

SHELLS SEAFOOD RESTAURANTS INC  
Form 424B3  
August 30, 2006

Prospectus Supplement  
(To Prospectus dated October 7, 2005)

Filed Pursuant to Rule 424(b)(3) and 424(c)  
Commission File No. 333-126487

27,772,411 Shares

Common Stock

This prospectus supplement supplements the prospectus dated October 7, 2005, which relates to the shares of our common stock that may be sold by the selling stockholders named therein.

This prospectus supplement should be read in connection with, and may not be delivered or utilized without, the prospectus dated October 7, 2005, and the prospectus supplements dated November 2, 2005, December 1, 2005, December 2, 2005, March 23, 2006, April 7, 2006, April 27, 2006, May 1, 2006, August 2, 2006, August 3, 2006, August 4, 2006, August 28, 2006 and August 29, 2006. This prospectus supplement is qualified by reference to the prospectus and the prospectus supplements, except to the extent that the information in this prospectus supplement updates or supersedes the information contained in the prospectus dated October 7, 2005, or the prospectus supplements dated November 2, 2005, December 1, 2005, December 2, 2005, March 23, 2006, April 7, 2006, April 27, 2006, May 1, 2006, August 2, 2006, August 3, 2006, August 4, 2006, August 28, 2006 and August 29, 2006.

*Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.*

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The date of this prospectus supplement is August 30, 2006

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q/A**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended July 3, 2005  
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-28258

**SHELLS SEAFOOD RESTAURANTS, INC.**  
(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**65-0427966**  
(IRS) Employer Identification Number

**16313 North Dale Mabry Highway, Suite 100, Tampa, FL 33618**  
(Address of principal executive offices) (zip code)

**(813) 961-0944**  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

**Class**  
Common stock, \$0.01 par value

**Outstanding at August 16, 2005**  
15,703,737

EXPLANATORY NOTE

Shells Seafood Restaurants, Inc. (“Shells,” “we,” “us,” “our,” or “Company”) is restating our previously issued consolidated financial statements for the second quarter of fiscal 2005 (“Restatement”), because we discovered the need for an adjustment to our accounting for the issuance of the Series B Preferred Stock and warrants in the May 2005 private placement. The adjustment was recorded as a non-cash implied dividend consisting of a warrant valuation and a beneficial conversion feature reflecting a non-detachable in-the-money conversion feature of the Series B Preferred Stock. This adjustment was identified in connection with internal procedures relative to the fiscal 2005 year end audit. Further information on the adjustment can be found in Note 6, “Restatement of Financial Statements,” to the accompanying financial statements.

This Amendment No. 1 on Form 10-Q/A (this “Form 10-Q/A”) to the Company’s Quarterly Report on Form 10-Q for the quarterly period ended July 3, 2005, initially filed with the Securities and Exchange Commission (the “SEC”) on August 17, 2005 (the “Original Filing”), is being filed to amend the Original Filing to reflect restatements of the Company’s consolidated balance sheet as of July 3, 2005, the consolidated statements of operations for the three and six month periods ended July 3, 2005, the consolidated statement of stockholders’ equity for the six month period ended July 3, 2005 and the notes related thereto. For a more detailed description of the Restatement, see Note 6, “Restatement of Financial Statements,” to the accompanying consolidated financial statements and the section entitled “Restatement” in Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in this Form 10-Q/A.

Subsequent to the filing of this Form 10-Q/A, we will file Amendment No. 1 on Form 10-Q/A for the quarter ended October 2, 2005 to reflect restatement of the Company’s consolidated balance sheet as of October 2, 2005, the consolidated statements of operations and the consolidated statement of stockholders’ equity for the nine month period ended October 2, 2005, and the notes related thereto.

For the convenience of the reader, this Form 10-Q/A sets forth the Original Filing in its entirety. However, this Form 10-Q/A amends and restates only Items 1, 2, and 4 of Part I of the Original Filing, in each case, solely as a result of, and to reflect, the Restatement, and no other information in the Original Filing is amended hereby. The foregoing items have not been updated to reflect other events occurring after the Original Filing or to modify or update those disclosures affected by subsequent events. This Form 10-Q/A continues to speak as of the filing date of the Original Filing for the quarterly period ended July 3, 2005. In addition, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain currently dated certifications from the Company’s Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. The certifications of the Company’s Chief Executive Officer and Chief Financial Officer are attached to this Form 10-Q/A as Exhibits 31.1, 31.2, and 32.1.

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SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES  
Index

Part I. Financial Information		Page Number
Item 1.	Financial Statements	
	Consolidated Balance Sheets	3
	Consolidated Statements of Operations (Unaudited)	4-5
	Consolidated Statements of Cash Flows (Unaudited)	6-7
	Consolidated Statement of Stockholders' Equity (Unaudited)	8
	Notes to Consolidated Financial Statements - (Unaudited)	9-14
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	15-20
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	20
Item 4.	Controls and Procedures	21
Part II. Other Information		22-24
Signatures		25

**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	(Unaudited)	
	As Restated	
	see Note 6	
	July 3, 2005	January 2, 2005
<b>ASSETS</b>		
Cash	\$ 2,805,201	\$ 2,349,519
Inventories	457,348	396,823
Other current assets	876,126	497,178
Receivables from related parties	106,651	109,477
Total current assets	4,245,326	3,352,997
Property and equipment, net	9,180,236	7,095,922
Goodwill	2,474,407	2,474,407
Other assets	621,523	535,376
Prepaid rent	361,781	59,956
<b>TOTAL ASSETS</b>	<b>\$ 16,883,273</b>	<b>\$ 13,518,658</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 1,786,615	\$ 2,311,584
Accrued expenses	2,678,988	2,567,026
Sales tax payable	276,570	202,666
Convertible debentures and interest payable	—	2,395,301
Current portion of long-term debt	345,785	515,764
Total current liabilities	5,087,958	7,992,341
Notes and deferred interest payable to related parties	—	2,238,941
Long-term debt, less current portion	1,370,504	1,494,845
Deferred rent	831,436	849,287
Total liabilities	7,289,898	12,575,414
Minority partner interest	463,919	441,618
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; authorized 2,000,000 shares;		
Series A - 35,275 shares issued and outstanding	353	353
Series B - 461,954 shares issued and outstanding	4,620	—
Common stock, \$0.01 par value; authorized 58,000,000 and 20,000,000 shares, respectively; 15,641,417 and 8,565,406 shares issued and outstanding, respectively	156,414	85,654
Additional paid-in-capital	24,645,178	14,926,627
Accumulated deficit	(15,677,109)	(14,511,008)
Total stockholders' equity	9,129,456	501,626
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 16,883,273</b>	<b>\$ 13,518,658</b>

**See accompanying notes to consolidated financial statements.**



**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

	13 Weeks Ended	
	July 3, 2005 As Restated see Note 6	June 27, 2004
<b>REVENUES</b>	\$ 11,919,012	\$ 10,996,898
<b>COST AND EXPENSES:</b>		
Cost of revenues	3,900,006	3,730,111
Labor and other related expenses	3,493,548	3,249,954
Other restaurant operating expenses	2,845,893	2,509,812
General and administrative expenses	877,392	866,163
Depreciation and amortization	383,339	282,593
Pre-opening expenses	2,828	—
	11,503,006	10,638,633
<b>INCOME FROM OPERATIONS</b>	416,006	358,265
<b>OTHER INCOME (EXPENSE):</b>		
Interest expense	(172,779)	(104,926)
Interest income	4,315	889
Other (expense) income, net	(24,098)	74,645
	(192,562)	(29,392)
<b>INCOME BEFORE ELIMINATION OF MINORITY PARTNER INTEREST</b>	223,444	328,873
<b>ELIMINATION OF MINORITY PARTNER INTEREST</b>	(64,618)	(70,722)
<b>NET INCOME BEFORE PREFERRED STOCK DIVIDEND</b>	158,826	258,151
Deemed dividend associated with warrants and beneficial conversion feature of preferred stock	(1,735,169)	—
<b>NET (LOSS) INCOME APPLICABLE TO COMMON STOCK</b>	\$ (1,576,343)	\$ 258,151
<b>NET (LOSS) INCOME PER SHARE OF COMMON STOCK:</b>		
Basic	\$ (0.10)	\$ 0.05
Diluted	\$ (0.10)	\$ 0.02
<b>AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:</b>		
Basic	15,087,955	4,720,756
Diluted	15,087,955	10,713,403

See accompanying notes to consolidated financial statements.

**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

	26 Weeks Ended	
	July 3, 2005 As Restated See Note 6	June 27, 2004
REVENUES	\$ 24,445,073	\$ 23,588,270
<b>COST AND EXPENSES:</b>		
Cost of revenues	7,997,186	7,840,779
Labor and other related expenses	7,160,464	6,997,919
Other restaurant operating expenses	5,520,767	5,321,266
General and administrative expenses	1,788,152	1,659,557
Depreciation and amortization	731,565	578,786
Pre-opening expenses	303,206	—
	23,501,340	22,398,307
INCOME FROM OPERATIONS	943,733	1,189,963
<b>OTHER INCOME (EXPENSE):</b>		
Lease buy-out option	600,000	—
Provision for impairment of assets	(211,000)	—
Interest expense	(344,261)	(207,124)
Interest income	7,483	2,194
Other (expense) income, net	(277,629)	57,320
	(225,407)	(147,610)
INCOME BEFORE ELIMINATION OF MINORITY PARTNER INTEREST	718,326	1,042,353
ELIMINATION OF MINORITY PARTNER INTEREST	(149,258)	(139,552)
NET INCOME BEFORE PREFERRED STOCK DIVIDEND	569,068	902,801
Deemed dividend associated with warrants and beneficial conversion feature of preferred stock	(1,735,169)	—
NET (LOSS) INCOME APPLICABLE TO COMMON STOCK	\$ (1,166,101)	\$ 902,801
<b>NET (LOSS) INCOME PER SHARE OF COMMON STOCK:</b>		
Basic	\$ (0.08)	\$ 0.19
Diluted	\$ (0.08)	\$ 0.08
<b>AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:</b>		
Basic	13,722,536	4,677,384
Diluted	13,722,536	10,911,221

See accompanying notes to consolidated financial statements.





**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

	26 Weeks Ended	
	July 3, 2005	June 27, 2004
<b>OPERATING ACTIVITIES:</b>		
Net income before preferred stock dividend	\$ 569,068	\$ 902,801
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	731,565	578,786
Loss (gain) on disposal of assets	162,424	(89,161)
Loss on sale of assets applied against reserves	—	24,776
Lease buy-out option	(600,000)	—
Provision for impairment of assets	211,000	—
Minority partner net income allocation	149,258	139,561
Changes in current assets and liabilities	(33,602)	(658,456)
Changes in assets and liabilities:		
(Increase) decrease in prepaid rent	(324,825)	7,811
(Increase) decrease in other assets	(94,265)	10,986
Decrease in deferred rent	(17,851)	(49,489)
Total adjustments	183,704	(35,186)
Net cash provided by operating activities	752,772	867,615
<b>INVESTING ACTIVITIES:</b>		
Proceeds from sale of lease buy-out option	600,000	—
Proceeds from sale of assets	—	88,776
Purchase of property and equipment	(3,158,185)	(467,951)
Net cash used in investing activities	(2,558,185)	(379,175)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from debt financing	206,518	162,298
Repayment of debt	(2,740,610)	(206,135)
Proceeds from issuance of stock	4,922,144	16,800
Distributions to minority partner	(126,957)	(132,223)
Net cash provided by (used in) financing activities	2,261,095	(159,260)
Net increase in cash	455,682	329,180
<b>CASH AT BEGINNING OF PERIOD</b>	<b>2,349,519</b>	<b>723,939</b>
<b>CASH AT END OF PERIOD</b>	<b>\$ 2,805,201</b>	<b>\$ 1,053,119</b>

**See accompanying notes to consolidated financial statements.**

**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) (continued)**

	26 Weeks Ended	
	July 3, 2005	June 27, 2004
<b>Cash flows (outflows) from changes in current assets and liabilities:</b>		
Inventories	\$ (60,525)	\$ (20,228)
Receivables from related parties	2,826	22,548
Other current assets	(378,948)	(341,380)
Accounts payable	(524,969)	(582,979)
Accrued expenses	854,110	153,535
Sales tax payable	73,904	29,613
Increase in accrued interest to related parties	-	80,435
Change in current assets and liabilities	\$ (33,602)	\$ (658,456)
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$ 273,947	\$ 122,336
Cash from hurricane-related insurance recoveries	\$ 357,198	\$ —
Financing costs, line of credit	\$ 80,000	\$ —
Cash paid for income taxes	\$ —	\$ 634

**Non-cash operating, investing and financing activities:**

Deemed dividend of \$1,735,169 for warrants and beneficial conversion features of preferred stock recorded relative to the May 2005 private financing transaction.

Warrant valuation reserves of \$284,364 and \$223,000 relating to the exercise of warrants were applied to Paid in Capital in the first and second quarters of 2005, respectively.

Principal on related party debt of \$500,000 was used by the noteholders to acquire common stock in conjunction with the exercise of warrants in each of March and May 2005.

Principal and accrued interest of \$347,588 was used by the debenture holders to acquire Series B Preferred Stock in May 2005.

Principal and accrued interest on related party debt of \$1,281,666 was used by the noteholders to acquire Series B Preferred Stock in May 2005.

Accrued interest to related parties of \$165,315 was refinanced through a second mortgage in June 2004 and classified as long-term debt.

Insurance reserves of \$96,000 have been applied to asset impairment charges in June 2004.

Loss on sale of assets applied against reserves of \$24,776 reduced net book value of property and equipment by \$19,062 and deferred rent by \$5,714 in June 2004.

Deferred rent of \$114,602 was applied to gain on sale of restaurant in April 2004.

Asset impairment charges of \$110,000 were applied against gain on sale of restaurant in April 2004.

**See accompanying notes to consolidated financial statements.**

**SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)**

	PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL		ACCUMULATED DEFICIT	TOTAL
	Series A Shares	Series B Amount	Shares	Amount	CAPITAL	DEFICIT		
Balance at January 2, 2005	35,275	\$ 353	8,565,406	\$ 85,654	\$ 14,926,627	\$ (14,511,008)	\$	501,626
Net income before preferred stock dividend						569,068		569,068
Preferred stock issued in private placement financing, net of issuance costs of \$1,137,672		461,954	\$ 4,620			5,787,018		5,791,638
Issuance costs, private placement financing						(123,872)		(123,872)
Series B Preferred Stock Warrant issued to placement agent for private placement financing						123,872		123,872
Deemed dividend for warrants and beneficial conversion feature of preferred stock						1,735,169	(1,735,169)	—
Warrants exercised			7,063,011	70,630	1,683,390			1,754,020

Warrant valuation reserve (see note 5)										507,364	507,364
Stock options exercised				13,000	130					5,610	5,740
Balance at July 3, 2005 As Restated, See Note 6	35,275	\$ 353	461,954	\$ 4,620	15,641,417	\$ 156,414	\$ 24,645,178	\$ (15,677,109)	\$ 9,129,456		

**See accompanying notes to consolidated financial statements.**

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

**NOTE 1. BASIS OF PRESENTATION**

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

The consolidated financial statements of Shells Seafood Restaurants, Inc. (the "Company") should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Form 10-K for the year ended January 2, 2005 filed with the Securities and Exchange Commission. Company management believes that the disclosures are sufficient for interim financial reporting purposes. Certain prior year amounts have been reclassified in the accompanying condensed consolidated financial statements to conform with the current year presentation.

**NOTE 2. EARNINGS PER SHARE**

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

13 Weeks Ended	July 3, 2005 As Restated See Note 6	June 27, 2004
Net (loss) income applicable to common stock	\$ (1,576,343)	\$ 258,151
Weighted common shares outstanding	15,087,955	4,720,756
Basic net (loss) income per share of common stock	\$ (0.10)	\$ 0.05
Effect of dilutive securities:		
Preferred stock	—	268,029
Warrants	—	5,690,683
Stock options	—	33,935
Diluted weighted common shares outstanding	15,087,955	10,713,403
Diluted net (loss) income per share of common stock	\$ (0.10)	\$ 0.02
26 Weeks Ended		
Net (loss) income applicable to common stock	\$ (1,166,101)	\$ 902,801
Weighted common shares outstanding	13,722,536	4,677,384
Basic net (loss) income per share of common stock	\$ (0.08)	\$ 0.19
Effect of dilutive securities:		
Preferred stock	—	292,885
Warrants	—	5,875,509
Stock options	—	65,443
Diluted weighted common shares outstanding	13,722,536	10,911,221

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Diluted net (loos) income per share of common stock	\$	(0.08)	\$	0.08
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9

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The earnings per share calculation excluded warrants and options to purchase an aggregate of 781,583 shares of common stock during the 13 weeks ended June 27, 2004, and warrants and options to purchase an aggregate of 621,177 shares of common stock during the 26 weeks ended June 27, 2004, as the exercise prices of the warrants and options were greater than the average market price of the common shares.

The loss per share calculations for the 13 and 26 weeks ended July 3, 2005 excludes anti-dilutive stock options, warrants and preferred stock to purchase 11,625,963 and 9,204,663 shares of common stock, respectively.

### **NOTE 3. STOCK COMPENSATION PLANS**

At July 3, 2005, we had four stock-based employee compensation plans. We account for these plans under the recognition and measurement principles of Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based compensation cost is reflected in net income, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

On June 22, 2005, the Compensation Committee and the Board of Directors of the Company approved the acceleration of vesting of certain unvested and "out-of-the-money" stock options with exercise prices equal to or greater than \$0.85 per share (the market value) previously awarded to its employees, including its executive officers, and its directors under the Plan that were originally scheduled to vest during 2006. The acceleration of vesting is effective for stock options outstanding as of June 22, 2005. Options to purchase approximately 295,000 shares of common stock or 18.5% of the Company's outstanding unvested options (of which options to purchase approximately 233,000 shares or 14.6% of the Company's outstanding unvested options are held by the Company's executive officers and directors) were subject to the acceleration. The weighted average exercise price of the options subject to the acceleration is \$1.10.

The purpose of the acceleration is to enable the Company to avoid recognizing compensation expense associated with these options in future periods in its consolidated statements of income, upon adoption of FASB Statement No. 123 R (Share-Based Payment) in December 2005. The pre-tax charge which the Company expects to avoid in 2006 amounts to approximately \$87,000 based on the original vesting periods. The Company also believes that because many of the options to be accelerated have exercise prices in excess of the current market value of the Company's common stock, these options have limited economic value and are not fully achieving their original objective of incentive compensation and employee retention.

Based on the vesting schedules of stock options outstanding as of July 3, 2005, net of the effect of the acceleration of vesting discussed previously, adoption of revised FASB Statement No. 123 is expected to result in the recognition of compensation expense of approximately \$160,000 in fiscal 2006, \$210,000 in fiscal 2007 and \$85,000 in fiscal 2008. The fair value was estimated using the Black-Scholes option-pricing model. Using this model, fair value is calculated based on assumptions with respect to (i) expected volatility of the Company's common stock price, (ii) the periods of time over which employees and directors are expected to hold their options prior to exercise (expected term), (iii) expected dividend yield on the Company's common stock, and (iv) risk-free interest rates, which are based on quoted U.S. Treasury rates for securities with maturities approximating the options' expected term. Expected volatility has been estimated based on the change in the Company's stock price over the past 12 months. Expected term is based on the Company's limited historical exercise experience with option grants with similar exercise prices. The expected dividend yield is zero as the Company has never paid dividends and does not currently anticipate paying any in the foreseeable future. The following table summarizes the weighted average values of the assumptions used in computing the fair value of option grants:



	(Unaudited)
Volatility	50%
Weighted-average estimated life	5 years
Weighted-average risk-free interest rate	4.5%
Dividend yield	0

#### NOTE 4. NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs", which amended Accounting Research Bulletin No. 43, Chapter 4. The amendments made by FASB Statement No. 151 will improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. The provisions of FASB Statement No. 151 are to be applied prospectively. Adoption of FASB Statement No. 151 is not expected to materially impact our consolidated financial statements.

In December 2004, the FASB revised Statement No. 123, "Accounting for Stock-Based Compensation." This Statement supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Revised Statement No. 123 focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement does not change the accounting guidance for share-based payment transactions with parties other than employees provided in Statement 123 as originally issued and EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," nor address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." Revised Statement No. 123 is effective for the Company as of the first quarter of 2006. Adoption of revised FASB Statement No. 123 is discussed in Note 3.

In December 2004, the FASB issued Statement No. 153, "Exchanges of Non-monetary Assets" which amended APB Opinion No. 29, "Accounting for Non-monetary Transactions." The amendments made by FASB Statement No. 153 are based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for non-monetary exchanges of similar productive assets and replace it with a broader exception for exchanges of non-monetary assets that do not have commercial substance. Previously, APB Opinion No. 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. The Statement is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for non-monetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement are to be applied prospectively. Adoption of FASB Statement No. 153 is not expected to materially impact our consolidated financial statements.

In March 2005, the FASB issued Interpretation 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143" clarifying that the term conditional asset retirement obligation as used in FASB Statement No. 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional

even though uncertainty exists about the timing and (or) method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Clarifications found in Interpretation 47 are not expected to materially impact our consolidated financial statements.

In May 2005, the FASB issued Statement No. 154, “Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3.” This Statement replaces APB Opinion No. 20, “Accounting Changes”, and FASB Statement No. 3, “Reporting Accounting Changes in Interim Financial Statements,” and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This Statement requires retrospective application to prior periods’ financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement carries forward without change the guidance contained in Opinion 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. This Statement also carries forward the guidance in Opinion 20 requiring justification of a change in accounting principle on the basis of preferability. FASB Statement No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We are not aware of any accounting changes or error corrections required in our historical financial statements.

#### NOTE 5. ACCRUED EXPENSES

Accrued expenses consist of the following:

	(Unaudited)	
	July 3, 2005	January 2, 2005
Accrued payroll	\$ 1,077,312	\$ 776,652
Accrued insurance	237	26,382
Restaurant closing expenses	208,571	216,677
Warrant valuation reserve	440,000	947,364
Other	825,664	348,453
Unearned gift card revenue	127,204	251,498
	\$ 2,678,988	\$ 2,567,026

The warrant valuation reserve consists of the following:

Date and description	(Unaudited)	
	July 3, 2005	January 2, 2005
January 2002 at inception of \$2,000,000 financing	\$ —	\$ 61,364
August 2004 for the extension of maturity date of above	—	446,000
December 2004 at inception of debentures	440,000	440,000
	\$ 440,000	\$ 947,364

The warrant valuation reserve relates to warrants issued as inducement to creditors in various financing transactions. In each case, the warrants were valued by an independent valuation expert. The reserves were and will be relieved to Paid In Capital when the warrants are exercised or upon the registration of the underlying common stock in accordance with Emerging Issues Task Force Issue 00-19 (“EITF-0019”), “Accounting for Derivative Financial Instruments to, and Potentially Settled in, a Company’s Own Stock.” We believe that such registration of our common stock will be completed with the Securities and Exchange Commission in the third quarter of 2005. The warrants and related calculations are discussed below.

In January 2002, due to the Company’s then financial condition, the Company was not able to borrow money at rates it could afford and raised \$2,000,000 in a private financing transaction, consisting of secured promissory notes and warrants to purchase common stock. As part of the then financing transaction, the Company was able to negotiate the deferral of approximately one-half of the interest payable on this outstanding indebtedness until the maturity of the loans. Warrants issued to purchase 8,908,030 shares of common stock were independently valued at \$105,977, or \$0.0119 per share. In November 2004, investors exercised 3,750,000 warrants and the reserve was reduced by \$44,613, leaving a balance at fiscal year end 2004 of \$61,364. The remaining warrants were exercised on January 31, 2005 and the remaining reserve was applied to Paid In Capital.

In August 2004, the maturity date of the \$2,000,000 loans was extended for two years until January 2007 in exchange for warrants. Warrants were issued to purchase 2,000,000 shares of common stock and were independently valued at \$446,000, or \$0.223 per warrant. On March 9, 2005, investors exercised 1,000,000 warrants and the reserve was reduced by 50%. The remaining warrants were exercised in May 2005 in a transaction that was completed in conjunction with our private placement financing and the remaining reserve of \$223,000 was applied to Paid In Capital.

In December 2004, as part of the then \$2,375,000 financing, the purchasers of the convertible debentures were issued warrants as an inducement for the loans. Warrants to purchase 1,971,250 shares of common stock were independently valued at \$440,000, or \$0.223 per share based on an independent valuation completed in August 2004. Since this valuation was five months old, the Company considered other factors to support its use, specifically: (i) the stock price was \$0.60 on both of August 4, 2004 and December 6, 2004, (ii) a Black-Scholes calculation indicated that a valuation between \$0.20 and \$0.25 per share was appropriate, and (iii) the August 4 valuation fell within an acceptable range of a min-max calculation based on the proposed future range of the exercise price of the warrants. Warrants to purchase 1,187,500 shares of common stock were valued at \$265,000 and was charged to interest expense at the commitment date due to the short-term (4-months) nature of the debentures. Warrants to purchase 783,750 shares of common stock were issued to the placement agent, valued at \$175,000 and charged to financing costs.

**NOTE 6. RESTATEMENT OF FINANCIAL STATEMENTS**

We are restating our consolidated financial statements for the second quarter and first six months of fiscal 2005 to reflect an adjustment to our accounting for the issuance of the Series B Preferred Stock and warrants in the May 2005 private placement, which is more fully described in Note 7. In addition, certain disclosures in Note 2 to the consolidated financial statements contained in this report have been restated to reflect the corrections.

The impact of the corrections on the Consolidated Statements of Operations and Consolidated Statement of Stockholders' Equity is shown in the accompanying tables. The \$1,735,000 "Deemed dividend associated with warrants and beneficial conversion feature of preferred stock" adjustment to the statement of operations for the three and six months ended July 3, 2005 is also reflected in the Stockholders' Equity section of the Balance Sheet as of July 3, 2005 as an adjustment to Additional Paid-in-Capital and Accumulated Deficit.

**CONSOLIDATED STATEMENTS OF OPERATIONS (DOLLARS IN THOUSANDS)**  
(UNAUDITED)

	13 Weeks Ended July 3, 2005			26 Weeks Ended July 3, 2005		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
<b>NET INCOME BEFORE PREFERRED STOCK DIVIDEND</b>	\$ 159	—	\$ 159	569	—	569
Deemed dividend associated with warrants and beneficial conversion feature of preferred stock	—	(1,735)	(1,735)	—	(1,735)	(1,735)
<b>NET INCOME (LOSS) APPLICABLE TO COMMON STOCK</b>	\$ 159	\$ (1,735)	\$ (1,576)	\$ 569	\$ (1,735)	\$ (1,166)
<b>NET INCOME (LOSS) PER SHARE OF COMMON STOCK:</b>						
Basic	\$ 0.01	\$ (0.11)	\$ (0.10)	\$ 0.04	\$ (0.12)	\$ (0.08)
Diluted	\$ 0.01	\$ (0.11)	\$ (0.10)	\$ 0.03	\$ (0.11)	\$ (0.08)

**CONSOLIDATED BALANCE SHEETS (DOLLARS IN THOUSANDS)**  
(UNAUDITED)

	July 3, 2005		
	As Previously Reported	Adjustment	As Restated
<b>Stockholders' Equity:</b>			
Additional paid-in-capital	\$ 22,910	\$ 1,735	\$ 24,645
Accumulated deficit	(13,942)	(1,735)	(15,677)
Total stockholders' equity	9,129	—	9,129

**NOTE 7. SERIES B CONVERTIBLE PREFERRED STOCK**

In May 2005, we issued 461,954 units of securities in a private placement offering to accredited investors generating gross proceeds of \$6,929,000. Each unit consisted of one share of Series B Convertible Preferred Stock, par value \$0.01 per share (the "Series B Preferred Stock"), which is initially convertible into 20 shares of our common stock, subject to certain specified adjustments under certain circumstances, and a warrant to purchase 10 shares of our common stock at an exercise price of \$1.30 per share.

A non-cash implied dividend of \$1,735,000 was recorded in conjunction with the private placement offering, consisting of a warrant valuation and a beneficial conversion feature. The beneficial conversion feature reflects a non-detachable in-the-money conversion feature of the Series B Preferred Stock as defined by the Emerging Issues Task Force Consensus No. EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Features."

The warrant to purchase 37,651 units (consisting of 37,651 shares of Series B Preferred Stock and warrants to purchase 376,510 shares of common stock) issued to the placement agent was valued at \$124,000. The value was based upon the per unit fair market value of the securities issued to the investors in the transaction less the cash exercise price.

The Series B Preferred Stock votes together with our common stock on an "as-converted" basis as a single class on all actions to be taken by our stockholders. Without the consent of a majority of the outstanding Series B Preferred Stock, we cannot alter or change adversely the powers, preferences or rights given to the Series B Preferred Stock, authorize or create any class of stock ranking as to a distribution of assets upon a liquidation event senior to or pari passu with the Series B Preferred Stock, issue any additional shares of the Series A Preferred Stock, or alter or change the powers, preferences or rights given to the Series A Preferred Stock. Upon any dissolution, liquidation, merger, consolidation, reorganization or other series of transactions, under certain conditions, the holders of Series B Preferred Stock are entitled to be paid out of our assets legally available for distribution to our stockholders, before any payment is made to the holders of our common stock. If dividends are declared payable on our common stock, then dividends shall be declared for the Series B Preferred Stock. All shares of Series B Preferred Stock issued and outstanding on May 23, 2015 will automatically be converted at that time into shares of our common stock, based on the conversion price then in effect.

## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **GENERAL**

Comparable restaurant sales rose 7% at Shells during the second quarter of fiscal 2005, the third consecutive quarterly increase. Revenues were also higher, up 8.4%. The favorable sales trend is due to increases in menu mix and price. Comparable guest traffic, while slightly lower than the prior year, continued to improve. This trend of improvement has increased period over period for the last several quarters, and we believe reflects that our customers continue to embrace the enhancements we have made to our menu, food quality, service and atmosphere.

Net income for the second quarter and 26-week period was lower than for the comparable periods in fiscal 2004, primarily due to higher non-controllable expenses including interest, depreciation, occupancy and utility costs. We also incurred significant pre-opening expenses during the first quarter of 2005 related to the new waterfront restaurant we opened in Clearwater Beach.

Our restaurant teams are doing a better job of managing our cost of sales, labor, and controllable areas of operating expense, as a percentage of revenue. Safety and training improvements over the recent years have resulted in a sharp reduction of slips, falls and other accidents at our restaurants, leading to a significant workers compensation refund and a favorable workers compensation reserve adjustment.

We continue to invest not only in our atmosphere improvements, but in raising the level of the service we provide to guests. We have expanded our training department and invested in additional front-of-the-house labor to try and ensure our guests receive attentive and personal service. We have completed the changeover to a new mystery shopper system that provides us with actionable guest satisfaction feedback. We have set high operating standards for our directors of operations, managers and employees, and are continuously striving to raise the bar so we can deliver outstanding service and high-quality seafood to every guest in every restaurant.

During the quarter, we completed an important round of financing, securing a \$6.9 million private placement. This financing allowed us to retire debt and provided us with the funding to remodel our remaining company restaurants with Shells' contemporary new look. The new atmosphere and décor package, combined with the steps we've taken to elevate operating excellence, have resulted in significantly greater improvements in sales and guest traffic over the prior year at our remodeled restaurants compared with our non-remodeled restaurants. We are in the process of remodeling the additional Shells restaurants, and are also exploring locations for potential new restaurants.

### **RESTATEMENT**

We are restating our consolidated financial statements for the second quarter and first six months of fiscal 2005 for an adjustment to our accounting for the issuance of the Series B Preferred Stock and warrants in the May 2005 private placement. The adjustment was recorded as a non-cash implied dividend consisting of a warrant valuation and a beneficial conversion feature reflecting a non-detachable in-the-money conversion feature of the Series B Preferred Stock. This adjustment was identified in connection with internal procedures relative to the fiscal 2005 year end audit. The corrections are the result of our failure to properly identify the accounting treatment for the warrants and conversion feature of the preferred stock during the quarter when the transaction occurred.

The restated financial statements do not affect our business outlook for future fiscal periods, nor impact our cash position or future cash flows from operations. The impact of the adjustment on the consolidated balance sheet, consolidated financial statements of operations, and consolidated statement of stockholders' equity is shown in note 6 to our consolidated financial statements included in this Form 10-Q/A.





**PERCENTAGES TO TOTAL REVENUES**

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

	13 Weeks Ended		26 Weeks Ended	
	July 3, 2005 Restated	June 27, 2004	July 3, 2005 Restated	June 27, 2004
<b>REVENUES</b>	100.0%	100.0%	100.0%	100.0%
<b>COST AND EXPENSES:</b>				
Cost of revenues	32.7%	33.9%	32.7%	33.2%
Labor and other related expenses	29.3%	29.6%	29.3%	29.7%
Other restaurant operating expenses	23.9%	22.8%	22.6%	22.6%
Total restaurant costs and expenses	85.9%	86.3%	84.6%	85.5%
General and administrative expenses	7.4%	7.9%	7.3%	7.0%
Depreciation and amortization	3.2%	2.6%	3.0%	2.5%
Pre-opening expenses	0.0%	0.0%	1.2%	0.0%
Income from operations	3.5%	3.2%	3.9%	5.0%
Lease buy-out option	0.0%	0.0%	2.5%	0.0%
Provision for impairment of assets	0.0%	0.0%	-0.9%	0.0%
Interest expense, net	-1.4%	-0.9%	-1.4%	-0.9%
Other income (expense), net	-0.2%	0.7%	-1.1%	0.2%
Elimination of minority partner interest	-0.5%	-0.6%	-0.6%	-0.6%
Income before preferred stock dividend	1.4%	2.4%	2.4%	3.7%
Deemed dividend associated with warrants and beneficial conversion feature of preferred stock	-14.6%	0.0%	-7.1%	0.0%
Net (loss) income applicable to common stock	-13.2%	2.4%	-4.7%	3.7%

**RESULTS OF OPERATIONS****13 weeks ended July 3, 2005 and June 27, 2004**

*Revenues.* Total revenues for the second quarter of 2005 were \$11,919,000 as compared to \$10,997,000 for the second quarter of 2004. The \$922,000, or 8.4%, increase in revenues was primarily due to a 7.0% increase in comparable store sales which reflected an increase in check average from menu price increases implemented during the second quarter of 2005 to compensate for the Florida minimum wage increase, partially offset by slightly declining guest counts compared to last year. Total revenues were also impacted by the opening of a new restaurant at the end of the first quarter of 2005 and the closure of two restaurants during the first half of 2004. Comparisons of same store sales include only stores which were open during the entire periods being compared and, due to the time needed for a restaurant to become established and fully operational, at least six months prior to the beginning of that period.

*Cost of revenues.* The cost of revenues as a percentage of revenues decreased to 32.7% for the second quarter of 2005 from 33.9% for the second quarter of 2004. This improvement in cost of revenues as a percentage of revenues primarily related to menu price increases implemented during the second quarter of 2005 to compensate for the Florida minimum wage increase and higher costs last year relating to elevated chicken and dairy procurement costs. We are continually attempting to anticipate and reacting to fluctuations in food costs by purchasing seafood directly

from numerous suppliers, promoting certain alternative menu selections in response to price and availability of supply and adjusting our menu prices accordingly to help control the cost of revenues.

*Labor and other related expenses.* Labor and other related expenses as a percentage of revenues decreased to 29.3% during the second quarter of 2005 as compared to 29.6% for the second quarter of 2004. We benefited from second quarter non-recurring reductions in benefits and taxes relating to a workers compensation insurance reserve reduction of \$106,000 and corresponding refund of \$238,000 in 2005 of which \$330,000 was allocated to restaurant labor costs. In 2004, we had a reserve reduction and corresponding refund of \$161,000 of which \$142,000 was allocated to restaurant labor costs. Exclusive of the non-recurring items, labor and other related expenses as a percentage of revenues was 32.1% and 30.8% for the second quarters of 2005 and 2004, respectively. This increase over prior year primarily was related to the Florida minimum wage increase which became effective in May 2005 and our investment in training to elevate guest service levels.

*Other restaurant operating expenses.* Other restaurant operating expenses as a percentage of revenues increased to 23.9% for the second quarter of 2005 as compared with 22.8% for the second quarter of 2004. The increase primarily was due to increased occupancy costs mostly related to the new restaurant and utilities expenses from significantly higher electricity and gas costs.

*General and administrative expenses.* General and administrative expenses were \$877,000, or 7.4% as a percentage of revenues, for the second quarter of 2005 compared to \$866,000, or 7.9% as a percentage of revenues, for the second quarter of 2004. There was a one-time non-recurring charge for severance of \$39,000 in the second quarter of 2004 for downsizing of administrative personnel. Exclusive of this one-time charge, general and administrative expenses were 7.5% as a percentage of revenues for the second quarter of 2004.

*Depreciation and amortization.* Depreciation and amortization expense as a percentage of revenues was 3.2% and 2.6% for the second quarters of 2005 and 2004, respectively. The increase over prior year relates to increases in depreciation of remodeled restaurants.

*Pre-opening expenses.* Non-recurring pre-opening expenses of \$3,000 in the second quarter of 2005 related to the new restaurant which opened on March 22, 2005 at Clearwater Beach, Florida. There were no restaurant openings in 2004. Pre-opening expenses represent start-up costs incurred prior to opening for business and include occupancy expenses, training labor, advertising and classified ads, utilities and supplies.

*Interest expense, net.* Interest expense, net, was \$168,000 in the second quarter of 2005 compared to \$104,000 in the second quarter of 2004. The increase was primarily related to the 12% annual interest and late penalties on the \$2,375,000 aggregate principal amount of debentures, which we issued in December 2004 and repaid in May 2005.

*Deemed dividend associated with warrants and beneficial conversion feature of preferred stock.* The deemed dividend associated with warrants and beneficial conversion feature of preferred stock of \$1,735,000 related to the May 2005 private placement financing transaction when we issued Series B Convertible Preferred Stock and warrants to purchase common stock. The beneficial conversion feature reflects a non-detachable in-the-money conversion feature of the Series B Preferred Stock. This one-time implied preferred stock dividend was recorded through retained earnings.

*Income from operations and net (loss) income applicable to common stock.* As a result of the factors discussed above, we had income from operations of \$416,000 for the second quarter of 2005 compared to \$358,000 for the second quarter of 2004. Exclusive of non-recurring items noted above, income from operations was \$75,000 and \$236,000 for the second quarters of 2005 and 2004, respectively. Shells had a net loss applicable to common stock of \$1,576,000 for the second quarter of 2005 compared to net income of \$258,000 for the second quarter of 2004. Exclusive of nonrecurring items, we incurred a net loss of \$182,000 for the second quarter of 2005 compared to net income of \$47,000 for the second quarter of 2004. A non-recurring item affecting net loss for the second quarter of 2005 included the \$1,735,000 implied preferred stock dividend. A non-recurring item affecting net income for the second quarter of 2004 included an \$89,000 gain on the sale of property.



**26 weeks ended July 3, 2005 and June 27, 2004**

*Revenues.* Total revenues for the 26 weeks ended July 3, 2005 were \$24,445,000 as compared to \$23,588,000 for the 26 weeks ended June 27, 2004. The \$857,000, or 3.6%, increase primarily was due to an increase in same store sales of 6.8%, which reflected an increase in check average from menu price increases implemented during the second quarter of 2005 to compensate for the Florida minimum wage increase, partially offset by slightly declining guest counts compared to last year. In addition, we opened a new restaurant at the end of the first quarter of 2005. We closed two units during the first half of 2004.

*Cost of revenues.* The cost of revenues as a percentage of revenues decreased to 32.7% for the 26 weeks ended July 3, 2005 from 33.2% for the comparable period in 2004. This improvement in cost of revenues as a percentage of revenues primarily related to menu price increases implemented to compensate for the Florida minimum wage increase. Additionally, last year's cost of revenues was negatively impacted by elevated chicken and dairy procurement costs.

*Labor and other related expenses.* Labor and other related expenses decreased to 29.3% as a percentage of revenues for the 26 weeks ended July 3, 2005 as compared to 29.7% for the same period in 2004. We benefited from second quarter non-recurring reductions in benefits and taxes relating to workers compensation insurance reserve reductions and corresponding refunds of \$344,000 and \$161,000 in 2005 and 2004, respectively, of which \$330,000 and \$142,000 were allocated to restaurant labor costs. Exclusive of the non-recurring items, labor and other related expenses as a percentage of revenues was 30.6% and 30.3% for the 26 weeks of 2005 and 2004, respectively. This increase over prior year primarily was related to the Florida minimum wage increase which became effective in May 2005 and our investment in training to elevate guest service levels.

*Other restaurant operating expenses.* Other restaurant operating expenses were 22.6% as a percentage of revenues for each of the 26 weeks ended July 3, 2005 and June 27, 2004. As a percentage of revenues, occupancy expense declined in the first quarter and increased in the second quarter when compared to last year due to the timing of the opening of a restaurant this year and the closings of restaurants last year. As a percentage of revenues, utilities expense increased for the 26 week period of 2005 compared to the prior year, which was offset by reductions in non-food supplies and contract services when comparing the same periods.

*General and administrative expenses.* General and administrative expenses were \$1,788,000, or 7.3% as a percentage of revenues, for the 26 weeks ended July 3, 2005 compared to \$1,659,000, or 7.0% as a percentage of revenues, for the same period in 2004. This increase in dollar expenditures was primarily due to increases in manager training and recruiting costs in the first six months of 2005. A non-recurring charge of \$39,000 for severance pay occurred in 2004. Exclusive of this non-recurring item, general and administrative expenses were 6.9% as a percentage of revenues for the first six months of 2004.

*Depreciation and amortization.* Depreciation and amortization expenses as a percentage of revenues was 3.0% for the 26 weeks ended July 3, 2005 compared to 2.5% for the prior year. The increase relates to additional depreciation for remodeling expenditures incurred in 2004 and the first quarter of 2005.

*Pre-opening expenses.* Pre-opening expenses of \$303,000 for the 26 weeks ended July 3, 2005 related to the new restaurant which opened on March 22, 2005 at Clearwater Beach, Florida. There were no restaurant openings in 2004.

*Lease buy-out option.* In January 2005, we entered into an agreement with our landlord in St. Pete Beach, Florida, whereby on February 22, 2005, the landlord paid \$600,000 to Shells for an option to buy-out the lease. Commencing February 22, 2006, the landlord can provide notice of lease termination to Shells. Thereafter, we have 60 days to wind down business and vacate the premises.



*Provision for impairment of assets.* The provision for impairment of assets of \$211,000 occurred on February 22, 2005 due to a valuation adjustment for the St. Pete Beach location for an expected shortened lease period relating to the lease buy-out option. There was no provision in the first six months of 2004.

*Interest expense.* Interest expense was \$344,000 in the 26 week period ended July 3, 2005 compared to \$207,000 in the same period of 2004. The increase primarily related to interest expense, at 12% per annum, and late payment penalties on the \$2,375,000 aggregate principal amount of debentures, which we issued in December 2004 and repaid on May 25, 2005.

*Other expense, net.* Other expense was \$278,000 for the 26 weeks ended July 3, 2005 compared to other income of \$57,000 for the comparable period in 2004. The increase over the prior year primarily was due to a loss on disposal of assets of \$162,000 relating to the write-down of fixed assets replaced during remodeling, and financing costs of \$80,000 paid by us for a \$1.6 million line-of-credit. Exclusive of these non-recurring items, other expense was \$36,000 for the 26 weeks ended July 3, 2005. Non-recurring income of \$89,000 was recognized in 2004 relating to gain on the sale of a restaurant location. Exclusive of this non-recurring item, other expense was \$32,000 for the 26 weeks ended June 27, 2004.

*Deemed dividend associated with warrants and beneficial conversion feature of preferred stock.* The deemed dividend associated with warrants and beneficial conversion feature of preferred stock of \$1,735,000 related to the May 2005 private placement financing transaction when we issued Series B Convertible Preferred Stock and warrants to purchase common stock. The beneficial conversion feature reflects a non-detachable in-the-money conversion feature of the Series B Preferred Stock. This one-time implied preferred stock dividend was recorded through retained earnings.

*Income from operations and net (loss) income applicable to common stock.* As a result of the factors discussed above, our income from operations was \$944,000 for the 26 weeks ended July 3, 2005 compared to \$1,190,000 for the same period in 2004. Exclusive of non-recurring items noted above, our income from operations was \$902,000 and \$1,068,000 for the 26 weeks ended July 3, 2005 and June 27, 2004, respectively. We had a net loss applicable to common stock for the 26 weeks ended July 3, 2005 of \$1,166,000 compared to net income of \$903,000 in the same period in 2004. Exclusive of non-recurring items, our net income applicable to common stock was \$381,000 and \$692,000 for the 26 weeks ended July 3, 2005 and June 27, 2004, respectively.

## **LIQUIDITY AND CAPITAL RESOURCES**

In May of 2005, we completed an aggregate financing of \$6.9 million through a private placement of securities to accredited investors. Under the terms of the transaction, we issued 461,954 units with each unit consisting of (i) one share of Series B Convertible Preferred Stock, initially convertible into 20 shares of common stock, and (ii) a warrant to purchase 10 shares of common stock at an exercise price of \$1.30 per share. The purchase price was \$15.00 per unit. We realized net proceeds of approximately \$5.8 million from the financing. Of the total proceeds from securities issued, \$1,282,000 represented related party debt and \$348,000 represented existing convertible debentures, all of which converted into the securities issued in the transaction. As a condition to the transaction, our existing \$1.6 million revolving line of credit previously scheduled to expire on the closing of the transaction, was extended to May 23, 2007. We used a portion of the net proceeds from the private placement to retire the remaining \$2,232,000 of loans and accrued interest from debenture holders and \$8,000 of related party accrued interest. The remainder of the net proceeds from the offering, together with the \$1,600,000 line of credit and proceeds from an anticipated sale/leaseback financing, is anticipated to be used to complete the remodeling of our existing restaurants, and, to the extent funds are available, acquire and build out new restaurant locations. We anticipate investing approximately \$3.6 million in remodeling our existing restaurants. Additionally, in conjunction with the private placement, \$500,000 principal amount of related party debt was used to exercise warrants to purchase 1,000,000 shares of our common stock. We believe, based on our current outlook, that our current cash position and cash flows from operations will be

adequate to satisfy our contemplated cash requirements over the next twelve months.

We have, from time-to-time utilized, and to the extent applicable may utilize real estate mortgage and restaurant equipment financing with various banks or financing institutions as necessary, to help support our cash flow needs. We also may utilize as a form of financing, sale/leaseback options on two owned restaurant properties. In the event that our plans change, assumptions prove to be inaccurate, or due to unanticipated expenses, and in the event projected cash flow or third party financing otherwise prove to be insufficient to fund operations, we could be required to seek additional financing from sources not currently anticipated. There can be no assurance that third party financing will be available to us when needed, on acceptable terms, or at all.



As of July 3, 2005, our current liabilities of \$5,088,000 exceeded current assets of \$4,245,000, resulting in a working capital deficiency of \$843,000. In comparison, the January 2, 2005 working capital deficiency was \$4,639,000. The favorable decrease in the working capital deficiency primarily related to the repayment of the convertible debentures and reduction in accounts payable, along with increases in cash and other current assets, all primarily as a result of the equity financing in May 2005. Our operating leverage has improved. We may still encounter operating pressures from declining sales, increasing food, labor or other operating costs or additional restaurant disposition or pre-opening costs. Historically, we have generally operated with minimal or marginally negative working capital as a result of the investment of current assets into non-current property and equipment, as well as the turnover of restaurant inventory relative to more favorable vendor terms in accounts payable.

Cash provided by operating activities for the 26 weeks ended July 3, 2005 was \$753,000 compared to \$868,000 for the comparable period in 2004. The net decrease of \$115,000 compared to the same period in 2004 primarily related to unfavorable variances in net income before preferred stock dividends, prepaid advertising, prepaid rent and prepaid workers compensation insurance.

The cash used in investing activities was \$2,558,000 for the 26 weeks ended July 3, 2005 compared to \$379,000 for the same period in 2004. The net increase in cash used in investing activities of \$2,179,000 was due to \$2,690,000 in additional capital expenditures over the prior year, partially offset by \$511,000 in additional proceeds on the sale of assets over the prior year. The additional capital expenditures related primarily to the acquisition and remodeling of our new Clearwater Beach restaurant, while proceeds of \$600,000 received in 2005 related to the lease buy-out option compared to \$89,000 in proceeds on the sale of assets in 2004.

The cash provided by financing activities was \$2,261,000 for the 26 weeks ended July 3, 2005 compared to cash used in financing activities of \$159,000 for the comparable period in 2004. The net increase of \$2,420,000 over the prior year primarily related to an increase in net proceeds from the issuance of stock of \$4,905,000 over the prior year, partially offset by an increase in repayments of debt of \$2,534,000 over the prior year.

### **QUARTERLY FLUCTUATION OF FINANCIAL RESULTS**

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

In addition, quarterly results have been substantially affected by the timing of restaurant closings or openings. Because of the seasonality of our business and the impact of restaurant closings, results for any quarter are not generally indicative of the results that may be achieved for a full fiscal year on an annualized basis and cannot be used to indicate financial performance for the entire year.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in interest rates on debt and changes in commodity prices. Our exposure to interest rate risk relates to the \$1,053,000 in outstanding debt with banks that is based on variable rates. Borrowings under the loan agreements bear interest at the rate equal to the applicable bank's base rate.



#### **Item 4. Controls and Procedures**

We maintain "disclosure controls and procedures," as such term is defined under Securities Exchange Act Rule 13a-15(e), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As required by SEC Rule 13a-15(b), we have carried out an evaluation, as of the end of the period covered by this report, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures.

As previously disclosed in a Current Report on Form 8-K which we filed on April 3, 2006 and as described in our Explanatory Note to this Form 10-Q/A and note 6 to our accompanying consolidated financial statements included herein, in connection with internal procedures relative to the fiscal 2005 year end audit, we identified the need for an adjustment to our accounting for the issuance of the Series B Preferred Stock and warrants in the May 2005 private placement. The errors are the result of our failure to properly identify the accounting treatment for the warrants and conversion feature of the preferred stock during the quarter when the transaction occurred. Based on the impact of the aforementioned accounting adjustment, we determined to restate our interim financial statements for the quarters ended July 3, 2005 and October 2, 2005.

During the period from April to May 2006, we changed our policy for conducting accounting research to coincide with the quarter in which any complex or one-time transaction occurs rather than waiting until year-end audit procedures are completed.

## **Part II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On April 20, 2005, we received a notice from the Equal Employment Opportunity Commission (EEOC) that an employee in a Tampa Shells restaurant had filed a charge of discrimination with the EEOC. Specifically, this employee claimed age discrimination in violation of the Age Discrimination in Employment Act of 1964. Based on our investigation to date, we believe the charge is without merit and intend to vigorously defend our position.

On April 28, 2005, the Company received notification from a law firm representing three holders of our then outstanding debentures, each in the principal amount of \$40,000. The notification demanded payment of the debentures in full plus accrued interest and penalties owed thereon. The notification stated that the holders had authorized the law firm to commence legal action against the Company unless the amounts owed under the debentures were repaid in full within 10 days of the date of the letter. The debentures, related accrued interest and penalties were paid in full on May 24, 2005.

In the ordinary course of business, Shells is and may be a party to various legal proceedings, the outcome of which, singly or in the aggregate, is not expected to be material to our financial position, results of operations or cash flows.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On May 24, 2005, we sold an aggregate of 461,954 units in a private placement to accredited investors, at an aggregate purchase price of \$6.9 million. Each unit consisted of (i) one share of our Series B Convertible Preferred Stock convertible into 20 shares of our common stock, subject to adjustment under certain circumstances, and (ii) a warrant to purchase 10 shares of our common stock at an exercise price of \$1.30 per share. We sold the units in reliance upon exemptions from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), provided by Section 4(2) of the Securities Act and Regulation D promulgated thereunder based upon, among other things, written investment representations of the purchasers as to their status as accredited investors (as that term is defined in Regulation D). In addition, the certificates representing the shares of Series B Convertible Preferred Stock and warrants issued in the financing each bear customary restrictive stock legends. In addition, we issued a warrant to purchase 37,651 units (consisting of 37,651 shares of our Series B Convertible Preferred Stock and warrants to purchase 376,510 shares of our common stock) at a purchase price of \$15.00 per unit to the placement agent in our May 2005 financing. We realized net proceeds of approximately \$5.8 million from the financing. Of the total proceeds from securities issued, \$1,282,000 represented related party debt and \$348,000 represented existing convertible debentures, all of which converted into the securities issued in the transaction. We used the proceeds from the private placement to retire the remaining \$2,232,000 of loans and accrued interest from debenture holders and \$8,000 of related party accrued interest. As a condition to the transaction, our existing \$1,600,000 revolving line of credit previously scheduled to expire on the closing of the transaction, was extended to May 23, 2007. The remainder of the net proceeds from the offering, together with the \$1,600,000 line of credit and proceeds from an anticipated sale/leaseback financing, is anticipated to be used to complete the remodeling of our existing restaurants, and, to the extent funds are available, acquire and build out new restaurant locations. Additionally, in conjunction with the private placement, \$500,000 principal amount of related party debt was used to exercise warrants to purchase 1,000,000 shares of our common stock.

Employees exercised stock options and were issued 11,000 shares of common stock during the second quarter of 2005 for which proceeds of \$4,840 were received. The proceeds were used for working capital purposes.

### **Item 3. Defaults Upon Senior Securities**

In accordance with the \$2,375,000 12% convertible debentures dated December 7, 2004, the original principal amount of each note, plus interest, was due no later than April 5, 2005. On May 24, 2005, the debentures, related accrued interest and penalties were paid in full (to the extent not converted into securities sold in the May 2005 private placement).

**Item 4. Submission of Matters to a Vote of Security Holders**

On June 22, 2005, at our company's Annual Meeting of Stockholders, the following directors were elected by the votes indicated:

Philip R. Chapman:	14,013,944 For,	22,930 Against or Withheld,	0 Abstaining
Leslie J. Christon:	14,021,400 For,	15,474 Against or Withheld,	0 Abstaining
Robert S. Ellin:	14,012,575 For,	24,299 Against or Withheld,	0 Abstaining
Michael R. Golding:	14,019,585 For,	17,289 Against or Withheld,	0 Abstaining
Gary L. Herman:	14,010,705 For,	26,169 Against or Withheld,	0 Abstaining
Christopher D. Illick:	14,020,200 For,	16,674 Against or Withheld,	0 Abstaining
Jay A. Wolf:	14,003,849 For,	33,025 Against or Withheld,	0 Abstaining

At this Annual Meeting, our stockholders approved certain amendments to our 2002 Equity Incentive Plan, including an amendment to increase the number of shares of common stock issuable under the Plan from 1,850,000 to 5,000,000. The vote was 10,319,079 For, 114,355 Against or Withheld, and 5,890 Abstaining.

Also at this Annual Meeting, our stockholders approved an additional increase in the authorized shares of our common stock, \$0.01 par value per share, from 40,000,000 shares to 58,000,000 shares. An increase in the capitalization of our common stock was previously announced in March 2005 from 20,000,000 shares to 40,000,000 shares. The vote was 14,003,768 For, 28,416 Against or Withheld, and 4,690 Abstaining.

**Item 5. Other Information**

None

**Item 6. Exhibits**

31.1 Certification of Chief Executive Officer under Rule 13a-14(a) as of August 29, 2006

31.2 Certification of Chief Financial Officer under Rule 13a-14(a) as of August 29, 2006

32.1 Certification of Chief Executive Officer and Chief Financial Officer under Section 906 as of August 29, 2006

24

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**SIGNATURES**

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

SHELLS SEAFOOD RESTAURANTS, INC.  
(Registrant)

/s/ Leslie J. Christon  
President and Chief Executive Officer  
August 29, 2006

/s/ Warren R. Nelson  
Executive Vice President and Chief Financial Officer  
August 29, 2006



Exhibit 31.1

**Certification of Chief Executive Officer**

I, Leslie J. Christon, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Shells Seafood Restaurants, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Leslie J. Christon

President and Chief Executive Officer

August 29, 2006

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Exhibit 31.2

**Certification of Chief Financial Officer**

I, Warren R. Nelson, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Shells Seafood Restaurants, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Warren R. Nelson

Executive Vice President and Chief Financial Officer

August 29, 2006

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Exhibit 32.1

**Certification of Chief Executive Officer and Chief Financial Officer  
pursuant to 18 U.S.C. Section 1350, as adopted pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

Securities and Exchange Commission  
Washington, DC

The undersigned Chief Executive Officer and Chief Financial Officer of Shells Seafood Restaurants, Inc. do hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Shells Seafood Restaurants, Inc. on Form 10-Q/A, as filed on the date hereof, for the quarter ended July 3, 2005 fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in such Quarterly Report on Form 10-Q/A fairly presents, in all material respects, the financial condition and results of operations of Shells Seafood Restaurants, Inc.

A signed original of this written statement required by Section 906 has been provided to Shells Seafood Restaurants, Inc. and will be retained by Shells Seafood Restaurants, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ Leslie J. Christon  
President and Chief Executive Officer  
August 29, 2006

/s/ Warren R. Nelson  
Executive Vice President and Chief Financial Officer  
August 29, 2006

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