the Company. Since February 17, 1999, the Company has been treated for income tax purposes as a corporation.

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

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

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

### NET INCOME PER SHARE

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

All references to share and per share information have been adjusted to give effect to the 770,500 shares of restricted common stock issued by Elmer's in connection with the merger of CBW on February 18, 1999 with and into Elmer's as described above, the 5% stock dividend declared on November 30, 1999 and the 10% stock dividend declared on August 18, 2000.

### RECLASSIFICATION

A reclassification has been made to the consolidated financial statements for the year ended March 31, 2000 to transfer the fair value of shares issued in the November 30, 1999 5% stock dividend from retained earnings to common stock. The effect of the reclassification was to decrease retained earnings and increase common stock as of March 31, 2000 by \$495,744.

This reclassification has no effect on previously reported net income or earnings per share.

Certain other amounts in the 2000 and 1999 consolidated financial statements have been reclassified to conform to the 2001 presentation. Net income and cash flows were not affected by the reclassifications.

### IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

The Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 130, REPORTING COMPREHENSIVE INCOME, which establishes requirements for disclosure of comprehensive income. The objective of SFAS No. 130 is to report a measure of all changes in equity that result from transactions and economic events other than transactions with owners. Comprehensive income is the total of net income and all other non-owner changes in equity. Comprehensive income did not differ significantly from

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reported net income in the periods presented.

The Company has also adopted FASB issued SFAS No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION. This statement changes the way public companies report information about segments of their business in their annual financial statements and requires selected segment information in quarterly reports issued to shareholders. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues, and its major customers.

In June 1998, the FASB issued SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 also requires that changes in the derivative instrument's fair value be recognized currently in results of operations unless specific hedge

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

accounting criteria are met. SFAS No. 133, as amended by SFAS No. 137, is effective for fiscal years beginning after June 15, 2000. The Company's management has studied the implications of SFAS 133 and expects the adoption to have no impact on the Company's financial condition or results of operations.

In December 1999, the Securities and Exchange Commission (SEC) released Staff Accounting bulletin (SAB) 101 REVENUE RECOGNITION IN FINANCIAL STATEMENTS. SAB 101 establishes guidelines in applying generally accepted accounting principles to the recognition of revenue in financial statements based on the following four criteria: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectibility is reasonably assured. SAB 101, as amended by SAB 101A, is effective no later than the first fiscal quarter of the fiscal year beginning after December 15, 1999. The Company expects SAB 101 and SAB 101A to have no material effect on the Company's revenue recognition process.

#### UNAUDITED PRO FORMA FINANCIAL INFORMATION

As more fully described in Note 4, CBW has been taxed for federal and state income tax purposes as an S corporation for certain periods in the years ended March 31, 1999. The unaudited pro forma information reflects provisions for income taxes that would have been recorded had CBW been a taxed as a corporation for all periods presented.

#### 2. NOTES RECEIVABLE - RELATED PARTIES

Notes receivable consist of the following at April 2, 2001:

Notes receivable bearing interest at 10.5%, due on or before January 1, 2002, secured by a stock pledge agreement for 15,000 shares of Elmer's Restaurants, Inc. common stock	\$76,199
Note receivable bearing interest at 8% due on or before October 15, 2002, secured by franchise agreement and restaurant furniture, fixtures and equipment	115,124
Note receivable bearing interest at 10% due on or before March 15, 2003, secured by a stock pledge agreement for 50,000 shares of Elmer's Restaurants. Inc. common stock	191,935

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	-----
	383,258
Less current portion	180,213
	-----
Notes receivable net of current portion	\$203,045
	=====

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

3. PROPERTY, BUILDINGS AND EQUIPMENT

	APRIL 2, 2001	MARCH 31, 2000
	-----	-----
Land	\$2,246,700	\$2,246,700
Buildings	1,911,903	1,894,204
Furniture, fixtures and equipment	3,508,920	2,676,821
Leasehold improvements	2,117,301	894,471
Automobiles	23,409	16,932
	-----	-----
	9,808,233	7,729,128
Less accumulated depreciation and amortization	(1,366,366)	(836,284)
	-----	-----
	\$8,441,867	\$6,892,844
	=====	=====

Depreciation expense charged to operations was \$598,927, \$484,204, \$292,730 for the years ending April 2, 2001 and March 31, 2000 and 1999 respectively.

4. INCOME TAXES

CBW was treated for federal income tax purposes as an S corporation under Subchapter S of the Internal Revenue Code of 1986, as amended, since May 22, 1997 (and was a limited liability company from organization to that date) and was treated as an S corporation for state income tax purposes under comparable state tax laws. As a result, CBW's earnings through February 17, 1999 have been taxed directly to CBW shareholders, at their individual federal and state income tax rates, rather than to the Company.

The earnings of Elmer's from August 31, 1998 through February 17, 1999 are taxed as a taxable corporation. Effective with the merger of CBW with and into Elmer's (see Note 9), on February 18, 1999 (Termination date) CBW's S corporation status terminated. Subsequent to the Termination date, the Company has been treated as a corporation for federal and state tax purposes.

The provision for income taxes has been computed in accordance with SFAS No. 109 ACCOUNTING FOR INCOME TAXES, as if the Company had been a taxable corporation for all periods presented (information with respect to the year ended March 31, 1999 is unaudited pro forma information):

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

	YEARS ENDED		
	APRIL 2, 2001	MARCH 31, 2000	MARCH 31, 1999
Current:			
Federal	\$ 419,112	\$ 400,000	\$ 160,000
State	90,000	60,000	34,000
	509,112	460,000	194,000
Deferred income taxes	(21,000)	20,000	17,000
	\$ 488,112	\$ 480,000	\$ 211,000
	=====	=====	=====

A reconciliation of the federal income tax rate to the Company's effective income tax rate is as follows (information with respect to the year ended March 31, 1999 is unaudited pro forma information):

	APRIL 2, 2001	MARCH 31, 2000	MARCH 31, 1999
	-----	-----	-----
			(UNAUDITED PRO FORMA)
Federal income tax at statutory rate	34.0%	34.0%	34.0%
State income taxes, net of federal income tax benefit	3.6	3.9	3.5
Non deductible expenses	2.9	1.9	1.2
Federal income tax credits	(6.7)	(6.0)	(4.3)
	-----	-----	-----
	33.8%	33.8%	34.4%
	=====	=====	=====

The income tax provision of \$185,000 for the year ended March 31, 1999 relates to the results of operations of Elmer's from August 31, 1998 through February 17, 1999 and the results of operations of the Company from February 18, 1999 through March 31, 1999.

Deferred income taxes are the result of provisions in the tax laws that either require or permit certain items of income or expense to be reported for income tax purposes in different periods than they are reported for financial reporting. As of April 2, 2001 and March 31, 2000, the deferred tax liability of

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\$772,000 and \$793,000 respectively, primarily represents the difference between the book basis of property, buildings equipment and intangibles and the related tax basis of approximately \$2,270,000 and \$2,300,000, respectively.

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

5. NOTES PAYABLE

	APRIL 2, 2001	MARCH 31, 2000
	-----	-----
Note payable to financial institution, payable in monthly principal installments of \$34,900 plus interest at varying rates as follows: On 50% of the outstanding balance - interest fixed at 8.04%, based on contractual interest rate swap agreement On 50% of the outstanding balance - variable interest rate of LIBOR plus 2.25% adjusted monthly (7.25% at April 2, 2001) Matures September 2004; secured by real estate and all assets of the Company	\$1,615,150	\$2,127,271
Note payable to financial institution, principal and interest due monthly at 8.15%, matures March 2009; secured by real estate and all assets of the Company	444,364	464,325
Note payable to financial institution, principal and interest due monthly at 8.18%, matures January 2011; secured by real estate and all assets of the Company	1,194,538	1,238,241
Note payable to financial institution, principal and interest due monthly at 8.25%, matures February 2008; secured by real estate and all assets of the Company	555,335	581,617
Note payable to financing company, interest payable due monthly at 15%; subordinated, principal balance due February 2004	1,250,000	1,253,402
Note payable to individual, principal and interest due monthly at 10%; secured by stock of a subsidiary	8,709	31,673
Convertible notes payable, private placement, interest payable monthly at 10%; convertible to common stock at \$6.50 per share; principal due December 2007	1,300,000	-----
	-----	-----
Total long-term debt	6,368,096	5,696,529

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Less current portion	569,327	572,399
	-----	-----
Net of current portion	\$5,798,769	\$5,124,130
	=====	=====

Certain notes payable contain restrictive covenants pertaining to financial ratios and minimum cash flow coverage. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 4.0 to 1.0, and a ratio of cash generation (defined as net income before

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

taxes, interest expense, depreciation and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.25 to 1.0.

The Company has available with a financial institution a \$250,000 line of credit, which matures September 1, 2001, and is secured by substantially all assets of the Company excluding real estate. Interest on the unpaid balance accrues at a rate of prime plus 1%. The prime rate at April 2, 2001 was 8.0%. There were no balances outstanding on the line at April 2, 2001 and March 31, 2000.

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

2002	\$ 569,327
2003	570,655
2004	1,827,392
2005	309,754
2006	121,811
Thereafter	2,969,157
	-----
	\$6,368,096
	=====

All interest costs incurred during the years ended April 2, 2001 and March 31, 2000 and 1999 have been expensed during the respective periods.

6. COMMITMENTS AND CONTINGENCIES

The Company leases certain facilities under operating lease agreements. Minimum fiscal year rental commitments for the year ending April 2, 2001 for property, buildings and equipment with non-cancelable terms of more than one year are:

2002	\$1,262,867
2003	1,236,321
2004	1,210,181
2005	1,157,486
2006	916,528
Thereafter	2,278,499
	-----
	\$8,061,882
	=====

The leases generally provide for additional rentals based upon a specified percentage of sales and require the Company to pay certain other costs. Rental

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expense on operating leases amounted to approximately \$1,431,000, \$884,000, \$848,000 for the years ending April 2, 2001 and March 31, 2000 and 1999, respectively.

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

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

### 7. RELATED PARTY TRANSACTIONS

Jaspers Food Management, Inc. (JFMI), is an privately held restaurant management company. Certain officers and directors hold a majority interest in JFMI. Amounts outstanding with JFMI are as follows:

	APRIL 2, 2001 -----	MARCH 31, 2000 -----
Accounts receivable	\$ 26,364	\$ 3,148

Accounts payable and other liabilities due to the affiliate are due on demand and accrue interest at an annual rate of 10.5% based on the outstanding balance over 28 days.

Transactions applicable to the affiliate were approximately as follows:

	APRIL 2, 2001 -----	MARCH 31, 2000 -----	MARCH 31, 1999 -----
Interest expense	-	-	\$ 14,000
Labor and related expenses	\$930,000	\$903,000	\$452,000

Under the terms of a management services agreement, the affiliate provides substantially all store labor, management, accounting, human resources, training and other administrative services related to the operation of the six Ashley's Deli and four Richard's Deli and Pub restaurants as disclosed in labor and related expenses above.

Included in accounts receivable at April 2, 2001 is a note receivable from a franchisee in the amount of \$20,735.

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

8. RESTAURANT AND FRANCHISE OPERATIONS

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

	APRIL 2, 2001	MARCH 31, 2000	MARCH 31, 1999
	-----	-----	-----
Revenues:			
Restaurant operations	\$ 25,011,807	\$ 21,404,597	\$ 11,591,646
Franchise operations	840,529	774,977	361,082
	-----	-----	-----
Consolidated	\$ 25,852,336	\$ 22,179,574	\$ 11,952,728
	=====	=====	=====
Income from operations:			
Restaurant operations	\$ 1,731,667	\$ 1,620,632	\$ 649,753
Franchise operations	137,389	276,837	395,548
	-----	-----	-----
Consolidated	\$ 1,869,056	\$ 1,897,469	\$ 1,045,301
	=====	=====	=====
Capital and intangible expenditures:			
Restaurant operations	\$ 3,206,615	\$ 493,333	\$ 191,748
Franchise operations	92,867	33,832	25,767
	-----	-----	-----
Consolidated	\$ 3,299,482	\$ 527,165	\$ 217,515
	=====	=====	=====
Depreciation and amortization:			
Restaurant operations	\$ 692,755	\$ 561,440	\$ 261,635
Franchise operations	52,989	68,649	79,535
	-----	-----	-----
Consolidated	\$ 745,744	\$ 630,089	\$ 341,170
	=====	=====	=====
Assets:			
Restaurant operations	\$ 15,246,621	\$ 12,495,871	\$ 11,571,468
Franchise operations	1,127,526	1,351,337	1,475,216
	-----	-----	-----
Consolidated	\$ 16,374,147	\$ 13,847,208	\$ 13,046,684
	=====	=====	=====

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

APRIL 2, 2001	MARCH 31, 2000	MARCH 31, 1999
------------------	-------------------	-------------------



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	-----	-----	-----
Company owned stores	26	21	20
Operating franchises	19	18	18

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

9. ACQUISITIONS AND MERGER

ACQUISITION OF SIX MITZEL'S AMERICAN KITCHEN RESTAURANTS.

Effective December 13, 2000 Elmer's Restaurants, Inc. (the "Company") executed an asset purchase agreement with the owners of six Mitzel's American Kitchen restaurants, acquiring substantially all the assets of those locations for \$975,000 in cash and issuance of 130,000 shares of the Company's restricted common stock. These locations are wholly owned by and operated as a division of the Company. The acquisition was recorded as a purchase and the excess of the acquisition cost over fair value of the tangible assets acquired was allocated to goodwill. The total cost of the acquisition was as follows:

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

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

ACQUISITION OF SPRINGFIELD RESTAURANT

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

CBW ACQUISITION OF AND MERGER WITH ELMER'S

On August 25, 1998, CBW acquired a controlling interest (705,000 shares representing 53.8% of the outstanding stock) in Elmer's for \$4,500,000. The total cost of the acquisition of \$4,612,013, including \$112,013 of related acquisition costs, was provided by approximately \$4,000,000 of debt financing and the balance in CBW's own cash. The purchase method of accounting was used to record this transaction and a new basis of accounting was established for the assets and liabilities of Elmer's to the extent of the change in ownership based on fair values as follows:

Current assets	\$ 1,190,536
Property, building and equipment	3,790,027
Intangible assets	2,171,048
Other assets	43,587
Liabilities assumed	(2,163,185)
Deferred income taxes	(420,000)
	-----

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\$ 4,612,013

=====

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

On February 18, 1999, CBW merged with and into Elmer's in a transaction in which Elmer's was the surviving corporation. In consideration for the issuance by Elmer's of 770,500 shares of Elmer's restricted common stock to CBW shareholders and the assumption of approximately \$4 million in debt owed by CBW arising from CBW's acquisition of the controlling block of Elmer's common stock on August 25, 1998, Elmer's acquired all the stock and assets of CBW including CBW's wholly-owned subsidiary, CBW Food Company, LLC.

Each CBW shareholder received 144.4507 shares of Elmer's restricted common stock for every CBW share owned. The shares of Elmer's stock previously acquired by CBW, a total of 705,000 shares, were concurrently transferred to Elmer's and were canceled upon receipt thereof. In further consideration for the issuance and to secure various indemnification obligations of CBW shareholders under the merger agreement, Elmer's and the individual CBW shareholders executed an escrow agreement for a period of one year from the date of closing of the merger transaction.

Elmer's entered into a new financing agreement in connection with the merger whereby it borrowed funds to refinance existing debt and debt of CBW totaling approximately \$1,750,000. Elmer's also used existing cash to reduce debt by approximately \$1,000,000. The merger transaction was accounted for as a purchase of the remaining 46.2% separate public ownership of Elmer's by CBW. A new basis of accounting was established for the assets and liabilities of Elmer's, based on fair values, upon execution of the merger agreement. The total estimated fair value of assets acquired in the merger transaction is comprised of the following:

Estimated value of 606,109 shares of outstanding common stock of Elmer's (other than CBW ownership) at the date of the merger	\$ 2,803,000
Assumed liabilities	2,123,804
Accrued expenses related to the transaction	20,000
Deferred income taxes	320,000
	-----
	\$ 5,266,804
	=====

The purchase price has been allocated to the assets to be acquired and obligations to be assumed, based on the estimate of the 46.2% proportionate fair values of the assets and liabilities, as follows:

Current assets	\$ 839,988
Property , buildings and equipment	3,173,264
Intangible assets	1,220,701
Other assets	32,851
	-----
	\$ 5,266,804
	=====

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

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ACQUISITION OF GRASS VALLEY LTD., INC. (DBA RICHARD'S DELI AND PUB)  
 Effective March 31, 1999, Elmer's executed a stock exchange agreement with Grass Valley Ltd., Inc. (GVL), a closely held Oregon corporation, in a transaction in which Elmer's acquired 100% of the outstanding stock of GVL in consideration for the payment by Elmer's of \$110,000 in cash and the issuance of 209,620 restricted shares of Elmer's common stock to the GVL shareholders. GVL is now a wholly-owned and operating subsidiary of the Company.

The total cost of the merger transaction is comprised of the following:

Cash	\$ 110,000
Estimated value of 209,620 shares of common stock of Elmer's issued in connection with merger transaction	1,048,500
Assumed liabilities	181,161
Expenses related to the transaction	44,000
	-----
	\$1,383,661
	=====

The excess of the estimated fair value of the assets acquired (\$1,383,661) over the historical cost (\$223,553) was allocated to goodwill (\$1,160,108), as the historical costs of all tangible assets was assumed to be equal to their fair value.

### SUMMARY

The following table represents the unaudited pro forma results of operations for the year ended March 31, 1999 as if the acquisition of 53.8% of the outstanding common stock of Elmer's, the merger of CBW with and into Elmer's and the acquisition of GVL had occurred at the beginning of the respective periods. These pro forma results have been prepared for comparative purposes only and are not necessarily indicative of what would have occurred had the acquisitions been made at the beginning of the respective periods, or of results which may occur in the future.

	YEAR ENDED MARCH 31, 1999
	-----
Total revenue	\$ 21,231,597
Income from operations	1,649,526
Income before provision for income taxes	1,141,293
Net income	751,278
Basic earnings per share of common stock	.45
Weighted-average number of shares outstanding	1,665,548
Number of Company owned stores	20

### 10. EMPLOYEE BENEFIT PLAN

The Company formed a 401(k) profit sharing plan on April 1, 2000 whereby eligible employees may contribute up to 20% of their regular earnings. Employees are eligible to

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

participate after one year of half-time employment with the Company and attainment of 21 years of age. The plan provides that the Company can also make

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matching and other contributions to the plan. The Company contributed \$29,200 to the plan for the year ended April 2, 2001.

11. STOCK OPTIONS

The Board of Directors adopted a stock option plan (Plan) which provides for the award of incentive stock options to key employees and the award of nonqualified stock options to employee and non-employee Directors. Under the terms of the Plan, the option price is determined as the fair value of the Company's common stock at the time the option is granted. Under the Plan, 369,600 shares of common stock are authorized for issuance. The Board of Directors has approved an increase in the number of shares available under the Plan of 150,400 shares, to a total of 520,000 shares. This proposal will be submitted to the Company's shareholders for approval at the Company's 2001 Annual Meeting. Some of the options listed in the table below were granted in anticipation of shareholder approval of the proposal. Options are exercisable upon vesting. Options generally vest 20% annually and expire 10 - 15 years after the date of grant.

A summary of the Company's stock options as of April 2, 2001 and March 31, 2000 and 1999 and changes during the years ended is presented below:

	OPTIONS OUTSTANDING	WEIGHTED- AVERAGE EXERCISE PRICE
	-----	-----
Balance, March 31, 1998	-	
Options granted	187,688	\$ 4.11
	-----	
Balance, March 31, 1999	187,688	4.11
Options granted	180,400	5.38
Options cancelled	(17,325)	4.11
	-----	
Balance, March 31, 2000	350,763	4.77
Options granted	90,000	4.92
Options cancelled	(20,900)	4.66
	-----	
Balance, April 2, 2001	419,863	\$ 4.81
	=====	

The following table summarizes information about stock options outstanding as of April 2, 2001:

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

EXERCISE	NUMBER	WEIGHTED- AVERAGE REMAINING CONTRACTUAL	OPTIONS EXERCISABLE		
			WEIGHTED- AVERAGE EXERCISE	NUMBER	WEIGHTED- AVERAGE EXERCISE
			-----		

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PRICE	OUTSTANDING	LIFE - YEARS	PRICE	EXERCISABLE	PRICE
-----	-----	-----	-----	-----	-----
\$4.11	158,813	10.79	\$4.11	84,315	\$4.11
4.75	60,000	9.69	4.75	22,500	4.75
5.25	30,000	11.67	5.25	-	5.25
5.34	55,550	9.87	5.34	11,110	5.34
5.41	115,500	13.05	5.41	115,500	5.41

There were 100,137 shares of common stock reserved for the grant of stock options under the Plan at April 2, 2001.

The FASB issued SFAS No. 123, Accounting for Stock-Based Compensation, which defines a fair value based method of accounting for employee stock options and similar equity instruments and encourages all entities to adopt that method of accounting for all of their employee stock compensation plans. However, it also allows an entity to continue to measure compensation cost of those plans using the method of accounting prescribed by APB 25. Entities electing to continue to use the accounting treatment in APB 25 must make pro forma disclosures of net income and, if presented, earnings per share, as if the fair value based method of accounting defined in SFAS No. 123 had been adopted.

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

	2001	2000	1999
	-----	-----	-----
Net income - as reported	\$956,006	\$939,549	\$290,512
Net income - pro forma	798,951	652,404	290,512
Diluted earnings per share - as reported	\$.51	\$.51	\$.30
Diluted earnings per share - pro forma	.43	.35	.30

The pro forma effect on net income for 2000 and 2001 is not representative of the pro forma effect in future years because compensation expense related to grants made in prior years is not considered. For purposes of the above pro forma information, the fair value of each option grant was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

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

APRIL 2,                      MARCH 31,                      MARCH 31,

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	2001 -----	2000 -----	1999 -----
Risk-free interest rate	5.5%	6.0%	6.0%
Expected life	10 years	10 years	8.14 years
Expected volatility	26%	26%	59%
Expected dividend yield	0%	0%	0%

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts and additional awards are anticipated in future years.