CHECKERS DRIVE IN RESTAURANTS INC /DE
Form 10-K
March 15, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 29, 2003

OR

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

For the transition period from __________ to __________

Commission file number 0-19649

Checkers Drive-In Restaurants, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**58-1654960**
(State or other jurisdiction	**(I.R.S. Employer**

of incorporation or organization)	**Identification No.)**
4300 West Cypress Street, Suite 600	**33607**
Tampa, Florida	**(Zip Code)**
(Address of principal executive offices)	

Registrant s telephone number, including area code: (813) 283-7000

Securities registered pursuant to 12(b) of the Act:

None

Securities registered pursuant to 12 (g) of the Act:

Common Stock

(Title of Class)

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. x

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b 2). Yes x No ¨

The number of shares outstanding of the Registrant s Common Stock as of February 23, 2004 was 12,049,356 shares. The aggregate market value of the voting stock of the Registrant held by non-affiliates of the Registrant at the close of business on June 16, 2003 (the last business day of the registrant s most recently completed second fiscal quarter) was $87.5 million. For purposes of the foregoing calculation only, all directors, executive officers and affiliated corporations through directors of the Registrant have been deemed affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this 10-K incorporates information by reference from the Registrant s definitive proxy statement, which will be filed on or before April 27, 2004.

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CHECKERS DRIVE-IN RESTAURANTS, INC.

2003 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

General

Checkers Drive-In Restaurants, Inc. (Checkers), a Delaware corporation, and its wholly-owned subsidiaries (collectively, the Company) is in the business of operating and franchising Checkers and Rally s Hamburgers restaurants. We are the single largest chain of double drive-thru restaurants in the United States. Our Company is a combination of two similar quick-service restaurant chains, Checkers and Rally s Hamburgers (Rally s), which were merged in August 1999. Both companies were founded on a simple premise serve the highest quality food, made fresh-to-order, served quickly and at a fair price.

The Company has developed and owns a comprehensive system for developing and operating double drive-thru restaurants, which includes trademarks, building designs and layouts, equipment, ingredients, recipes and specifications for authorized food products, methods of inventory control and certain operational and business standards.

At December 29, 2003, there were 784 restaurant locations, consisting of 222 Company-owned restaurants and 562 franchisee-owned restaurants. Of the 784 locations, 379 are Rally s restaurants operating in 17 different states and 405 are Checkers restaurants operating in 20 different states, the District of Columbia and the West Bank. Ten states have both Checkers and Rally s restaurants. Checkers was founded in 1986 and Rally s was founded in 1985.

Our financial information, including the information contained in this report filed on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; and any amendments to the above mentioned reports, may be viewed on the Internet at www.checkers.com. Copies are also available, without charge, from Checkers Drive-In Restaurants, Inc., Investor Relations, 4300 West Cypress Street, Suite 600, Tampa, FL 33607. Alternatively, reports filed with the SEC may be viewed or obtained at the SEC Public Reference Room in Washington, D.C., or at the SEC s Internet site at www.sec.gov.

Concept and Strategy

The Company operates under two brands Checkers® and Rally s Hamburgers®. The Company s operating concept for both brands are very similar which includes: (i) offering a limited menu to permit the maximum attention to quality and speed of preparation; (ii) utilizing a distinctive restaurant design which features a double drive-thru concept that creates significant curb appeal; (iii) providing fast service using a distinctive design for its restaurants and a computerized point-of-sale system that expedites the ordering and preparation process; and (iv) unique and great tasting quality food and drinks made fresh to order at a fair price. The Company s primary strategy is to serve the drive-thru and take-out segment of the quick-service restaurant industry.

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Restaurant Locations

As of December 29, 2003, there were 222 Company-owned and operated restaurants in eleven states and 562 restaurants operated by our franchisees in 25 states, the District of Columbia and the West Bank. The following table sets forth the locations of each restaurant:

Region	State Name	Company	Franchise	Grand Total
Southeast	Florida	84	102	186
	Georgia	41	43	84
	Alabama		39	39
	Kentucky	1	35	36
	Tennessee	10	8	18
	Virginia		21	21
	North Carolina		9	9
	South Carolina		11	11
	Mississippi	1	9	10
	West Virginia		6	6
	Washington, D.C.		2	2
Southeast Total		137	285	422
North Central	Ohio	20	68	88
	Indiana	20	32	52
	Michigan	10	16	26
	Missouri		20	20
	Illinois		19	19
	Wisconsin		3	3
	Iowa		2	2
North Central Total		50	160	210
Northeast	Maryland		24	24
	New York		15	15
	New Jersey		15	15
	Pennsylvania	11		11
	Delaware	1		1
Northeast Total		12	54	66
Southwest	California		34	34
	Arizona		4	4
Southwest Total			38	38
South Central	Louisiana	23	12	35
	Arkansas		10	10
	Texas		1	1
South Central Total		23	23	46

West Bank		2	2
Grand Total	222	562	784

During fiscal 2003, 17 restaurants were opened or reopened, consisting of 14 franchisee operated restaurants and three Company-owned restaurants. During the same period, 17 restaurants were closed, consisting of 10 franchisee operated restaurants and seven Company-owned restaurants. Also during fiscal 2003, we reacquired three restaurants from franchisees, and the minority interest in one joint venture restaurant. We sold 25 company-owned restaurants, including one joint venture restaurant, to franchisees. Our growth strategy for the next two years is to focus on the controlled development of additional franchised and company operated restaurants primarily in our existing core markets and to further penetrate markets currently under development by franchisees. We also intend to develop select international markets.

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Site Selection

The selection of a site for a restaurant is critical to its success. Management inspects and approves each potential Company-owned restaurant site prior to final selection of the site. In evaluating particular sites, we consider various factors including traffic count, speed of traffic, convenience of access, size and configuration, demographics and density of population, visibility and cost. We also review competition and the sales and traffic counts of national and regional chain restaurants operating in the area. The majority of Company-owned and operated restaurants are located on leased land. We intend to continue to use leased sites where possible.

Restaurant Design and Service

Our double drive-thru restaurants have a highly visible, distinctive and uniform look that is intended to appeal to customers of all ages. Restaurants are generally 760 to 980 sq. ft., which is less than one-fourth the size of the typical restaurants of the four largest quick-service hamburger chains. New and many existing restaurants are moveable modular buildings. Our experience is that the building component of a modular restaurant generally costs less than comparably built outlets using conventional, on-site construction methods. Our restaurants, due to their small size, require only 18,000 to 25,000 square feet of land area, which is approximately one-third to one-half the land area used by the four largest quick service hamburger chains. As a result of the small size of the restaurant building, our restaurants generally require a smaller capital investment and have lower occupancy and operating costs per restaurant than traditional quick-service competitors. The size of the facility also permits somewhat greater flexibility with respect to the selection of prospective sites for restaurants.

The Rally s standard restaurant presents a distinctive design which conveys a message of clean and fast to the passing motorist. The Checkers standard restaurant is designed around a 1950 s diner and art deco theme with the use of white and black tile in a checkerboard motif, glass block corners, a protective drive-thru cover on each side of the restaurant supported by red aluminum columns piped with white neon lights and a wide stainless steel band piped with red neon lights that wraps around the restaurant as part of the exterior decor. Both Rally s and Checkers restaurants utilize a double drive-thru concept that permits simultaneous service of two automobiles from opposite sides of the restaurant. Although a substantial portion of the Company s sales are made through its drive-thru windows, service is also available through walk-up windows. While the restaurants normally do not have an interior dining area, most have parking and a patio for outdoor eating. The patios contain canopy tables and benches, are well landscaped and have outside music in order to create an attractive and fun eating experience. Although each sandwich is made-to-order, the Company s objective is to serve customers within 30 seconds of their arrival at the drive-thru window. Each restaurant has a computerized point-of-sale system which displays each individual item ordered in front of the food and drink preparers. This enables the preparers to begin filling a second order before the prior order is completed and totaled, thereby increasing the speed of service to the customer and the opportunity to increase sales per hour. It also provides better inventory and labor cost controls and permits the monitoring of sales volumes and product utilization.

The Company s restaurants are generally open from 12 to 15 hours per day, seven days a week, for lunch, dinner and late-night snacks and meals.

Menu

Extensive research and focus group testing indicates customers recognize the uniqueness and superior quality of our food over other competing quick-serve restaurant food products. The signature flavors and distinctive products that our menus offer keep people coming back, again and again.

The menu at Checkers and Rally s is a hamburger product line including the original ¼ pound Champ Burger®, a fully dressed and seasoned made-to-order burger, the signature Big Buford®, a fully dressed double cheeseburger, all white-meat chicken sandwiches, all beef hotdogs including chili-cheese dogs, Checkers Famous Fries™ or Rally s seasoned fries, Coca-Cola soft drinks and super thick shakes. The limited menus are designed to deliver quality, a high taste profile and unmatched speed of delivery. We are engaged in product development research and seek to enhance variety through many, limited time only product promotions throughout the year.

Marketing Program

Checkers/Rally s award-winning advertising campaign, You Gotta Eat℠ entered its third year in 2003, and continued to play a significant role in driving sales and increasing brand awareness among our target consumers. The fun, upbeat, music-driven spots have served as a memorable advertising campaign that has created a hip, fast image for our stores. It has resonated with consumers who are on-the-go and consume many of their meals at the keyboard or at the dashboard. A hit with our customers, the campaign has also served as a powerful idea that has raised morale and motivated our leadership team, employees and franchisees to drive the Company s business. Coupled with an aggressive media buying strategy, franchisees have embraced the campaign, increasing the number of Checkers/Rally s markets advertising on television from 16 to 45 in just three years. Moreover, You Gotta Eat has been fully integrated into our print, POP, outdoor, crew uniforms, bags, cups and every other consumer touch point. We will launch the fourth year of the You Gotta Eat[SM] campaign in the coming months.

In addition to Checkers/Rally s successful advertising campaign, the Company utilizes strategic sports sponsorships to tap into fan loyalty and maximize brand awareness. In 2003, Checkers/Rally s partnered with the Indianapolis Motor Speedway to become the Official Burger of the Indianapolis 500 and NASCAR s Brickyard 400, two of the largest single-day sporting events in the world. Under the agreement, the Company also became the title sponsor of the Checkers/Rally s Pit Stop Challenge, an Indy-500 race-week tradition. In 2003, Checkers was also the Official Burger of NFL teams, including the Super Bowl Champion Tampa Bay Buccaneers®. Through its Pewter Partner Sponsorship, Checkers participated in exclusive Bucs promotions including collectible cups, special combo meals, and a limited-time sale of Coach Jon Gruden bobble head dolls for charity. To kick off 2004, Checkers announced a sponsorship with the Tampa Bay Devil Rays MLB team.

Purchasing

All restaurants purchase food, beverages and supplies from Company-approved suppliers. All products must meet our standards and specifications, and management constantly monitors the quality of the food, beverages and supplies provided to the restaurants.

We believe that our efforts over time have achieved cost savings, improved food quality and consistency and helped decrease volatility of food and supply costs for the restaurants. All essential food and beverage products are available, or upon short notice, could be made available from alternate qualified suppliers. Among other factors, our profitability is dependent upon our ability to anticipate and react to changes in food costs. Various factors beyond our control, such as climate changes and adverse weather conditions, may affect food costs.

Management and Employees

A typical restaurant employs approximately 20 hourly employees, many of whom work part-time on various shifts. The management staff of a typical restaurant operated by the Company consists of a General Manager, one Assistant Manager and two Shift Managers. A General Manager is generally required to have prior restaurant management experience, preferably within the quick-service industry, and reports directly to an Area Manager. The Area Manager typically has responsibility for eight to ten restaurants and for assuring that each Company-owned restaurant consistently delivers high-quality food and service. Area Managers report to Directors of Operation. The Company has an incentive compensation program for Area Managers and restaurant level managers that provides for a monthly bonus based upon the achievement of certain sales and profit goals.

As of December 29, 2003, we employed approximately 4,300 employees, substantially all of which were restaurant personnel. Most employees, other than restaurant management and certain corporate personnel, are paid on an hourly basis. We believe the Company provides working conditions and wages that are comparable with those of other companies within the quick-service restaurant industry. We also believe we have good employee relations. None of the Company s employees are covered by a collective bargaining agreement.

Supervision and Training

Each new franchisee and restaurant manager attends a comprehensive training program. The program was developed by the Company to enhance consistency of restaurant operations and is considered by management as an important step in operating a successful restaurant. During this program, the attendees are taught certain basic elements that we believe are vital to the Company s operations and are provided with a complete operations manual, together with training aids designed as references to guide and assist in the day-to-day operations. In addition, hands-on experience is incorporated into the program by requiring each attendee, prior to completion of the training course, to work in an existing Company-operated restaurant. Continuing training classes for both Company-operated and franchise restaurant personnel have also been developed. After a restaurant is opened, we continue to monitor the consistency and uniformity of operations for both franchised and Company-operated restaurants.

We also employ Franchise Business Consultants, who have been fully trained by us, to assist franchisees in implementing our operating procedures and policies once a restaurant is open. As part of these services, the Franchise Business Consultants rate the restaurant s hospitality, food quality, speed of service, cleanliness and maintenance of facilities. The franchisees receive a written report of the Franchise Business Consultant s findings with deficiencies, if any noted, and recommended procedures to correct such deficiencies.

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Restaurant Reporting

Each Company-owned restaurant has a computerized point-of-sale system coupled with a back office computer. With this system, management is able to monitor sales, labor and food costs, customer counts and other pertinent information. The information gathered allows management to better control labor utilization, inventories and operating costs. These systems, at Company-owned restaurants, are polled daily by our corporate office.

Inflation

Food and labor costs are significant inflationary factors in the Company s operations. Many of our employees are paid hourly rates related to the statutory minimum wage; therefore, increases in the minimum wage increase the Company s labor costs. In addition, some of our leases require us to pay base rents with escalation provisions based on the consumer price index, percentage rents based on revenues, and to pay taxes, maintenance, insurance, repairs and utility costs, all of which are expenses subject to inflation. The Company currently has one franchisee who operates in Israel and management does not expect any adverse affect to the Company s financial position due to this franchisee. We have generally been able to offset the effects of inflation to date through small menu price increases. There can be no assurance that we will be able to continue to offset the effects of inflation through menu price increases.

Working Capital

The restaurant industry in general, operates with a working capital deficit because most of our investments are in long-term restaurant operating assets. We do not normally require large amounts of working capital to maintain operations since sales are for cash, purchases are on open accounts and meat and produce inventories are limited to a three-to-five day supply to assure freshness. We do not have significant levels of accounts receivable or inventory, and we receive credit from our trade suppliers. Funds available from cash sales not needed immediately to pay our trade suppliers are used for non-current capital expenditures or invested in high quality short term investments.

We ended fiscal 2003 with working capital of $7.3 million as compared to $1.5 million at December 30, 2002. The factors having the greatest impact on working capital include a decrease in the valuation allowance on current deferred tax assets of $3.6 million and a $1.0 million reduction in accounts payable, resulting from quicker payment on food and paper purchases to take advantage of vendor term discounts offered.

Seasonality

The seasonality of restaurant sales due to consumer spending habits can be significantly affected by the timing of advertising, competitive market conditions and weather related events. While restaurant sales for certain quarters can be stronger, or weaker, there is no predominant pattern.

Franchise Operations

Strategy. We encourage controlled development of franchised restaurants in our existing markets, as well as in certain additional states. The primary criteria considered by us in the selection, review and approval of prospective franchisees are the availability of adequate capital to open and operate the number of restaurants franchised and prior experience in operating quick-service restaurants. Franchisees operated 562, or 72%, of the total restaurants open at December 29, 2003. In the future, our success will continue to be dependent upon our franchisees and the manner in which they operate and develop their restaurants to promote and develop the Checkers and Rally s concepts and our reputation for quality and speed of service.

Although we have established criteria to evaluate prospective franchisees, there can be no assurance that franchisees will have the business abilities or access to financial resources necessary to open the number of restaurants the franchisees currently anticipate opening in 2004, or that the franchisees will successfully develop or operate restaurants in their franchise areas in a manner consistent with our concepts and standards. We have registered our trademarks in various foreign countries in the event we develop additional international markets. The most likely format for international development is through the issuance of master franchise agreements and/or joint venture agreements. The terms and conditions of these agreements may vary from the standard area development agreement and franchise agreement in order to comply with laws and customs different from those of the United States.

Franchisee Support Services. We maintain a staff of well-trained and experienced restaurant operations personnel whose primary responsibilities are to help train and assist franchisees in opening new restaurants and to monitor the operations of existing restaurants. These services are provided as part of the Company s franchise program. Upon the opening of a new franchised restaurant by a franchisee, we typically send a team to the restaurant to assist the franchisee during the first four days the restaurant is open. This team monitors compliance with the Company s standards as to quality of product and speed of service. In addition, the team provides on-site training to all restaurant personnel. This training is in addition to the training provided to the franchisee and the franchisee s management team described under Supervision and Training above.

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Franchise Agreements. The franchise agreement grants to the franchisee an exclusive license at a specified location to operate a restaurant in accordance with the Checkers and Rally s systems and to utilize the Company s trademarks, service marks and other rights of the Company relating to the sale of its menu items. The term of the current franchise agreement is generally 20 years. Upon expiration of the franchise term, the franchisee will generally be entitled to acquire a successor franchise for the restaurants on the terms and conditions of the Company s then current form of franchise agreement if the franchisee remains in compliance with the franchise agreement throughout its term and if certain other conditions are met, including the payment of a fee equal to 25% of the then current franchise fee.

In some instances, we grant to the franchisee the right to develop and open a specified number of restaurants within a limited period of time and in a defined geographic area (the Franchised Area) and thereafter to operate each restaurant in accordance with the terms and conditions of a franchise agreement. In that event, the franchisee ordinarily signs two agreements, an area development agreement and a franchise agreement. Each area development agreement establishes the number of restaurants the franchisee is to construct and open in the Franchised Area during the term of the area development agreement (normally a maximum of five years) after considering many factors, including the residential, commercial and industrial characteristics of the area, geographic factors, population of the area and the previous experience of the franchisee. The franchisee s development schedule for the restaurants is set forth in the area development agreement. The Company may terminate the area development agreement of any franchisee that fails to meet its development schedule.

The franchise agreement and area development agreement require that the franchisee select proposed sites for restaurants within the franchised area and submit information regarding such sites to us for our review, although final site selection is at the discretion of the franchisee. We do not arrange or make any provisions for financing the development of restaurants by our franchisees. Each franchisee is required to purchase all fixtures, equipment, inventory, products, ingredients, materials and other supplies used in the operation of its restaurants from approved suppliers, all in accordance with the Company s specifications. We provide a training program for management personnel of our franchisees at our corporate office. Under the terms of the franchise agreement, the Company has mandated standards of quality, service and food preparation for franchised restaurants. Each franchisee is required to comply with all of the standards for restaurant operations as published in the Company s operations manual.

We may terminate a franchise agreement for several reasons including the franchisee s bankruptcy or insolvency, default in the payment of indebtedness to the Company or suppliers, failure to maintain standards set forth in the franchise agreement or operations manual, continued violation of any safety, health or sanitation law, ordinance or governmental rule or regulation or cessation of business. In such event, we may also elect to terminate the franchisee s area development agreement.

Franchise Fees and Royalties. Under the current franchise agreement, a franchisee is generally required to pay application fees, site approval fees and an initial franchise fee together totaling $30,000 for each restaurant opened by the franchisee. If a franchisee is awarded the right to develop an area pursuant to an area development agreement, the franchisee typically pays the Company a $5,000 development fee per restaurant, which will be applied to the franchise fee as each restaurant is developed. Each franchisee is also generally required to pay the Company a semi-monthly royalty of 4% of the restaurant s gross sales (as defined) and to expend certain amounts for advertising and promotion. Beginning on June 1, 2003, the Company began an incentive program to existing franchisees, whereby the franchise fee of $30,000 was reduced to $15,000 and royalties were reduced to 2% during the first year of operation. This incentive program is offered through December 31, 2004.

Competition

Our restaurant operations compete in the quick-service industry, which is highly competitive with respect to price, concept, quality and speed of service, location, attractiveness of facilities, customer recognition, convenience and food quality and variety. The industry includes many quick-service chains, including national chains which have significantly greater resources than the Company that can be devoted to advertising, product development and new restaurants, and which makes them less vulnerable to fluctuations in food, paper, labor and other costs. In certain markets, we will also compete with other quick-service double drive-thru hamburger chains with operating concepts similar to the Company. The quick-service industry is often significantly affected by many factors, including changes in local, regional or national economic conditions affecting consumer spending habits, demographic trends and traffic patterns, changes in consumer taste, consumer concerns about the nutritional quality of quick-service food and increases in the number, type and location of competing quick-service restaurants. We compete primarily on the basis of speed of service, price, value, food quality and taste. All of the major chains have increasingly offered selected food items and combination meals, including hamburgers, at temporarily or permanently discounted prices. Increased competition, additional discounting and changes in marketing strategies by one or more of these competitors could have an adverse effect on the Company s sales and earnings in the affected markets. In addition, with respect to selling franchises, we compete with many franchisors of restaurants and other business concepts.

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Trademarks and Service Marks

We believe that our rights in our trademarks and service marks are important to our marketing efforts and a valuable part of our business. We own a number of trademarks and service marks that have been registered, or for which applications are pending, with the United States Patent and Trademark Office including but not limited to: Rally s Hamburgers®, One of a Kind Fries®, Big Buford®, Checkers®, Checkers Famous Fries™ Checkers Burger•Fries•Colas®, Champ Burger® and You Gotta Eat℠. It is the Company s policy to pursue registration of its marks whenever possible and to vigorously oppose any infringement of its marks.

Foreign Operations

The Company receives royalties from a franchisee in a foreign market. Royalty revenues recorded for fiscal 2003 were approximately $2,000 for the West Bank in Israel.

Government Regulation

The restaurant industry is subject to numerous federal, state and local government regulations, including those relating to the preparation and sale of food and building and zoning requirements. In addition, the Company is subject to laws governing its relationship with employees, including minimum wage requirements, overtime, working and safety conditions and citizenship requirements. Many of our employees are paid hourly rates based upon the federal and state minimum wage laws. Legislation increasing the minimum wage has resulted in higher labor costs to the Company. An increase in the minimum wage rate, employee benefit costs or other costs associated with employees could have a material adverse effect on the Company s business, financial condition and results of operation.

The Company is also subject to extensive federal and state regulations governing franchise operations and sales which impose registration and disclosure requirements on franchisors in the offer and sale of franchises and in certain cases, dictating substantive standards that govern the relationship between franchisors and franchisees, including limitations on the ability of franchisors to terminate franchisees and alter franchise arrangements.

Environmental Matters

The Company is subject to various federal, state and local environmental laws. These laws govern discharges to air and water from the Company s restaurants, as well as handling and disposal practices for solid and hazardous waste. These laws may impose liability for damages for the costs of cleaning up sites of spills, disposals or other releases of hazardous materials. The Company may be responsible for environmental conditions relating to its restaurants and the land on which the restaurants are located or were located, regardless of whether the restaurants or land in question are leased or owned and regardless of whether such environmental conditions were created by the Company or by a prior owner, tenant, or other third party.

We are not aware of any environmental conditions that would have a material adverse effect on our businesses, assets or results of operations taken as a whole. We cannot be certain that environmental conditions relating to prior, existing or future restaurants will not have a material adverse effect on the Company. Moreover, there is no assurance that: (1) future laws, ordinances or regulations will not impose any material environmental liability; or (2) the current environmental condition of the properties will not be adversely affected by tenants or other third parties or by the condition of land or operations in the vicinity of the properties.

Special Note Regarding Forward-Looking Statements

Certain statements in this Form 10-K under Item 1. Business, Item 3. Legal Proceedings , Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-K constitute forward-looking statements which we believe are within the meaning of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended. Also, when we use words such as believes , expects , anticipates or similar expressions, we are making forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Some of the risks that should be considered include:

(i) The fact that we compete with numerous well established competitors who have substantially greater financial resources and longer operating histories than us, which enables them to engage in heavy and sustained discounting as well as substantial advertising and promotion. While this competition is already intense, if it increases, it could have an even greater adverse impact on revenues and profitability of company and franchise restaurants.

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(ii) The fact that we anticipate the need to continue the improvement in same restaurant sales if we are to achieve improved profitability. Sales increases will depend, among other things, on the success of our advertising and promotion efforts and the success of other operating and training initiatives, all of which are speculative.

We may also be negatively impacted by other factors common to the restaurant industry such as changes in consumer eating habits; consumer perceptions of food safety; consumer acceptance of new products; consumer purchase frequency; increases in the costs of food; paper, labor, health care, workers compensation or energy; an inadequate number of available hourly paid employees; and/or decreases in the availability of affordable capital resources; development and operating costs. Other factors which may negatively impact the Company include, among others, adverse publicity; general economic and business conditions; availability, locations, and terms of sites for restaurant development; changes in business strategy or development plans; quality of management; availability, terms and deployment of capital; the results of financing efforts; business abilities and judgment of personnel; availability of qualified personnel; changes in, or failure to comply with, government regulations; continued NASDAQ listing; weather conditions; construction schedules, results of existing and future litigation and other factors referenced in this Form 10-K in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the heading Risk Factors That May Affect Results of Operations and Financial Condition and Item 8 Financial Statements and Supplementary Data under footnote 12 Commitments and Contingencies Litigation.

ITEM 2. PROPERTIES

We owned 222 restaurants as of December 29, 2003. We held ground leases on 181 of these restaurants and owned the land on the remaining 41. Our leases are generally written for a term of 20 years with one or more five year renewal options. Some leases require the payment of additional rent equal to a percentage of annual revenues in excess of specified amounts. When practicable, we prefer to lease the land for our restaurants.

As of December 29, 2003, we leased 375 parcels of land. Of these, we operated 181 Company-owned restaurants on the land, 177 are subleased and 17 are surplus vacant. In addition, we owned 20 parcels of land of which 15 were subleased and five remained vacant at December 29, 2003.

We have 101 restaurants owned or subleased which are subject to a mortgage or act as collateral to our primary debt with GE Capital Franchise Finance Corporation.

Our executive offices are located in approximately 19,300 square feet of leased office space at 4300 West Cypress Street, Suite 600, Tampa, Florida 33607.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations or liquidity. For a description of the cases currently being litigated by the Company, see Notes 12(d) Commitments and Contingencies-Litigation of the Consolidated Financial Statements, Item 8 of Part II of this Report on Form 10-K.

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

None.

PART II

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

Our common stock is quoted on the National Market System of the NASDAQ Stock Market under the symbol CHKR . As of February 24, 2004, there were approximately 19,000 stockholders of record of our common stock. The following table sets forth the high and low closing sales price quotations of the Company s common stock, as reported on the NASDAQ National Market, for the periods indicated.

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2003

Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	$ 7.04	$ 9.32	$ 12.70	$ 10.75
Low	4.52	5.38	8.15	8.62

2002

Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	$ 11.42	$ 13.50	$ 11.90	$ 8.25
Low	5.91	9.84	6.92	6.25

Dividends

The Company currently intends to retain its earnings to finance future growth and, therefore, does not anticipate paying any cash dividends on its Common Stock in the foreseeable future. Any determination as to the payment of dividends will depend upon the future results of operations, capital requirements and financial condition of the Company and such other facts as the Board of Directors of the Company may consider, including any contractual or statutory restrictions on the Company s ability to pay dividends. The Company has not paid any dividends since incorporation.

Stock Repurchase Program

In April 2003, the Board of Directors authorized the Company s stock repurchase program. The program allowed for repurchase of up to 1,300,000 shares. The Company purchased 703,367 shares during fiscal 2003 for $5.1 million.

Future Registrations

None.

ITEM 6. SELECTED FINANCIAL DATA

The following tables present our selected financial data. On August 9, 1999, Checkers merged with Rally s. The merger was accounted for as a reverse acquisition whereby Rally s was treated as the acquirer and Checkers as the acquiree, as the former shareholders of Rally s owned a majority of the outstanding common stock of Checkers subsequent to the merger. The fiscal 1999 financial information includes the results of Rally s for the entire year and the results of Checkers for the period from August 9, 1999 to January 3, 2000. The fiscal 2003, 2002, 2001 and 2000 financial information includes the results of the merged companies. The selected historical statement of operations and historical balance sheet data presented have been derived from our audited consolidated financial statements. Please note that our fiscal year ended January 3, 2000 contained 53 weeks. You should read the following selected financial data in conjunction with Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and accompanying notes.

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Consolidated Statements of Operations

For the years ended (1)

(In thousands, except per share amounts)

	December 29, 2003	December 30, 2002	December 31, 2001	January 1, 2001	January 3, 2000
Company restaurant sales	$ 174,231	$ 164,063	$ 145,442	$ 162,804	$ 192,340
Other revenues	16,088	14,983	16,170	18,386	9,495
Total revenues	190,319	179,046	161,612	181,190	201,835
Operating income (loss) (2) (5)	17,277	158	7,431	7,822	(16,335)
Other expenses and minority interest	(1,629)	(1,825)	(3,034)	(5,955)	(9,217)
Income (loss) before taxes	15,648	(1,667)	4,397	1,867	(25,552)
Income tax expense (benefit)	(186)	39	62	(475)	336
Cumulative effect of change in accounting principle, net of tax	51				
Net income (loss)	$ 15,783	$ (1,706)	$ 4,335	$ 2,342	$ (25,888)
Basic earnings (loss) per share	$ 1.31	$ (0.14)	$ 0.43	$ 0.25	$ (3.89)
Diluted earnings (loss) per share:	$ 1.23	$ (0.14)	$ 0.36	$ 0.23	$ (3.89)
Weighted average number of common shares outstanding:					
Basic	12,047	11,895	10,139	9,419	6,657
Diluted	12,845	11,895	11,908	10,194	6,657

Consolidated Balance Sheet Data (4)

(In thousands)

	December 29, 2003	December 30, 2002	December 31, 2001	January 1, 2001	January 3, 2000
Working capital	$ 7,273	$ 1,465	$ (5,956)	$ (10,837)	$ (32,809)
Total assets	$ 129,435	$ 125,035	$ 127,260	$ 125,998	$ 165,653
Long-term debt and obligations under capital leases, including current portion	$ 28,027	$ 30,984	$ 36,916	$ 40,538	$ 80,767

Total stockholders equity	$ 73,467	$ 60,529	$ 59,624	$ 50,934	$ 46,663
Cash dividends declared per common share	$	$	$	$	$

Selected Operating Data

As of and for the years ended

(In thousands, except restaurant count)

	December 29, 2003	December 30, 2002	December 31, 2001	January 1, 2001	January 3, 2000
Restaurant sales	$ 174,231	$ 164,063	$ 145,442	$ 162,804	$ 192,340
Franchise royalty income (3)	15,136	14,583	15,457	14,377	7,073
Franchise fees	952	400	713	4,009	2,422
Total revenue	$ 190,319	$ 179,046	$ 161,612	$ 181,190	$ 201,835
Restaurants open at end of period:					
Company	222	248	235	195	367
Franchised	562	536	586	659	540
Total	784	784	821	854	907

(1) The information presented for the period ending January 3, 2000 reflects the results for Rally s for the full year and only the post merger period from August 10, 1999 to January 3, 2000 for Checkers. Fiscal 2003, 2002, 2001 and 2000 include the results of the merged companies.

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(2) Includes asset impairment charges of approximately $0.4 million, $7.4 million, $1.2 million, $0.6 million, and $22.3 million for fiscal 2003, 2002, 2001, 2000, and 1999, respectively.

(3) Franchise royalties derived from franchisee sales of $380.5 million, $365.6 million, $400.7 million, $373.7 million and $209.6 million for fiscal 2003, 2002, 2001, 2000, and 1999, respectively.

(4) The consolidated balance sheet data presented as of December 29, 2003, December 30, 2002, December 31, 2001, January 1, 2001 and January 3, 2000 represent the consolidated balance sheet data of the merged entity.

(5) See Note 1(k) to the 2003 consolidated financial statements for a discussion of our change in accounting for goodwill and its impact on 2002 and 2003 operating results.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements of the Company and the related Notes thereto included elsewhere herein.

OVERVIEW

The Company is in the business of operating and franchising Checkers and Rally s restaurants. We are the single largest chain of double drive-thru restaurants in the United States. Our Company is a combination of two similar quick-service restaurant chains, Checkers and Rally s Hamburgers (Rally s), which were merged in August 1999. Both companies were founded on a simple premise serve the highest quality food, made fresh-to-order, served quickly and at a fair price.

At December 29, 2003, the Company s system included 784 restaurants, comprised of 222 Company-owned and operated and 562 franchised restaurants. At December 29, 2003, there were 379 Rally s restaurants operating in 17 different states and there were 405 Checkers restaurants operating in 20 different states, the District of Columbia and the West Bank. Ten states have both Checkers and Rally s restaurants. In fiscal 2003, we opened three and closed seven restaurants. Franchisees opened 14 and closed 10 restaurants in fiscal 2003. During fiscal 2003, we purchased 3 restaurants from franchisees, excluding one joint venture from a minority interest, and sold 25 company-owned restaurants to franchisees.

Restaurants Operating in the System

For the Quarters Ended

	March 25, 2002	June 17, 2002	Sept. 9, 2002	Dec. 30, 2002	March 24, 2003	June 16, 2003	Sept. 8, 2003	Dec. 29, 2003
Company-operated:								
Beginning of quarter	235	255	253	248	248	242	242	242

Openings/transfers in	23	2					1	5
Closings/transfers out	(3)	(4)	(5)		(6)		(1)	(25)
End of quarter	255	253	248	248	242	242	242	222
Franchise:								
Beginning of quarter	586	540	541	541	536	536	539	540
Openings/transfers in		3	7	3	2	4	2	31
Closings/transfers out	(46)	(2)	(7)	(8)	(2)	(1)	(1)	(9)
End of quarter	540	541	541	536	536	539	540	562
	795	794	789	784	778	781	782	784

We receive revenues from restaurant sales, franchise fees and royalties. Our revenues also included payments resulting from an operating agreement with CKE through July 3, 2001, at which time the agreement terminated. These revenues are included in franchise fees and other income in the accompanying consolidated financial statements for 2001. Restaurant food and paper cost, labor costs, occupancy expense, other operating expenses, depreciation and amortization, and advertising expense relate directly to Company-owned restaurants. Other expenses, such as other depreciation and amortization, and general and administrative expenses,

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relate both to Company-owned restaurant operations and franchise sales and support functions. Our revenues and expenses are affected by the number and timing of additional restaurant openings and the sales volumes of both existing and new restaurants.

Effective November 30, 1997, Checkers and Rally s entered into a Management Services Agreement (Agreement) whereby Checkers provided accounting, technology, and other functional and management services to predominantly all of the operations of Rally s. Checkers received fees from Rally s relative to the shared departmental costs times the respective restaurant ratio. Upon completion of the Merger, this Agreement was terminated. During the period from December 29, 1998 through August 9, 1999, Checkers charged Rally s $4.7 million in accordance with the Agreement.

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RESULTS OF OPERATIONS

The table below sets forth the percentage relationship to total revenues, unless otherwise indicated, of certain items included in our consolidated statements of income and operating data for the periods indicated:

	Fiscal Year Ended		
	December 29, 2003	December 30, 2002	December 31, 2001
Revenues:			
Restaurant sales	91.5 %	91.6 %	90.0 %
Franchise royalty revenue	8.0 %	8.2 %	9.6 %
Franchise fees and other income	0.5 %	0.2 %	0.4 %
	100.0 %	100.0 %	100.0 %
Costs and expenses:			
Restaurant food and paper costs (1)	31.6 %	30.7 %	32.6 %
Restaurant labor costs (1)	30.4 %	31.8 %	32.2 %
Restaurant occupancy expense (1)	7.1 %	7.6 %	8.1 %
Restaurant depreciation and amortization (1)	3.5 %	3.8 %	3.1 %
Other restaurant operating expenses (1)	12.8 %	13.6 %	12.9 %
General and administrative expenses	7.6 %	6.8 %	7.3 %
Advertising (1)	6.2 %	6.3 %	5.6 %
Bad debt expense	0.2 %	0.2 %	0.5 %
Non-cash compensation	0.0 %	0.0 %	0.0 %
Other depreciation and amortization	0.5 %	0.4 %	2.1 %
Impairment of long-lived assets	0.2 %	4.1 %	0.7 %
Restaurant retirement costs	(0.2)%	2.9 %	0.4 %
Gain on sales of assets	(1.0)%	(0.4)%	(0.6)%
Operating income	9.1 %	0.1 %	4.6 %
Other income (expense):			
Interest income	0.6 %	0.8 %	1.1 %
Interest expense	(1.4)%	(1.8)%	(3.0)%
Income (loss) before minority interest, income tax expense (benefit) and cumulative effect of change in accounting principle	8.3 %	(0.9)%	2.7 %
Minority interest in operations of joint ventures	(0.1)%	0.0 %	0.0 %
Income (loss) before income tax expense (benefit) and cumulative effect of change in accounting principle	8.2 %	(0.9)%	2.7 %
Income tax expense (benefit)	(0.1)%	0.1 %	0.0 %
Income (loss) before cumulative effect of change in accounting principle	8.3 %	(1.0)%	2.7 %
Cumulative effect of change in accounting principle (net of tax)	0.0 %	0.0 %	0.0 %
Net income (loss)	8.3 %	(1.0)%	2.7 %

Number of restaurants Company-owned and franchised:			
Restaurants open at the beginning of period	784	821	854
Company-owned restaurants opened, closed or transferred, net during period	(26)	13	40
Franchised restaurants opened, closed or transferred, net during period	26	(50)	(73)
Total restaurants acquired, opened, closed or transferred, net during period		(37)	(33)
Total restaurants open at end of period	784	784	821

(1) As a percentage of restaurant sales.

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Results of Operations

Comparison of Historical Results Fiscal Years 2003 and 2002

Restaurant Sales

Total revenues were $190.3 million for the year ended December 29, 2003 compared to $179.0 million for the year ended December 30, 2002. Company-owned restaurant sales increased by $10.1 million for the year, from $164.1 million in fiscal 2002, to $174.2 million in fiscal 2003. The primary reasons for the increase were same-store sales growth of 7.6% and the opening or acquisition of 6 restaurants during fiscal 2003. The increase was partially offset by the closure or sale of 32 restaurants during fiscal 2003.

Franchise Royalty Revenue

Franchise royalties increased by $0.6 million as compared to 2002 primarily as a result of the increase in franchise restaurant locations during fiscal 2003. The sale of 25 Company-owned restaurants to franchisees during fiscal 2003 contributed to the increase in franchise royalties, in addition, royalties increased due to increasing year-over-year same-store sales of 2.9% at franchise locations.

Franchise Fees and Other Income

Franchise fees and other income increased $0.6 million in fiscal 2003 as compared to fiscal 2002. The increase is primarily the result of franchise fees received in 2003 for the sale of 22 restaurants between the Company and a new franchisee in fiscal year 2003.

Restaurant Food and Paper Costs

Restaurant food and paper costs totaled $55.0 million or 31.6% of restaurant sales in fiscal 2003 compared with 30.7% in fiscal 2002. The increase in these costs as a percentage of restaurant sales was due to increased beef and cheese prices during the current fiscal year as compared to the prior fiscal year, net of increased volume rebates for soda syrup.

Restaurant Labor Costs

Restaurant labor costs, which include restaurant employees salaries, wages, benefits, workers compensation costs, bonuses and related taxes totaled $53.0 million or 30.4% of restaurant sales for fiscal 2003 compared with $52.1 million or 31.8% for fiscal 2002. The decrease in restaurant labor costs as a percentage of restaurant sales compared to the prior year was due to the increase in restaurant same-store sales, as well as a benefit from a decrease in workers compensation expense experienced in 2003. Workers compensation costs as a percentage of sales decreased by 60 basis points for 2003 as compared to 2002, attributed primarily to favorable claims development.

Restaurant Occupancy Expense

Restaurant occupancy expense, which includes rent, property taxes, licenses and insurance, was $12.3 million or 7.1% of restaurant sales in 2003 compared with $12.5 million or 7.6% of restaurant sales in 2002. The decrease in restaurant occupancy expense as a percentage of restaurant sales is due primarily to the increase in comparable restaurant sales.

Restaurant Depreciation

Restaurant depreciation totaled $6.0 million or 3.5% of restaurant sales for fiscal 2003 compared to $6.2 million or 3.8% for fiscal 2002. The decrease was due primarily to the increase in same-store sales growth and the result of $7.4 million in impairments for under-performing locations in 2002 and $0.4 million in impairments in 2003. Such impairments reduced the depreciable bases and depreciation expense on these assets. This decrease was partially offset by depreciation on $14.5 million of capital additions and restaurant assets acquired during 2003.

Other Restaurant Operating Expenses

Other restaurant operating expense includes all other restaurant level operating expenses, and specifically includes utilities, repairs and maintenance and other costs. These expenses totaled $22.2 million, or 12.8% of restaurant sales for the year ended December 29, 2003 compared to $22.3 million, or 13.6% of restaurant sales for the year ended December 30, 2002. Repairs and maintenance decreased to 3.5% as a percentage of restaurant sales for 2003 compared to 4.5% for 2002. Utilities increased slightly to 5.0% in 2003 as compared to 4.9% in 2002 as a percentage of restaurant sales. Other costs in this category remained relatively constant at 4.3% as a percentage of restaurant sales as compared to 4.2% in 2002.

General and Administrative Expenses

General and administrative expenses were $14.4 million, or 7.6% of total revenues for fiscal 2003 compared to $12.1 million, or 6.8% of total revenues for fiscal 2002. These costs have increased due to increased professional fees for income tax related matters and legal costs to protect the Company s trademarks and rights in the current year.

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Advertising

Advertising expense was $10.8 million or 6.2% of restaurant sales in fiscal 2003 as compared to $10.3 million, or 6.3% of restaurant sales for 2002. The increase was due primarily to increased spending on media for the motor sports initiative which began in the second quarter of 2003.

Impairment of Long-Lived Assets

During fiscal 2003, the Company recorded impairment charges of $0.4 million. These impairments were for obsolete equipment and assets located at 2 restaurants based upon the review of their current and projected operating results. During 2002, the Company recognized $7.4 million in impairment charges. During 2002, the Company completed an evaluation of properties held for sale by obtaining appraisals on land and buildings for six locations which resulted in an impairment of $0.3 million. Likewise, an impairment of $0.8 million was necessary to reflect fair market value of non-standard modular buildings and equipment held for sale. An additional $0.7 million charge was recognized for 5 restaurant buildings in New Orleans, which management initiated plans during 2002 to replace in 2003. The Company also reviewed historical and projected cash flows of all operating restaurants and recorded impairment charges for 58 under-performing restaurants of $5.6 million.

Restaurant Retirement Costs

During fiscal 2003, the Company recognized a benefit of $0.5 million, resulting from management s successful negotiation out of lease obligations previously reserved for. During 2002, the Company recognized charges of $5.2 million from restaurant closures related to the estimated future cost of surplus properties. The Company remains obligated to make ongoing lease payments on 17 vacant sites and 7 other sites which are subleased for less than the Company s lease cost.

Gain on Sale of Assets

During fiscal 2003, the Company recognized a gain of $2.0 million from the sale of assets. This gain was primarily due to the sale of 22 restaurants in the California, Phoenix and Nashville markets to a new franchisee during the fourth quarter of 2003.

Income Tax

The Company s 2003 income tax benefit represents current taxes of approximately $224,000 and a deferred tax benefit of approximately $410,000. The Company recognized a reduction of $29.7 million of the valuation allowance for deferred tax assets in 2003, for which $23.5 million was recorded as a reduction of goodwill. The valuation allowance was reduced because the Company believes that the deferred tax assets will be realized, resulting from its current operating success, coupled with our future positive outlook. The Company s 2002 income tax expense represented current state income taxes.

Comparison of Historical Results Fiscal Years 2002 and 2001

Restaurant Sales

Total revenues were $179.0 million for the year ended December 30, 2002, compared to $161.6 million for the year ended December 31, 2001. Company-owned restaurant sales increased by $18.7 million for the year, from $145.4 million in fiscal 2001, to $164.1 million in fiscal 2002. The primary reason for the increase was the addition of 25 restaurants during fiscal 2002 and the full year of revenues for restaurants acquired during fiscal 2001. Restaurants added during the current year accounted for approximately $10.7 million of the increase while restaurants acquired in 2001 accounted for approximately $10.3 million of the increase. The increase in revenues from these additional restaurants was partially offset by the closure or sale of 12 restaurants and negative year-over-year comparable sales of 0.17% for fiscal 2002.

Franchise Royalty Revenue

Franchise royalties decreased by $0.9 million as compared to 2001 primarily as a result of the decrease in franchise restaurant locations during fiscal 2002 as compared to fiscal 2001. The acquisition of franchise restaurants by the Company during both 2001 and 2002, and a decrease in year-over-year comparable sales of 1.8% at franchise locations also contributed to the decrease in royalties.

Franchise Fees and Other Income

Franchise fees and other income decreased $0.3 million in fiscal 2002 as compared to fiscal 2001. The decrease is primarily the result of franchise fees received in 2001 for the transfer of approximately 70 restaurants between franchisees in fiscal year 2001.

Restaurant Food and Paper Costs

Restaurant food and paper costs totaled $50.4 million or 30.7% of restaurant sales in fiscal 2002 compared with 32.6% in fiscal 2001. The decrease in these costs as a percentage of restaurant sales was due to decreased beef and cheese prices during the 2002 fiscal year as compared to the fiscal year 2001. In addition, gross margin for the promotional campaigns run in fiscal year 2002 were more favorable to the Company compared to the promotions that ran in fiscal year 2001.

Restaurant Labor Costs

Restaurant labor costs, which include restaurant employees salaries, wages, benefits, workers compensation costs, bonuses and related taxes totaled $52.1 million or 31.8% of restaurant sales for fiscal 2002 compared with $46.9 million or 32.2% for fiscal

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2001. The staffing at our restaurants was increased significantly subsequent to the merger of Checkers Drive-In Restaurants, Inc. and Rally s Hamburgers, Inc. on August 9, 1999. This was approximately the same time new management began running the combined Company. At the time of the merger, the restaurants were understaffed and several were without managers. Management s initial goal was to increase staffing levels in an effort to reduce service time and increase customer satisfaction. By the end of 2001, the restaurants were deemed adequately staffed and management then began to focus on properly managing the labor costs. A labor management matrix, primarily based upon sales, was created for the Company and labor cost management was added to the Restaurant Manager performance evaluations. As a result, the cost of management labor and direct labor as a percentage of sales decreased 88 basis points for 2002 as compared to 2001. Workers compensation costs as a percentage of sales increased by 76 basis points for 2002 as compared to 2001. The increase in workers compensation costs was due to an increase in the estimated loss per claim for claims in 2002 based upon the 2002 independent actuarial report; and an increase in estimated total losses on claims for years prior to 2002 based upon the same actuarial report.

Restaurant Occupancy Expense

Restaurant occupancy expense, which includes rent, property taxes, licenses and insurance totaled $12.5 million or 7.6% of restaurant sales in 2002 compared with $11.8 million or 8.1% in 2001. The decrease in restaurant occupancy expense as a percentage of restaurant sales is due primarily to the increase in comparable restaurant sales in the California market by 21.4% for six comparable periods of 2002, and the increase in comparable restaurant sales in the Macon, GA market by 6.3% for five comparable periods of 2002, although total company year-over-year comparable sales decreased in 2002.

Restaurant Depreciation

Restaurant depreciation and amortization totaled $6.2 million or 3.8% of restaurant sales for fiscal 2002 compared to $4.5 million or 3.1% for fiscal 2001. The increase was the result of management s plan to continue to operate 45 Company-owned restaurants which were originally forecasted to be sold as part of the 1999 restructuring plan. The assets at these locations were reclassified from Held for Sale to Held for Use at December 31, 2001. As a result, we began recording depreciation on these assets during fiscal year 2002. The increase in depreciation was also due to capital additions during fiscal year 2002.

Other Restaurant Operating Expenses

Other restaurant operating expense includes all other restaurant level operating expenses, and specifically includes utilities, repairs and maintenance and other costs. These expenses totaled $22.3 million, or 13.6% of restaurant sales for the year ended December 30, 2002 compared to $18.7 million, or 12.9% of restaurant sales for the year ended December 31, 2001. Repairs and maintenance, the largest component of this category, increased to 4.5% as a percentage of restaurant sales for 2002 compared to 3.9% for 2001. Utilities remained consistent at 4.9% as a percentage of restaurant sales for 2002 and 2001, whereas other costs increased to 4.2% as a percentage of restaurant sales for 2002 compared to 4.1% for 2001. The increase in the category was attributed to additional repairs and maintenance as we continue to improve and refurbish the restaurants, additional expenses incurred for maintenance agreements on new POS equipment rolled out during the course of the prior year, as well as increased utilities in acquired company restaurants.

General and Administrative Expenses

General and administrative expenses were $12.1 million, or 6.8% of total revenues for fiscal 2002 compared to $11.7 million, or 7.3% of total revenues for fiscal 2001. These costs have decreased as a percentage of total revenues due to their relatively fixed nature and increased revenues.

Advertising

Advertising expense increased approximately $2.2 million to $10.3 million, or 6.3% of restaurant sales for 2002 compared with 5.6% for 2001. The increase was due to an increase in the average number of Company-owned restaurants operated during fiscal 2002 as compared to fiscal 2001, incremental marketing to spur sales and increase brand awareness in regions where the Company began operating restaurants which were previously franchise only regions, and additional outlays to roll out soft-serve treats.

Other depreciation and amortization

Other depreciation and amortization decreased by $2.7 million to $0.7 million. The decrease was due to the adoption of SFAS No. 142 for intangible assets on January 1, 2002. As a result, the goodwill and tradename carried on the books of the company are no longer amortized. Upon adoption of SFAS No. 142, we performed an initial impairment review of our goodwill and tradename as of January 1, 2002. Based upon the review, no impairment charge was required. Amortization for goodwill and the tradename amounted to approximately $2.4 million for 2001. The remaining decrease was attributed to locations acquired in July 2001, which were operated by a franchisee under a separate operating agreement. Depreciation for these locations was classified as other depreciation while operated by the franchisee. As they are now Company-owned, it is classified as restaurant depreciation.

Impairment of Long-Lived Assets

During 2002, the Company recognized $7.4 million in impairment charges. The Company completed an evaluation of properties held for sale by obtaining appraisals on land and buildings for six locations which resulted in an impairment of $0.3 million.

Likewise, an impairment of $0.8 million was necessary to reflect fair market value of non-standard modular buildings and equipment held for sale. An additional $0.7 million charge was recognized for 5 restaurant buildings in New Orleans, which management initiated plans during 2002 to replace in 2003. The Company also reviewed historical and projected cash flows of all operating restaurants and recorded impairment charges for 58 under-performing restaurants of $5.6 million. During fiscal 2001, the Company recorded impairment charges of $1.2 million.

Restaurant Retirement Costs

During 2002, the Company recognized charges totaling $5.2 million from restaurant closures related to the estimated future cost of surplus properties. This charge represents only properties held under operating leases. The Company remains directly obligated to make lease payments on 24 vacant sites plus 9 other sites which are subleased for amounts less than the Company s original lease obligation. While the lease agreements do allow for subleasing, they do not allow for cancellation. After significant efforts by the Company to sublease the remaining 24 vacant sites with minimal progress, the lease accrual was increased to reflect our best estimate of our remaining obligations under the leases, generally representing the remaining payments under their minimum lease obligations. During fiscal 2001, the Company recognized losses of $0.6 million from restaurant closures.

Income Tax

The Company s 2002 income tax expense represents income taxes assessed at the state level for states which the Company does not have any net operating losses available or the state has suspended the use of net operating losses during 2002. The Company s 2001 income tax expense represented federal alternative minimum tax based upon estimated federal alternative minimum taxable income after utilizing the allowable portion of our net operating loss carryforwards, prior to the Jobs Creation and Workers Assistance Act of 2002.

A valuation allowance was provided for 100 percent of the net deferred tax assets in 2002. The benefit related to the net deductible temporary differences and net operating loss and credit carryforwards will be recognized as a reduction of income tax expense and goodwill when realization is more likely than not to occur.

Liquidity and Capital Resources

The restaurant industry, in general, operates with a working capital deficit because most of our investments are in long-term restaurant operating assets. We do not normally require large amounts of working capital to maintain operations since sales are for cash, purchases are on open accounts and meat and produce inventories are limited to a three-to-five day supply to assure freshness. We do not have significant levels of accounts receivable or inventory, and receive credit from our trade suppliers. Funds available from cash sales not needed immediately to pay our trade suppliers are generally used for non-current capital expenditures or invested in high quality short term investments.

We have working capital of $7.3 million at December 29, 2003 as compared to $1.5 million at December 30, 2002. This change was primarily due to the decrease in the the valuation allowance on current deferred tax assets of $3.6 million, the reduction of accounts payable for food and paper purchases by $1.0 million to take advantage of vendor term discounts offered, and the decrease of $1.0 million in accrued liabilities primarily due to the timing of our real estate tax payments.

The Company is subject to certain restrictive financial and non-financial covenants under certain of its debt agreements, including EBITDA and a Fixed Charge Coverage ratio. We were in compliance with all of the covenants for fiscal year 2003.

The Company obtained a credit facility with U.S. Bancorp Equipment Finance, Inc. in 2003 that allows it to borrow up to $3 million, which is available through December 31, 2004. The agreement allows the Company to borrow at 2.2% plus the 7-year interest rate swap published in the Federal Reserve Statistical Release. During fiscal year 2002, the Company had received separate commitments from two lenders for financing. The commitments were for obligations up to $15 million in the aggregate for property development. The credit facility with Merrill Lynch was available through October 1, 2003 with an interest rate equal to the 5-year swap rate plus 440 basis points. The credit facility with CNL Franchise Network, LP (CNL) was available through December 31, 2003. The agreement committed CNL to enter into a sale-leaseback transaction for properties to be developed and operated by the Company as Checkers or Rally s restaurants. Both commitments expired under their original terms. There were no borrowings or sale-leaseback transactions under these facilities as of December 29, 2003.

Cash and cash equivalents decreased approximately $0.8 million to $13.6 million since the fiscal year ended December 30, 2002. Cash flow provided by operating activities was $16.4 million for fiscal year 2003 as compared to $17.2 million for fiscal year 2002. Current year operating cash flows are largely attributable to current profits net of non-cash expenses, a decrease in outstanding notes receivable, offset by an increase to accounts receivable and decreases in accounts payable and accrued liabilities.

Cash flow used for investing activities was $9.9 million and related primarily to capital expenditures at existing restaurants, the construction of three new restaurants and the acquisition of 3 restaurants and one equity interest for a joint venture restaurant from former franchisees, net of proceeds received from the sale of property and equipment in the current year.

Cash used by financing activities was $7.3 million. Over the past two years we have paid down $9.6 million in outstanding debt. In fiscal 2003, we paid down principal of $3.1 million on outstanding debt. In fiscal 2002, we paid down $2.7 million of 14% debt, along with other principal payments of $3.8 million. The Company purchased treasury stock for $5.1 million and increased restricted cash by $0.3 million. These outlays were offset against receipts of $1.2 million from the exercise of stock options during the year ended December 29, 2003. We continue to evaluate the Company s capital structure and refinancing opportunities.

We have capital lease receivables for certain restaurants previously sold which are subject to capital lease and mortgage obligations for which we continue to be the primary obligor, and have equivalent liabilities recorded. The amount of capital lease receivables as of December 29, 2003 was approximately $5.8 million.

The Company, as original lessee, has also subleased certain land associated with the sale of Company-owned restaurants under operating leases. The revenue from these subleases is offset against rent expense, as we continue to be responsible for the rent payments to the original lessors. Sublease rental income recorded for December 29, 2003, December 30, 2002 and December 31, 2001, was $7.6 million, $8.0 million and $9.3 million, respectively.

Capital expenditures for fiscal 2004 are expected to total $24 million. These expenditures include the development of new restaurants, the remodeling of existing restaurants as well as other capital equipment and improvements on operating restaurants. Although there can be no assurance, we believe that our existing cash at December 29, 2003, the expected cash provided from operations, and the available $3 million credit facility with U.S. Bancorp Equipment Finance, Inc. will be sufficient to meet our working capital and capital expenditure requirements for the next 12 months.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financials statements, and the reported amount of revenues and expenses during the reported periods. We base our estimates on historical experience and assumptions we consider reasonable at the time of making those estimates. We evaluate our estimates on an on-going basis. Actual results may differ from these estimates under different circumstances or using different assumptions.

Our critical accounting policies are as follows:

Revenue Recognition Franchise fees and area development franchise fees are generated from the sale of rights to develop, own and operate restaurants. Such fees are based on the number of potential restaurants in a specific area which the franchisee agrees to develop pursuant to the terms of the franchise agreement between the Company and the franchisee and are recognized as income when substantially all of the Company s obligations per location are satisfied (generally at the opening of the restaurant). Franchise fees are nonrefundable. Franchise fees and area development franchise fees received prior to substantial completion of the Company s obligations are deferred. The Company receives royalty fees from franchisees based on a percentage of each restaurant s gross revenues. Royalty fees are recognized as earned.

Gains associated with the sale of certain Company-owned restaurants to franchisees with associated mortgages and capital leases are recognized over the life of the related capital leases. During fiscal years 1999 and 2000, several Company-owned restaurants were sold to franchisees with associated mortgages and capital leases. As a result of the sales, we have recorded lease receivables for those restaurants sold which are subject to capital lease and mortgage obligations. The amount of capital lease receivables as of December 29, 2003 was approximately $5.8 million. We have recorded deferred gains of $4.0 million from these sales since we continue to be responsible for the payment of the obligations to the original lessors and mortgagors. The deferred gains are included in our consolidated balance sheet under the captions accrued liabilities-current and deferred revenues for $0.5 million and $3.5 million, respectively and will be recognized over the next 16 years. Additionally, the Company has deferred approximately $0.4 million of gains in accordance with SFAS No. 66, where notes receivable were accepted as consideration for sales of certain Company-owned restaurants. These notes as well as the associated deferred gains are scheduled to be collected and recognized over the term of the notes, which are due over the next 6 years.

Valuation of Long-Lived Assets We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

- offers from current or potential franchisees for restaurants below carrying value;
- significant underperformance relative to expected historical or projected future operating results; and
- significant negative industry or economic trends.

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Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets requires the write-down of certain intangibles and tangible property associated with under-performing assets. In applying SFAS No. 144, we reviewed historical and projected cash flows of all restaurants and performed a discounted cash flow analysis where indicated for each restaurant based upon such results projected over a ten year period. This period of time was selected based upon the lease term and the age of the related buildings. Impairments or recoveries are recorded to adjust the asset values to the amount recoverable under the discounted cash flow analysis, in accordance with SFAS No. 144. The effect of applying these standards resulted in a reduction of property, equipment and intangible assets of approximately $0.4 million for the fiscal year 2003, $7.4 million for the fiscal year 2002, and $1.2 million for the fiscal year 2001. For further discussion, see Note 1(j) Summary of Significant Accounting Policies Valuation of Long-Lived Assets of the Consolidated Financial Statements, Item 8 of Part II of this Report on Form 10-K.

Allowance for doubtful receivables Management must make estimates of the collectability of our receivables. Management specifically analyzes its receivables and related historical bad debts, franchise concentrations, franchise credit-worthiness, and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Current portion of accounts, notes and leases receivable totaled $7.1 million, net of allowance for doubtful accounts of $3.9 million as of December 29, 2003.

Contingencies Management s current estimated range of liability related to some of the pending litigation is based on claims for which we can estimate the amount and range of loss. We have recorded the minimum estimated liability related to those claims, where a range of loss has been identified. Because of the uncertainties related to both the amount and range of loss on the remaining pending litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates accordingly. Such revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

Restaurant retirement costs Reserves for restaurant relocations and abandoned sites consist of our estimates for the ongoing costs of each location which has been closed or was never developed. Those costs include rent, property taxes, costs associated with relocating the modular restaurant to a storage facility, and any other retirement costs. The cash outlays for these costs have been estimated for the remaining terms of the lease obligations, ranging from less than 1 year to 12 years. Although the Company has negotiated out of several of these sites, the current economic outlook and lack of alternative investment opportunities have hindered the Company s ability to successfully negotiate out of the remaining sites. As a result, management believes that cash outlays for these sites will continue through lease maturity. During fiscal 2003, the Company recognized a benefit of $0.5 million from successfully negotiating out of certain lease obligations.

Accounting for income taxes The Company accounts for income taxes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires the Company to recognize income tax benefits and liabilities for loss carryforwards and other income tax assets and liabilities. The tax benefits must be reduced by a valuation allowance in certain circumstances. Realization of the deferred tax benefits is dependant on generating sufficient taxable income prior to expiration of any net operating loss carryforwards (NOL s). The deferred tax assets are reviewed periodically for recoverability, and valuation allowances are provided for as necessary. During 2003, the Company reversed $29.7 million of the valuation allowance. As of December 29, 2003 the Company has deferred tax assets available to reduce future income taxes. Currently there is a valuation allowance of $31.5 million recorded against approximately $56.1 million of the net deferred tax assets.

Valuation of Intangible Assets and Goodwill We assess the impairment of intangible assets on an annual basis, including such assets as franchise rights, tradename and enterprise level goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

significant underperformance relative to expected historical or projected future operating results;

significant negative industry or economic trends;

significant decline in our stock price for a sustained period; and

our market capitalization relative to net book value.

In accordance with SFAS No. 142 Goodwill and Other Intangible Assets we ceased to amortize approximately $24 million of goodwill and $17.5 million for the intangible value of our tradename in fiscal 2002. We recorded approximately $2.4 million of amortization on these amounts during 2001 and would have recorded approximately $2.4 million of amortization for 2002 and 2003. In lieu of amortization, we performed an initial impairment review of our goodwill and tradename as of January 1, 2002. Subsequently, we performed annual impairment reviews on December 30, 2002 and December 29, 2003. Based upon these reviews, no impairment was required, and we do not believe circumstances have changed since the review date which would

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make it necessary to reassess their values subsequent to the balance sheet date. We will continue our annual evaluation, unless circumstances call for us to perform an evaluation prior to then. The Company recorded an adjustment to goodwill in fiscal 2003 of $23.5 million, reducing goodwill to $0.7 million in conjunction with the reduction to the valuation allowance on net deferred tax assets.

New Accounting Standards

In November 2002, FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others was issued. The interpretation addresses the disclosure required by a guarantor in its financial statements about its obligations under guarantees. It also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. Certain of the disclosure requirements of this interpretation were effective after December 15, 2002 and the provisions for the initial recognition and measurement of a liability associated with a guarantee is effective beginning after December 31, 2002, prospectively. This interpretation did not materially effect the Company for fiscal years 2002 and 2003.

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51 (FIN 46). FIN 46 was revised with FIN 46(R) in December 2003. It requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46(R) is effective for all entities subject to this interpretation no later than the end of the first period that ends after March 15, 2004. The Company is evaluating the impact the adoption of FIN 46(R) will have on the Company s results of operations and financial position.

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations, which addresses accounting and financial accounting and reporting for obligations associated with the retirement of tangible long-lived asset retirement costs. This statement requires that the fair value of a liability for an asset retirement be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated present value of the asset retirement costs are capitalized as part of the carrying value of the long-lived asset. This statement is effective for fiscal years beginning after June 15, 2002. We have adopted the standard for fiscal 2003, and have recorded the impact of such obligations on our balance sheet and income statement for estimated costs to return the premises to their previous states for those leased premises with such contractual obligations. The depreciable base of property and equipment was increased by $10,321, net of accumulated depreciation of $15,662 for the cumulative effect of the change as of the end of our fiscal year December 30, 2002. The asset retirement obligation, included in other long-term liabilities, recorded for the cumulative effect of the change as of December 30, 2002 was $60,993. The impact on the consolidated income statement for the year ended December 29, 2003 was $57,672, of which $50,672 is reflected as a cumulative effect of the adoption of SFAS No. 143 and an additional $7,000 of ongoing expense reflected in restaurant depreciation and restaurant retirement costs. Had the change in accounting principle been retroactively recorded, the pro forma net income and earnings per share would have been as follows:

(Dollars in thousands, except per share amounts)

	For the Year Ended		
	December 29, 2003	**December 30, 2002**	**December 31, 2001**

Net income, as reported	$ 15,783	$ (1,706)	$ 4,335
Change: assuming retroactive adjustment of the change in accounting principle	51	(7)	(7)
Pro forma net income	$ 15,834	$ (1,713)	$ 4,328
Earnings per share:			
Basic as reported	1.31	(0.14)	0.43
Basic pro forma	1.31	(0.14)	0.43
Diluted as reported	1.23	(0.14)	0.36
Diluted pro forma	1.23	(0.14)	0.36

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 replaces current accounting literature and requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. The provisions of the Statement are effective for exit or disposal

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activities that are initiated after December 31, 2002. This new standard will affect the timing of when the Company recognizes the cost for restaurant closings. We adopted SFAS No. 146 in the first quarter of fiscal 2003. The adoption of SFAS No. 146 did not materially impact our consolidated financial statements.

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The adoption of SFAS No. 150 did not materially impact our consolidated financial statements.

Off-Balance Sheet Arrangements

The Company does not maintain any off-balance sheet transactions, arrangements, obligations or other relationships with unconsolidated entities or others, except for operating leases as disclosed, that are reasonably likely to have a material current or future effect on the Company s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations

The Company is obligated under future commitments as part of its normal business operations. The future commitments are for long term debt, capital lease obligations and operating lease payments, summarized as follows:

	Obligations due by period (Dollars in thousands)				
	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Contractual Obligations					
Long term debt (1)	$ 21,746	$ 1,772	$ 3,438	$ 3,883	$ 12,653
Capital lease obligations (1)	10,415	2,012	2,104	1,524	4,775
Operating lease payments	115,315	18,099	33,758	24,633	38,825
Purchase obligations					
Other long-term liabilities reflected on the Registrant s balance sheet under GAAP	8,905		3,666	2,180	3,059
	$ 156,381	$ 21,883	$ 42,966	$ 32,220	$ 59,312

(1) The maturity on our Long Term Debt and Capital Lease Obligations could be accelerated if we do not maintain certain covenants.

Risks Factors That May Affect Results of Operations and Financial Condition

The following risk factors and others that we may add from time to time, are some of the factors that could cause our actual results to differ materially from the expected results described in our forward-looking statements.

We may experience operating losses if we cannot sustain our current sales volume. In fiscal 2002 and prior to fiscal 2000, we had net losses for the previous four years. While we had net income of $2.3, $4.3, and $15.8 million for fiscal 2000, 2001, and 2003, respectively, we cannot assure you that we will not have a loss for the current fiscal year which will end on January 3, 2005. Our prior years losses were primarily caused by impairment charges related to lower restaurant sales at certain restaurants during these periods, and these losses may occur again if we are unable to sustain our current level of sales.

Our available cash is limited by our debt service obligations. At December 29, 2003, we had outstanding long term debt and capital lease obligations of approximately $28.0 million, pursuant to which we are required to make principal, interest and lease payments. During fiscal 2003, we paid $2.6 million in interest on our long term debt. Our debt service and capital lease obligations limit our available cash flow.

Our debt and lease agreements contain financial covenants. We are subject to certain restrictive financial and non-financial covenants under certain of our debt and lease agreements, including EBITDA and a Fixed Charge Coverage ratio. Though we were in compliance with all financial and non-financial covenants at December 29, 2003, if we are unable to make the required interest payments or to comply with the provisions of our debt covenants, our creditors may accelerate the due date of our debt and foreclose upon the operating assets we used to secure these obligations. Any such actions would adversely affect our operations and strain our cash flow.

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We may incur substantial liability arising from lawsuits to which we are a party. We are parties to the litigation described in Item 8. Note 12(d) Commitments and Contingencies-Litigation , in this filing. Although we cannot determine at this time the outcome of the lawsuits to which we are a party, if the result in one or more of the cases is adverse to us, the potential liability could be material. In addition, we believe that the costs of defending these actions could be significant. The litigation matters include disputes with our franchisees and include claims of fraud and violations of state franchise laws, and a securities class action.

There are many risks associated with the food services industry. The food service industry is affected by changes in consumer tastes, national, regional, and local economic conditions, demographic trends, traffic patterns and the type, number, and location of competing restaurants. Food service chains can also be adversely affected by publicity resulting from food quality, illness, injury or other health concerns (including food-borne illness claims) stemming from one store or a limited number of stores. Claims relating to foreign objects or food-borne illness are common in the food services industry and a number of such claims may exist at any given time. Dependence on frequent deliveries of produce and supplies also subjects food service businesses such as ours to the risk that shortages or interruptions in supply caused by adverse weather or other conditions could adversely affect the availability, quality, and cost of ingredients. In addition, material changes in, or our failure to comply with, applicable federal, state, and local government regulations, and factors such as inflation, increased food, labor, and employee benefits costs, regional weather conditions and the availability of an adequate number of experienced managers and hourly employees may also adversely affect the food service industry in general and our results of operations and financial condition.

The quick-service restaurant industry is intensely competitive and our operating results may be adversely affected by our need to adjust our operations to meet this competition. There is intense competition in the quick-service restaurant industry which has adversely affected us. We expect to continue to experience intense competition, especially from the major chains, which have substantially greater financial resources and longer operating histories then us, and dominate the quick-service restaurant industry. We compete primarily on the basis of food quality, price and speed of service. A significant change in pricing or other marketing strategies by one or more of our competitors could have a material adverse impact on our sales, earnings and growth. In order to compete with each other, all of the major quick-service chains have increasingly offered selected food items and combination meals at discounted prices. We anticipate that the major quick-service hamburger chains will continue to offer promotions of value priced meals, many specifically targeting the $.99 price point at which we sell many of our products. As a result, we cannot rely on low prices to give us a competitive advantage.

Our growth strategy is dependent upon franchisees. As of December 29, 2003, 222 restaurants were operated by us, and 562 were operated by franchisees. Our growth strategy will continue to be heavily dependent upon the opening of new stores owned by franchisees, and the manner in which they operate and develop their restaurants to promote and develop our concepts and our reputation for quality food and speed of service. The opening and success of stores is dependent on a number of factors, including the availability of suitable sites, the negotiation of acceptable lease or purchase terms for such sites, permitting and regulatory compliance, the ability to hire and train qualified personnel, the financial and other capabilities of our franchisees and area developers, and general economic and business conditions. Many of these factors are beyond our control or the control of our franchisees and area developers.

We may be harmed by actions taken by our franchisees that are outside of our control. Franchisees are generally independent operators and are not our employees. We provide training and support to franchisees, but the quality of franchised store operations may be diminished by any number of factors beyond our control. Consequently, area developers and individual franchisees may not successfully operate stores in a manner consistent with our standards and requirements, or may not hire and

train qualified managers and other store personnel. If they do not, our image and reputation may suffer, and systemwide sales could decline.

The ability to attract and retain highly qualified personnel is extremely important and our failure to do so could adversely affect us. We are heavily dependent upon the services of our officers and key management involved in restaurant operations, marketing, finance, purchasing, expansion, human resources and administration. The loss of any of these individuals could have a material adverse effect on our business and results of operations. Other than our Chief Executive Officer and Vice-President of Operations, we currently do not have employment agreements with any of our employees. Our success is also dependent upon our franchisee s ability to attract and maintain a sufficient number of qualified managers and other restaurant employees. Qualified individuals needed to fill these positions are in short supply in some geographic areas. The inability to recruit and retain such individuals may result in higher employee turnover in existing restaurants, which could have a material adverse effect on our business and results of operations.

Our resources may be strained by implementing our business strategy. Our growth strategy may place a strain on our management, financial and other resources. To manage our growth effectively, we must maintain the level of quality and service at our existing and future restaurants. We must also continue to enhance our operations, financial and management systems and locate, hire, train and retain experienced and dedicated operating personnel, particularly restaurant managers. We may not be able to effectively manage any one or more of these aspects of our expansion. Failure to do so could have a material adverse effect on our business and results of operations.

If we are not able to anticipate and react to our food and labor costs, our profitability could be adversely affected. Our stores operating costs consist principally of food and labor costs. Our profitability is dependent in part on our ability to anticipate and react to changes in food and labor costs. Various factors beyond our control, including adverse weather conditions and governmental regulation, may affect our food costs. We may not be able to anticipate and react to changing food costs, whether through purchasing practices, menu composition or menu price adjustment in the future. In the event that food or labor price increases cause us to increase our menu prices, we face the risk that our customers will choose our competitors if their prices are lower. Failure to react to changing food costs, or retaining customers if we are forced to raise menu prices, could have a material adverse effect on our business and results of operations.

Our ability to develop new franchised stores and to enforce contractual rights against franchisees may be adversely affected by franchise laws and regulations, which could cause our franchise revenues to decline and adversely affect our growth strategy. As a franchisor, we are subject to regulation by both the Federal Trade Commission and state laws regulating the offer and sale of franchises. Our failure to obtain or maintain approvals to sell franchises would cause us to lose franchise revenues. If we are unable to sell new franchises, we will not be able to accomplish our growth strategy. In addition, state laws that regulate substantive aspects of our relationships with franchisees may limit our ability to terminate or otherwise resolve conflicts with our franchisees. Because we plan to grow primarily through franchising, any impairment of our ability to develop new franchised stores will negatively affect us and our growth strategy more than if we planned to develop additional company stores.

Our quarterly results may fluctuate and could fall below expectations of securities analysts and investors, resulting in a decline in our stock price. Our quarterly and yearly results have varied in the past, and we believe that our quarterly operating results will vary in the future. For this reason, you should not rely upon our quarterly operating results as indications of future performance. In some future periods, our operating results may fall below the expectations of securities analysts and investors. This could cause the trading price of our common stock to fall. Factors such as seasonality and unanticipated increases in labor, food, insurance or other operating costs may cause our quarterly results to fluctuate.

You should not rely on our same-store sales as an indication of our future results of operations because they may fluctuate significantly. A number of factors have historically affected, and will continue to affect, our same-store sales results. Such factors include unusually strong sales performance by new stores (operated at least one year), competition, regional and national economic conditions, consumer trends, and our ability to execute our business strategy effectively. Significant fluctuations could result in lower than planned sales, adversely impacting our profitability goals and straining cash flow.

Future sales of shares of our common stock could decrease its market price. As of February 23, 2004, we had 12,049,356 shares of our common stock outstanding and grants of options outstanding to purchase a total of 2,242,555 shares of our common stock. Possible or actual sales of any of these shares under Rule 144 or otherwise, may in the future decrease the price of shares of our common stock.

Our largest stockholders still have a significant influence on matters put to a vote. The percentage interest held by our largest shareholders may have significant influence on elections of directors and other matters put to a vote of stockholders. Ownership percentages of such large shareholders can be found under the heading SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT in the Company s definitive Proxy Statement to be used in connection with the Company s Annual Meeting of Stockholders, which will be filed with the commission on or before April 27, 2004.

ITEM 7A. QUANTITIVE AND QUALIT IVE DISCLOSURES ABOUT MARKET RISKS

Interest Rate and Foreign Exchange Rate Fluctuations

Our exposure to financial market risks is the impact that interest rate changes and availability could have on our debt. Borrowings under our primary debt facilities and capital lease obligations bear interest ranging from 4.9% to 16.4%. An increase in short-term and long-term interest rates would result in a reduction of pre-tax earnings. Substantially all of our business is transacted in U.S. dollars. Accordingly, foreign exchange rate fluctuations have not had a significant impact on the Company and are not expected to in the foreseeable future.

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Commodity Price Risk

We purchase certain products which are affected by commodity prices and are, therefore, subject to price volatility caused by weather, market conditions and other factors which are not considered predictable or within the Company s control. Although many of the products purchased are subject to changes in commodity prices, certain purchasing contracts or pricing arrangements have been negotiated in advance to minimize price volatility. Typically, the Company uses these types of purchasing techniques to control costs as an alternative to directly managing financial instruments to hedge commodity prices. In many cases, the Company believes it will be able to address commodity cost increases, which are significant and appear to be long-term in nature by adjusting its menu pricing or changing our product delivery strategy. However, increases in commodity prices could result in lower restaurant-level operating margins.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPL EMENTARY DATA

(1) Index to Consolidated Financial Statements:

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