ELMERS RESTAURANTS INC
Form 10-Q
September 04, 2003

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 21, 2003 or

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

For the transition period from ________________ to _________________

Commission file number 0-14837

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

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

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

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

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

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

Number of shares of Common Stock outstanding at September 1, 2003: 2,041,709

ELMER'S RESTAURANTS, INC.

INDEX

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

		JULY 21, 2
		(Unaudite
ASSETS		
Current assets:		
Cash and cash equivalents	$	2,48
Marketable securities		74
Accounts receivable		25
Notes receivable - franchisees and related parties, current portion		18
Inventories		41
Prepaid expenses and other		51
Income taxes receivable		
Total current assets		4,60
Notes receivable - franchisees and related parties, net of current portion		19
Property, buildings and equipment, net		7,03
Goodwill		4,89
Intangible assets		60
Principal debt service account for convertible debt		23
Other assets		28
Total assets	$	17,86
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable, current portion	$	33
Accounts payable		1,16
Accrued expenses		44
Accrued payroll and related taxes		47
Total current liabilities		2,40
Notes payable, net of current portion		4,34
Deferred income taxes		95
Total liabilities		7,71
Commitments and contingencies		
Shareholders' equity		
Common stock, no par value; 10,000,000 shares authorized, 2,041,709 shares issued and outstanding.		7,28
Retained earnings		2,84
Accumulated other comprehensive gain (loss), net of taxes		1
Total shareholders' equity		10,15
Total liabilities and shareholders' equity	$	17,86

=============

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

ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	FOR THE SIXTEEN WEEKS ENDED	
	JULY 21, 2003	July 22, 2002
	(Unaudited)	(Unaudited)
REVENUES	$ 10,059,012	$ 9,438
COSTS AND EXPENSES:		
Cost of restaurant sales:		
Food and beverage	3,099,959	2,649
Labor and related costs	3,398,561	3,421
Restaurant operating costs	1,378,674	1,287
Occupancy costs	635,805	612
Depreciation and amortization	252,147	221
Restaurant opening and closing expenses	-	9
General and administrative expenses	670,902	687
Loss (gain) on sale of land, buildings and equipment	4,071	(755
	9,440,119	8,134
INCOME FROM OPERATIONS	618,893	1,303
OTHER INCOME (EXPENSE):		
Interest income	24,756	72
Interest expense	(115,993)	(134
Loss on debt extinguishment	-	(97
Gain (loss) on sale of marketable securities	3,449	(55
Income before provision for income taxes	531,105	1,088
Income tax provision	(168,000)	(375
NET INCOME	$ 363,105	$ 713
PER SHARE DATA:		
Net income per share - Basic	$ 0.18	$
Weighted average number of		

common shares outstanding - Basic	2,041,728	2,058
Net income per share - Diluted common shares outstanding	$ 0.17	$
Weighted average number of common shares outstanding - Diluted	2,131,478	2,229

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

4

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

	F
	JULY 20
Cash flows from operating activities:	
Net income	$
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	
Net loss (gain) on disposition of property	
Gain (loss) on sale of marketable securities	
Loss on debt extinguishment	
Changes in assets and liabilities:	
Current assets	
Other assets	
Accounts payable	
Accrued expenses	
Income taxes	
Net cash provided by operating activities	
Cash flows from investing activities:	
Additions to property, buildings and equipment	
Purchases of available-for-sale securities	
Proceeds from sale of available-for-sale securities	
Business acquisition	
Issuance of note receivable	
Principal collected on note receivables	
Proceeds from sale of assets	
Net cash (used in) provided by investing activities	
Cash flows from financing activities:	
Repurchase of convertible notes	

Net change in principal debt service accounts	
Payments on notes payable	

Net cash used in financing activities	

Net change in cash and cash equivalents	
Cash and cash equivalents, beginning of period	

Cash and cash equivalents, end of period	$
	==========
Supplemental disclosures of cash flow information:	
Cash paid during the period for:	
Interest	$
	==========
Income taxes	$
	==========
Supplemental disclosures of non-cash transactions:	
Sale of equipment for note receivable	$
	==========
Change in unrealized gain (loss) on available-for-sale securities, net of taxes	$
	==========
Change in fair market value of interest rate swap agreement	$
	==========
Forgiveness of notes receivable as partial consideration for purchase of property, equipment and goodwill	
	==========
Notes payable issued or assumed in conjunction with acquisition of certain restaurants	$
	==========
Note receivable issued for franchise fee receivable	$
	==========

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

5

ELMER'S RESTAURANTS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim financial statements do not include all the information and footnotes necessary for a fair presentation of financial position and results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. These condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended March 31, 2003. Operating results reflected in the interim consolidated financial statements are not necessarily indicative of the results that may be expected for the year ended March 29, 2004.

In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position of the Company and its subsidiaries, and their results of operations and cash flows.

The Company had comprehensive income of $37,388 for the sixteen weeks ended July 21, 2003. This was composed of an increase in the market value of available-for-sale securities of $48,471 (net of taxes) partially offset by the liability associated with an interest rate swap agreement of $11,083 (net of taxes).

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles have been evaluated against this new criteria and no changes were considered necessary to the previously recorded intangibles. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles (those deemed to have an indefinite life) will be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles are determined to be more than their fair value. The Company's intangible assets were tested for impairment in the third quarter of the fiscal year ended March 31, 2003 and no impairment was found.

Interest rate swap agreement - In June 2003, and in conjunction with the modification of the Wells Fargo real estate debt agreement discussed below, the Company entered into an interest rate swap agreement with Wells Fargo to reduce the impact of changes in interest rates on its floating rate mortgage. The debt modification and related swap agreement effectively changes the Company's interest rate exposure on the Wells Fargo real estate debt to a fixed percentage of 6.17%. The interest rate swap agreement matures May 24, 2010.

Under the terms of the swap agreement, the Company has committed to paying or receiving interest on the spread between 30-day LIBOR and a fixed rate of 3.92%. If 30-day LIBOR exceeds 3.92%, the Company receives interest income from the bank equal to the spread. If 30-day LIBOR is less than 3.92%, the Company makes interest payments to the bank equal to the spread. The 30-day LIBOR rate is fixed on a monthly basis by the bank.

The swap is inversely correlated to the related hedged long-term debt and is therefore considered an effective cash flow hedge of the underlying long-term debt. The level of effectiveness of the hedge is measured by changes in the fair value of the hedged long-term debt resulting from fluctuations in interest rates. As a matter of policy, the Company does not enter into derivative transactions for trading or speculative purposes.

The interest rate swap agreement qualifies as a cash flow hedge under Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS no. 133 requires that the fair value of derivative instruments to be recorded and changes in the fair value of the

derivative instruments to be recognized in other comprehensive income. As of July 21, 2003 the fair market value of this agreement results in a liability of $11,100 (net of tax effect) and recognition of $11,100 in other comprehensive loss.

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

SFAS No. 123 was amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure - An Amendment of FASB Statement No. 123, which among other things, requires more prominent disclosures in both annual and interim financial statements. The Company has adopted the disclosure provisions of SFAS No. 148.

The Company complies with the disclosure-only provisions of SFAS No. 148 and 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:

	July 21, 2003	July 22, 2002
Net income - as reported	$ 363,105	$ 713,082
Net income - pro forma	$ 338,670	$ 679,946
Diluted earnings per share - as reported	$ 0.17	$ 0.32
Diluted earnings per share - pro forma	$ 0.16	$ 0.30

RECENT TRANSACTIONS

Purchase of Cornell Oaks Property

July 29, 2003 the Company purchased a one-acre site in Beaverton, Oregon for $775,000. Construction has begun and the restaurant is expected to open mid-December, 2003. The Company has secured, but not yet drawn upon project financing of approximately $1.6 million.

Franchise Opening.

Elmer's newest franchised restaurant opened on July 21, 2003. The 5,000 square foot restaurant in Coeur d'Alene, Idaho occupies a converted Village Inn site.

Purchase of Cooper's Deli and Pub

July 1, 2002 the Company acquired three Cooper's Deli units located in Salem, Oregon, from Cooper's Inc. The Cooper's units are substantially similar to the Company's existing deli operations. Purchase consideration included $100,000 cash, a $66,500, two-year promissory note, $11,500 in assumed liabilities and the assumption of a $155,000 promissory note due to the Company. The acquisition cost of $333,000 included $100,000 in tangible assets and $233,000 in goodwill.

Repurchase of convertible debt

June 28, 2002 the Company repurchased half ($650,000) of its 10% convertible notes, paying a 15% premium over face value. As permitted by the early adoption provisions of SFAS No. 145 - Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections, the total premium of $97,500 was recorded as a loss on extinguishment. In addition to reducing the Company's debt, this transaction eliminates the potential obligation to issue up to 105,000 shares of common stock upon conversion and reduced the Company's required balances in and contributions to, the debt service account by half.

Relocation of Richard's Deli & Pub

May 28, 2002 the Company relocated one of two Hillsboro, Oregon units to a nearby retail mall. The prior landlord's bankruptcy, combined with the superiority of the new space, made the decision to move compelling. The Company terminated its occupancy lease and recorded a $77,000 loss on the surrender of leasehold improvements. The Company entered into a five-year lease for approximately 4,000 sq. ft. at the new location. This is larger than the operating requirement; therefore the Company has subleased 1,900 sq. ft. of the new space to a non-competing use.

Sale of Southern Oregon Elmer's

The quarter ended July 22, 2002 results include a gain on sale of land, building and equipment related to the sale of three company owned restaurants. Effective May 7, 2002 Elmer's Restaurants, Inc. (the "Company") executed asset purchase and franchise agreements with Southern Oregon Elmer's LLC (the "Buyer"), refranchising three of the Company's Elmer's restaurants located in Grants Pass, Medford and Roseburg, Oregon. The Company sold substantially all the assets of those locations in consideration for $1,385,500 in cash and promissory notes valued at $349,500. The Buyer signed 25-year franchise agreements for each location and operates the locations under the Elmer's Breakfast o Lunch o Dinner(TM) name.

The Buyer has signed a development agreement to open an additional two units within five years. The first unit in Klamath Falls, Oregon opened October 23, 2002.

The principals of Southern Oregon Elmer's LLC, Robert Brutke and David Thomason, have substantial industry experience. They are both past-presidents of the Oregon Restaurant Association, Mr. Thomason operates a 10-unit Carl's Jr. franchise from Carl Karcher Enterprises and Mr. Brutke has operated a number of independent concepts in the southern Oregon market, including Brutke's Wagon Wheel in Roseburg, Oregon.

As a result of this transaction, the Company posted a one-time after tax gain of approximately $504,000 or $.25 per share in the quarter ending July 22, 2002. For the year ended April 1, 2002, revenues from the three restaurants were $5.07 million, contributing $332,000 in earnings before taxes and interest expense.

The Company agreed to provide a limited amount of seller financing. The Company holds notes receivable totaling $364,000, all but $198,000 is due within the next year.

In valuing the restaurants, the Company considered discounted historical cash flows, future capital spending requirements, as well as the impact on the Company's franchise program. The Company believes the consideration paid to be fair, from a financial point of view, to the Company's shareholders. The franchise agreements with the Buyer are comparable to other recent Company franchise agreements.

The Company has assigned its rights and obligations under the occupancy leases for the Medford and Roseburg locations. The Company remains a guarantor of the Medford lease until April 2007. The Company's guarantee of the Roseburg lease could extend until 2018 if the Buyer exercises its options in 2003, 2008 and

2013. The Company has subleased the Grants Pass location to the Buyer for five years under substantially the same terms and conditions as the underlying master lease. Provided all parties are in good standing under the lease at the end of the sublease, the Grants Pass landlord has agreed to lease directly to the Buyer under substantially similar terms.

The Buyer has indemnified the Company against all losses incurred as a result of the Company's obligations as a Guarantor. This indemnification is personally guaranteed by Mssrs. Brutke and Thomason and their spouses.

8

However, in the event of default by the Buyer of the terms of the occupancy leases, and the failure of Mssrs. Brutke and Thomason to make good on their personal guarantees, the Company could be required to pay all rent and other amounts due under the terms of the lease for the remainder of the guarantee term. In the event of default, the Company expects it would exercise its right to reoccupy and continue to operate the restaurants as Elmer's Breakfast o Lunch o Dinner(TM).

The Buyer's obligations under the franchise agreements, promissory notes, lease assignments and sublease are guaranteed by the Buyer and personally by Mssrs. Brutke and Thomason.

Purchase of Vancouver, Oregon Elmer's

April 15, 2002 the Company acquired an Elmer's restaurant located in Vancouver, Washington from franchisee and former board member, Paul Welch for approximately $250,000 in cash and assumed liabilities. The Company has entered into a long-term occupancy lease at the same location, and continues to operate the location as an Elmer's restaurant. The purchase price was allocated to the tangible assets of the restaurant. The Company has spent approximately $148,000 remodeling the facility.

RECENTLY ISSUED ACCOUNTING STANDARDS
In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period after June 15, 2003. The Company's management does not expect that the application of the provisions of this statement will have a material effect on the Company's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends and clarifies financial accounting and reporting for derivative instruments including certain derivatives embedded in other contracts. This statement is effective for contracts entered into or modified after June 30, 2003. The Company's management does not expect that the application of the provisions of this statement will have a material effect on the Company's consolidated financial statements.

In January 2003, FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. This interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, and requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The Company's management does not expect that the application of the provisions of this interpretation will have a material impact on the Company's consolidated financial statements.

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure--an Amendment of FASB Statement No. 123." This statement amends FASB Statement No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Management intends to continue using the intrinsic value method for stock-based employee compensation arrangements and, therefore, does not expect that the application provisions of this statement will have a material impact on the Company's condensed consolidated financial statements. Additional required disclosures have been included in the financial statements.

In November 2002, FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation elaborates on the disclosures to be made by a guarantor about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the

fair value of the obligation undertaken in issuing a guarantee. The Company has complied with the disclosure requirements of FIN 45. The initial recognition and initial measurement provisions shall be applied on a prospective basis to guarantees issued or modified after December 31, 2002. Management does not expect that the application of the provisions of this interpretation will have a material impact on the Company's condensed consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities. The Company has adopted this statement and there was no material impact on the condensed consolidated financial statements.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Among other things, this statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." The Company adopted the provisions of SFAS No. 145 under its early application provisions in the first quarter of 2003. The Company recorded a loss on extinguishment of debt totaling $97,500 that is included in "Other income (expense)" on the condensed consolidated financial statements.

PART I - FINANCIAL INFORMATION

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

Elmer's Restaurants, Inc. (the "Company" or "Elmer's") (NASDAQ Small Cap Market symbol: ELMS), located in Portland, Oregon, is a franchisor and operator of full-service, family oriented restaurants under the names "Elmer's Breakfast o Lunch o Dinner" and "Mitzel's American Kitchen" and an operator of delicatessen restaurants under the names "Ashley's", "Cooper's" 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 franchises or operates a total of 36 full-service, family-oriented restaurants, with a warm, friendly atmosphere and comfortable furnishings. Most of the restaurants are decorated in a home style, with fireplaces in the dining rooms. The restaurants are primarily freestanding buildings, ranging in size from 4,600 to approximately 9,000 square feet with seating capacities ranging from 120 to 220. 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. The menu offers an extensive selection of items for breakfast, lunch and dinner.

CRITICAL ACCOUNTING POLICIES

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

Property, Buildings and Equipment

When the Company purchases property, buildings and equipment, the assets are recorded at cost. However, when the Company acquires an operating restaurant or business, the Company must allocate the purchase price between the fair market value of the tangible assets acquired and any excess to goodwill. The fair market value

of restaurant equipment fixtures and furnishings in an operating restaurant is difficult to separate from the going concern value of the restaurant. Most of the value of the equipment is due to the fact that it is in the restaurant and working. The Company values in place equipment with reference to replacement cost, age and condition, and utility in its intended use.

Intangible Assets

The Company reviews the valuation of its intangible assets annually based on its third quarter financial statements. If the fair values of the intangibles were less than their recorded values, an impairment loss would be recognized. The fair values of the reporting units are estimated using multiples of earnings before interest, taxes, depreciation and amortization. The market for these intangibles is limited and the realizable value will differ from the fair values estimated by using a multiple of earnings.

Depreciation

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

Revenue Recognition

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

Stock Options

The Company accounts for its stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Based on this methodology the Company has not recorded any compensation costs related to its stock options since all options have been issued at an exercise price equal to or greater than the market value of the Company's stock at the time of issuance.

HIGHLIGHTS OF HISTORICAL RESULTS. The Company reported net income of $363,105 or $.18 per share for the quarter ended July 21, 2003, on sales of $10.1 million as compared to reported net income of $713,082 or $.35 per share on sales of $9.4 million for the first quarter ended July 22, 2002. Results for the previous quarter ended July 22, 2002 reflect the after tax gain on sale of the three Southern Oregon restaurants of $504,000 or $.25 per share net of tax, partially offset by losses totaling $.07 per share from the debt repurchase, relocation and losses on investments. There were no comparable transactions in the current quarter, which accounts for the decrease in net income of approximately $350,000. The Company's total assets as of July 21, 2003 were $17.9 million, an increase of $475,000 from March 31, 2003. In the sixteen weeks ended July 21, 2003, working capital increased $383,000 while notes payable decreased $94,000. Cash provided by operating activities totaled $511,000 for the period ended July 21, 2003 compared to $249,000 for the period ended July 22, 2002. The increase in cash provided from operations is primarily attributable to the pay down of negative working capital attributable to the sale of the three Southern Oregon units in the prior quarter. The Company has also placed a $350,000 deposit with the Company's primary food vendor in exchange for improved pricing. The deposit increased prepaid expenses and reduced cash provided by operations. The deposit will be returned to the Company when an electronic funds transfer agreement is finalized with this food vendor.

COMPARISON OF RESULTS OF OPERATIONS. The following discussion and analysis presents the Company's results of operations for the 16 weeks ended July 21, 2003 and July 22, 2002.

11

For the period ended July 21, 2003, the Company's net income and earnings per share decreased 49% from the comparable period in 2002. Net income as a percentage of total revenue decreased from 7.6% for the period ended July 22, 2002, to 3.6% for the period ended July 21, 2003. Excluding gains and losses, earnings before tax increased from 5.2% of sales to 5.3% of sales.

Dollar amounts in thousands except per share data (unaudited)	RESULTS OF OPERATIONS FOR THE SIXTEEN WEEKS ENDED JULY 21, 2003		RESULTS O FOR THE SIXT JULY
	Amount	Percent of Revenues	Amount
Revenues	$10,059	100.0%	$9,438
Restaurant costs and expenses	8,765	87.1	8,202
General and administrative expenses	671	6.7	687
Loss (Gain) on sale of land buildings and equipment	4	0.1	(755)

Income from operations	619	6.1	1,304
Non operating income (expense)	(88)	(0.9)	(215)
Net income	363	3.6	713
Basic earnings per share	$0.18	$0.35	
Weighted average shares outstanding	2,041,728	2,058,003	

	REVENUE FOR THE SIXTEEN WEEKS ENDED JULY 21, 2003		REVENUE FOR THE SIXTEEN WEEKS ENDED JULY 22, 2002	
	Amount	Percent of Revenues	Amount	Percent of Revenues
Restaurant operations:				
Restaurant sales	$8,547	85.0%	$8,133	86.2%
Lottery	1,128	11.2	919	9.7
	9,675	96.2	9,052	95.9
Franchise operations	384	3.8	386	4.1
Total revenue	$10,059	100.0%	$9,438	100.0%

REVENUES. Revenues for the period ended July 21, 2003 were 6.6% more than the comparable period in 2002, reflecting increased same store sales and revenues from three Cooper's Deli's acquired July 1, 2002. Revenues from same store restaurant operations were up 5.4% compared to the sixteen weeks ended July 22, 2002. Same store sales at the Company's Elmer's restaurants were up 4.9%. The Company defines same store sales as restaurants that were Company owned and operating continuously from April 1, 2002 through July 21, 2003. Revenue from franchise operations decreased $2,000 with decreases in initial franchise fees largely offset by increases in royalty income.

RESTAURANT COSTS AND EXPENSES. A comparison of restaurant costs and expenses as a percent of revenue for the 16 weeks ended July 21, 2003 and July 22, 2002 are as follows:

	RESTAURANT COSTS AND EXPENSES FOR THE SIXTEEN WEEKS ENDED		RESTAURANT COST FOR THE SIXTEE
	JULY 21, 2003	JULY 21, 2003	JULY 22, 2002

Cost of restaurant sales:			
Food and beverage	3,100	30.8%	2,650
Labor and related costs	3,399	33.8%	3,421
Restaurant operating costs	1,379	13.7%	1,288
Occupancy costs	636	6.3%	613
Depreciation and amortization	252	2.5%	221
Restaurant opening and closing expenses	--	0.0%	10
Total Cost of Restaurant Sales	$8,766	87.1%	$8,203

The Company was operating 15 restaurants and 10 delis in 2002 and 15 restaurants and 13 delis in 2003. The addition of three delis to the Company's restaurant portfolio had the effect of increasing food and beverage costs as a percentage of sales and decreasing labor and related costs as a percentage of sales. Deli operations typically experience higher food costs and lower labor costs as a percentage of sales, than the Company's full service Elmer's and Mitzel's concepts. Food and beverage costs at the Company's Elmer's restaurants increased 0.8% of sales while labor and related costs declined 0.6%.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative ("G&A") expenses were 6.7% of total revenue for the 16 weeks ended July 21, 2003 compared to 7.3% in the comparable period in 2002. Following the sale of the three Southern Oregon restaurants, the Company has worked to reduce G&A expense in conjunction with the reduction in the number of Company owned restaurants.

LOSS (GAIN) ON SALE OF LAND BUILDINGS AND EQUIPMENT. Gain on sale of land, buildings and equipment declined from 8.0% of sales for the quarter ended July 22, 2002 to 0.1% for the current quarter. The Company sold no restaurants in the current quarter, compared to three in the quarter ended July 22, 2002.

INCOME FROM OPERATIONS. Income from operations decreased $685,000 to $619,000. Decreases in Gain on Sale of $759,000 were offset by increased contribution from restaurant and franchise operations of $74,000.

NON-OPERATING INCOME/(EXPENSE). Non-operating expense was 0.9% of total revenues for the 16 weeks ended July 21, 2003 compared to 2.3% of total revenues in the comparable period in 2002. The company had no losses on marketable securities or debt extinguishment in the current quarter compared to $153,000 in the year ago period.

LIQUIDITY AND CAPITAL RESOURCES. As of July 21, 2003 the Company had cash and cash equivalents of approximately $2.5 million representing an increase from March 31, 2003 of approximately $283,000. Cash provided by operations was $511,000. Cash used in investing activities was $104,000. Additions to property buildings and equipment of $220,000 were partly offset by net sales of marketable securities and principal collected on note receivables. Cash used in financing activities totaled $125,000, principally payments on notes payable.

The Company's primary liquidity needs arise from debt service on indebtedness, operating lease requirements and the funding of capital expenditures. The Company's primary source of liquidity during the year is the operation of its restaurants, franchise fees earned from its franchisees, cash on hand, and borrowings. As of July 21, 2003, the Company had outstanding indebtedness of $2.4 million with GE Capital, $1.6 million in real estate debt with Wells Fargo Bank and $650,000 in convertible notes.

In May 2003, the Company granted non-executive incentive stock options for 45,000 shares to employees of the Company. The options vest over five years and have a ten-year term. The exercise price of $5.48 was equal to the market value of the Company's stock on the grant date.

The Wells Fargo real estate debt agreement was amended June 2003 changing the fixed interest rate of 8% to a variable interest rate based on LIBOR. In conjunction with this modification, the Company entered into an interest rate swap agreement, which effectively fixed the interest rate at 6.17%. The mortgages now have a weighted-average maturity of 7.5 years, bear interest at an average of 6.0%, require monthly payments of principal and interest, and are collateralized by three real estate assets.

The $650,000 in convertible notes have a remaining maturity of approximately five and a half years, bear interest at 10%, require monthly interest-only payments, straight line principal amortization into a Company-held sinking fund, and are subordinated to the other Company funded debt. The notes include a convertible feature that permits the holder to convert the principal of the note into common stock at any time at $6.19 per share. The Company may call the notes with a five percent premium beginning December 2003.

Subsequent to the quarter end the Company entered into a financing agreement with GE Capital to fund approximately $1.6 million toward the Cornell Oaks land, building and equipment. The loans can be drawn as needed to fund the construction. The loans have a variable interest rate and terms of seven and 15 years.

Certain of the Company's debt agreements require compliance with debt covenants. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.5 to 1.0, and a ratio of cash generation (defined as net income before taxes, interest expense, depreciation and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.0 to 1.0. Management believes that the Company is in compliance with such requirements.

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

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

CONTRACTUAL OBLIGATIONS

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

		Commitment expiration period		
	Total amount committed	1 year or less	1-3 years	4-5
Term debt	$4,028,432	$332,308	$698,833	$1,1
Convertible debt	650,000			6
Operating Leases	5,763,827	1,372,897	2,098,798	1,1

Guarantees	2,292,065	266,942	569,504	3
Totals	$12,734,324	$1,972,147	$3,367,135	$3,2

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS:

Certain statements in this form 10-Q constitute "forward-looking statements" which we believe are reasonable and 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

15

relating to the Company's business, financial condition, and operations 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 ability to accomplish stated goals and objectives; successful integration of acquisitions; the impact of competitive products and pricing; success of operating initiatives; development and operating costs; advertising and promotional efforts; adverse publicity; acceptance of new product offerings; consumer trial and frequency; availability, locations, and terms of sites for restaurant development; changes in business strategy or development plans; changes in regulations affecting lottery commissions; quality of management; availability, terms and deployment of capital; the results of financing efforts; business abilities and judgment of personnel; availability of qualified personnel; food, labor and employee benefit costs; changes in, or the failure to comply with, government regulations; continued NASDAQ listing; weather conditions; construction and remodeling schedules; and other factors referenced in this Form 10-Q.

Market Risks

The Company invests excess cash beyond its working capital requirements in liquid marketable securities. These securities consist primarily of corporate and government bond mutual funds focusing on issues with medium and short term maturities. The Company actively manages its portfolio to reduce interest rate risk. However, an increase in interest rate levels will tend to reduce the value of the portfolio.

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. A rise in prevailing interest rates could have adverse effects on the Company's financial condition and results of operations. The fair value of financial instruments approximate the book value at July 21, 2003.

ITEM 4. CONTROLS AND PROCEDURES

The Company's President and its Corporate Controller, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c) and 15d-14(c)) as of a date within 90 days of the filing date of this quarterly report on Form 10-Q (the "Evaluation Date"), have concluded that as of the Evaluation Date, The Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this quarterly report on Form 10-Q was being prepared.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the Evaluation Date, nor any significant deficiencies or material weaknesses in such disclosure controls and procedures requiring corrective actions. As a result, no corrective actions were taken.

PART II - OTHER INFORMATION

ITEM 5. OTHER INFORMATION

In accordance with amendments adopted on May 21, 1998 to Rule 14a-4 under the Securities and Exchange Act of 1934, if notice of a shareholder proposal to be raised at the annual meeting of shareholders is received at the principal executive offices of the Company after May 15, 2004 (45 days prior to the month and date in 2004 corresponding to the date on which the Company mailed its proxy materials for the 2003 annual meeting), proxy voting on that proposal when and if raised at the 2004 annual meeting will be subject to the discretionary voting authority of the designated proxy holders. Any shareholder proposal to be considered for inclusion in proxy

materials for the Company's 2004 annual meeting must be received at the principal executive office of the Company no later than January 21, 2004.

ITEM 6. EXHIBITS AND REPORTS OF FORM 8-K

a) Exhibits:

Exhibits required to be attached by Item 601 of Regulation S-K are listed in the Index to Exhibits of this Form 10-Q and are incorporated herein by this reference.

b) Reports on Form 8-K:
None

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: /s/ BRUCE N. DAVIS

Bruce N. Davis
Chief Executive Officer and President

Dated: September 4, 2003

CERTIFICATION

I, Bruce N. Davis, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Elmer's 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 respect 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 am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the "Evaluation Date"); and

(c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officer and I have disclosed, based on

our most recent evaluation, to the registrant's auditors and the Audit Committee of registrant's Board of Directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ BRUCE N. DAVIS

Bruce N. Davis
Chief Executive Officer and President
September 4, 2003

18

CERTIFICATION

I, Dennis R. Miller, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Elmer's 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 respect 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 am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the "Evaluation Date"); and

(c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the Audit Committee of registrant's Board of Directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ DENNIS R. MILLER

Dennis R. Miller
Corporate Controller
September 4, 2003

EXHIBIT INDEX

Exhibit No.	Description	Sequential Page No.
3 (i)	* Restated Articles of Incorporation of the Company (Incorporated herein by reference from Exhibit No. 3.1 to the Company's Annual Report on Form 10-K for the year ended March 31, 1988.)	
3 (ii)	* By-Laws of the Company, as amended. (Incorporated herein by reference from Exhibit 3.2 of the Company's Annual Report on Form 10-K for the year ended March 31, 1990.)	
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Chief Executive Officer.	20
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Corporate Controller.	20

20

Exhibit 99.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Elmer's Restaurants, Inc. (the "Company") on Form 10-Q for the period ended July 21, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bruce N. Davis, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ BRUCE N. DAVIS

Bruce N. Davis
Chief Executive Officer and President
September 4, 2003

Exhibit 99.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Elmer's Restaurants, Inc. (the "Company") on Form 10-Q for the period ended July 21, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dennis R. Miller, Corporate Controller of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DENNIS R. MILLER

Dennis R. Miller
Corporate Controller
September 4, 2003