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GRILL CONCEPTS INC
Form 10-K
May 23, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

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

For the Fiscal Year Ended December 26, 2004

☐ 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. 0-23226

GRILL CONCEPTS, INC.

(Exact name of registrant as specified in its charter)

Delaware

13-3319172

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification Number)

11661 San Vicente Blvd., Suite 404, Los Angeles, California 90049

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Include Area Code: (310) 820-5559

Securities Registered Under Section 12(b) of the Exchange Act:

| Title of Each Class ----- | Name of Each Exchange on Which Registered ----- |
|------------------------------|--|
| None | None |

Securities Registered Under Section 12(g) of the Exchange Act:

Common Stock, \$.00004 par value

(Title of Class)

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price on the NASDAQ Small-Cap Market, as of the close of business June 30, 2004 was approximately \$7,240,000.

Number of shares outstanding of the registrant's common stock, \$.00004 par value, as of April 11, 2005: 5,650,146 shares.

DOCUMENTS INCORPORATED BY REFERENCE

None

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PART I

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities

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Exchange Act of 1934. The Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference are discussed in the section entitled "Certain Factors Affecting Future Operating Results" beginning on page 38 of this Form 10-K.

ITEM 1. BUSINESS

Except as expressly indicated or unless the context otherwise requires, as used herein, the "Company", "we", "our", or "us", means Grill Concepts, Inc., a Delaware corporation and its subsidiaries.

GENERAL

Grill Concepts, Inc. and its subsidiaries (the "Company") develop and operate casual dining restaurants under the name "Daily Grill" and fine dining restaurants under the name "The Grill on the Alley." In addition, we own and operate, or have management or licensing agreements with respect to, other restaurant properties.

The Company was incorporated under the laws of the State of Delaware in November of 1985. Since our acquisition of Grill Concepts, Inc., a California corporation ("GCI"), in March of 1995, we have focused principally on the expansion of the "Daily Grill" and "The Grill on the Alley" restaurant formats of GCI.

At December 26, 2004, we owned and operated fifteen restaurants and managed or licensed eight additional restaurants. Eleven Daily Grill restaurants and four The Grill on the Alley restaurants are owned and operated, six Daily Grill restaurants are managed and we license two Daily Grill restaurants. With the exception of three The Grill on the Alley restaurants, and two Daily Grill restaurants that are operated by partnerships, all of the Daily Grill and The Grill on the Alley restaurants, which were owned and operated at December 26, 2004, were solely owned and operated by us.

In 2001 we entered into a strategic alliance with Starwood Hotels and Resorts Worldwide, Inc. to jointly develop restaurant properties in Starwood hotels. Management believes that the opening of restaurants in hotel properties in strategic markets will help further establish brand name recognition for the opening of additional restaurants in those markets.

During 2004, we continued to pursue a strategic growth plan whereby the Company plans to open, and/or convert, and operate, and/or manage, Daily Grill and The Grill on the Alley restaurants in hotel properties, and non-hotel based restaurants, in strategic markets throughout the United States.

During 2004 we opened two restaurants consisting of (1) a 100% owned Daily Grill, not covered by the Starwood alliance, opened in January 2004 in the Hyatt Bethesda Hotel in Bethesda, Maryland and (2) a managed Daily Grill restaurant, not subject to the Starwood alliance, opened in November 2004 in the Hilton Hotel in Long Beach, California.

In March 2005, we opened a 100% owned Daily Grill in an office park in Santa Monica, California.

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The following table sets forth unaudited restaurant count information for all restaurants.

| 2004 | 2003 |
|------|------|
| ---- | ---- |

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Number of restaurants:

Daily Grill restaurants:

Company Restaurants:

| | | |
|---------------------|------|------|
| Beginning of year | 10 | 9 |
| Restaurant opening | 1 | 1 |
| Restaurant closings | - | - |
| | ---- | ---- |
| End of year | 11 | 10 |

Managed or Licensed Restaurants:

| | | |
|---------------------|------|------|
| Beginning of year | 7 | 6 |
| Restaurant openings | 1 | 1 |
| | ---- | ---- |
| End of year | 8 | 7 |

Total Daily Grill restaurants:

| | | |
|----------------------------|-------|-------|
| Beginning of year | 17 | 15 |
| Restaurant openings | 2 | 2 |
| Restaurants closed or sold | - | - |
| | ---- | ---- |
| End of year | 19 | 17 |
| | ===== | ===== |

Grill restaurants:

Company Restaurants:

| | | |
|---------------------|------|------|
| Beginning of year | 4 | 4 |
| Restaurant openings | - | - |
| | ---- | ---- |
| End of year | 4 | 4 |

Total Grill restaurants:

| | | |
|---------------------|-------|-------|
| Beginning of year | 4 | 4 |
| Restaurant openings | - | - |
| | ---- | ---- |
| End of year | 4 | 4 |
| | ===== | ===== |

Other restaurants:

Company Restaurants:

| | | |
|----------------------------|------|------|
| Beginning of year | - | - |
| Restaurants closed or sold | - | - |
| | ---- | ---- |
| End of year | - | - |

Managed or Licensed Restaurants:

| | | |
|---------------------|------|------|
| Beginning of year | 1 | 1 |
| Restaurant closings | (1) | - |
| | ---- | ---- |
| End of year | - | 1 |

Total Other restaurants:

| | | |
|----------------------------|-------|-------|
| Beginning of year | 1 | 1 |
| Restaurants closed or sold | (1) | - |
| | ---- | ---- |
| End of year | - | 1 |
| | ===== | ===== |

Total restaurants:

| | | |
|----------------------------|------|------|
| Beginning of year | 22 | 20 |
| Restaurant openings | 2 | 2 |
| Restaurants closed or sold | (1) | - |
| | ---- | ---- |

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| | | |
|-------------|------|------|
| End of year | 23 | 22 |
| | ==== | ==== |

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The following table sets forth unaudited per restaurant sales information, comparable restaurant sales information for restaurants open twelve months in both periods, and total sales information during 2004 and 2003 by restaurant concept for owned restaurants ("Company Restaurants"):

| | 2004 | 2003 |
|---|--------------|--------------|
| | ----- | ----- |
| Weighted average weekly sales per restaurant: | | |
| Daily Grill restaurants: | | |
| Company Restaurants | \$ 57,757 | \$ 58,052 |
| Grill restaurants: | | |
| Company Restaurants | \$ 77,545 | \$ 75,971 |
| Change in comparable restaurant sales: | | |
| Daily Grill restaurants | | |
| Company Restaurants | 4.6% | 4.9% |
| Grill restaurants | | |
| Company Restaurants | 2.1% | 8.1% |
| Total sales: | | |
| Daily Grill | \$33,809,000 | \$30,056,000 |
| Grill | 16,129,000 | 15,802,000 |
| | ----- | ----- |
| Total consolidated sales | \$49,938,000 | \$45,858,000 |
| | ===== | ===== |

We also earn management and license fee revenue based on a percentage of gross sales at restaurants under management and under licensing arrangements. Our management and license fee revenue typically is earned at a rate of five to eight percent of reported gross sales at these restaurants. The gross sales of managed and licensed restaurants are not included in our statements of operations. However, we consider the disclosure of these gross sales to be a key indicator of brand strength and important to understanding how changes in gross sales at the managed and licensed restaurants impact our revenue.

Sales at non-Company owned Grill Concepts-branded restaurants, categorized as, managed and licensed restaurants were as follows:

| | 2004 | 2003 |
|-----------------------------|--------------|--------------|
| | ----- | ----- |
| Gross Sales | | |
| Managed Daily Grills | \$16,382,000 | \$13,256,000 |
| Licensed Daily Grills | 8,003,000 | 8,773,000 |
| | ----- | ----- |
| | \$24,385,000 | \$22,029,000 |
| | ===== | ===== |
| Management and license fees | \$1,282,000 | \$ 1,037,000 |
| | ===== | ===== |
| Percent of gross sales | 5.3% | 4.7% |

RESTAURANT CONCEPTS

- DAILY GRILL RESTAURANTS

Background. At December 26, 2004, we, through our subsidiaries, GCI and

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Grill Concepts Management, Inc., owned and operated, managed or licensed eleven Daily Grill restaurants in Southern California, four Daily Grill restaurants in the Washington, D.C./Virginia market, one Daily Grill restaurant in Skokie, Illinois, one Daily Grill restaurant in San Francisco, California, one Daily Grill restaurant in Houston, Texas and one Daily Grill in Portland, Oregon. Daily Grill restaurants are patterned after "The Grill on the Alley" in Beverly Hills. See "-- The Grill on the Alley." The Grill on the Alley was founded by Robert Spivak, Michael Weinstock and Richard Shapiro (the founders of GCI) in the early 1980's to offer classic American foods in the tradition of the classic American dinner house. After successfully operating The Grill on the Alley for a number of years, in 1988, Messrs. Spivak, Weinstock and Shapiro decided to expand on that theme by opening the first Daily Grill restaurant. Daily Grill, in an effort to offer the same qualities that made The Grill on the Alley successful, but at more value oriented prices, adopted six operating principles that characterize each Daily Grill restaurant: high quality food, excellent service, good value, consistency, appealing atmosphere and cleanliness. GCI emphasized those principles in an effort to create a loyal patron who will be a "regular" at its restaurants.

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Restaurant Sites. Current and planned Daily Grill restaurants can be characterized as either owned, in part or in whole, managed or licensed and as either hotel based or based in shopping malls and other commercial properties. At December 26, 2004, nineteen Daily Grill restaurants were in operation, eight of which were 100% owned by us and located in shopping malls and other commercial properties, one of which is 100% owned by us and located in a hotel, one of which was 50% owned and located in Universal CityWalk, California, one of which was 50.1% owned by us and located in an office park, six of which were managed by us and located in hotels and two of which were licensed restaurants.

Daily Grill locations which are opened, or are scheduled to open in the following months and years, are owned, managed or licensed as indicated and, where indicated, are located in the referenced hotels:

| Location ----- | Opened or Scheduled Opening ----- | Ownership Interest, Licensed or Managed ----- |
|---------------------------------------|--|---|
| Brentwood, California | September 1988 | 100% |
| Los Angeles, California | April 1990 | 100% |
| Newport Beach, California | April 1991 | 100% |
| Studio City, California | August 1993 | 100% |
| Palm Desert, California | January 1994 | 100% |
| Irvine, California | September 1996 | 100% |
| Los Angeles International Airport | January 1997 | Licensed |
| Washington, D.C. | March 1997 | 100% |
| Tysons Corner, Virginia | October 1998 | 100% |
| Burbank, California (Hilton Hotel) | January 1999 | Managed |
| Washington, D.C. (Georgetown Inn) | April 1999 | Managed |
| Universal CityWalk, California | May 1999 | 50% |
| Skokie, Illinois (DoubleTree Hotel) | September 2000 | Licensed |
| San Francisco, California | | |
| (Handlery Union Square Hotel) | February 2002 | Managed |
| Houston, Texas (Westin Galleria) | July 2002 | Managed |
| El Segundo (South Bay), California | January 2003 | 50.1% |
| Portland, Oregon (Portland Westin) | September 2003 | Managed |
| Bethesda, Maryland (Hyatt Hotel) | January 2004 | 100% |
| Long Beach, California (Hilton Hotel) | November 2004 | Managed |
| Santa Monica, California | March 2005 | 100% |

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Downtown Los Angeles, California

2nd Quarter 2005

58.4%

Each 100% owned Daily Grill restaurant is located in leased facilities. Site selection is viewed as critical to the success of our restaurants and, accordingly, significant effort is exerted to assure that each site selected is appropriate. For non-hotel based restaurants, the site selection process focuses on local demographics and household income levels, as well as specific site characteristics such as visibility, accessibility, parking availability and traffic volume. Each site must have sufficient traffic such that management believes the site can support at least twelve strong meal periods a week (i.e., five lunches and seven dinners). Preferred Daily Grill sites, which characterize the existing 100% owned restaurants, are high-end, mid-size retail shopping malls in large residential areas with significant daytime office populations and some entertainment facilities. Historically, Daily Grill restaurants have been viewed as desirable tenants drawing traffic to the high profile malls where we locate and, therefore, have received significant tenant improvement allowances.

Hotel based Daily Grill restaurants may be newly constructed facilities or remodeled facilities on the premises of, or adjacent to, a hotel. Such facilities may be leased, operated pursuant to a partnership, a joint venture, a license arrangement, or a management agreement. As with non-hotel based restaurants, site selection is viewed as critical and, accordingly, significant effort is exerted to assure that each site selected is appropriate. The site selection process for hotel-based restaurants is the responsibility of Hotel Restaurant Properties, Inc. ("HRP"), which identifies suitable locations and negotiates leases, license or management agreements for those properties. See "-- Hotel Property Agreement" and " Certain Relationships and Related Transactions".

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Existing non-hotel based Daily Grill restaurants range in size from 3,750 to 7,000 square feet of which approximately 30% is devoted to kitchen and service areas and seat between 100 and 250 persons. Our costs for existing non-hotel based restaurants, including leasehold improvements, furniture, fixtures and equipment and pre-opening expenses, have averaged \$325 per foot per restaurant, less tenant improvement allowances.

Existing hotel based Daily Grill restaurants range in size from 5,000 to 8,000 square feet of which approximately 30% is devoted to kitchen and service areas and seat between 140 and 252 persons. Management anticipates that additional hotel based Daily Grill restaurants will require minimal capital investment on our part. However, each hotel restaurant arrangement will be negotiated separately and our capital investment may vary widely. Our portion of opening costs of existing hotel restaurants, including leasehold improvements, furniture, fixtures and equipment and pre-opening expenses, have ranged from \$64,000 to \$513,000 per restaurant.

Menu and Food Preparation. Each Daily Grill restaurant offers a similar extensive menu featuring over 100 items. The menu was designed to be reminiscent of the selection available at American-style grill restaurants of the 1930's and 1940's. Daily Grill offers such "signature" items as Cobb salad, Caesar salad, meatloaf with mashed potatoes, chicken pot pie, chicken burgers, hamburgers, rice pudding and fresh fruit cobbler. The emphasis at the Daily Grill is on freshly prepared American food served in generous portions.

Entrees range in price, subject to regional differences, from \$8.95 for a hamburger to \$23.95 for a char-broiled New York steak with all the trimmings. The average lunch check is \$17.00 per person and the average dinner check is \$26.00 per person, including beverage. Daily Grill restaurants also offer a

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children's menu with reduced portions of selected items at reduced prices. All of the existing Daily Grill restaurants offer a full range of beverages, including beer, wine and full bar service. During the year ended December 26, 2004, food and non-alcoholic beverage sales constituted approximately 85% of the total restaurant revenues for the Daily Grill restaurants, with alcoholic beverages accounting for the remaining 15%.

Proprietary recipes have been developed for substantially all of the items offered on the Daily Grill menu. The same recipes are used at each location and all chefs undergo extensive training in order to assure consistency and quality in the preparation of food. Virtually all of the menu items offered at the Daily Grill are cooked from scratch utilizing fresh food ingredients. Our management believes that our standards for ingredients and the preparation of menu items are among the most stringent in the industry.

Each Daily Grill restaurant has up to seven cooks on duty during regular lunch and dinner hours to provide prompt, specialized service. Restaurant staff members utilize a "point-of-sale" computer system to monitor the movement of food items to assure prompt and proper service of guests and for fiscal control purposes.

Atmosphere and Service. Most Daily Grill restaurants are open for lunch and dinner seven days a week and for Sunday brunch. Each Daily Grill location is designed to provide the sense and feel of comfort. In the tradition of an old-time American-style grill, the setting is very open with a mix of booths and tables. Several of the restaurants have counters for singles to feel comfortable. A number of the Daily Grill restaurants have private dining rooms for banquets or additional seating. Each restaurant emphasizes the quality and freshness of Daily Grill food dishes in addition to the cleanliness of operations. The dining area is well-lit and is characterized by a "high energy level". Reservations are accepted but not required.

Attention to detail and quality of decor is carried through to the professional service. All Daily Grill employees are trained to treat each person who visits the restaurant as a "guest" and not merely a customer. Each server is responsible for assuring that his or her guest is satisfied. In keeping with the traditions of the past, each Daily Grill employee is taught that at the Daily Grill "the guest is always right." The Daily Grill's policy is to accommodate all reasonable guest requests, ranging from substitutions of menu items to take-out orders.

In order to assure that our philosophy of guest service is adhered to, all Daily Grill employees from the kitchen staff to the serving staff undergo extensive training making each employee knowledgeable not only in our procedures and policies but in every aspect of Daily Grill operations. Our policy of promoting from within and providing access to senior management for all employees has produced a work force which works in a cooperative team approach and has resulted in an employee turnover rate of just over 66% per year for all employees, considerably below the industry average which management believes to be approximately 125%.

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We believe that the familiarity and feeling of comfort, which accompanies dining in a familiar setting, with familiar food and quality service by familiar servers, produces satisfied customers who become "regulars." Management believes that at the Daily Grills which have been open for over a year repeat business is significantly greater than the industry average, with many guests becoming "regulars" in the tradition of the neighborhood restaurant.

THE GRILL ON THE ALLEY

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Background. At December 26, 2004, we, through our subsidiary, GCI, owned and operated four The Grill on the Alley restaurants ("Grill"), one in Beverly Hills, California, one in San Jose, California, one in Chicago, Illinois and one in Hollywood, California, named The Grill on Hollywood.

The original Grill is a fine dining Beverly Hills restaurant, which opened in 1984 and served as the model for the Daily Grill restaurants. The Grill is set in the traditional style of the old-time grills of New York and San Francisco, with black-and-white marbled floors, polished wooden booths and deep green upholstery. In 1995, the Grill was inducted into Nation's Restaurant News' Fine Dining Hall of Fame and was described by W Magazine as "home of the quintessential Beverly Hills power lunch." The Grill offers five-star American cuisine and uncompromising service in a comfortable, dignified atmosphere.

In April of 1996, we acquired the original Grill from a partnership, the managing partner of which was controlled by our then principal shareholders and directors.

Restaurant Sites. At December 26, 2004, we operated four Grill restaurants, two of which are non-hotel based facilities and two of which are hotel-based facilities.

Grill locations opened in the following months and years, are owned or managed as indicated and, where indicated, in the referenced hotels:

| Location ----- | Opened ----- | Ownership Interest or Managed -- ----- |
|---------------------------------------|-----------------|--|
| Beverly Hills, California | January 1984 | 100.00% |
| San Jose, California (Fairmont Hotel) | May 1998 | 50.05% |
| Chicago, Illinois (Westin Hotel) | June 2000 | 60.00% |
| Hollywood, California | November 2001 | 51.00% |

Our Grill restaurants are located in leased facilities. As with the Daily Grill restaurants, site selection is viewed as critical to success and, accordingly, significant effort is exerted to assure that each site selected is appropriate. For non-hotel based Grill restaurants, the site selection process focuses on local demographics and household income levels, as well as specific site characteristics such as visibility, accessibility, parking availability and traffic volume. Because of the upscale nature of Grill restaurants, convenience for business patrons is considered a key site selection criterion.

Hotel based Grill restaurants may be newly constructed facilities or remodeled facilities on the premises of, or adjacent to, a hotel. Such facilities may be leased by us, operated pursuant to a partnership, a joint venture arrangement, or a management agreement. As with freestanding (non hotel based) restaurants, site selection is viewed as critical to success and, accordingly, significant effort is exerted to assure that each site selected is appropriate.

The Beverly Hills based Grill restaurant is approximately 4,300 square feet of which approximately 35% is devoted to kitchen and service areas and seats 120 persons. The Hollywood based Grill restaurant is approximately 5,600 square feet of which approximately 36% is devoted to kitchen and service areas and seats 200 persons.

The San Jose based Grill restaurant is approximately 8,000 square feet of which approximately 38% is devoted to kitchen and service areas and seats 280 persons. The Chicago based Grill restaurant is approximately 8,500 square feet, of which approximately 35% is devoted to kitchen and service areas, and seats

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more than 300 guests.

Because of the unique nature of Grill restaurants, the size, seating capacity and opening costs of future sites cannot be reasonably estimated. Management anticipates that additional hotel based Grill restaurants will require minimal capital investment on our part. However, each hotel restaurant arrangement will be negotiated separately and our capital investment may vary widely. Total project costs of the existing hotel based restaurants, including leasehold improvements, furniture, fixtures and equipment and pre-opening expenses, have ranged from \$2.1 million to \$3.1 million.

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Menu and Food Preparation. Each Grill restaurant offers a similar extensive menu featuring over 100 items. The menu was designed to be reminiscent of the selection available at fine American-style grill restaurants of the 1930's and 1940's, featuring steaks and seafood and freshly prepared salads and vegetables served in generous portions.

Entrees range in price from \$13.25 for a cheeseburger to \$36.75 for a prime porterhouse steak. The average lunch check is \$29.00 per person and the average dinner check is \$59.00 per person, including beverage. All of the existing Grill restaurants offer a full range of beverages, including beer, wine and full bar service. During the year ended December 26, 2004, food and non-alcoholic beverage sales constituted approximately 71% of the total restaurant revenues for Grill restaurants, with alcoholic beverages accounting for the remaining 29%.

Proprietary recipes have been developed for substantially all of the items offered on the Grill menu. The same recipes are used at each location and all chefs undergo extensive training in order to assure consistency and quality in the preparation of food. Virtually all of the menu items offered at the Grill are cooked from scratch utilizing fresh food ingredients. Our management believes that our standards for ingredients and the preparation of menu items are among the most stringent in the industry.

Each Grill has up to 8 cooks on duty during regular lunch and dinner hours to provide prompt, specialized service. Restaurant staff members utilize a "point-of-sale" computer system to monitor the movement of food items to assure prompt and proper service of guests and for fiscal control purposes.

Atmosphere and Service. Each Grill restaurant is presently open for lunch six days a week and dinner seven days a week. Each Grill location is designed to provide the sense and feel of comfort and elegance. In the tradition of an old-time American-style grill, the setting is an open kitchen adjacent to tables and booths. The open kitchen setting emphasizes the quality and freshness of food dishes in addition to the cleanliness of operations. The dining area is well-lit and is characterized by a "high energy level". Reservations are accepted but are not required.

Attention to detail and quality of decor is carried through to the professional service. All Grill employees are trained to treat each person who visits the restaurant as a "guest" and not merely a customer. Each server is responsible for assuring that his or her guest is satisfied. In keeping with the traditions of the past, each Grill employee is taught that "the guest is always right." The Grill's policy is to accommodate all reasonable guest requests, ranging from substitutions of menu items to take-out orders.

In order to assure that our philosophy of guest service is adhered to, all Grill employees from the kitchen staff to the serving staff undergo extensive training making each employee knowledgeable not only in our procedures and

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policies but in every aspect of Grill operations. Our policy of promoting from within and providing access to senior management for all employees has produced a work force which works in a cooperative team approach.

We believe that the familiarity and feeling of comfort which accompanies dining in a familiar setting, with familiar food and quality service by familiar servers, produces satisfied customers who become "regulars." Management believes that at the original Grill repeat business is significantly greater than the industry average, with many guests becoming "regulars" in the tradition of the neighborhood restaurant.

SALE OF PIZZERIA UNO RESTAURANTS

In April 2002, with the sale of our Cherry Hill, New Jersey Pizzeria Uno Restaurant for \$325,000, we completed our planned divestiture of our interests in Pizzeria Uno Restaurants. Previously, we operated as many as three franchised Pizzeria Uno Restaurants. During 1998, we determined that the continued ownership and operation of the Pizza Restaurants did not fit with our strategic growth plan. Based on that determination, in July 2000, we closed our Pizzeria Uno restaurant in Media, Pennsylvania and, in July 2001, we sold our Pizzeria Uno restaurant in South Plainfield, New Jersey for \$700,000.

OTHER RESTAURANT ACTIVITIES

In addition to owning and operating Daily Grills and The Grills, we, at December 26, 2004, also provided management services for Daily Grill restaurants at the Burbank Hilton, the Georgetown Inn, the Handlery Hotel, the Westin Galleria, the Portland Westin and the Long Beach Hilton and had granted licenses to operate a Daily Grill at LAX and a Daily Grill at the DoubleTree Hotel in Skokie, Illinois. Under the terms of our management agreements, we are responsible for all aspects of the restaurant's operation for which we earn a fee, however, we have no ownership in the restaurant. We are liable for all debts and obligations that we incur on behalf of the managed outlets including payroll and related costs of the restaurant staff who are our employees. All such costs are included as expenses in our statements of operations and we also record revenue for those costs that are reimbursed by the restaurants.

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HOTEL PROPERTY AGREEMENT

In order to facilitate our efforts to open restaurants on a large scale basis in hotel properties, in August of 1998, we entered into the Hotel Property Agreement with Hotel Restaurant Properties, Inc. ("HRP") pursuant to which HRP has agreed to assist us in locating suitable hotel locations for the opening of our restaurants. HRP is considered a related party as one of its owners is a family member of a director and preferred stock holder. In May 11, 1999 the HRP agreement was amended under the same terms and conditions except that it is now 100% owned by the family member. HRP is responsible for identifying suitable hotel locations in which a Grill or Daily Grill can be operated ("Managed Outlets") and negotiating and entering into leases or management agreements for those properties. We will, in turn, enter into management agreements with HRP or the hotel owners, as appropriate. We may advance certain pre-opening costs and certain required advances ("Manager Loans") and will manage and supervise the day-to-day operations of each Managed Outlet. From the gross management fee, we are entitled to receive a base overhead fee equal to \$1,667 per month per Managed Outlet. The remaining fee income, less any expenses and after repayments required on Manager Loans from each Managed Outlet, are allocated 75% to us and 25% to HRP.

In July 2001, in conjunction with an investment in the Company by Starwood

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Hotels, the Hotel Property Agreement was amended to limit, for so long as we are subject to the exclusivity provisions of a Property Development Agreement with Starwood, the amounts payable to HRP to \$400,000 annually plus 12.5% of the amounts otherwise payable to HRP with respect to the Burbank, Georgetown and San Jose Hilton restaurants.

The operating agreement between HRP and GCI contains a clause whereby, HRP has the right to cause GCI to purchase HRP (the put option) at any time there is a change in control or after May 2004 subject to certain conditions and at the same time, GCI has the right to purchase HRP (the call option) after May 2004 subject to certain conditions. The purchase is governed by the following terms:

The Agreed Purchase Price ("APP") (principally paid in stock) under the put or call option will be 25% multiplied by 10 (Multiple) times the Operating Income of HRP (Gross Receipts for the prior twelve months less Operating Expenses which are averaged over a five year period), with certain allowed exclusions from Operating Income minus the principal balance of any outstanding loans (with certain allowed exclusions) to HRP. Under the Put Option the Multiple may change if 87.5% multiplied by the Closing Price of the Company's Common Stock divided by EBITDA per share is less than 10. If the Company sells assets or stock to certain third parties introduced to GCI by HRP which causes a Change in Control, then purchase price will be the greater of: (A) \$3,000,000 or (B) the APP not to exceed \$4,500,000.

RESTAURANT MANAGEMENT SERVICES

Restaurant management services include overseeing the design, development, construction, equipping, furnishing and operation of the restaurant. Once the restaurant is open to the public, the manager is responsible for rendering and performing all services in connection with the operation of the restaurant. Those services include employing, training and supervising personnel, purchasing and maintaining adequate inventory, etc.

In May 1998, pursuant to the Hotel Property Agreement with HRP (see below), we began providing management services for a restaurant in the Burbank Hilton Hotel. The restaurant was converted from its former concept to a Daily Grill in January 1999. Pursuant to our management agreement with the hotel, we invested \$500,000 for conversion of the restaurant to a Daily Grill and are responsible for management and supervision of the restaurant. We, with HRP, are entitled to a management fee equal to 8.5% of the gross receipts of the restaurant. Additionally, we, with HRP, are entitled to 30% of the annual profits of the restaurant in excess of a base amount increased annually by the CPI.

In March 1999, pursuant to the Hotel Property Agreement, we began providing management services for a Daily Grill restaurant at the Georgetown Inn. Pursuant to our management agreement with the hotel, we were not required to invest in the restaurant but we are responsible for management and supervision of the restaurant. We, with HRP, are entitled to a management fee equal to 8% of the gross receipts of the restaurant. Additionally, we, with HRP, are entitled to 30% of the annual profits of the restaurant.

In February 2002, pursuant to the Hotel Property Agreement, we began providing management services for a Daily Grill restaurant at the Handlery Hotel in San Francisco. Pursuant to our management agreement with the hotel, we contributed \$331,000 to the restaurant which was expensed through reimbursed costs in 2002 and 2003. We, with HRP, are entitled to a management fee equal to 6% of gross receipts of the restaurant. Additionally, we, with HRP, are entitled to 25% of the net income of the restaurant.

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In July 2002, pursuant to the Hotel Property Agreement, we began providing management services for a Daily Grill restaurant at the Westin Galleria in Houston, Texas. Pursuant to our management agreement with the hotel, we advanced the restaurant \$64,000 which was repaid out of net income available for distribution in May 2003. We, with HRP, are entitled to a management fee equal to 5% of gross receipts of the restaurant. Additionally, we, with HRP, are entitled to 35% of the annual profits of the restaurant after working capital requirements are satisfied.

In September 2003, pursuant to the Hotel Property Agreement, we began providing management services for a Daily Grill restaurant at the Portland Westin in Portland, Oregon. We were not required to invest in the restaurant. We, with HRP, are entitled to a management fee of 5% of gross receipts of the restaurant and 35% of annual profit after working capital requirements are satisfied. Due to the slow start at this restaurant we have not received any of the management fees earned and therefore have reserved for them 100%.

In November 2004, pursuant to the Hotel Property Agreement, we began providing management services for a Daily Grill restaurant at the Long Beach Hilton in Long Beach, California. We were not required to invest in the restaurant. We, with HRP, are entitled to a management fee of 6% of gross receipts of the restaurant guaranteed by the owner to be no less than \$150,000 per year subject to certain cancellation rights after two years. We, with HRP, are also entitled to an incentive fee of 35% of the annual profits of the restaurant.

RESTAURANT LICENSING

Under restaurant licensing agreements, we earn a licensing fee in exchange for use of our brand, as well as, the proprietary menu.

LAX Daily Grill. Since January 1997, CA One Services, Inc. has operated a Daily Grill restaurant (the "LAX Daily Grill") in the International Terminal of the Los Angeles International Airport. The LAX Daily Grill was originally operated as a joint venture between us and CA One Services, Inc., and since April 1998 has been operated by CA One Services under a license agreement.

Pursuant to the terms of the License Agreement, we are entitled to receive license fees in an amount equal to 2.5% of the first \$5 million of annual revenues from the restaurant and 4% of annual revenues in excess of \$5 million.

San Jose City Bar and Grill. In conjunction with our entry into the hotel restaurant market and pursuant to the Hotel Property Agreement, in May 1998, we began providing management services at the City Bar & Grill at the San Jose Hilton. In September 2002 the agreement relating to our management of the City Bar and Grill was converted to a license agreement under which we, with HRP, were entitled to receive license fees equal to the greater of \$2,500 per month or 1.5% on sales. In 2004 the agreement was terminated.

Skokie Daily Grill. In September 2000, pursuant to the Hotel Property Agreement, a licensed Daily Grill restaurant was opened in the DoubleTree Hotel in Skokie, Illinois. Under the terms of the license, the hotel operator paid all costs to build and open the restaurant and we, with HRP, are entitled to a license fee equal to the greater of \$65,000 increased by 4% per year or 2% of sales per year.

BUSINESS EXPANSION

Our expansion plans focus on the addition of Daily Grill restaurants with selected expansion of the Grill restaurant concept also planned.

Management continually reviews possible expansion into new markets and

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within existing markets. Such reviews entail careful analysis of potential locations to assure that the demographic make-up and general setting of new restaurants is consistent with the patterns which have proven successful at the existing Daily Grills and Grills. While the general appearance and operations of future Daily Grills and Grill restaurants are expected to conform generally to those of existing facilities, we intend to monitor the results of any modifications to our existing restaurants and to incorporate any successful modifications into future restaurants. All future restaurants are expected to feature full bar service.

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Our future expansion efforts are expected to concentrate on (1) expansion into new markets through a combination of Company owned restaurants and the establishment of hotel based restaurants pursuant to the Hotel Property Agreement, and (2) expansion within existing markets through the opening of non-hotel based restaurants. With the assistance of HRP, we expect to establish name recognition and market presence through the opening of Daily Grill and Grill restaurants in fine hotel properties in strategic markets throughout the United States. Upon establishing name recognition and a market presence in a market, we intend to construct and operate clusters of restaurants within those markets. Management intends to limit the construction and operation of Grill restaurants to one restaurant per market while constructing multiple Daily Grill restaurants within each market. The exact number of Daily Grill restaurants to be constructed within any market will vary depending upon population, demographics and other factors.

At December 26, 2004, we operated non-hotel based Daily Grill and Grill restaurants in Southern California, principally the greater-Los Angeles market, and metropolitan Washington, D.C. In March 2005, we opened a non-hotel based Daily Grill in Santa Monica, California and we plan to open a non-hotel based Daily Grill in downtown Los Angeles, California in the second quarter of 2005. Management is presently evaluating the opening of additional non-hotel based Daily Grill and Grill restaurants in existing markets and in other major metropolitan areas. Existing markets will be evaluated for expansion in order to establish market presence and economies of scale. As of March 2005, negotiations are under way for several sites, however no definitive site had been identified for future construction of restaurants. Management anticipates that the cost to open additional Daily Grill and Grill restaurants will average \$325 per square foot per restaurant, less tenant improvement allowances, with each restaurant expected to be approximately 6,000 to 7,000 square feet in size. Actual costs may vary significantly depending upon the tenant improvements, market conditions, rental rates, labor costs and other economic factors prevailing in each market in which we pursue expansion.

At December 26, 2004, hotel based Daily Grill restaurants were operated under management or licensing agreements in Southern California, Washington, D.C., Skokie, Illinois, San Francisco, California, Houston, Texas, and Portland, Oregon and hotel based Grill restaurants were operated in San Jose, California and Chicago, Illinois. We, and HRP, are presently evaluating the opening of additional hotel based Daily Grill restaurants in existing markets and in other major metropolitan areas. Each hotel restaurant arrangement will be negotiated separately and the size of the restaurants, ownership and operating arrangements and capital investment on our part may vary widely. We opened a hotel-based company owned Daily Grill restaurant in Bethesda, Maryland in January 2004 and a hotel-based managed restaurant in Long Beach, California in November 2004.

STARWOOD DEVELOPMENT AGREEMENT

On July 27, 2001, in conjunction with the purchase by Starwood Hotels and Resorts of 666,667 shares of our common stock and 666,667 \$2.00 warrants for

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\$1,000,000, we and Starwood entered into a Development Agreement under which we and Starwood agreed to jointly develop our restaurant properties in Starwood hotels.

Under the Starwood Development Agreement, either we, or Starwood, may propose to develop a Daily Grill, Grill or City Bar and Grill restaurant in a Starwood hotel property. If the parties agree in principal to the development of a restaurant, the parties will attempt to negotiate either a management agreement or a license agreement with respect to the operation of the restaurant.

So long as Starwood continues to meet certain development thresholds set forth in the Development Agreement, we are prohibited from developing, managing, operating or licensing our restaurants in any hotel owned, managed or franchised by a person or entity, other than Starwood, with more than 50 locations operated under a single brand. Existing hotel based restaurants are excluded from the exclusive right of Starwood. The development thresholds required to be satisfied to maintain Starwood's exclusive development rights require, generally, (1) the signing of an average of one management agreement or license agreement with respect to Daily Grill restaurants annually over the life of the Development Agreement, (2) the signing of one management agreement or license agreement in any two year period with respect to Grill restaurants, and (3) the signing of an aggregate average of three management agreements or license agreements with respect to all of our restaurants annually over the life of the Development Agreement. Satisfaction of the thresholds set forth in the Development Agreement are determined on each anniversary of the Development Agreement. With respect to satisfaction of the specific thresholds applying to Daily Grill restaurants and Grill restaurants, the failure to satisfy the development thresholds with respect to those individual brands will terminate the exclusivity provisions relative to such brand but will not affect the exclusivity rights as to the other brand or in general.

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Under the Development Agreement, we are obligated to issue to Starwood warrants to acquire a number of shares of our common stock equal to four percent of the outstanding shares upon the attainment of certain development milestones. Such warrants are issuable upon execution of management agreements and/or license agreements relating to the development and operation, and the commencement of operation, of an aggregate of five, ten, fifteen and twenty of our branded restaurants. If the market price of our common stock on the date the warrants are to be issued is greater than the market price on the date of the Development Agreement, the warrants will be exercisable at a price equal to the greater of (1) 75% of the market price as of the date such warrant becomes issuable, or (2) the market price on the date of the Development Agreement. If the market price of our common stock on the date the warrants are to be issued is less than the market price on the date of the Development Agreement, the warrants will be exercisable at a price equal to the market price as of the date such warrants become issuable. The warrants will be exercisable for a period of five years.

In addition to the warrants described above, if and when the aggregate number of restaurants operated under the Development Agreement exceeds 35% of the total Daily Grill, Grill and City Grill-branded restaurants, we will be obligated to issue to Starwood a warrant to purchase a number of shares of our common stock equal to 0.75% of the outstanding shares on that date exercisable for a period of five years at a price equal to the market price at that date. On each anniversary of that date on which the restaurants operated under the Development Agreement continues to exceed the 35% threshold, for so long as the Development Agreement remains effective, we shall issue to Starwood additional warrants to purchase 0.75% of the outstanding shares on that date at an exercise

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price equal to the market price on that date.

Following the events of September 11, 2001, Starwood substantially curtailed new development activities and only two management agreements have, as yet, been entered into under the Development Agreement. Certain portions of the exclusivity agreement have terminated due to the lack of performance on Starwood's part.

RESTAURANT MANAGEMENT

We strive to maintain quality and consistency in our restaurants through the careful hiring, training and supervision of personnel and the adherence to standards relating to food and beverage preparation, maintenance of facilities and conduct of personnel. We believe that our concept and high sales volume enable us to attract quality, experienced restaurant management and hourly personnel. We have experienced a relatively low turnover at every level at its Daily Grill and Grill restaurants. See "-- Daily Grill Restaurants" above.

Each Daily Grill and Grill restaurant, including both free standing and hotel-based restaurants, is managed by one general manager and up to four managers or assistant managers. Each restaurant also has one head chef and one or two sous chefs, depending on volume. On average, general managers have approximately seven years experience in the restaurant industry and three years with us. The general manager has primary responsibility for the operation of the restaurant and reports directly to an Area Director who in turn reports to our Vice President of Operations. In addition to ensuring that food is prepared properly, the head chef is responsible for product quality, food costs and kitchen labor costs. Each restaurant has approximately 77 employees. Restaurant operations are standardized, and a comprehensive management manual exists to ensure operational quality and consistency.

We maintain financial and accounting controls for each Daily Grill and Grill restaurant through the use of a "point-of-sale" computer system integrated with centralized accounting and management information systems. Inventory, expenses, labor costs, and cash are carefully monitored with appropriate control systems. With the current systems, revenue and cost reports, including food and labor costs, are produced every night reflecting that day's business. The restaurant general manager, as well as corporate management, receives these daily reports to ensure that problems can be identified and resolved in a timely manner. All employees receive appropriate training relating to cost, revenue and cash control. Financial management and accounting policies and procedures are developed and maintained by our Corporate Controller, Director of Information Systems, and Chief Financial Officer.

All managers participate in a comprehensive six-week training program during which they are prepared for overall management of the dining room. The program includes topics such as food quality and preparation, customer service, food and beverage service, safety policies and employee relations. In addition, we have developed training courses for assistant managers and chefs. We typically have a number of employees involved in management training, so as to provide qualified management personnel for new restaurants. Our senior management meets bi-weekly with each restaurant management team to discuss business issues, new ideas and revisit the manager's manual. Overall performance at each location is also monitored with shoppers' reports, guest comment cards and third party quality control reviews.

Servers at each restaurant participate in approximately ten days of training during which the employee works under close supervision, experiencing all aspects of the operations both in the kitchen and in the dining room. The

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extensive training is designed to improve quality and customer satisfaction. Experienced servers are given responsibility for training new employees and are rewarded with additional hourly pay plus other incentives. Management believes that such practice fosters a cooperative team approach which contributes to a lower turnover rate among employees. Representatives of corporate management regularly visit the restaurants to ensure that our philosophy, strategy and standards of quality are being adhered to in all aspects of restaurant operations.

PURCHASING

We have developed proprietary recipes for substantially all the items served at our Daily Grill and Grill restaurants. In order to assure quality and consistency at each of the Daily Grill and Grill restaurants, ingredients approved for the recipes are ordered on a unit basis by each restaurant's head chef from a supplier designated by our Vice President-Purchasing. Because of the emphasis on cooking from scratch, virtually all food items are purchased "fresh" rather than frozen or pre-cooked, with the exception being bread, which is ordered from a central supplier which prepares the bread according to a proprietary recipe and delivers daily to assure freshness. In order to reduce food preparation time and labor costs while maintaining consistency, we work with outside suppliers to produce a limited number of selected proprietary items such as salad dressings, soups and seasoning combinations.

We utilize our point-of-sale computer system to monitor inventory levels and sales, then order food ingredients daily based on such levels. We employ contract purchasing in order to lock in food prices and reduce short-term exposure to price increases. Our Vice President-Purchasing establishes general purchasing policies and is responsible for controlling the price and quality of all ingredients. The Senior Vice President - Culinary in conjunction with our team of chefs, constantly monitors the quality, freshness and cost of all food ingredients. All essential food and beverage products are available, or upon short notice can be made available, from alternative qualified suppliers.

ADVERTISING AND MARKETING

Our marketing philosophy is to provide our guests with an exceptional and enjoyable dining experience that creates loyalty and frequent visits. Our marketing and promotional efforts have been fueled historically by our quality reputation, word of mouth, and positive local reviews. The Grill on the Alley and The Daily Grill have been featured in articles and reviews in numerous local as well as national publications. We supplement our reputation with a program of marketing and public relations activities designed to keep the Daily Grill and Grill name before the public. Such activities include media advertising, direct mail promotions, a birthday club, as well as holiday and special interest events. We also support and participate in local charity campaigns. These activities are managed by a full time Director of Marketing. A toll free phone-in guest survey is utilized to gather guest feelings on their dining experience. During 2004, expenditures for advertising and promotion were approximately 0.9% of total revenues.

COMPETITION

The Daily Grill restaurants compete within the mid-price, full-service casual dining segment. Daily Grill competitors include national and regional chains, such as Cheesecake Factory and Houston's, as well as local owner-operated restaurants. Grill restaurants compete within the fine dining segment. Grill competitors include a limited number of national fine dining chains as well as selected local owner-operated fine dining establishments. Competition for our hotel-based restaurants is primarily limited to restaurants within the immediate proximity of the hotels.

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The restaurant business is highly competitive with respect to price, service, restaurant location and food quality and is affected by changes in consumer tastes, economic conditions and population and traffic patterns. We believe we compete favorably with respect to these factors. We believe that our ability to compete effectively will continue to depend in large measure on our ability to offer a diverse selection of high quality, fresh food products with an attractive price/value relationship served in a friendly atmosphere.

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EMPLOYEES

We, and our subsidiaries, employ approximately 1,408 people, 35 of whom are corporate personnel and 124 of whom are restaurant managers, assistant managers and chefs. The remaining employees are restaurant personnel. Of our employees, approximately 40% are full-time employees, with the remainder being part-time employees.

Management believes that its employee relations are good at the present time. An anonymous employee survey is taken each year and the results are disseminated to keep corporate and restaurant management aware of the level of employee satisfaction.

With the exception of the Chicago Grill on the Alley, none of our employees are represented by labor unions or are subject to collective bargaining or other similar agreements. The current union contract expires in August 2005. Management believes that its employee relations are good at the present time.

TRADEMARKS AND SERVICE MARKS

We regard our trademarks and service marks as having significant value and as being important to our marketing efforts. We have registered our "Daily Grill" mark and logo and our "Satisfaction Served Daily," "Think Daily," "Daily Grind" and other marks with the United States Patent and Trademark Office as service marks for restaurant service, and have secured California state registration of such marks. Our policy is to pursue registration of our marks and to oppose strenuously any infringement.

GOVERNMENT REGULATION

We are subject to various federal, state and local laws affecting our business. Each of our restaurants is subject to licensing and regulation by a number of governmental authorities, which may include alcoholic beverage control, health and safety, and fire agencies in the state or municipality in which the restaurants are located. Difficulties or failures in obtaining or renewing the required licenses or approvals could result in temporary or permanent closure of our restaurants.

Alcoholic beverage control regulations require each of our restaurants to apply to a state authority and, in certain locations, county and municipal authorities for a license or permit to sell alcoholic beverages on the premises. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time. Alcoholic beverage control regulations relate to numerous aspects of the daily operation of our restaurants, including minimum age of patrons and employees, hours of operation, advertising, wholesale purchasing, inventory control, and handling, storage and dispensing of alcoholic beverages.

We may be subject in certain states to "dram-shop" statutes, which generally provide a person injured by an intoxicated person the right to recover damages from an establishment which served alcoholic beverages to such person. In addition to potential liability under "dram-shop" statutes, a number of

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states recognize a common-law negligence action against persons or establishments which serve alcoholic beverages where injuries are sustained by a third party as a result of the conduct of an intoxicated person. We presently carry liquor liability coverage as part of our existing comprehensive general liability insurance.

Various federal and state labor laws govern our relationship with our employees, including such matters as minimum wage requirements, overtime and other working conditions. Significant additional government-imposed increases in minimum wages, paid leaves of absence and mandated health benefits, or increased tax reporting requirements for employees who receive gratuities, could be detrimental to the economic viability of our restaurants. Management is not aware of any environmental regulations that have had a material effect on us to date.

ITEM 2. PROPERTIES

With the exception of certain properties that may be operated pursuant to management arrangements or partnership or joint venture arrangements, all of our restaurants are located in space leased from unaffiliated third parties. The leases have initial terms ranging from 10 to 25 years, with varying renewal options on all but one of such leases. Most of the leases provide for a base rent plus payment of real estate taxes, insurance and other expenses, plus additional percentage rents based on revenues of the restaurant. See "Business."

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The Grill restaurant in San Jose is located in space leased from a hotel management company that may be deemed to be controlled by one of our directors, Lewis Wolff.

Our executive offices are located in 5,000 square feet of office space located in Los Angeles, California. Such space is leased from an unaffiliated party pursuant to a lease expiring in May 2007.

Management believes that our existing restaurant and executive office space is adequate to support current operations. We intend to lease, from time to time, such additional office space and restaurant sites as management deems necessary to support our future growth plans.

ITEM 3. LEGAL PROCEEDINGS

Restaurants such as those we operate are subject to litigation in the ordinary course of business, most of the related costs we expect to be covered by our general liability insurance. However, punitive damages awards are not covered by general liability insurance. Punitive damages are routinely claimed in litigation actions against us. There can be no assurance that punitive damages will not be given with respect to any actions that may arise in the future.

In June 2004, one of our former hourly restaurant employees filed a class action lawsuit against us in the Superior Court of California of Orange County. We requested and were granted a motion to move the suit from Orange County to Los Angeles County. The lawsuit was then filed in the Superior Court of California of Los Angeles County in December 2004. The plaintiff has alleged violations of California labor laws with respect to providing meal and rest breaks. The lawsuit sought unspecified amounts of penalties and other monetary payments on behalf of the plaintiffs and other purported class members. We believe that all of our employees were provided with the opportunity to take all required meal and rest breaks. The Company filed a motion to dismiss several of

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the claims, which is scheduled to be argued in court in May 2005. Concurrently, discovery is continuing in these matters and we intend to vigorously defend our position in all of these matters although the outcome cannot be ascertained at this time.

In November 2004, a sexual harassment case was filed against the Company in Superior Court of California of Los Angeles. We filed a motion to dismiss and the case was dismissed with the plaintiff having the right to re-file. The plaintiff re-filed the case. We filed a second motion to dismiss in March 2005 as we believe the suit is unfounded.

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

No matters were submitted to a vote of our stockholders through the solicitation of proxies, or otherwise, during the fourth quarter of our fiscal year ended December 26, 2004.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is currently traded in the over-the-counter market and is quoted on the Nasdaq Small-Cap Market ("Nasdaq") under the symbol "GRIL". The following table sets forth the high and low bid price per share for our common stock for each quarterly period during the last two fiscal years:

| | | High | Low |
|------|----------------|-------|-------|
| | | ----- | ----- |
| 2003 | - | | |
| | First Quarter | 1.620 | 0.830 |
| | Second Quarter | 2.850 | 1.050 |
| | Third Quarter | 2.950 | 2.010 |
| | Fourth Quarter | 2.900 | 1.940 |
| 2004 | - | | |
| | First Quarter | 3.650 | 2.460 |
| | Second Quarter | 3.440 | 1.800 |
| | Third Quarter | 2.960 | 1.550 |
| | Fourth Quarter | 2.530 | 1.450 |

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The quotations reflect inter-dealer prices without retail mark-up, mark-down or commission and may not represent actual transactions.

At April 11, 2005, the closing bid price of our Common Stock was \$2.75.

As of April 11, 2005, there were approximately 1,200 holders of record of our Common Stock.

We have never declared or paid any cash dividend on our Common Stock and do not expect to declare or pay any such dividend in the foreseeable future.

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ITEM 6. SELECTED FINANCIAL DATA

The following tables present selected historical consolidated financial data derived from our consolidated financial statements. The financial results for fiscal years 2003, 2002, 2001 and 2000 have been restated. See footnote 1 to

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the consolidated financial statements for the impact of the restatement on the 2003 and 2002 results. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of the impact of the restatement on 2001 and 2000. The following data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements included elsewhere herein.

| | Fiscal Year Ended December | | | |
|---|----------------------------|---------------------------------|------------|-----------|
| | 2004 | 2003 | 2002 | 2001 |
| | | Restated | Restated | Restated |
| | | (In thousands except per share) | | |
| Statement of Operations Data: | | | | |
| Sales | \$ 49,938 | \$ 45,858 | \$ 41,826 | \$ 45,022 |
| Reimbursed managed outlet operating expenses | 12,439 | 9,728 | 7,270 | 3,594 |
| Management and license fees | 1,282 | 1,037 | 901 | 771 |
| | ----- | ----- | ----- | ----- |
| Total revenues | 63,659 | 56,623 | 49,997 | 49,387 |
| Operating expenses: | | | | |
| Cost of sales | 14,465 | 13,274 | 11,927 | 12,915 |
| Restaurant operating expenses | 30,552 | 28,050 | 25,649 | 27,100 |
| Managed outlet operating expenses | 12,439 | 9,772 | 7,557 | 3,594 |
| General and administration | 4,472 | 3,696 | 3,426 | 3,381 |
| Depreciation and amortization | 2,005 | 1,816 | 1,868 | 1,838 |
| Pre-opening costs | 167 | 182 | 69 | 199 |
| Gain on sale of assets | (2) | (11) | (71) | (225) |
| Unusual charges | - | - | - | - |
| | ----- | ----- | ----- | ----- |
| Total | 64,098 | 56,779 | 50,425 | 48,802 |
| Income (loss) from operations | (439) | (156) | (428) | 585 |
| Interest expense, net | (272) | (331) | (364) | (564) |
| | ----- | ----- | ----- | ----- |
| Income (loss) before taxes and minority interest | (711) | (487) | (792) | 21 |
| Provision for income taxes | (65) | (89) | (37) | (65) |
| Minority interest | 814 | 704 | 422 | 110 |
| | ----- | ----- | ----- | ----- |
| Net income (loss) | 38 | 128 | (407) | 66 |
| | ----- | ----- | ----- | ----- |
| Preferred dividends accrued | (50) | (50) | (50) | (50) |
| | ----- | ----- | ----- | ----- |
| Net income (loss) applicable to common stock | \$ (12) | \$ 78 | \$ (457) | \$ 16 |
| | ===== | ===== | ===== | ===== |
| Net income (loss) per share applicable to common stock: | | | | |
| Basic | \$ 0.00 | \$ 0.01 | \$ (0.08) | \$ 0.0 |
| | ===== | ===== | ===== | ===== |
| Diluted | \$ 0.00 | \$ 0.01 | \$ (0.08) | \$ 0.0 |
| | ===== | ===== | ===== | ===== |

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| | | | | |
|-------------------------------------|-----------|-----------|-----------|--------|
| Weighted average shares outstanding | | | | |
| Basic | 5,608,541 | 5,537,071 | 5,537,071 | 4,776, |
| | ===== | ===== | ===== | ===== |
| Diluted | 5,608,541 | 5,640,842 | 5,537,071 | 4,776, |
| | ===== | ===== | ===== | ===== |

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| | Fiscal Year Ended December | | | |
|-----------------------------------|----------------------------|--------------------------------|------------|----------|
| | 2004 | 2003 | 2002 | 2001 |
| | ----- | ----- | ----- | ----- |
| | | Restated | Restated | Restated |
| | | (In thousands except per share | | |
| Balance Sheet Data: | | | | |
| Working capital surplus (deficit) | \$ 209 | \$ 378 | \$ (1,045) | \$ (628) |
| Total assets | 19,749 | 17,047 | 16,579 | 17,321 |
| Long-term debt, less | | | | |
| current portion | 977 | 1,254 | 1,743 | 2,371 |
| Stockholders' equity | 3,830 | 3,744 | 3,616 | 4,023 |

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

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference are discussed in the section entitled "Certain Factors Affecting Future Operating Results" beginning on page 38 of this Form 10-K.

GENERAL

Grill Concepts develops, owns and operates casual dining restaurants under the name "Daily Grill" and fine dining restaurants under the name "The Grill on the Alley." Additionally, we manage or license other restaurant properties.

Our revenues are derived from sales at company-owned restaurants, management and license fees from restaurants managed or licensed by us and reimbursements of operating expenses of managed outlets.

During the fiscal year ended December 26, 2004, we owned and operated, for the full fiscal year, thirteen restaurants (ten Daily Grill and four Grill restaurants), including two Daily Grill and three Grill restaurants owned in partnership with third parties. During fiscal 2004, we also operated one fully owned Daily Grill that opened in January.

Also during fiscal 2004, we managed or licensed, for the full fiscal year, six Daily Grill restaurants. During fiscal 2004, we commenced management of one Daily Grill that opened in November and terminated our license relating to the San Jose City Bar and Grill.

During the fiscal year ended December 28, 2003, we owned and operated, for the full fiscal year, thirteen restaurants (nine Daily Grill and four Grill restaurants), including one Daily Grill and three Grill restaurants owned in partnership. During 2003, we also operated one Daily Grill that opened in

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January and is owned in partnership.

Also during fiscal 2003, we managed or licensed, for the full fiscal year, seven restaurants (six Daily Grill and one City Bar and Grill restaurant). During fiscal 2003, we commenced management of one Daily Grill that opened in September.

Sales revenues are derived from sales of food, beer, wine, liquor and non-alcoholic beverages. Approximately 73% of combined 2004 sales were food and 27% were beverage. Sales revenues from restaurant operations are primarily influenced by the number of restaurants in operation at any time, the timing of the opening of such restaurants and the sales volumes of each restaurant.

Management and license fee revenues are derived from individually negotiated arrangements by which we manage restaurants on behalf of third parties or license to third parties the right to operate Daily Grill restaurants. Management and license fees are primarily influenced by the number of management and license arrangements in place, the negotiated management or license fee and the revenues of the managed or licensed restaurants. Management and license fees typically range from five to eight percent of gross sales of the subject restaurants.

Revenues derived from reimbursement of operating expenses of managed outlets relate to contractual undertakings relating to managed restaurants wherein we assume responsibility for some or all operating expenses of managed restaurants and the restaurant owner undertakes to reimburse all of those expenses. Pursuant to the guidance of EITF 01-14 and EITF 99-19, we are considered to be the primary obligor with respect to the reimbursed expenses and, as such, report the reimbursed expenses as revenues with the expenses being reported as "Reimbursed Costs" under operating expenses.

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Expenses are comprised primarily of cost of food and beverages, restaurant operating expenses, including payroll, rent and occupancy costs and reimbursed costs. Our largest expenses are payroll and the cost of food and beverages, which is primarily a function of the price of the various ingredients utilized in preparing the menu items offered at our restaurants. Restaurant operating expenses consist primarily of wages paid to part-time and full-time employees, rent, utilities, insurance and taxes. Reimbursed costs are costs incurred on behalf of managed restaurants that are reimbursable by the managed restaurant. We typically analyze these costs as a percentage of restaurant sales, not total revenues.

In addition to restaurant operating expenses, we pay certain general and administrative expenses that relate primarily to operation of our corporate offices. Corporate office general and administrative expenses consist primarily of salaries of officers, management personnel and clerical personnel, rent, legal and accounting costs, travel, insurance and office expenses.

RESTATEMENT OF FINANCIAL STATEMENTS

The Company began a review of its lease accounting policies following announcements in February 2005 that the Chief Accountant of the Securities and Exchange Commission ("SEC") issued a letter to the American Institute of Certified Public Accountants regarding lease accounting issues. As a result of our review, the Company has revised its accounting for leases in 2004 and restated its historical financial statements as of December 28, 2003 and for each of the two years in the period then ended, as well as the historical financial data as of and for the fiscal years 2001 and 2000 and the 2003 and 2004 quarterly financial data, to correct for these errors in its lease

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accounting. The Company has also corrected the accounting for complimentary meals and promotional activities as part of this restatement process.

Historically, the Company recognized straight-line rents and amortized lessor lease incentives using the initial non-cancelable term of the lease commencing on the date rent payments began. Under generally accepted accounting principles, the Company should have recognized rent expense (net of the related lessor lease incentive amortization) on a straight-line basis over the term of the lease as defined in SFAS No. 13 which begins on the later of when the Company had access to the site or the lease is executed. The impact of correctly calculating rent expense and lessor lease incentive amortization was to increase restaurant operating expenses and decrease general and administrative expenses by \$117,000 and \$1,000, respectively, for fiscal year 2003, to decrease restaurant operating expenses and general and administrative expenses by \$61,000 and \$4,000, respectively, for fiscal year 2002, to decrease restaurant operating expenses and general and administrative expenses by \$135,000 and \$18,000, respectively, for fiscal year 2001, and to increase restaurant operating expenses and decrease general and administrative expenses by \$32,000 and \$80,000, respectively, for fiscal year 2000. The Company also increased other current assets by \$1,116,000 and \$228,000 in fiscal years 2003 and 2002, respectively, to recognize a receivable for tenant improvement allowances to be received, increased fixed assets by \$272,000 in fiscal year 2002 to recognize additional construction in progress and increased long-term liabilities by \$2,862,000, \$2,129,000, \$1,694,000 and \$1,849,000 for deferred rent and lease incentives, to properly reflect the correct lease accounting in each of the fiscal years 2003, 2002, 2001 and 2000, respectively.

In closing the 2004 books and records, the Company also reviewed the estimated useful lives that it was using to amortize its leasehold improvements. In the case of six restaurants, it was found that the incorrect lives had been used. The Company has revised the amortization period to reflect the shorter of their estimated useful lives or the initial lease term. The impact of the change is to increase depreciation and amortization expense by \$70,000, \$69,000, \$76,000 and \$15,000 in fiscal years 2003, 2002, 2001, 2000, respectively.

A portion of the above adjustments was recorded on the books of the LLC's in which we have a majority ownership or we consolidate under FIN 46R. As discussed in the footnotes to the consolidated financial statements the Company allocates results to the minority interests based on the underlying economics of the investment. The impact of the above adjustments increased/(decreased) the amount of loss allocated to the minority interests by \$256,000, \$6,000 and (\$16,000) in fiscal years 2003, 2002 and 2001, respectively, and increased the amount of income allocated to the minority interests by \$22,000 in fiscal year 2000.

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During fourth quarter of 2004, the Company eliminated amounts that had previously been recorded as restaurant sales revenue arising from complimentary meals and promotional activities. The Company's previous method of recording these activities as restaurant sales revenue at the full retail price of each item with a corresponding increase in operating expense is not in accordance with generally accepted accounting principles. Historically the amounts associated with complimentary meals and promotional activities have been recorded as restaurant revenues, with an offsetting amount in restaurant operations and corporate general and administrative expenses. As revised, the Company has eliminated the complimentary portion of meals and promotional activities from revenues and operating expenses. As a result of these adjustments, revenue and expenses were decreased by \$1.7 million, \$1.5 million, \$1.5 million and \$1.4 million in fiscal years 2003, 2002, 2001 and 2000, respectively. These adjustments have no impact on previously reported net

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income.

The individual per share impact of each adjustment noted above was not considered material. The overall impact on earnings per share is shown below in the tables that follow.

The above revisions impacted the balance sheets, statements of operations and statements of cash flows for each of the fiscal years 2000 to 2003. The impact of all the above is as follows:

The following table reflects the effects of the restatement on the Consolidated Balance Sheet:

| | DECEMBER 28, 2003 | |
|--|------------------------|--------------|
| | As previously reported | Restated |
| Prepaid expenses and other current assets | \$ 612,000 | \$ 1,728,000 |
| Total current assets | 3,931,000 | 5,047,000 |
| Furniture, equipment and improvements, net | 11,061,000 | 10,988,000 |
| Total Assets | 16,005,000 | 17,047,000 |
| Other Long Term Liabilities | 2,734,000 | 5,596,000 |
| Total Liabilities | 8,657,000 | 11,519,000 |
| Minority Interest | 2,058,000 | 1,784,000 |
| Accumulated Deficit | (8,311,000) | (9,857,000) |
| Total Stockholders Equity | 5,290,000 | 3,744,000 |
| Total Liabilities & Equity | 16,005,000 | 17,047,000 |

| | DECEMBER 29, 2002 | |
|--|------------------------|-------------|
| | As previously reported | Restated |
| Prepaid expenses and other current assets | \$ 532,000 | \$ 760,000 |
| Total current assets | 3,285,000 | 3,513,000 |
| Furniture, equipment and improvements, net | 11,088,000 | 11,356,000 |
| Total Assets | 16,083,000 | 16,579,000 |
| Other Long Term Liabilities | 1,739,000 | 3,868,000 |
| Total Liabilities | 8,040,000 | 10,169,000 |
| Minority Interest | 2,811,000 | 2,794,000 |
| Accumulated Deficit | (8,369,000) | (9,985,000) |
| Total Stockholders Equity | 5,232,000 | 3,616,000 |
| Total Liabilities & Equity | 16,083,000 | 16,579,000 |

| | DECEMBER 30, 2001 | |
|--|------------------------|---------------|
| | As previously reported | Restated |
| Furniture, equipment and improvements, net | \$ 11,687,000 | \$ 11,752,000 |
| Total Assets | 17,256,000 | 17,321,000 |
| Other Long Term Liabilities | 1,864,000 | 3,558,000 |
| Total Liabilities | 9,259,000 | 10,953,000 |
| Minority Interest | 2,356,000 | 2,345,000 |
| Accumulated Deficit | (7,960,000) | (9,578,000) |
| Total Stockholders Equity | 5,641,000 | 4,023,000 |
| Total Liabilities & Equity | 17,256,000 | 17,321,000 |

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| | DECEMBER 28, 2000 | |
|--|------------------------|---------------|
| | As previously reported | Restated |
| Furniture, equipment and improvements, net | \$ 12,230,000 | \$ 12,372,000 |

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| | | |
|-----------------------------|-------------|-------------|
| Total Assets | 15,927,000 | 16,069,000 |
| Other Long Term Liabilities | 1,960,000 | 3,809,000 |
| Total Liabilities | 10,940,000 | 12,789,000 |
| Minority Interest | 1,441,000 | 1,414,000 |
| Accumulated Deficit | (7,964,000) | (9,644,000) |
| Total Stockholders Equity | 3,546,000 | 1,866,000 |
| Total Liabilities & Equity | 15,927,000 | 16,069,000 |

The following table reflects the effects of the restatement on the Consolidated Statement of Operations:

| | December 28, 2003 | | December 29, 2002 | |
|---|------------------------|---------------|------------------------|---------------|
| | As previously reported | Restated | As previously reported | Restated |
| Sales | \$ 47,578,000 | \$ 45,858,000 | \$ 43,336,000 | \$ 41,000,000 |
| Total Revenues | 58,343,000 | 56,623,000 | 51,507,000 | 49,000,000 |
| Restaurant operating expenses | 29,535,000 | 28,050,000 | 27,082,000 | 25,000,000 |
| General & administrative | 3,815,000 | 3,696,000 | 3,568,000 | 3,000,000 |
| Depreciation & amortization | 1,746,000 | 1,816,000 | 1,799,000 | 1,000,000 |
| Total operating expenses | 58,313,000 (1) | 56,779,000 | 51,931,000 (1) | 50,000,000 |
| Income (loss) from operations | 30,000 | (156,000) | (424,000) | (4,000,000) |
| Loss before taxes & minority interest | (301,000) | (487,000) | (788,000) | (7,000,000) |
| Loss before minority interest | (390,000) | (576,000) | (825,000) | (8,000,000) |
| Minority interest | 448,000 | 704,000 | 416,000 | 4,000,000 |
| Net income (loss) | 58,000 | 128,000 | (409,000) | (4,000,000) |
| Net income (loss) applicable to common stock | 8,000 | 78,000 | (459,000) | (4,000,000) |
| Net income (loss) per share applicable to common stock: | | | | |
| Basic Net Income (loss) | \$ 0.00 | \$ 0.01 | \$ (0.08) | \$ (0.08) |
| Diluted Net Income (loss) | \$ 0.00 | \$ 0.01 | \$ (0.08) | \$ (0.08) |

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| | December 30, 2001 | | December 31, 2000 | |
|--|------------------------|---------------|------------------------|---------------|
| | As previously reported | Restated | As previously reported | Restated |
| Sales | \$ 46,541,000 | \$ 45,022,000 | \$ 46,809,000 | \$ 45,000,000 |
| Total Revenues | 50,906,000 | 49,387,000 | 51,276,000 | 49,000,000 |
| Restaurant operating expenses | 28,624,000 | 27,100,000 | 28,460,000 | 27,000,000 |
| General & administrative | 3,530,000 | 3,381,000 | 3,357,000 | 3,000,000 |
| Depreciation & amortization | 1,762,000 | 1,838,000 | 1,640,000 | 1,000,000 |
| Total operating expenses | 50,399,000 (1) | 48,802,000 | 50,975,000 (1) | 49,000,000 |
| Income from operations | 507,000 | 585,000 | 301,000 | 0,000 |
| Income (loss) before taxes & minority interest | (57,000) | 21,000 | (279,000) | (2,000,000) |
| Loss before minority interest | (122,000) | (44,000) | (293,000) | (2,000,000) |
| Minority interest | 126,000 | 110,000 | (37,000) | (0,000) |
| Net income (loss) | 4,000 | 66,000 | (330,000) | (3,000,000) |
| Net income (loss) applicable to common stock | (46,000) | 16,000 | (380,000) | (3,000,000) |

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Net income (loss) per share
applicable to common stock:

| | | | | | | | |
|--------------------|----|--------|----|------|----|--------|----|
| Basic Net Income | \$ | (0.01) | \$ | 0.00 | \$ | (0.09) | \$ |
| Diluted Net Income | \$ | (0.01) | \$ | 0.00 | \$ | (0.09) | \$ |

(1) Includes cost of sales amounts that were not included in the "Total operating expenses" subtotal in prior financial statements.

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RESULTS OF OPERATIONS

The following table sets forth certain items as a percentage of total revenues from our Statements of Operations during 2004, 2003 and 2002. As noted above, we typically analyze our operating expenses as a percentage of sales revenues, not total revenues.

| | Fiscal Year Ended December | | |
|------------------------------------|----------------------------|----------|----------|
| | 2004 | 2003 | 2002 |
| | ----- | ----- | ----- |
| | | Restated | Restated |
| Sales revenues | 78.5% | 81.0% | 83.7% |
| Cost reimbursements | 19.5 | 17.2 | 14.5 |
| Management and licensing fees | 2.0 | 1.8 | 1.8 |
| | ----- | ----- | ----- |
| Total revenues | 100.0 | 100.0 | 100.0 |
| Cost of sales | 22.7 | 23.4 | 23.9 |
| Restaurant operating expense | 48.0 | 49.5 | 51.3 |
| Reimbursed costs | 19.5 | 17.4 | 15.1 |
| General and administrative expense | 7.0 | 6.5 | 6.9 |
| Depreciation and amortization | 3.2 | 3.2 | 3.7 |
| Pre-opening costs | 0.3 | 0.3 | 0.1 |
| Gain on sale of assets | (0.0) | (0.0) | (0.1) |
| | ----- | ----- | ----- |
| Total operating expenses | 100.7 | 100.3 | 100.9 |
| | ----- | ----- | ----- |
| Operating income (loss) | (0.7) | (0.3) | (0.9) |
| Interest expense, net | (0.4) | (0.6) | (0.7) |
| | ----- | ----- | ----- |
| Loss before income tax | (1.1) | (0.9) | (1.6) |
| Provision for taxes | (0.1) | (0.2) | (0.1) |
| Minority interest | 1.3 | 1.3 | 0.8 |
| | ----- | ----- | ----- |
| Net income (loss) | 0.1% | 0.2% | (0.9)% |
| | ===== | ===== | ===== |

FISCAL YEAR 2004 COMPARED TO FISCAL YEAR 2003

Revenues. Revenues for 2004 increased 12.4% to \$63.7 million from \$56.6 million in 2003. Sales revenues increased 8.9% to \$49.9 million in 2004 from \$45.9 million in 2003. Reimbursed managed outlet operating expenses increased 27.9% to \$12.4 million from \$9.7 million in 2003. Management and license fee

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revenues increased to \$1.3 million in 2004 from \$1.0 million in 2003. The restaurant sales information excludes revenue related to reimbursed operating expenses and management and license fees.

Sales for Daily Grill restaurants increased by 12.5% from \$30.1 million in 2003 to \$33.8 million in 2004. The increase in sales revenues for the Daily Grill restaurants from 2003 to 2004 was primarily attributable to an increase in same store sales of 4.6% (\$1.3 million) for restaurants open for 12 months in both 2004 and 2003 and opening of the Bethesda Daily Grill (\$2.9 million) and a decrease at our South Bay Daily Grill (\$400,000). Weighted average weekly sales at the Daily Grill restaurants decreased 1.1% from \$58,052 in 2003 to \$57,757 in 2004.

Sales for Grill restaurants increased by 2.1% from \$15.8 million in 2003 to \$16.1 million in 2004. The increase in sales revenues for the Grill restaurants from 2003 to 2004 was attributable to the improved check averages partially offset by decreased guest counts. Weighted average weekly sales at the Grill restaurants increased 2.1% from \$75,971 in 2003 to \$77,545 in 2004.

Selected price increases may be implemented from time to time in the future, consistent with the casual dining industry and how the economy fares. Future revenue growth is expected to be driven principally by a combination of expansion into new markets and the opening of additional restaurants and establishment of market share in those new markets as well as increases in guest count at existing restaurants and selected price increases. When entering new markets where we have not yet established a market presence, sales levels are expected to be lower than in existing markets where we have a concentration of restaurants and high customer awareness. Although our experience in developing markets indicates that the opening of multiple restaurants within a particular market results in increased market share, decreases in comparable restaurant sales could result.

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Cost reimbursements increased in 2004 primarily due to the full year operation of Portland Daily Grill, the opening of Long Beach Daily Grill and improved sales at other managed restaurants.

Management and license fee revenues during 2004 were attributable to (1) hotel restaurant management services which accounted for \$1,073,000 of management fees, and (2) licensing fees from the LAX Daily Grill, Skokie, Illinois Daily Grill and the San Jose City Bar and Grill which totaled \$209,000. The increase in management fees during 2004 was attributable to (1) management of the Portland Daily Grill open a full year compared to 15 weeks in 2003, (2) a 26.6% increase in sales at the San Francisco Daily Grill and (3) sales increase of over 6% at the Georgetown Daily Grill, Burbank Daily Grill and Houston Daily Grill. We have reserved 100% of the Portland management due to slower than expected sales. We terminated the licensed operation of the San Jose City Bar and Grill in 2004.

Operating Expenses and Operating Results. Total operating expenses, including cost of sales, restaurant operating expenses, reimbursed costs, general and administrative expense, depreciation and amortization, and pre-opening costs, increased 12.9% to \$64.1 million in 2004 from \$56.8 million in 2003.

Cost of Sales. Cost of sales consists exclusively of the cost of food and beverages sold. Cost of sales increased by 9.0% (\$1.2 million) and increased slightly as a percentage of sales to 29.0% in 2004 compared to 28.9% in 2003. The increase in cost of sales reflects the opening of new restaurants and higher revenues, generally. The slight increase in cost of sales as a percentage of

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sales reflects fluctuation in food costs.

Restaurant Operating Expenses. Restaurant operating expenses consist of wages and benefits of restaurant personnel and all other operating expenses. The operating expenses include, but are not limited to, supplies, advertising, occupancy, maintenance and utilities. Restaurant operating expenses increased 8.9% to \$30.6 million in 2004 from \$28.1 million in 2003. As a percentage of sales, restaurant operating expenses represented 61.2% in both 2004 and 2003. The opening during 2004 of the Bethesda Daily Grill accounted for \$1.9 million of the increase. For comparable restaurants the expenses as a percentage of sales improved slightly to 60.3% from 60.5% in 2003.

Reimbursed Costs. Reimbursed costs increased 27.3% from \$9.8 million in 2003 to \$12.4 million in 2004. These expenses represent the operating costs for which we are the primary obligor of the restaurants we do not consolidate. The increase is primarily due to the full year operations of the Portland Daily Grill, the opening of the Long Beach Daily Grill and improved sales at other restaurants.

General and Administrative. General and administrative expenses rose to \$4.5 million in 2004 compared to \$3.7 million in 2003. General and administrative expenses represented 7.0% of total revenues in 2004 as compared to 6.5% of total revenues in 2003. The increase was the result of higher payroll and related benefits related to building staff for our growth (\$367,000), increased professional services (\$248,000), increased travel due to new locations (\$76,000), and reserve for uncollected management fees (\$109,000).

Depreciation and Amortization. Depreciation and amortization expense was \$2.0 million during 2004 and \$1.8 million in 2003. The increase was due primarily to the addition of the Bethesda Daily Grill.

Pre-opening costs. Pre-opening costs totaled \$167,000 in 2004 as compared with \$182,000 in 2003. These pre-opening costs were attributable to the opening in January 2003 of the South Bay Daily Grill and the opening of the Bethesda Daily Grill in January 2004.

Interest Expense. Interest expense, net, totaled \$272,000 during 2004 as compared to \$331,000 in 2003. The decrease in interest expense was primarily attributable to reduced debt levels as a result of the maturing of loans.

Provision for income taxes. The income tax provision for 2004 and 2003 are due mainly to state taxes as the company has a federal net operating loss to carry forward. The tax rates in 2004 and 2003 were comprised of the federal and state statutory rates, less any permanent items and tax credits based on the annual estimated effective tax rates for the respective years.

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Minority Interest. We reported a minority interest in the loss of our majority owned subsidiaries of \$814,000 during 2004, consisting of a minority interest in the earnings of San Jose Grill on the Alley, LLC of \$154,000, a minority interest in the loss of The Grill on Hollywood, LLC of \$357,000, a minority interest in the loss of The Daily Grill at Continental Park, LLC of \$483,000, a minority interest in the loss of the 612 Flower Daily Grill LLC of \$3,000 and a partnership loss in the Universal CityWalk Daily Grill of \$125,000. During 2003 we reported a minority interest in the loss of our majority owned subsidiaries of \$704,000, consisting of a minority interest in the earnings of San Jose Grill on the Alley, LLC of \$141,000, a minority interest in the loss of The Grill on Hollywood, LLC of \$366,000 and a minority interest allocation from The Daily Grill at Continental Park of \$334,000 and partnership loss in the Universal CityWalk Daily Grill of \$145,000. The Company allocates profits and

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losses to the minority interest in its partially owned subsidiaries based on the underlying economics of the investment. These may or may not reflect the Company's ownership percentage and can be inconsistent with the allocation provisions specified in the joint venture agreements. Where there is a disparity among the ownership percentages, the terms of the agreements and the underlying economics, the Company utilizes a hypothetical liquidation model to allocate profits and losses. Under this model, all of the venture's assets and liabilities as reflected in the balance sheet are assumed to be realized at their GAAP carrying values. The hypothetical liquidating proceeds are calculated at the end of each period and applied to the capital accounts as would occur under a true liquidation scenario. The change in this balance from period to period represents the investors' share of the income or loss.

Net Income. We reported a net income of \$38,000 in 2004 as compared to a net income of \$128,000 in 2003.

FISCAL YEAR 2003 COMPARED TO FISCAL YEAR 2002

Revenues. Revenues for 2003 increased 13.3% to \$56.6 million from \$50.0 million in 2002. Sales revenues increased 9.6% to \$45.9 million in 2003 from \$41.8 million in 2002. Reimbursed managed outlet operating expenses increased 33.8% to \$9.7 million from \$7.3 million in 2002. Management and license fee revenues increased to \$1.0 million in 2003 from \$0.9 million in 2002. The restaurant sales information excludes revenue related to reimbursed operating expenses and management and license fees.

Sales for Daily Grill restaurants increased by 10.7% from \$27.2 million in 2002 to \$30.1 million in 2003. The increase in sales revenues for the Daily Grill restaurants from 2002 to 2003 was primarily attributable to a increase in same store sales of 5.3% (\$1.3 million) for restaurants open for 12 months in both 2003 and 2002 and opening of the South Bay Daily Grill (\$2.6 million), offset by the closure of the Encino Daily Grill (\$0.5 million) and the Cherry Hill Pizzeria Uno (\$0.5 million). Weighted average weekly sales at the Daily Grill restaurants increased 8.1% from \$53,701 in 2002 to \$58,052 in 2003. Comparable restaurant sales and weighted average weekly sales at the Daily Grill restaurants in 2003 were favorably affected approximately equally by increased guest counts and improved average checks.

Sales for Grill restaurants increased by 8.1% from \$14.6 million in 2002 to \$15.8 million in 2003. The increase in sales revenues for the Grill restaurants from 2002 to 2003 was attributable to the improved check averages and increased guest counts. Weighted average weekly sales at the Grill restaurants increased from \$70,252 in 2002 to \$75,971 in 2003.

Reimbursed costs which represent employee and other operating expenses of managed restaurants for which we are reimbursed by the restaurants increased in 2003 primarily due to the opening of Portland Daily Grill and the full year of operations for San Francisco Daily Grill and Houston Daily Grill, which were open for a partial year in 2002.

Management and license fee revenues during 2003 were attributable to (1) hotel restaurant management services which accounted for \$834,000 of management fees, and (2) licensing fees from the LAX Daily Grill, Skokie, Illinois Daily Grill and the San Jose City Bar and Grill which totaled \$203,000. The increase in management fees during 2003 was attributable to (1) management of the San Francisco Daily Grill open a full year compared to 44 weeks in 2002, (2) management of the Houston Daily Grill for the full year compared to 25 weeks in 2002 and (3) management of the Portland Daily Grill for 15 weeks in 2003.

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Operating Expenses and Operating Results. Total operating expenses, including cost of sales, restaurant operating expenses, managed outlet operating expenses, general and administrative expense, depreciation and amortization, and pre-opening costs, increased 12.6% to \$56.8 million in 2003 from \$50.4 million in 2002.

Cost of Sales. Cost of sales consists exclusively of the cost of food and beverages sold. While sales revenues increased by 9.6% (\$4.0 million) in 2003 as compared to 2002, cost of sales increased by 11.3% (\$1.3 million) and increased as a percentage of sales from 28.5% in 2002 to 28.9% in 2003. The increase in cost of sales as a percentage of restaurant sales was attributable to higher beef costs during the second half of the year.

Restaurant Operating Expenses. Restaurant operating expenses consist of wages and benefits of restaurant personnel and all other operating expenses. The operating expenses include, but are not limited to, supplies, advertising, occupancy, maintenance and utilities. Restaurant operating expenses increased 9.4% to \$28.1 million in 2003 from \$25.7 million in 2002. As a percentage of restaurant sales, restaurant operating expenses represented 61.3% in 2003 compared to 61.3% in 2002. The dollar increase in restaurant operating expenses followed the sales increase and was negatively impacted by increases in marketing, stock option compensation expense, workers' compensation and general insurance. The decrease in operating expenses as a percentage of sales resulted from improved labor management.

Reimbursed Costs. Reimbursed costs expenses increased 29.3% from \$7.6 million in 2002 to \$9.8 million in 2003. These expenses represent the operating costs for which we are the primary obligor of the restaurants we do not consolidate. The increase is primarily due to the opening of the Portland Daily Grill and the full year of operations for San Francisco Daily Grill and Houston Daily Grill, which were open for a partial year in 2002.

General and Administrative. General and administrative expenses rose slightly to \$3.7 million in 2003 compared to \$3.4 million in 2002. General and administrative expenses represented 6.5% of total revenues in 2003 as compared to 6.9% of total revenues in 2002. While these expenses in total were nearly equal, there were increases in payroll and related benefits, stock option compensation expense, professional services and rent, partially offset by decreases in recruitment costs and office expenses.

Depreciation and Amortization. Depreciation and amortization expense was \$1.8 million during 2003 and \$1.9 million during 2002.

Pre-opening Costs. Pre-opening costs totaled \$182,000 in 2003 as compared with \$69,000 in 2002. These pre-opening costs were attributable to the opening in January 2003 of the South Bay Daily Grill and the opening of the Bethesda Daily Grill in January 2004.

Interest Expense. Interest expense, net, totaled \$331,000 during 2003 as compared to \$364,000 in 2002. The decrease in interest expense was primarily attributable to the maturing of the loans.

Provision for income taxes. The income tax provision for 2003 and 2002 are due mainly to state taxes as the company has a federal net operating loss to carry forward. The tax rates in 2003 and 2002 were comprised of the federal and state statutory rates, less any permanent items and tax credits based on the annual estimated effective tax rates for the respective years.

Minority Interest. We reported a minority interest in the loss of our majority owned subsidiaries of \$704,000 during 2003, consisting of a minority interest in the earnings of San Jose Grill on the Alley, LLC of \$141,000, a minority interest in the loss of The Grill on Hollywood, LLC of \$366,000, a

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minority interest in the loss of The Daily Grill at Continental Park, LLC of \$334,000 and a partnership loss in the Universal CityWalk Daily Grill of \$145,000. We reported a minority interest in the loss of our majority owned subsidiaries of \$422,000 for the year ended December 29, 2002 comprised of a minority interest in the earnings of San Jose Grill on the Alley, LLC of \$111,000, a minority interest in the loss of The Grill on Hollywood, LLC of \$307,000 and a minority interest allocation from The Daily Grill at Continental Park of \$3,000 and a partnership loss in the Universal CityWalk Daily Grill of \$229,000.

Net Income/(Loss). We reported net income of \$128,000 in 2003 as compared to a net loss of \$407,000 for 2002.

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LIQUIDITY AND CAPITAL RESOURCES

CASH POSITION AND SHORT-TERM LIQUIDITY. At December 26, 2004, we had a working capital surplus of \$209,000 and a cash balance of \$1.4 million as compared to a working capital surplus of \$378,000 and a cash balance of \$1.5 million at December 28, 2003. In 2004 we generated cash from operations of \$4.1 million which included tenant improvement allowances of \$2.1 million, purchased fixed assets of \$2.9 million increased restricted cash of \$0.8 million and repaid debt of \$0.5 million. During 2003 we generated cash from operations of \$1.8 million used cash to purchase fixed assets of \$1.4 million and repay debt of \$0.7 million.

Our need for capital resources historically has resulted from, and for the foreseeable future is expected to relate primarily to, the construction and opening of new restaurants. Funds necessary to operate restaurants under management agreements are usually funded by cash generated by the restaurants. Sales from these outlets are deposited into an agency account belonging to the owner and we pay the outlet operating expenses, including our fee, from this agency account. Historically, we have funded our day-to-day operations through operating cash flows that have ranged from a \$803,000 to \$4.1 million over the past three fiscal years. Growth has been funded through a combination of bank borrowing, loans from stockholders/officers, the sale of debentures and stock, loans and tenant allowances from certain of our landlords, and, beginning in 1999, through joint venture arrangements.

FINANCING FACILITIES. At December 26, 2004, the Company had \$45,000 owing under equipment leasing financing transactions, an obligation to a member of Chicago - The Grill on the Alley, LLC of \$1.0 million for a guaranteed return of its invested capital, loans from stockholders/ officers/directors of \$0.2 million, equipment loans of \$0.2 million, and loans/advances from a landlord of \$0.1 million.

On August 1, 2000, we received a \$400,000 loan from private individuals. The loan bears interest at 9% and is payable in monthly installments over four years. In connection with the loan, we issued 40,000 warrants. In June 2001 the lender became a member of our Board of Directors and the loan was reclassified as related party debt. The loan had been paid in full at December 26, 2004.

In June 2004, we finalized an agreement with respect to the establishment of a new bank credit facility to replace our facility that expired in October 2004. Under the terms of the new bank credit facility, we have been provided with financing in the form of a revolving line of credit in the amount of \$500,000, an irrevocable standby letter of credit in the amount of \$700,000, increased to \$860,000 in January 2005, and equipment financing in the amount of \$500,000. The facility has a one-year term, is secured by assets and is subject

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to certain standard borrowing covenants. We have not utilized any funds from the current or prior lines of credit dating back to 2001 except for \$45,000 of equipment leasing in 2004; therefore, there should be no negative impact if the current facility is not extended. Interest is at the bank's variable reference rate. Although we were in default of a covenant at year-end, the bank has granted us a waiver.

We held preliminary talks with the bank to renew its existing credit lines for another year. Given the expected capital expenditures of approximately \$600,000 (net of \$3.5 million in both landlord reimbursements and joint venture contributions) for the new restaurants planned for 2005 and refurbishments on existing restaurants, management believes we will be able to meet our expected obligations from our existing cash flow from operations if it is unable to secure bank financing.

OPERATING LEASES. During 2004, we, and our subsidiaries, were obligated under eighteen leases covering the premises in which our Daily Grill and Grill Restaurants are located as well as leases on our executive offices. Such restaurant leases and the executive office lease contain minimum rent provisions which provided for the payment of minimum aggregate annual rental payments of approximately \$3.7 million in 2004 and percentage rent obligations, above and beyond minimum rent, of \$0.7 million. Our minimum rent obligations for 2005 are \$3.3 million.

CONTRACTUAL OBLIGATIONS. Our only material contractual obligations requiring determinable future payments on our part are various notes payable and our leases relating to our executive offices and restaurants, each of which is described above.

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The following table details our contractual obligations as of December 26, 2004:

| | Payments due by period | | | | |
|--|------------------------|---------------------|--------------------|--------------------|------------|
| | Total | 2005 | 2006 - 2007 | 2008 - 2009 | Th |
| Long-term debt | \$ 1,467,000 | \$ 490,000 | \$ 386,000 | \$ 465,000 | \$ |
| Capital lease obligations | - | - | - | - | |
| Operating lease commitments | 25,062,000 | 3,282,000 | 6,103,000 | 4,753,000 | 1 |
| Other contractual purchase obligations | - | - | - | - | |
| Other long-term liabilities | - | - | - | - | |
| Total | \$26,529,000 | \$ 3,772,000 | \$6,489,000 | \$5,218,000 | \$1 |

COMMITMENTS RELATING TO MANAGED RESTAURANTS AND LLCs. Funds necessary to operate restaurants under management agreements are usually funded by cash generated by the restaurant. Sales from these outlets are deposited directly into an agency account belonging to the owner and we pay the outlet operating expenses, including our fee, from this agency account. We began management in February 2002, of the San Francisco Daily Grill in the Handlery Hotel in Union Square. Cost of opening the Handlery Hotel Daily Grill in San Francisco was \$2.8 million, of which we contributed approximately \$331,000, with the balance being paid by the hotel owners.

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We began management of a hotel-based Daily Grill in the Westin Galleria in Houston, Texas on July 10, 2002. Under the terms of the Management Agreement, we advanced \$64,000 to the restaurant for initial working capital which has since been repaid in full.

We began management in September 2003, of the Portland Daily Grill in the Portland Westin Hotel in Portland, Oregon. Under the terms of the Management Agreement, we had no cash obligations for initial advances or construction costs.

We began management in November 2004, of the Long Beach Daily Grill in the Hilton Hotel in Long Beach, California. Under the terms of the Management Agreement, we had no cash obligations for initial advances or construction costs.

Under certain of our operating and management agreements we have an obligation to potentially make additional cash advances and/or contributions and may not realize any substantial returns for some time. The agreements and arrangements under which we may be required to make cash advances or contributions, guarantee obligations or defer receipt of cash are:

CITYWALK. The CityWalk management agreement requires that each member loan, interest free, to the joint venture 50 percent of any operating deficit forecast for the next quarter, such loans to be repaid out of the first cash available from operations. Each time funds were necessary, we have agreed with our partner, to consider the advances additional capital contributions rather than loans. As of December 26, 2004, we had made additional capital contributions to the CityWalk Partnership of \$201,000.

SAN FRANCISCO DAILY GRILL. The management agreement for the San Francisco Daily Grill stipulates that if in any month there is insufficient working capital to pay operating expenses, excluding payments to us or the owner, we will provide one-half of the required working capital. Such advances are to be repaid prior to deferred payments to us or the owner. No working capital advances have been necessary.

PORTLAND DAILY GRILL. The management agreement for the Portland Daily Grill stipulates that the Owner shall provide working capital of no less than \$50,000 or more than \$150,000. If during any month there is insufficient working capital to pay for operating expenses the Owner agreed to advance the required working capital until the balance of the Owner Working Capital Advance equals \$150,000. Thereafter if additional working capital is necessary we as the manager will be required to loan it. Any advances we make will earn interest at a rate of 12% per annum and will be repaid as second priority behind owner's working capital advance but before owner's return of capital. At December 26, 2004 the owner had advanced \$150,000.

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CHICAGO - THE GRILL ON THE ALLEY. The Operating Agreement and the Senior Promissory Note for Chicago - The Grill on the Alley, LLC stipulates that the non-manager member shall receive a preferred return of eight percent on its capital contribution and a payment on its converted capital prior to any distribution of cash. We have guaranteed the repayment of the Senior Promissory Note as well as the contributed capital for Chicago - The Grill on the Alley.

THE GRILL ON HOLLYWOOD. The Operating Agreement for The Grill on Hollywood, LLC stipulates that 90% of distributable cash shall go to the non-managing member until its preferred return, unrecovered contribution

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and any additional contribution have been returned. As of December 26, 2004 no cash has been distributed.

SAN JOSE GRILL. The Operating Agreement for San Jose Grill, LLC stipulates that distributable cash shall be paid first 10% to the manager and 90% to the members in proportion to their ownership percentage until initial capital is recovered, then as a preferred return on the capital contributions to both members in proportion to their ownership percentage, then to the managing member and non-managing member in proportion to their ownership percentage until the additional capital contribution is recovered, and finally 16 2/3% to the manager and the balance to the members in proportion to their ownership percentages.

Our San Jose Grill, Chicago - Grill on the Alley, Grill on Hollywood and South Bay Daily Grill restaurants are each owned by limited liability companies (the "LLCs") for which we serve as manager and own a controlling interest. Each of the LLCs has minority interest owners, some of whom have participating rights in the joint venture such as the ability to approve operating and capital budgets and the borrowing of money. In connection with the financing of each of the LLCs, the minority members may have certain rights to priority distributions of capital until they have received a return of their initial investments ("Return of Member Capital") as well as rights to receive defined preferred returns on their invested capital ("Preferred Return").

Our Universal CityWalk Daily Grill is owned by a partnership for which we serve as manager. Our partner has certain rights to priority distribution of capital from the CityWalk partnership until they have received their initial investments ("Return of Member Capital").

The following tables set forth a summary for each of the LLCs and the partnership of (1) the initial capital contributions of the Company and the minority LLC members or partner (the "Members"), (2) additional capital contributions, (3) the distributions of capital to the Members and/or us during the year ended December 26, 2004, (4) the unreturned balance of the capital contributions of the Members and/or us at December 26, 2004, (5) the Preferred Return rate to Members and/or us, (6) the accrued but unpaid preferred returns due to the Members and/or us at December 26, 2004, (7) the management incentive fees, if any, payable to us, and (8) a summary of the principal distribution provisions. In each of the tables, the balance of distributable cash represents cash available for distribution to the members after all obligations, including minimum working capital advances, have been satisfied. The distribution provisions outlined below are consistent with the order of distributions in a liquidation scenario and are utilized for purposes of allocated profits and losses under the liquidation model described elsewhere in this accounting policy footnote under "Principles of Consolidation and Minority Interests."

SAN JOSE GRILL LLC

| | | |
|--|-------------|-------------|
| Initial Capital Contribution: | Members (a) | \$1,149,650 |
| | | ===== |
| | Company | \$ 350,350 |
| | | ===== |
| Distributions of profit during the year ended December 26, 2004: | Members | \$ 171,000 |
| | | ===== |
| | Company | \$ 171,000 |
| | | ===== |
| Unreturned Initial Capital Contributions at December 26, 2004: | Members | \$ 0 |
| | | ===== |
| | Company | \$ 0 |
| | | ===== |

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| | | |
|--|---------|------|
| Preferred Return rate: | Members | 10% |
| | Company | 10% |
| Accrued but unpaid Preferred Returns at December 26, 2004: | Members | \$ 0 |
| | Company | \$ 0 |
| Management Fee: | Company | 5% |

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Principal Distribution Provisions:

| Order of Distributions ----- | ALLOCATION ----- |
|--|---|
| 1 Until Return of Initial Capital | 10% to Company (Manager) 50.05% of 90% to Company 49.95% of 90% to Members |
| 2 Until Return of Preferred Return | 50.05% to Company 49.95% to Members |
| 3 Until Return of Additional Contributions | 50.05% to Company 49.95% to Members |
| Thereafter: | |
| 4 Balance of distributable cash | 16.67% to Company (Manager) 50.05% of 83.33% to Company 49.95% of 83.33% to Members |

CHICAGO - GRILL ON THE ALLEY

| | | |
|---|-------------|----------------------|
| Initial Capital Contribution: | Members (b) | \$1,700,000 ===== |
| | Company | \$ 0 ===== |
| Distributions of capital and note repayments during the year ended December 26, 2004: | Members (b) | \$ 252,000 ===== |
| Unreturned Initial Capital Contributions at December 26, 2004: | Members | \$1,076,000 ===== |
| Preferred Return rate: | Members | 8% |
| Accrued but unpaid Preferred Returns at December 26, 2004: | Members | \$ 0 |
| Management Fee: | Company | 5% |

Principal Distribution Provisions:

| Order of Distributions ----- | ALLOCATION ----- |
|------------------------------------|---------------------|
| 1 Until Return of Members Capital | 100% to Members |
| 2 Until Return of Preferred Return | 100% to Members |
| Thereafter: | |

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| | | |
|---|-------------------------------|----------------------------------|
| 3 | Balance of distributable cash | 60% to Company 40% to Members |
|---|-------------------------------|----------------------------------|

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THE GRILL ON HOLLYWOOD LLC

| | | |
|---|-------------|----------------------|
| Initial Capital Contribution: | Members | \$1,200,000 ===== |
| | Company | \$ 250,000 ===== |
| Distributions of capital during the year ended December 26, 2004: | Members | \$ 0 ===== |
| | Company | \$ 0 ===== |
| Unreturned Initial Capital Contributions at December 26, 2004: | Members | \$1,200,000 ===== |
| | Company | \$ 250,000 ===== |
| Preferred Return rate: | Members | 12% |
| | Company | 12% |
| Accrued but unpaid Preferred Returns at December 26, 2004: | Members (d) | \$ 0 ===== |
| | Company (d) | \$ 0 ===== |
| Management Fee: | Company | 5% |

Principal Distribution Provisions:

| Order of Distributions ----- | ALLOCATION ----- |
|--|--|
| 1 Until Return of Members Capital and Preferred Return | 10% to Company (Manager) 90% to Members |
| 2 Until Return of Company's Capital and Preferred Return | 90% to Company (Manager) 10% to Members |

Thereafter:

| | | |
|---|-------------------------------|----------------------------------|
| 3 | Balance of distributable cash | 51% to Company 49% to Members |
|---|-------------------------------|----------------------------------|

SOUTH BAY DAILY GRILL (CONTINENTAL PARK LLC)

| | | |
|---|---------|----------------------|
| Initial Capital Contribution: | Members | \$1,000,000 ===== |
| | Company | \$ 350,000 ===== |
| Additional Capital Contribution | Members | \$ 0 ===== |
| | Company | \$ 100,000 ===== |
| Distributions of capital during the year ended December 26, 2004: | Members | \$ 0 |

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| | | |
|---|-------------|-------------|
| | Company | ===== |
| | | \$ 0 |
| | | ===== |
| Unreturned Initial Capital Contributions at December 26, 2004: | Members | \$1,000,000 |
| | | ===== |
| | Company | \$ 350,000 |
| | | ===== |
| Preferred Return rate: | Members | 10% |
| | Company (c) | 10% |
| Accrued but unpaid Preferred Returns at December 26, 2004: | Members (d) | \$ 0 |
| | | ===== |
| | Company (d) | \$ 0 |
| | | ===== |
| Management Fee: | Company | 5% |

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Principal Distribution Provisions:

| Order of Distributions ----- | ALLOCATION ----- |
|--|--------------------------------------|
| 1 Until payment in full of all deferred management fees | 100% to Company (Manager) |
| 2 Until Return of Any Additional Contributions and Preferred Returns thereon | Ratably to Company and Members |
| 3 Until \$300,000 is paid | 33.3% to Company 66.7% to Members |
| 4 Until Return of Members accrued and unpaid preferred returns | 10% to Company 90% to Members |
| 5 Until Members Capital Contribution Returned | 10% to Company 90% to Members |
| 6 Until Return of Company's Preferred Return | 90% to Company 10% to Members |
| 7 Until Return of Company's Capital Contribution | 90% to Company 10% to Members |
| Thereafter | |
| 8 Balance of distributable cash | 50.1% to Company 49.9% to Members |

UNIVERSAL CITYWALK DAILY GRILL

| | | |
|-----------------------------------|---------|-------------|
| Initial Capital Contribution: | Members | \$1,100,000 |
| | | ===== |
| | Company | \$ 0 |
| | | ===== |
| Additional Capital Contributions: | Members | \$ 201,106 |

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| | | |
|---|-------------|-------------|
| | Company | ===== |
| | | \$ 201,106 |
| | | ===== |
| Distributions of capital during year ended December 26, 2004: | Members | \$ 0 |
| | | ===== |
| | Company | \$ 0 |
| | | ===== |
| Unreturned Initial and Additional Capital Contributions at December 26, 2004: | Members | \$1,301,106 |
| | | ===== |
| | Company | \$ 201,106 |
| | | ===== |
| Preferred Return rate: | Members | Prime rate |
| | Company | 0% |
| Accrued but unpaid Preferred Returns at December 26, 2004: | Members (d) | \$ - |
| | | ===== |
| | Company | \$ - |
| | | ===== |
| Management Fee: | Company | 5% |

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Principal Distribution Provisions:

| Order of Distributions ----- | ALLOCATION ----- |
|---|--|
| 1 Until Return of Additional Capital Contributions | 50% to Company (Manager) 50% to Members |
| 2 Until Return of \$550,000 of Members Capital Contribution | 0% to Company (Manager) 100% to Members |
| 3 Until Members unpaid preferred return is paid in full | 0% to Company (Manager) 100% to Members |
| 4 Until return of initial contribution and preferred return | 20% to Company (Manager) 80% to Members |
| Thereafter: | |
| 5 Balance of distributable cash | 50% to Company 50% to Members |

- (a) The initial capital contributions of the Members of San Jose Grill LLC consisted of a capital contribution of \$349,650 and a loan of \$800,000.
- (b) The initial capital contributions of the Members of Chicago - Grill on the Alley LLC consisted of a capital contribution of \$1,000 and a loan of \$1,699,000. \$1,189,000 of the loan was converted to capital in 1999. Under the terms of the joint venture agreement, the LLC is obligated to repay both the converted capital and loan and the Company guaranteed the joint venture's payment of these obligations. Distributions of capital and note repayments for the year ended December 26, 2004 includes \$124,000 of capital and note repayments and \$128,000 of interest and preferred return. No losses are allocated to the minority interest partner as the investor has no equity at risk. The loan has been recognized as notes payable-related parties.
- (c) The Company's preferred return with respect to the South Bay Daily Grill is

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based on unrecovered capital contribution and accrued but unpaid management fees.

- (d) Due to the poor performance of the restaurant the preferred return is not being accrued. The Company is not liable to pay the preferred return distributions, such that they represent a non-recourse obligation of the subsidiary entity. If preferred returns were accrued for The Grill on Hollywood the Member would have an accrued preferred return of \$545,000 and the Company would have an accrued preferred return of \$113,000. If preferred returns were accrued for South Bay Daily Grill the Member would have an accrued preferred return of \$215,000 and the Company would have an accrued preferred return of \$96,000. If preferred returns were accrued for the CityWalk Partnership the Member would have an accrued return of \$430,000.

OFF-BALANCE SHEET ARRANGEMENTS. At December 26, 2004, we had no off-balance sheet arrangements of the nature described in Item 303(a)(4) of Regulation S-K.

CAPITAL EXPENDITURES. Management anticipates that new non-hotel based restaurants will cost between \$1 million and \$2 million per restaurant to build and open depending upon the location and available tenant allowances. Hotel based restaurants may involve remodeling existing facilities, substantial capital contributions from the hotel operators and other factors which will cause the cost to us of opening such restaurants to be less than our cost to build and open non-hotel based restaurants.

Capital expenditures were \$1.6 million in 2002, \$1.4 million in 2003 and \$2.9 million in 2004. Capital expenditures in fiscal 2005 are expected to be between \$0.2 million and \$2.2 million, primarily for the development of new restaurants, capital replacements and refurbishing existing restaurants. The amount of actual capital expenditures will be dependent upon, among other things, the proportion of free standing versus hotel based properties as hotel based restaurants are expected to generally require lower capital investment on our part. In addition, if we open more, or less, restaurants than we currently anticipate, our capital requirements will increase, or decrease, accordingly.

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In April 2004 we signed a lease for an owned restaurant in Santa Monica, California. The restaurant opened March 14, 2005. Construction of the restaurant was paid for through a \$2.2 million tenant improvement allowance.

In June 2004 we signed a lease for a majority owned restaurant in Los Angeles, California. The restaurant is scheduled to open in the second quarter of 2005. Construction of the restaurant will be paid for through a \$600,000 tenant improvement allowance, a \$1,250,000 capital contribution from the minority owner and a \$251,000 capital contribution by us.

CONVERTIBLE SECURITIES. We previously issued various convertible securities, warrants and common stock to finance restaurant openings in 1997 and 1998. 500 shares of Series II 10% Convertible Preferred Stock issued in that transaction remained outstanding at December 26, 2004. All warrants issued in that transaction expired in 2002.

The Series II 10% Convertible Preferred Stock is convertible into common stock commencing one year from the date of issuance at the greater of (i) \$4.00 per share, or (ii) 75% of the average closing price of our common stock for the five trading days immediately prior to the date of conversion; provided, however, that the conversion price shall in no event exceed \$10.00 per share. The Series II 10% Convertible Preferred Stock is entitled to receive an annual dividend equal to \$100 per share payable on conversion or redemption in cash or,

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at our option, in common stock at the then applicable conversion price. The Series II Convertible Preferred Stock is subject to redemption, in whole or in part, at our option on or after the second anniversary of issuance at \$1,000 per share. Accrued dividends in arrears total \$376,000 at December 26, 2004 and \$326,000 at December 28, 2003.

STARWOOD ALLIANCE

In July 2001, we completed a transaction with Starwood Hotels and Resorts Worldwide, Inc. pursuant to which we sold 666,667 shares of restricted common stock and 666,667 stock warrants at \$2.00 to Starwood for \$1,000,000. Concurrently, we sold an additional 666,666 shares of restricted common stock and 666,666 stock purchase warrants for \$2.25 to other strategic investors for \$1,000,000. Proceeds reflected in the financial statements are net of transaction costs.

In conjunction with the investment by Starwood, we and Starwood entered into a Development Agreement under which we and Starwood agreed to jointly develop our restaurant properties in Starwood hotels.

Under the Starwood Development Agreement, either we or Starwood may propose to develop a Daily Grill, Grill or City Bar and Grill restaurant in a Starwood hotel property. If the parties agree in principal to the development of a restaurant, the parties will attempt to negotiate either a management agreement or a license agreement with respect to the operation of the restaurant.

Under the Development Agreement, we are obligated to issue to Starwood warrants to acquire a number of shares of our common stock equal to four percent of the outstanding shares upon the attainment of certain development milestones. Such warrants are issuable upon execution of management agreements and/or license agreements relating to the development and operation, and the commencement of operation, of an aggregate of five, ten, fifteen and twenty of our branded restaurants. If the market price of our common stock on the date the warrants are to be issued is greater than the market price on the date of the Development Agreement, the warrants will be exercisable at a price equal to the greater of (1) 75% of the market price as of the date such warrant becomes issuable, or (2) the market price on the date of the Development Agreement. If the market price of our common stock on the date the warrants are to be issued is less than the market price on the date of the Development Agreement, the warrants will be exercisable at a price equal to the market price as of the date such warrants become issuable. The warrants will be exercisable for a period of five years.

In addition to the warrants described above, if and when the aggregate number of restaurants operated under the Development Agreement exceeds 35% of the total Daily Grill, Grill and City Grill-branded restaurants, we will be obligated to issue to Starwood a warrant to purchase a number of shares of our common stock equal to 0.75% of the outstanding shares on that date exercisable for a period of five years at a price equal to the market price at that date. On each anniversary of that date at which the restaurants operated under the Development Agreement continues to exceed the 35% threshold, for so long as the Development Agreement remains effective, we shall issue to Starwood additional warrants to purchase 0.75% of the outstanding shares on that date at an exercise price equal to the market price on that date.

Following the events of September 11, 2001, Starwood substantially curtailed new development activities and only two management agreements have, as yet, been entered into under the Development Agreement. Exclusivity portions of the agreement have terminated due to the lack of performance on Starwood's part.

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TERMINATION OF PIZZERIA UNO OPERATIONS

In April 2002, we sold our Cherry Hill, New Jersey Pizza Restaurant, the last of our Pizzeria Uno franchised restaurants, for net proceeds of \$264,000.

RESTAURANT CLOSINGS

In April 2002, we closed our Encino, California Daily Grill restaurant when the lease expired. Assets of the restaurant were sold for net proceeds of \$61,000.

In the third quarter of 2004, we terminated the licensed operation of our San Jose City Bar and Grill restaurant.

SHORT-TERM FINANCING REQUIREMENTS

Management believes that we have adequate resources on hand and operating cash flow to sustain operations for at least the following 12 months through March 2006. We project increased operating cash flows in 2005 which, when added to existing cash balances, will allow us to meet all operating, investing and financing needs. Such projections are based on sales increases due to store openings, as well as modest increases in same store sales. In the event of a decline in sales, as a result of deterioration of the economy or the hospitality industry or other factors, management believes it can respond to such a decrease in sales through cost controls, reductions in discretionary capital improvements and borrowings under the existing credit facility. In order to fund the opening of additional restaurants, we might require additional capital that might be raised through the issuance of debt or equity securities, or the formation of additional investment/loan arrangements, or a combination thereof. We presently have no commitments in that regard. See "Business -- Business Expansion" and "Management's Discussion and Analysis -- Certain Factors Affecting Future Operating Results."

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

Principals of Consolidation and Minority Interests

Our restaurant operations are conducted through multiple wholly-owned subsidiaries as well as through four majority-owned limited liability companies and through a 50% owned joint venture. Our consolidated financial statements include balance sheet and income statement items, after eliminating inter-company accounts and transactions, of each wholly-owned and majority-owned subsidiary and entities consolidated under FIN 46. The allocated interest of the earnings or loss of majority-owned subsidiaries attributable to the minority owners of those subsidiaries is reflected in a single statement of operations entry, with minority interests in earnings being a reduction in net income and minority interests in losses being an increase in net income. The proportionate interest in the equity of majority-owned subsidiaries attributable to the minority owners of those subsidiaries is reflected as a single balance sheet entry between liabilities and stockholders' equity.

We allocate profits and losses to the minority interest in our majority-owned subsidiaries based on the underlying economics of the investment.

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These may or may not reflect our ownership percentage and can be inconsistent with the allocation provisions specified in the joint venture agreements. Where there is a disparity among the ownership percentages, the terms of the agreements and the underlying economics, we utilize a hypothetical liquidation model to allocate profits and losses. Under this model, all of the ventures' assets and liabilities as reflected in the balance sheet are assumed to be realized at their GAAP carrying values. The hypothetical liquidating proceeds are calculated at the end of each period and applied to the capital accounts as would occur under a true liquidation scenario. The change in this balance from period to period represents the investors' share of the income or loss. Effective December 28, 2003 (the first day of fiscal year 2004), we retroactively adopted the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51."

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Under FIN 46, an entity is considered to be a variable interest entity ("VIE") when it has equity investors which lack the characteristics of a controlling financial interest, or its capital is insufficient to permit it to finance its activities without additional subordinated financial support. Consolidation of a VIE by an investor is required when it is determined that the investor is the primary beneficiary and will absorb a majority of the VIE's expected losses or residual returns if they occur.

Management has assessed all entities which are not wholly owned by us to determine if these entities would be considered VIEs and whether we would be considered the primary beneficiary. Upon adoption of FIN 46, it was determined that all of the following entities would be considered VIEs: The San Jose Grill LLC, Chicago - The Grill on the Alley LLC, The Grill on Hollywood LLC, The Daily Grill at Continental Park LLC, and the Universal CityWalk Daily Grill joint partnership. We determined that we are the primary beneficiary for all these entities.

If we had not retroactively adopted FIN 46, it was determined that the San Jose Grill, Chicago Grill and South Bay Daily Grill would not have been consolidated because the minority interests' have rights which preclude consolidation. The minority interests' rights in the San Jose LLC were deemed to be material in that they vote on the approval of the construction, capital and annual operating budgets as well as refinancing in excess of \$10,000. The minority interests' rights at Chicago are similar to San Jose except they do not approve the operating budget. They do however approve construction and capital budgets. The rights of the minority interest in South Bay are also considered material, as borrowings in excess of \$50,000 require the minority interest's approval. The minority interest in Hollywood has no such rights, and therefore, it was determined that we controlled the entity and consolidation would be appropriate. In the restaurant business ongoing capital expenditures are considered regular and routine, and as such, requiring approval on them from the minority investor is evidence of material control.

Impairment of Long-Lived Assets

We review all long-lived assets on a regular basis to determine if there has been impairment in the value of those assets. If, upon review, it is determined that the carrying value of those assets may not be recoverable, we will record a charge to earnings and reduce the value of the asset on the balance sheet to the amount determined to be recoverable.

For purposes of evaluating recoverability of long-lived assets, the recoverability test is performed using undiscounted cash flows of the individual restaurants and consolidated undiscounted net cash flows for long-lived assets

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not identifiable to individual restaurants compared to the related carrying value. If the undiscounted operating income is less than the carrying value, the amount of the impairment, if any, will be determined by comparing the carrying value of each asset with its fair value. Fair value is generally based on a discounted cash flow analysis.

Based on our review of our presently operating restaurants and other long-lived assets, during the fiscal year ended December 26, 2004, we recorded no impairments of our long-lived assets.

Valuation of Accounts Receivable

We review all of our accounts receivable on a regular basis to determine the collectability of each account based on age, response to collection efforts, and other factors. We establish a reserve for those accounts where collection seems doubtful. If a determination is made that the customer will definitely not pay, the amount is written off against the reserve.

Based on our review at December 26, 2004, the current reserve for uncollectable accounts receivable is adequate.

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Recording Reimbursable Costs

We operate a number of restaurants under management agreements whereby we are responsible for all aspects of restaurant operation. For our services, we typically receive a management fee based on a percentage of revenue and an incentive fee which is usually a profit sharing arrangement. Under the terms of the management agreements, we are hired as an independent contractor and are responsible for all debts and liabilities of the restaurant. Additionally, all employees are employees of Grill Concepts, not the individual restaurant. Although payroll and other operating expenses are paid out of an agency bank account belonging to the restaurant, based on the weight of the indicators identified in EIFT 01-14, "Income Statement Characterization of Reimbursements Received for 'Out of Pocket' Expenses Incurred," and EITF 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent," we consider ourselves the primary obligor in these arrangements. Accordingly, we recognize restaurant expenses of the managed outlets in our financial statements and record the reimbursement for such expenses as revenues.

HRP

The Company concluded that the options relating to HRP would be defined as a derivative under FAS 133. However, because the purchase price was based on a floating price, it was determined that the value of the put and call would be identical so long as the formula resulted in a representative fair value of HRP.

The Company concluded that the multiple was based on fair value because the original formula was negotiated between two parties. This fact was reconfirmed when the HRP agreement was amended approximately three years later at the time the Company entered into a development agreement with Starwood Hotels and the multiple for the HRP put and call options did not change. We believe the multiple used in the formula to be within a tolerable range of those found in the marketplace. Therefore, management asserts that the formula is a reasonable approximation of fair value of the HRP business that results in the put and call options having similar values. Additionally, because fair market puts and calls have little value on their own, any asset and liability related to these would

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be insignificant. No derivative accounting is necessary in these circumstances and therefore, no accounting recognition has been made in the financial statements.

The Company will continue to evaluate the appropriateness of formula to market conditions to ensure it represents fair market value, and will continue to evaluate the formula going forward and to the extent it no longer represents fair market value, will account for the derivative appropriately.

CERTAIN FACTORS AFFECTING FUTURE OPERATING RESULTS

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Our actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference include the following: adverse weather conditions and other conditions affecting agricultural output which may cause shortages of key food ingredients and volatility of food prices and which, in turn, may reduce operating margins; changes in consumer tastes, demographics and adverse economic conditions which may result in reduced frequency of dining at our restaurants; the dependence on key personnel and ability to attract and retain qualified management and restaurant personnel to support existing operations and future growth; regulatory developments, particularly relating to labor matters (i.e., minimum wage, health insurance and other benefit requirements), health and safety conditions, service of alcoholic beverages and taxation, which could increase the cost of restaurant operations; establishment of market position and consumer acceptance in new markets in light of intense competition in the restaurant industry and the geographic separation of senior management from such markets; potential delays in securing sites for new restaurants and delays in opening restaurants which may entail additional costs and lower revenues than would otherwise exist in the absence of such delays; the availability of capital to fund future restaurant openings; rising energy costs and the occurrence of rolling blackouts in California which may result in higher occupancy costs and periodic restaurant closures. In addition to the foregoing, the following specific factors may affect the Company's future operating results:

The anticipated opening of additional Daily Grill and Grill locations is expected to result in the incurrence of various pre-opening expenses and high initial operating costs which may adversely impact earnings during the first year of operations of such restaurants. However, management anticipates that each of such operations can be operated profitably within the first year of operations and that the opening of each of the restaurants presently contemplated will improve revenues and profitability.

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In order to better manage the cost of our workers compensation expense, commencing in 2004, we altered our workers compensation coverage to substantially increase our per event and aggregate deductibles. As a result, we expect to reduce our recurring cost of workers compensation insurance. On the other hand, we will have substantially higher exposure to losses resulting from claims under that policy should those claims exceed our prior deductible levels.

The employees of the Chicago restaurant are members of the Hotel Employees and Restaurant Employees Union AFL-CIO. The union contract covering the Chicago Grill will expire in August 2005. Under a new union contract, our labor costs are expected to increase slightly.

We are presently party to litigation in which a former hourly restaurant employee has alleged violations of California labor laws with respect to providing meal and rest breaks. While we believe that all of our employees were

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provided with the opportunity to take all required meal and rest breaks, many restaurant operators in California have incurred substantial expenses in settling similar claims and we may incur substantial expenses in connection with defending or settling the pending litigation.

NEW ACCOUNTING REQUIREMENTS

In April 2004, the EITF reached final consensus on EITF 03-06, "Participating Securities and the Two-Class Method under FASB Statement No. 128," which requires companies that have participating securities to calculate earnings per share using the two-class method. This method requires the allocation of undistributed earnings to the common shares and participating securities based on the proportion of undistributed earnings that each would have been entitled to had all the period's earnings been distributed. EITF 03-06 is effective for fiscal periods beginning after March 31, 2004 and earnings per share reported in prior periods presented must be retroactively adjusted in order to comply with EITF 03-06. The Company adopted EITF 03-06 for the quarter ended June 27, 2004, however there has been no impact on the Company's financial statements as the preferred shares are not participating securities.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB No. 25, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values. Pro forma disclosure is no longer an alternative.

As permitted by Statement 123, we currently account for share-based payments to employees using APB No. 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method may have a significant impact on our result of operations, although it will have no impact on our overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income and earnings per share above

We expect to adopt Statement 123(R) in the first quarter of 2006.

IMPACT OF INFLATION

Substantial increases in costs and expenses, particularly food, supplies, labor and operating expenses, could have a significant impact on our operating results to the extent that such increases cannot be passed along to customers. We do not believe that inflation has materially affected our operating results during the past two years.

A majority of our employees are paid hourly rates related to federal and state minimum wage laws and various laws that allow for credits to that wage. Our cost of operations have been affected by several increases in the Federal and State minimum wage in recent years. In addition, further increases in the minimum wage are also being discussed by the federal and various state governments. Although we have been able to and will continue to attempt to pass along increases in costs through food and beverage price increases, there can be no assurance that all such increases can be reflected in our prices or that increased prices will be absorbed by customers without diminishing, to some degree, customer spending at its restaurants.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates on funded debt. This exposure relates to our credit line facility. At December 26, 2004 there are no borrowings under the credit line. Borrowings under the credit facility bear interest at the lender's prime rate. A hypothetical 1% interest rate change would not have a material impact on our results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements, together with the reports of our independent registered public accounting firms appear herein. See Index to Financial Statements on F-1 of this report.

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

On October 18, 2004, we dismissed PricewaterhouseCoopers LLP ("PWC") as our independent registered public accounting firm. On the same date, we appointed Moss Adams LLP ("Moss Adams") as our new independent registered public accounting firm.

The decision to dismiss PWC and appoint Moss Adams was recommended and approved by our audit committee and board of directors.

PWC's reports on the financial statements for the years ended December 28, 2003 and December 29, 2002 did not contain an adverse or disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope, or accounting principles.

During the two years ended December 28, 2003 and the subsequent interim period through October 18, 2004, there were no disagreements with PWC on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s) if not resolved to the satisfaction of PWC, would have caused PWC to make reference to the subject matter of the disagreement(s) in connection with its report.

During the two years ended December 28, 2003 and the subsequent interim period through October 18, 2004, there have been no reportable events of the type required to be disclosed by Item 304(a)(1)(v) of Regulation S-K.

Prior to the engagement of Moss Adams, we did not consult with such firm regarding the application of accounting principles to a specific completed or contemplated transaction, or any matter that was either the subject of a disagreement or a reportable event. We also did not consult with Moss Adams regarding the type of audit opinion which might be rendered on our financial statements and no oral or written report was provided by Moss Adams.

We reported the change of independent accountants on a Form 8-K, provided PWC with a copy of the disclosures contained therein, and filed with Form 8-K a letter from PWC addressed to the Securities and Exchange Commission stating that it agreed with the statements made by us in the Form 8-K in response to Item 304(a).

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures-We maintain disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) that are

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designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate, to allow timely decisions regarding required disclosure.

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, as ours are designed to do, and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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In connection with the preparation of this Annual Report on Form 10-K, as of December 26, 2004, an evaluation was performed under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures. This evaluation was done in light of the two prior restatements of our financial statements which occurred during fiscal year 2004.

In preparing the annual report on Form 10-K, our management considered all disclosure controls and procedures and turned specific attention to our lease accounting practices in light of the recent pronouncement of February 7, 2005 by the Office of the Chief Accountant of the SEC in a letter to the AICPA. As a result of our review, we have concluded that our previously established lease accounting policies were incorrect.

In conjunction with our review of leases we also looked at the lives utilized for depreciating our leasehold improvements. Although our policy was to depreciate leasehold improvements over the shorter of their estimated useful lives or the term of the lease as defined in SFAS No. 13, we found that in some cases we were depreciating the assets incorrectly by using longer or shorter lives. In preparing the year end financial statements we also determined that we were incorrectly recording revenue and operating expenses for complimentary meals and promotional activities.

In light of the above items, we restated our financial statements for each of the years 2000 to 2003 and the first three quarters for fiscal year 2004 to correct our accounting under Generally Accepted Accounting Principles.

Based on the material weaknesses described below, we concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of December 26, 2004.

Management's Consideration of the Restatement- On March 24, 2005, the Audit Committee of the Board of Directors and senior management determined to restate our previously issued financial statements to correct the errors noted above. This decision follows two previous restatements of our historical financial statements undertaken during fiscal year 2004. The underlying issue causing these restatements is considered to be a material weakness as described below.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of December 26, 2004, the Company did not maintain effective controls over the selection, application and monitoring of its accounting policies to ensure that certain transactions were accounted for in conformity

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with generally accepted accounting principles. Specifically, the control deficiency resulted in the following:

a. During the first quarter review of 2004, the Company determined that its stock option plans should have been accounted for using variable accounting rather than fixed accounting. This resulted in restating employee compensation expense for periods prior to the first quarter of 2004.

b. During the second quarter review of 2004, the Company determined that (i) the Company's accounting for its joint ventures including loss allocations, guarantees of returns and consolidation decisions were incorrect, (ii) reimbursed costs related to management agreements should be presented on a grossed-up basis as both revenue and expense, and (iii) the accounting for certain equity awards needed to be adjusted. These items resulted in restating a number of accounts for periods prior to the second fiscal quarter of fiscal year 2004.

c. The Company determined that it was incorrectly accounting for its leases as well as the amortization of certain leasehold improvements. This resulted in restating depreciation expense, rent expense, leasehold improvements, receivables for tenant improvement allowances and liabilities for deferred rent and lease incentives for periods prior to the fourth quarter of 2004.

d. The Company determined that it was incorrectly reporting revenues and expenses for complimentary meals and promotional activities. This resulted in restating revenues and operating expenses for all periods prior to the fourth quarter of 2004.

This control deficiency resulted in the restatement of the Company's consolidated financial statements for 2000 through 2003 for each of the quarters for 2003 and for the first, second and third quarters for 2004 as well as certain audit adjustments to the fourth quarter 2004 financial statements. Additionally, this control deficiency could result in a misstatement of the aforementioned accounts that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness. Because of this material weakness, we have concluded that the Company did not maintain effective internal control over financial reporting as of December 26, 2004, based on criteria in "Internal Control-Integrated Framework" issued by the COSO.

Management's Remediation Efforts - Since the date of our first restatement in fiscal year 2004 to the date of this report, we have worked diligently to remediate the material weakness in the selection, application and monitoring of our accounting policies to ensure that certain transactions were accounted for in conformity with generally accepted accounting principles. During the second and third quarters of 2004, we took steps to identify, rectify and prevent the recurrence of the circumstances that resulted in our determination to restate prior period financial statements, including reviewing the terms of our stock option grant agreements in relation to the option plan agreement, reviewing the terms of all our joint venture and related agreements, reviewing the accounting for reimbursed costs under our management agreements and reviewing the accounting for all our equity awards. During the first and second quarter of fiscal year 2005, we have reviewed and summarized all the significant terms of our leases, reviewed the depreciation calculations of our leasehold improvements and instituted new accounting policies for complimentary meals and promotional activities. As part of this undertaking, we have consulted with our independent registered public accounting firm, increased emphasis on continuing education for our accounting personnel, increased emphasis on reviewing applicable accounting literature and implemented additional review procedures over the selection and monitoring of our accounting policies. We believe continued

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efforts in these areas will help enhance our system of internal controls and our disclosure controls and procedures.

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Change in Internal Control Over Financial Reporting - Except as otherwise stated herein, there were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

EXECUTIVE OFFICERS AND DIRECTORS

The following table sets forth the name, ages and current positions of our directors and executive officers as of April 15, 2005:

| NAME | AGE | POSITION |
|-------------------|-----|--|
| Robert Spivak | 61 | President and Chief Executive Officer |
| Michael Weinstock | 62 | Chairman of the Board and Executive Vice President |
| John Sola | 52 | Senior Vice President - Culinary |
| Philip Gay | 47 | Executive Vice President and Chief Financial Officer |
| Glenn Golenberg | 64 | Director |
| Stephen Ross | 56 | Director |
| Lewis Wolff | 69 | Director |
| Bruce Schwartz | 65 | Director |
| Norman Macleod | 54 | Director |

Except as noted below, each of the officers serves at the discretion of the board of directors.

Our directors serve until the next annual meeting of shareholders or their earlier resignation.

There are no family relationships among any of our officers or directors.

The following is a biographical summary of the business experience of our present directors and executive officers:

ROBERT SPIVAK has served as our President, Chief Executive Officer and a director since 1995. Mr. Spivak was a co-founder of our predecessor, Grill Concepts, Inc. (a California corporation) ("GCI") and served as President, Chief Executive Officer and a director of GCI from the company's inception in 1988 until 1995. Prior to forming GCI, Mr. Spivak co-founded, and operated, The Grill on the Alley restaurant in Beverly Hills in 1984. Mr. Spivak is a founder and past president of the Beverly Hills Restaurant Association. Mr. Spivak also chairs the executive advisory board of the Collins School of Hotel and Restaurant Management at California State Polytechnic University at Pomona, is Director Emeritus of the California Restaurant Association and is a member of the Board of Directors of DiRoNA - Distinguished Restaurants of North America.

MICHAEL WEINSTOCK has served as our Executive Vice President and a director since 1995 and as Chairman of the Board since 2000. From 1995 to 2000, Mr.

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Weinstock served as Vice-Chairman of the Board. Mr. Weinstock was a co-founder of GCI and served as Chairman of the Board, Vice President and a director of GCI from 1988 until 1995. Prior to forming GCI, Mr. Weinstock co-founded The Grill on the Alley restaurant in Beverly Hills in 1984. Mr. Weinstock previously served as President, Chief Executive Officer and a director of Morse Security Group, Inc., a security systems manufacturer.

JOHN SOLA has served as our Senior Vice President - Culinary since June 2004. Previously, Mr. Sola served as Executive Chef for GCI from 1988 until 1995 when he assumed the position of Vice President - Executive Chef of the Company from which he was promoted in September 2001 to Vice President - Operations and Development. Mr. Sola oversees all kitchen operations, including personnel, food preparation and food costs, as well as monitoring and maintaining the overall performance of the kitchens and establishing procedures and policies in connection with the opening of new Daily Grill restaurants. Mr. Sola, along with Mr. Spivak, created the Daily Grill menu. Prior to joining GCI, Mr. Sola served as opening chef at The Grill on the Alley from inception in 1984 to 1988. Previously, Mr. Sola served in various positions, including Executive Chef, at a wide range of restaurants.

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PHILIP GAY has served as our Executive Vice President and Chief Financial Officer since July 2004. From March 2000 until he joined Grill Concepts in July 2004, Mr. Gay served as Managing Director of Triple Enterprises, a business advisory firm that assisted mid-cap sized companies with financing, mergers and acquisitions, franchising and strategic planning. From March 2000 to November 2001, Mr. Gay served as an independent consultant with El Paso Energy. Previously he has served as Chief Financial Officer for California Pizza Kitchen (1987 to 1994), Chief Financial Officer and Interim Chief Executive Officer for Wolfgang Puck Food Company (1994 to 1996), Chief Executive Officer for Color Me Mine and has held various Chief Operating Officer and Chief Executive Officer positions with Diversified Food Group from 1996 to 2000. Mr. Gay is also on the financial advisory board for Concours Consulting and is on the Board of Motor Car Parts of America, a publicly traded company that remanufactures starters and alternators. He is a Certified Public Accountant, a former audit manager at Laventhol and Horwath and a graduate of the London School of Economics.

GLENN GOLENBERG has served as a Director since 1995. Mr. Golenberg is a Managing Director of Golenberg & Company, formed in 1978, and The Bellwether Group, LLC, merchant banking firms that invest in and provide consulting and financial advisory services to a broad range of businesses. Prior to forming Golenberg & Company, Mr. Golenberg served in various research and management positions in the investment banking industry from 1966 to 1978. Previously, Mr. Golenberg was a CPA with Arthur Andersen & Co.

STEPHEN ROSS has served as a Director since 2001. Mr. Ross is a consultant and private investor. From 1989 to 2001, Mr. Ross served as Executive Vice President - Special Projects for Warner Bros. Previously, Mr. Ross served as Senior Vice President and General Counsel for Lorimar Telepictures Corporation, and its predecessors, from 1981 to 1989. Since 2001, Mr. Ross has served as a director of MAI Systems Corporation, an information technology solutions provider for the hotel industry.

LEWIS WOLFF has served as a Director since 2001. Mr. Wolff is Chairman of Wolff Urban Management, Inc. and Wolff Urban Development LLC, real estate acquisition, investment, development and management firms. Mr. Wolff is also co-founder and, since 1994, has served as Chairman of Maritz, Wolff & Co., a privately held hotel investment group that acquires top-tier luxury hotel properties. Maritz, Wolff's holdings exceed \$1.0 billion. Mr. Wolff is currently Chairman of Sunstone Hotel Investors Inc. (NYSE: SHO) and Managing

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Partner of the Oakland Athletics Major League Baseball team.

BRUCE SCHWARTZ has served as a Director since 2004. Mr. Schwartz served, from 1989 until his retirement in 2003, in various executive capacities with Sysco Food Services of Los Angeles, Inc., a major food services company and subsidiary of NYSE traded Sysco Corporation. From 1989 to 1996, Mr. Schwartz served as President and Chief Operating Officer of Sysco Food Services and, from 1996 to 2003, Mr. Schwartz served as Chairman of the Board and Chief Executive Officer of Sysco Food Services.

NORMAN MACLEOD has served as a Director since 2001. Mr. MacLeod served as Executive Vice President of the Sheraton Hotels & Resorts division of Starwood Hotels & Resorts Worldwide, Inc until 2005. Mr. MacLeod served in various management positions with Starwood since 1996, beginning as Area Managing Director for the North American Southeast operations of the company's Westin Hotels & Resorts division and then Executive Vice President of the Westin Hotels & Resorts division and, most recently, Executive Vice President, Operations, North America Division. Previously, Mr. MacLeod served in various management positions with Omni Hotels.

COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Under the securities laws of the United States, the Company's directors, its executive officers, and any persons holding more than ten percent of the Company's Common Stock are required to report their initial ownership of the Company's Common Stock and any subsequent changes in that ownership to the Securities and Exchange Commission. Specific due dates for these reports have been established and the Company is required to disclose in this Proxy Statement any failure to file by these dates during 2004. Based solely on a review of such reports and written statements of its directors, executive officers and shareholders, the Company believes that all of the filing requirements were satisfied on a timely basis in 2004, except (1) Michael Weinstock filed one late Form 4, (2) Stephen Ross filed one late Form 4, (3) Lewis Wolff filed one late Form 4, (4) John Sola filed one late Form 4, and (5) Glenn Golenberg filed one late Form 4.

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ITEM 11. EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table sets forth information concerning cash and non-cash compensation paid or accrued for services in all capacities to the Company during the year ended December 26, 2004 of each person who served as the Company's Chief Executive Officer during fiscal 2004 and the next four most highly paid executive officers whose salary exceeded \$100,000 (the "Named Officers").

| Name and Principal Position ----- | Year ---- | Annual Compensation ----- | | | |
|---|--------------|------------------------------|---------------------|---------------------|-----|
| | | Salary (\$) ----- | Bonus (\$) ----- | Other (\$) ----- | |
| Robert Spivak President and Chief Executive Officer | 2004 | 259,123 | -0- | 48,050 | (1) |
| | 2003 | 244,039 | -0- | 55,178 | (1) |
| | 2002 | 235,000 | -0- | 33,500 | (1) |

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| | | | | |
|------------------------------|------|---------|-----|------------|
| John Sola | 2004 | 150,148 | -0- | -0- |
| Vice President - Operations | 2003 | 151,460 | -0- | -0- |
| and Development | 2002 | 146,000 | -0- | -0- |
| Michael Weinstock | 2004 | 148,327 | -0- | -0- |
| Executive Vice President and | 2003 | 116,829 | -0- | -0- |
| Chairman of the Board | 2002 | 112,500 | -0- | -0- |
| Philip Gay | 2004 | 93,101 | -0- | 15,000 (2) |
| Chief Financial Officer | 2003 | -0- | -0- | -0- |
| And Executive Vice President | 2002 | -0- | -0- | -0- |