SUNLINK HEALTH SYSTEMS INC
Form 8-K
May 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the

Securities and Exchange Act of 1934

Date of Report (Date of earliest event reported) May 8 , 2012

SUNLINK HEALTH SYSTEMS, INC.

(Exact Name Of Registrant As Specified In Charter)

Ohio	1-12607	31-0621189
(State or other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia	30339
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code (770) 933-7000

N/A

(Former Name Or Former Address, If Changed Since Last Report)

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a.-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act

(17 CFR 240.14d- 2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act

(17 CFR 240.13e- 4(c))

Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review.

(a) On May 7, 2012, the Board of Directors and Audit Committee of SunLink Health Systems, Inc., (*SunLink* , or the *Company*) concluded that the financial statements for the fiscal year ended June 30, 2011 and for the quarterly periods ended March 31, 2011, September 30, 2011 and December 31, 2011 should no longer be relied upon in light of the SEC s requirement that Medicare and Medicaid incentive payments for implementation of electronic health records (EHR) technology be accounted for on the basis of the gain contingency accounting model rather than a grant based accounting model as employed by SunLink with respect to such payments in fiscal quarters ending prior to December 31, 2011. As a result, the Company is restating its financial statements for such periods.

In addition to the description contained in this Current Report on Form 8-K, the Company plans to file, as soon as practicable amendments to its annual report on Form 10-K for the fiscal year ended June 30, 2011, Form 10-Q for the quarterly period ended March 31, 2011, Form 10-Q for the quarterly period ended, September 30, 2011 and Form 10-Q for the quarterly period ended December 31, 2011. The Company further intends to include the effect of the adjustments described herein on each applicable periodic report filed by the Company subsequent to the date hereof.

The restatement of financial statements does not affect the amount or the timing of past or future Medicare and Medicaid incentive payments.

The facts surrounding the foregoing determination to restate the applicable financial statements due to the EHR payments are as follows:

The Health Information Technology for Economic and Clinical Health Act, promulgated as part of the American Recovery and Reinvestment Act of 2009, provides for Medicare and Medicaid incentive payments beginning in calendar year 2011 for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record technology. Each of SunLink s six hospitals and its formerly owned Chilton Medical Center (Chilton) registered for the program with CMS and, on April 18, 2011, all successfully attested compliance with Part I of the Medicare EHR incentive program for such first year. The Company has also successfully attested to the meaningful use requirements for Medicaid programs for its six hospitals as has Chilton, its formerly owned hospital in Alabama. The Company has the right to receive 75% of EHR received by Chilton under a 2011 sale agreement. The Company has received approximately $7,731,000 in Medicare EHR incentive funds and approximately $2,169,000 in Medicaid EHR incentive funds to date. The Company has also received approximately $790,000 Medicare EHR incentive funds and approximately $188,000 Medicaid EHR incentive funds to date from Chilton.

For Medicare and Medicaid EHR incentive payments prior to the quarter ended December 31, 2011, SunLink followed what it considered the existing accounting guidance and the Company utilized a grant accounting model to recognize these revenues. Under this accounting policy, EHR incentive payments were recognized as revenues when attestation that the EHR meaningful use criteria for the required period of time was demonstrated and were recognized ratably over the relevant cost report period to determine the amount of reimbursement. This accounting policy was specifically reviewed on several occasions in the past by the Company s management and the Audit Committee of the Company s Board of Directors. In addition, the Company s use of the grant accounting model to recognize the income with respect to EHR incentive payments was believed to be consistent with the practices being used by other publicly held healthcare companies.

During the quarter ended December 31, 2011, SunLink became aware of what it understood to be the position of the staff (the *Staff*) of the Securities and Exchange Commission (the *SEC*) regarding incentive reimbursement accounting for public companies. The Company gained such knowledge from its review of filings of other public companies and the issues analysis paper issued by the Healthcare Financial Management Association in December 2011. In light of what the Company understood were the Staff s views, the Company elected to apply such interpretation of accounting for the EHR incentive reimbursement for future transactions beginning with the quarter ended December 31, 2011. Accordingly, the Company prospectively changed its recognition policy to a gain contingency accounting model income recognition of EHR incentive payments after October 1, 2011 based upon the Company s understanding of the informal guidance provided by the SEC and certain other non-authoritative guidance. SunLink also is reclassifying the amounts previously reported as revenue as a line item in the Costs and Expense category of the Consolidated Statement of Earnings and Loss for previously reported periods presented in its Form 10-K for the fiscal year ended June 30, 2011 and in its Form 10-Qs for the quarters ended March 31, 2011, September 30, 2011 and December 31, 2011, respectively. Under the gain contingency accounting model, EHR incentive payments are recognized when all contingencies relating to the incentive payment have been satisfied and compliance with the EHR meaningful use criteria have been attested to. For recognition of Medicaid EHR incentive payments, this model does not differ from the Company s previous model because Medicaid payments for the states in which the Company operates are based upon historical cost reports with no subsequent payment adjustment. However, for Medicare EHR incentive payments, recognition will be deferred until both the Medicare federal fiscal year during which EHR meaningful use was demonstrated ends and the cost report information utilized to determine the final amount of reimbursement is known.

On February 2, 2012, the Company received a letter from the Staff of the SEC with respect to the Staff s review of, and comments on, the Company s Form 10-K for the fiscal year ended June 30, 2011 (the *Form 10-K*) and the Company s Form 10-Q for the fiscal quarter ended September 30, 2011 (the *Form 10-Q*). Following correspondence and other communications with the Staff, on April 24, 2012, SunLink received correspondence from the Staff asserting the Staff s view that, among other things, the Company s prior accounting for EHR incentive payments should have been on a gain contingency accounting model rather than the grant accounting model being utilized. Subsequent to the Company s receipt of the Staff s April 2012 letter and following additional consultation by management with the Company s independent registered public accounting firm and the Audit Committee of the Company s Board of Directors, SunLink concluded that, in light of the existing non-authoritative guidance and the Staff s view, it will use the gain contingency accounting model for recognition of EHR payments rather than the grant accounting model in order for the Company s financial statements to be reported in accordance with generally accepted accounting principles in the United States

(GAAP). Accordingly, management determined and the Audit Committee concurred that the Company should report on Form 8-K that the Company s historical financial statements with respect to EHR incentive payments should no longer be relied upon and that the Company s applicable periodic reports should be amended.

In connection with such restatements, the Company will also report a material weakness in its internal controls as based on the Public Company Accounting Oversight Board s Auditing Standard No. 2, an Audit of Internal Control over Financial Reporting Performed in Conjunction with Audit of Financial Statements, restatement of financial statements in prior filings with the SEC is said to be a strong indicator of the existence of a material weakness in the design or operation of internal control over financial reporting. The Company has concluded that, because its historical financial statements required restatement as a result of the SEC Staff s requirement that treatment of the EHR incentive payments be based upon the gain contingency accounting model, a material weakness could be said to have existed in the effectiveness of the Company s internal controls to provide reasonable assurance that its accounting for EHR incentive payments was in accordance with GAAP as of the date of the Company s annual report on Form 10-K for the period ended June 30, 2011, and as of the date of the Company s quarterly report on Form 10-Q for the period ended March 31, 2011, quarterly report on Form 10-Q for the period ended September 30, 2011, and quarterly report on Form 10-Q for the period ended December 31, 2011 and assuming it should have used the gain contingency accounting model, to this extent, its internal control over financial reporting may be said to not have been effective.

As a result of the foregoing, the previously issued financial statements of the Company for the period ended March 31, 2011, for the period ended June 30, 2011, for the period ended September 30, 2011 and for the period ended December 31, 2011, will be restated to account for EHR incentive payments utilizing the gain contingency accounting model. The Company believes that it has implemented procedures which will remediate for future periods any material weakness in internal controls relating to the accounting for EHR incentive payments.

In an unrelated matter, such amended reports will reflect the retroactive reclassification of financial information with respect to the reclassification of the Company s Memorial Hospital of Adel to discontinued operations as a result of the Company s decision in the quarter ended March 31, 2012 to sell such operations and the entry by the Company and its HealthMont of Georgia, Inc. subsidiary, on March 8, 2012, into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Hospital Authority of Tift County, Georgia (Buyer) effective as of March 1, 2012 (the Adel Sale Agreement) to sell substantially all of the assets of the Company s owned Memorial Hospital of Adel and Memorial Convalescent Center (Adel) to the Buyer for approximately $8.3 million.

The Company s management discussed the matters disclosed in this Form 8-K with the Company s independent registered public accounting firm. The Company intends to file its amended annual report on Form 10-K for the period ended June 30, 2011, amended quarterly report on Form 10-Q for the period ended March 31, 2011, amended quarterly report on Form 10-Q for the period ended September 30, 2011, and amended quarterly report on Form 10-Q for the period ended December 31, 2011, each of which will also include the information on the effect of the adjustment to the financial statements, contemporaneously with this Current Report on Form 8-K.

Below is a table which sets for the expected effects of the restatements for periods listed on certain line items within our previously reported financial statements. The adjustments to the financial statements shown in the table below are estimates only, are based on information available to the Company as of the date of this filing, are not yet final, and are subject to change based upon the finalization of the Company s restatement of its historical financial statements as discussed above. The Company is working diligently to complete its review and analysis and to prepare its restated financial statements which, upon completion, will be provided to the Company s independent registered public accounting firm to perform and complete the applicable audit or review processes necessary for the filing of the Company s restated financial statements with the SEC.

(in thousands, except per share amounts)

Condensed Consolidated Statement of Earnings

and Loss

	Three Months Ended	
	March 31, 2011 Restated	March 31, 2011 Previously Reported
Net Revenues	$ 42,376	$ 52,028
Earnings (Loss) from continuing operations before income taxes	$ (857)	$ 4,082
Earnings (Loss) from continuing operations	$ (315)	$ 2,515
Earnings (Loss) from discontinued operations	$ 1	$ 168
Net Earnings (Loss)	$ (314)	$ 2,683
Earnings (Loss) per Share:		
Continuing Operations:		
Basic	$ (0.04)	$ 0.31
Diluted	$ (0.04)	$ 0.31
Discontinued Operations:		
Basic	$ -	$ 0.02
Diluted	$ -	$ 0.02
Net Earnings (Loss):		
Basic	$ (0.04)	$ 0.33
Diluted	$ (0.04)	$ 0.33

	Nine Months Ended	
	March 31, 2011	March 31, 2011
	Restated	Previously Reported
Net Revenues	$ 119,713	$ 137,947
Earnings (Loss) from continuing operations before income taxes	$ (6,523)	$ (1,934)
Earnings (Loss) from continuing operations	$ (4,455)	$ (1,849)
Earnings (Loss) from discontinued operations	$ (393)	$ (2)
Net Earnings (Loss)	$ (4,848)	$ (1,851)
Earnings (Loss) per Share:		
Continuing Operations:		
Basic	$ (0.55)	$ (0.23)
Diluted	$ (0.55)	$ (0.23)
Discontinued Operations:		
Basic	$ (0.05)	$ -
Diluted	$ (0.05)	$ -
Net Earnings (Loss):		
Basic	$ (0.60)	$ (0.23)
Diluted	$ (0.60)	$ (0.23)

	Fiscal Year ended	
	June 30, 2011	June 30, 2011
	Restated	Previously Reported
Net Revenues	$ 154,380	$ 181,161
Earnings (Loss) from continuing operations before income taxes	$ (24,025)	$ (16,159)
Earnings (Loss) from continuing operations	$ (15,416)	$ (10,552)
Earnings (Loss) from discontinued operations	$ (687)	$ (163)
Net Earnings (Loss)	$ (16,103)	$ (10,715)
Earnings (Loss) per Share:		
Continuing Operations:		
Basic	$ (1.90)	$ (1.30)
Diluted	$ (1.90)	$ (1.30)
Discontinued Operations:		
Basic	$ (0.08)	$ (0.02)
Diluted	$ (0.08)	$ (0.05)
Net Earnings (Loss):		
Basic	$ (1.99)	$ (1.32)
Diluted	$ (1.99)	$ (1.32)

	Three Months Ended	
	September 30, 2011 Restated	September 30, 2011 Previously Reported
Net Revenues	$ 35,517	$ 43,053
Earnings (Loss) from continuing operations before income taxes	$ (2,020)	$ (498)
Earnings (Loss) from continuing operations	$ (1,251)	$ (305)
Earnings (Loss) from discontinued operations	$ (304)	$ (13)
Net Earnings (Loss)	$ (1,555)	$ (318)
Earnings (Loss) per Share:		
Continuing Operations:		
Basic	$ (0.15)	$ (0.04)
Diluted	$ (0.15)	$ (0.04)
Discontinued Operations:		
Basic	$ (0.04)	$ -
Diluted	$ (0.04)	$ -
Net Earnings (Loss):		
Basic	$ (0.19)	$ (0.04)
Diluted	$ (0.19)	$ (0.04)

	Three Months Ended	
	December 31, 2011 Restated	December 31, 2011 Previously Reported
Net Revenues	$ 37,038	$ 41,231
Earnings (Loss) from continuing operations before income taxes	$ (1,598)	$ (2,382)
Earnings (Loss) from continuing operations	$ (1,093)	$ (1,586)
Earnings (Loss) from discontinued operations	$ 159	$ (14)
Net Earnings (Loss)	$ (934)	$ (1,600)
Earnings (Loss) per Share:		
Continuing Operations:		
Basic	$ (0.12)	$ (0.17)
Diluted	$ (0.12)	$ (0.17)

	Six Months Ended	
	December 31, 2011 Restated	December 31, 2011 Previously Reported
Net Revenues	$ 72,555	$ 84,284
Earnings (Loss) from continuing operations before income taxes	$ (3,618)	$ (2,880)
Earnings (Loss) from continuing operations	$ (2,344)	$ (1,891)
Earnings (Loss) from discontinued operations	$ (145)	$ (27)
Net Earnings (Loss)	$ (2,489)	$ (1,918)
Earnings (Loss) per Share:		
Continuing Operations:		

Basic	$ (0.25)	$ (0.20)
Diluted	$ (0.25)	$ (0.20)
Discontinued Operations:		
Basic	$ (0.02)	$ -
Diluted	$ (0.02)	$ -
Net Earnings (Loss):		
Basic	$ (0.27)	$ (0.21)
Diluted	$ (0.27)	$ (0.21)

Item 8.01 Other Events.

On March 19, 2012, the Company entered into the Fourth Modification to its Credit Facility. The Fourth Modification contained, among other things, the consent by the lenders under the Credit Facility to allow the Company to enter into a loan (the Callaway RDA loan) the collateralized by the real estate and equipment of its HealthMont of Missouri LLC subsidiary Callaway Community Hospital in Fulton, Missouri.

On March 26, 2012, the Company, HealthMont of Missouri, LLC (Borrower), HealthMont LLC (HLLC) and a bank closed on the $5,000 Callaway RDA Loan dated as of March 16, 2012. HealthMont of Missouri, LLC owns and operates Callaway in Fulton, Missouri.

The Callaway RDA Loan has a term of 25 years with monthly payments of principal and interest (currently $24,000 per month) until repaid. The Callaway RDA Loan bears interest at a floating interest rate computed as the prime rate (as published in The Wall Street Journal) plus 2%. The Callaway RDA Loan is collateralized by Callaway s real estate and equipment and is partially guaranteed under the U.S. Department of Agriculture, Rural Development Business and Industry Program. Approximately $3,250 of the Callaway RDA Loan proceeds was applied as payment against the Term Loan under the Company s Credit Facility. Approximately $1,000 of the Callaway RDA Loan proceeds will be used to finance improvements, including providing an inpatient geriatric psychiatry unit at Callaway, with the remainder of the Callaway RDA Loan proceeds used for working capital and costs. The Callaway RDA Loan contains covenants which the Company believes are customary to similar loan agreements as well as certain financial covenants with respect to the Borrower s Ratio of current assets to current liabilities and debt service coverage, all as defined in the Callaway RDA Loan Agreement, that the Borrower must maintain and that are measured at the end of each fiscal year. The Callaway RDA Loan is guaranteed by HLLC and the Company.

On May 3, 2012, the Company entered into the Fifth Modification to its Credit Facility. The Fifth Modification contained, among other things, the consent by the lenders under the Credit Facility to the Adel Sale Agreement and requires that the net proceeds of approximately $7,500 to the Company from the Adel Sale Agreement be applied to pay down the Term Loan under the Credit Facility.

On May 4, 2012, the Company entered into the Sixth Modification. The Sixth Modification was in response to, among other things, the requirement that Medicare and Medicaid EHR Incentive Payments be accounted under the gain contingency accounting model rather than the grant accounting model as described above and the expected resulting restatement of the Company s financial statements. Pursuant to the Sixth Modification, the lenders under the Credit Facility, among other things, consented to the continuing computation of Medicare and Medicaid EHR Incentive Payments under the grant accounting model for purposes of computing compliance with the Company s financial covenants under the Credit Facility notwithstanding such restatement of the Company s financial statements and waived any noncompliance that may have resulted by reason of such restatement of the Company s financial statements and prior use of the grant accounting model rather than the gain contingency accounting model.

Item 9.01 Financial Statements and Exhibits.

d. Exhibits The following exhibits are filed with this report:

Exhibit 99.1 Asset Purchase Agreement By and Among HealthMont of Georgia, Inc., SunLink Health Systems, Inc. and Hospital Authority of Tift County, Georgia dated as of March 1, 2012.

Exhibit 99.2 - Fourth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated March 19, 2012.

Exhibit 99.3 Fifth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated May 3, 2012.

Exhibit 99.4 Sixth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated May 4, 2012.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Current Report on Form 8-K to be signed on its behalf by the undersigned hereunto duly authorized.

SUNLINK HEALTH SYSTEMS, INC.

Dated: May 8, 2012

By: /s/ Mark J. Stockslager
Name: Mark J. Stockslager
Title: Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	**Description**
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99.2	Fourth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated March 19, 2012.
99.3	Fifth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated May 3, 2012.
99.4	Sixth Modification to Loan Documents between SunLink Health Systems, Inc., SunLink Healthcare LLC, Dexter Hospital LLC, Clanton Hospital LLC, Southern Health Corporation of Ellijay, Inc., Southern Health Corporation of Dahlonega, LLC, Southern Health Corporation of Houston, Inc., HealthMont of Georgia, Inc., HealthMont, LLC, HealthMont of Missouri, LLC, SunLink Services, Inc., SunLink ScriptsRX, LLC, Central Alabama Medical Associates, LLC, Dahlonega Clinic, LLC, Carmichael s Cashway Pharmacy, Inc., Carmichael s Nutritional Distributor, Inc., Breath of Life Home Health Equipment, Inc., and Chatham Credit Management III, LLC dated May 4, 2012.

plans at fair value. The Company has chosen to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related interpretations. NET INCOME PER SHARE - Basic earnings per share (EPS) is computed using the weighted-average number of shares of common stock outstanding for the period. Diluted EPS is computed using the weighted-average number of shares of common stock and dilutive common stock equivalents outstanding during the period, if any. Common equivalent shares, if any, are excluded from the computation when their effect is antidilutive. All references to share and per share information have been adjusted to give effect to stock dividends. RECLASSIFICATION - A reclassification has been made to the financial statements for the year ended March 31, 2000, to transfer the fair value of shares issued in the November 30, 1999 5% stock dividend from retained earnings to common stock. The effect of the reclassification was to decrease retained earnings and increase common stock as of March 31, 2000 by $495,744. This reclassification has no effect on previously reported net income or earnings per share. Certain other amounts in the 2001 and 2000 consolidated financial statements have been reclassified to conform to the 2002 presentation. Net income and cash flows were not affected by the reclassifications. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS - In June 2001, the FASB issued SFAS No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS. SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or the normal operation of a long-lived asset, except for certain obligations of lessees. As used in SFAS No. 143, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or a written or oral contract, or by legal construction for a contract under the doctrine of promissory estopel. This statement is effective for financial statements issued for fiscal years beginning after June 15, 2002, although earlier application is encouraged. The Company does not expect that application of the provisions of this statement will have a material impact on the Company's financial statements. F-9 --- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS --- NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued) In October 2001, the FASB issued SFAS No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS. SFAS No. 144 establishes a single accounting model, based on the framework established in SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, for long-lived assets to be disposed of by sale, and resolves significant implementation issues related to SFAS No. 121. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 2001, although earlier application is encouraged. The Company does not expect that application of the provisions of this statement will have a material impact on the Company's financial statements. NOTE 2 - MARKETABLE SECURITIES Cost and fair value of available-for-sale marketable debt and equity securities at April 1, 2002, are as follows: Gross Gross Amortized Unrealized Unrealized Fair Cost Gain Losses Value ---------- ---------- ---------- ---------- Mutual funds $1,251,344 $ 13,481 $ 36,011 $1,228,814 Corporate bonds 91,347 -- 2,477 88,870 Equity securities 75,624 7,297 1,140 81,781 ---------- ---------- ---------- ---------- $1,418,315 $ 20,778 $ 39,628 $1,399,465 ========== ========== ========== ========== These investments are classified on the balance sheet as follows: Marketable Money Securities Market Total ---------- ---------- ---------- Marketable securities (current asset) $1,149,171 $ -- $1,149,171 Bond sinking fund (noncurrent asset) 250,294 54,725 305,019 ---------- ---------- ---------- $1,399,465 $ 54,725 $1,454,190 ========== ========== ========== Net unrealized holding losses on available-for-sale securities in the amount of $18,850 for the year-end April 1, 2002, have been included in accumulated other comprehensive income, net of income taxes of $7,276. For the year ended April 1, 2002, realized losses on sales of available-for-sale securities were $6,857 and are included in other income. There were no marketable securities held by the Company at April 2, 2001. F-10 --- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS --- NOTE 3 - NOTES RECEIVABLE - RELATED PARTIES Notes receivable - related parties consist of the following: April 1, April 2, 2002 2001 --------- --------- Notes receivable bearing interest at 10.5%, due on or before January 1, 2002, secured by a stock pledge agreement for 15,000 shares of Elmer's Restaurants Inc. common stock $ 154,889 $ 76,199 Note receivable bearing interest at 8%, due on or before October 15, 2002, secured by a franchise agreement and restaurant furniture, fixtures, and equipment 48,266 115,124 Note receivable bearing interest at 10%, due on or before March 15, 2003, secured by a stock pledge agreement for 50,000 shares of Elmer's Restaurants Inc. common stock 135,460 191,935 Notes receivable from franchisees, bearing interest from 12% to 14%, due on or before October 2002 34,097 20,737 --------- --------- Total notes receivable - related parties 372,712 403,995 Less current portion (372,712) (200,950) --------- --------- Notes receivable - related parties, net of current portion $ -- $ 203,045 ========= ========= NOTE 4 - PROPERTY, BUILDINGS, AND EQUIPMENT April 1, April 2, 2002 2001 ----------- ----------- Land $ 1,686,700 $ 2,246,700 Buildings 1,551,378 1,911,903 Furniture, fixtures, and equipment 3,981,618 3,508,920 Leasehold improvements 2,505,232 2,117,301 Automobiles 55,814 23,409 ----------- ----------- 9,780,742 9,808,233 Less accumulated depreciation and amortization (2,126,645) (1,366,366) ----------- ----------- $ 7,654,097 $ 8,441,867 ===========

=========== Depreciation expense charged to operations was $786,593, $598,927, and $484,204 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively. F-11 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 4 - PROPERTY, BUILDINGS, AND EQUIPMENT - (continued) In October 2001, the Company's Gresham, Oregon franchise exercised their option to purchase the land and building leased from the Company. Proceeds from the transaction and the carrying value of the assets were $912,938 and $918,697, respectively. The Company recognized a $5,759 loss as a result of this transaction. NOTE 5 - INCOME TAXES The provision for income taxes consisted of current and deferred income tax expense as follows: April 1, April 2, March 31, 2002 2001 2000 --------- --------- --------- Current: Federal $ 487,000 $ 419,112 $ 400,000 State 86,000 90,000 60,000 --------- --------- --------- 573,000 509,112 460,000 Deferred (73,000) (21,000) 20,000 --------- --------- --------- Income tax provision $ 500,000 $ 488,112 $ 480,000 ========= ========= ========= A reconciliation of the federal income tax rate to the Company's effective income tax rate is as follows: April 1, April 2, March 31, 2002 2001 2000 -------------------- -------------------- --------------------- Federal income tax at $ 534,000 34.0% $ 491,112 34.0% $ 481,000 34.0% statutory rate State income taxes, net of federal income tax benefit 56,000 3.6 52,000 3.6 56,000 3.9 Nondeductible expenses 71,000 4.6 42,000 2.9 28,000 1.9 Federal income tax credits (161,000) (10.2) (97,000) (6.7) (85,000) (6.0) --------- ---- --------- ---- --------- ---- $ 500,000 32.0% $ 488,112 33.8% $ 480,000 33.8% ========= ==== ========= ==== ========= ==== Deferred income taxes are the result of provisions in the tax laws that either require or permit certain items of income or expense to be reported for income tax purposes in different periods than they are reported for financial reporting. As of April 1, 2002, and April 2, 2001, the deferred tax liability of $691,724 and $772,000, respectively, primarily represents the difference between the book basis of property, buildings, and equipment and intangibles and the related tax basis of approximately $2,056,000 and $2,270,000, respectively. F-12 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 6 - NOTES PAYABLE Notes payable consist of the following: April 1, April 2, 2002 2001 ----------- ----------- Note payable to financing company, principal and interest due monthly at 8.95%, matures July 2011, secured by all assets of the Company $ 1,715,338 $ -- Note payable to financing company, principal and interest due monthly, interest at average weekly yield of 30-day Commercial Paper, matures July 2011, secured by all assets of the Company 950,676 -- Note payable to financial institution, payable in monthly principal installments of $34,900 plus interest at varying rates, refinanced in June 2001 -- 1,615,150 Note payable to financial institution, principal and interest due monthly at 8.15%, repaid during 2002 -- 444,364 Note payable to financial institution, principal and interest due monthly at 8.18%, matures January 2011, secured by real estate 1,150,590 1,194,538 Note payable to financial institution, principal and interest due monthly at 8.25%, matures February 2008, secured by real estate 526,779 555,335 Note payable to financing company, interest due monthly at 15%, subordinated, refinanced during 2002 -- 1,250,000 Note payable to individual, principal and interest due monthly at 10%, repaid July 2001 -- 8,709 Convertible notes payable, interest payable monthly at 10%, principal due December 2007 (Note 7) 1,300,000 1,300,000 ----------- ----------- Total notes payable 5,643,383 6,368,096 Less current portion (277,333) (569,327) ----------- ----------- Notes payable, net of current portion $ 5,366,050 $ 5,798,769 =========== =========== Certain notes payable contain restrictive covenants pertaining to financial ratios and minimum cash flow coverage. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.25 to 1.0, and a ratio of cash generation (defined as net income before taxes, interest expense, depreciation, and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.25 to 1.0. F-13 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 6 - NOTES PAYABLE - (continued) Future maturities of notes payable for the following fiscal years are: Years ended April 1, 2003 $ 277,333 2004 301,614 2005 328,120 2006 380,194 2007 486,663 Thereafter 3,869,459 ---------- $5,643,383 ========== All interest costs incurred during the years ended April 1, 2002, April 1, 2001, and March 31, 2000, have been expensed during the respective periods. NOTE 7 - CONVERTIBLE DEBT The Company's outstanding convertible debt of $1,300,000 at

April 1, 2002, and April 2, 2001, is convertible into shares of the Company's common stock at a price of $6.19 per share. The notes are subject to conversion, in whole but not in part, at any time following May 1, 2001, into unregistered shares of the Company's common stock, at the option of the holder. The notes also contain a call feature whereby the Company may call the notes for call prices designated at a percent of the stated conversion price as follows: For the period: Call Price ---------- December 1, 2003 through November 30, 2004 105% December 1, 2004 through November 30, 2005 103% December 1, 2005 through November 30, 2005 101% December 1, 2005 through the maturity date 100% Under the terms of the convertible debt notes, the Company is required to make monthly payments (through December 2007) of principal in the amount of $15,476 to a principal debt service account. The balance in the account was $305,019 at April 1, 2002. There was no balance in the account at April 2, 2001. F-14 --- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS --- NOTE 8 - COMMITMENTS AND CONTINGENCIES The Company leases certain facilities under operating lease agreements. Minimum fiscal year rental commitments for the year ending April 1, 2002, for property, buildings, and equipment with noncancellable terms of more than one year are: Years ended April 1, 2003 $1,202,994 2004 1,192,628 2005 1,117,796 2006 868,496 2007 632,713 Thereafter 1,563,027 ---------- $6,577,654 ========== The leases generally provide for additional rentals based upon a specified percentage of sales and require the Company to pay certain other costs. Rental expense on operating leases amounted to approximately $1,819,032, $1,431,000, and $884,000 for the years ending April 1, 2002, April 2, 2001, and March 31, 2000, respectively. From time to time the Company is involved in litigation relating to claims arising in the normal course of its business. The Company maintains insurance coverage against potential claims in amounts that it believes to be adequate. Management believes that it is not presently a party to any litigation, the outcome of which could have a material adverse effect on the Company's business or operations. NOTE 9 - RELATED-PARTY TRANSACTIONS Jaspers Food Management, Inc. (JFMI), is a privately held restaurant management company. Certain officers and directors hold a majority interest in JFMI. Accounts payable and other liabilities due to the affiliate are due on demand and accrue interest at an annual rate of 10.5% based on the outstanding balance over 28 days. Under the terms of a management services agreement, the affiliate provides substantially all store labor, management, accounting, human resources, training, and other administrative services related to the operation of the six Ashley's Delis and four Richard's Deli and Pub restaurants. Labor and related expenses were $842,000, $930,000, and $903,000 as of April 1, 2002, April 2, 2001, and March 31, 2000, respectively. Amounts outstanding with JFMI are as follows: April 1, April 2, 2002 2001 ------- ------- Accounts (payable) receivable $(7,231) $26,364 ======= ======= F-15 --- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS --- NOTE 10 - RESTAURANT AND FRANCHISE OPERATIONS The consolidated results of operations and other selected financial information, from restaurant and franchise operations, are presented after elimination of intercompany transactions: April 1, April 2, March 31, 2002 2001 2000 ----------- ----------- ----------- Revenues: Restaurant operations $32,558,606 $25,011,807 $21,404,597 Franchise operations 1,217,042 840,529 774,977 ----------- ----------- ----------- Consolidated $33,775,648 $25,852,336 $22,179,574 =========== =========== =========== Income from operations: Restaurant operations $ 1,812,031 $ 1,731,667 $ 1,620,632 Franchise operations 222,350 137,389 276,837 ----------- ----------- ----------- Consolidated $ 2,034,381 $ 1,869,056 $ 1,897,469 =========== =========== =========== Capital and intangible expenditures: Restaurant operations $ 945,497 $ 3,206,615 $ 493,333 Franchise operations 29,035 92,867 33,832 ----------- ----------- ----------- Consolidated $ 974,532 $ 3,299,482 $ 527,165 =========== =========== =========== Depreciation and amortization: Restaurant operations $ 739,293 $ 692,755 $ 561,440 Franchise operations 47,300 52,989 68,649 ----------- ----------- ----------- Consolidated $ 786,593 $ 745,744 $ 630,089 =========== =========== =========== Assets: Restaurant operations $16,114,277 $15,246,621 $12,495,871 Franchise operations 571,006 1,127,526 1,351,337 ----------- ----------- ----------- Consolidated $16,685,283 $16,374,147 $13,847,208 =========== =========== =========== The number of Company-owned stores and operating franchises is as follows: April 1, April 2, March 31, 2002 2001 2000 ---- ---- ---- Company-owned stores 27 26 21 Operating franchises 20 19 18 F-16 --- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL

STATEMENTS -- NOTE 11 - RESTAURANT ACQUISITIONS ACQUISITION OF ROSEBURG RESTAURANT - On April 12, 2001, the Company executed an asset purchase agreement with Sandpiper Restaurants of Oregon, LLC, acquiring substantially all the assets of the Roseburg, Oregon, restaurant for $128,000 in cash and a promissory note payable to seller for $35,600. The acquisition cost of $164,000 was allocated to the fair market value of the assets acquired ($124,000) and the excess to goodwill ($40,000). The Company converted the restaurant to the Elmer's concept, and opened in June 2001. As further described in Note 15, the Company sold and refranchised this location on May 7, 2002. ACQUISITION OF SPRINGFIELD RESTAURANT - On August 1, 2000, the Company executed an asset purchase agreement with Hospitality Two LLC, acquiring substantially all the assets of the Springfield, Oregon, restaurant and lounge for $325,000 in cash. The Company converted the restaurant to the Elmer's concept, and opened November of 2000. The acquisition cost of $345,630 was allocated to the fair market value of the assets acquired ($109,110) and the excess to goodwill ($236,520). ACQUISITION OF MITZEL'S RESTAURANTS - Effective December 13, 2000, the Company executed an asset purchase agreement with the owners of six Mitzel's American Kitchen restaurants, acquiring substantially all the assets of those locations for $975,000 in cash and issuance of 130,000 shares of the Company's restricted common stock. These locations are wholly-owned and operated as a division of the Company. The acquisition was recorded as a purchase and the excess of the acquisition cost over fair value of the tangible assets acquired was allocated to goodwill. The total cost of the acquisition was as follows: Cash $ 975,000 Value of 130,000 shares of common stock issued in conjunction with the transactions 650,000 Assumed liabilities, closing, and relocation expenses 122,245 Related legal and other transaction costs 65,009 ---------- $1,812,254 ========== The acquisition cost of $1,812,254 was allocated to the fair market value of the assets acquired ($1,024,900) and the excess to goodwill ($787,354). NOTE 12 - GOODWILL AND INTANGIBLE ASSETS In July 2001, the FASB issued SFAS No. 141, BUSINESS COMBINATIONS and SFAS No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. SFAS No. 141 requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles have been evaluated against this new criteria and no changes were considered necessary to the previously recognized intangibles. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles (those deemed to have indefinite life) will be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles are determined to be more than their fair value. F-17 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 12 - GOODWILL AND INTANGIBLE ASSETS - (continued) The Company adopted SFAS No. 142 effective April 3, 2001. The changes in the carrying amount of goodwill and intangible assets for the year ended April 1, 2002, are as follows: Goodwill Intangibles ---------- ---------- Balance as of April 3, 2001 $4,642,152 $ 602,709 Acquired during the year 57,012 -- ---------- ---------- Balance as of April 1, 2002 $4,699,164 $ 602,709 ========== ========== Components of goodwill are tested for impairment in the third quarter. The fair value of the reporting units as estimated using multiples of earnings before interest, taxes, depreciation, and amortization (EBITDA) resulted in no impairment of goodwill. The pro forma effect of adjusted net income, basic and diluted earnings per share are as follows: April 1, April 2, March 31, 2002 2001 2000 ------------ ------------ ------------ Net income: Reported net income $ 1,065,856 $ 956,006 $ 939,549 Add back: Goodwill amortization, net of tax -- 97,715 83,259 Add back: Trademark amortization, net of tax -- 13,300 13,297 ------------ ------------ ------------ Adjusted net income $ 1,065,856 $ 1,067,021 $ 1,036,105 ============ ============ ============ Basic earnings per share: Reported net income $ 0.52 $ 0.48 $ 0.49 Add back: Goodwill amortization, net of tax -- 0.05 0.04 Add back: Trademark amortization, net of tax -- 0.01 0.01 ------------ ------------ ------------ Adjusted net income $ 0.52 $ 0.54 $ 0.54 ============ ============ ============ Diluted earnings per share Reported net income $ 0.51 $ 0.48 $ 0.48 Add back: Goodwill amortization, net of tax -- 0.05 0.04 Add back: Trademark amortization, net of tax -- 0.01 0.01 ------------ ------------ ------------ Adjusted net income $ 0.51 $ 0.54 $ 0.53 ============ ============ ============ All net income and per share amounts have been adjusted to reflect the March 7, 2002, 5% stock dividend. F-18 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

-- NOTE 13 - EMPLOYEE BENEFIT PLAN The Company formed a 401(k) profit sharing plan on April 1, 2000, whereby eligible employees may contribute up to 20% of their regular earnings. Employees are eligible to participate after one year of half-time employment with the Company and attainment of 21 years of age. The plan provides that the Company can also make matching and other contributions to the plan. The Company contributed $44,385 and $29,200 to the plan for the years ended April 1, 2002, and April 2, 2001, respectively. NOTE 14 - STOCK OPTIONS The Board of Directors adopted the 1999 Stock Option Plan (the Plan) in February 1999 which provides for the award of incentive stock options to key employees and the award of nonqualified stock options to employee and nonemployee directors. Under the terms of the Plan, the exercise price of the options are determined as the fair market value based on trading values of the Company's common stock at the time the option is granted. Under the Plan, 546,000 shares of common stock are authorized for issuance. Options are exercisable upon vesting. Options generally vest 20% annually and expire 10 to 15 years after the date of grant. A summary of the Company's stock options and changes during the years ended April 1, 2002, April 2, 2001, and March 31, 2000, is presented below: Weighted- Average Options Exercise Outstanding Price -------- -------- Balance, March 31, 1999 197,072 $ 3.91 Options granted 189,420 5.12 Options cancelled (18,191) 3.91 ------- Balance, March 31, 2000 368,301 4.54 Options granted 94,500 4.69 Options cancelled (21,945) 4.44 ------- Balance, April 2, 2001 440,856 4.58 Options granted 8,400 4.76 Options cancelled (37,869) 4.44 ------- Balance, April 1, 2002 411,387 $ 4.59 ======== ======== F-19 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 14 - STOCK OPTIONS - (continued) The following table summarizes information on stock options outstanding as of April 1, 2002: Weighted- ------------------------ Average Weighted- Weighted- Remaining Average Average Exercise Number Contractual Exercise Number Exercise Price Outstanding Life - Years Price Exercisable Price ------- ----------- ----------- ------- ----------- ------- $ 3.92 148,565 9.74 $ 3.92 89,139 $ 3.92 4.52 57,750 8.70 4.52 30,450 4.52 4.76 8,400 14.92 4.76 -- 4.76 5.00 25,725 10.52 5.00 5,145 5.00 5.09 49,671 8.81 5.09 23,334 5.09 5.15 121,276 12.05 5.15 121,276 5.15 There were 134,613 shares of common stock reserved for the grant of stock options under the Plan at April 1, 2002. The Company complies with the disclosure-only provisions of SFAS No. 123 and thus no compensation cost has been recognized for the Plan. Had compensation cost for the stock-based compensation plan been determined based on the fair value of options at the date of grant consistent with the provisions of SFAS No. 123, the Company's pro forma net income and pro forma earnings per share would have been as follows: April 1, April 2, March 31, 2002 2001 2000 ------------ ----------- ----------- Net income - as reported $ 1,065,856 $ 956,006 $ 939,549 Net income - pro forma $ 905,671 $ 798,951 $ 652,404 Diluted earnings per share - as reported $ 0.51 $ 0.48 $ 0.48 Diluted earnings per share - pro forma $ 0.44 $ 0.40 $ 0.33 F-20 -- ELMER'S RESTAURANTS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- NOTE 14 - STOCK OPTIONS - (continued) For purposes of the above pro forma information, the fair value of each option grant was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: April 1, April 2, March 31, 2002 2001 2000 -------- -------- -------- Risk-free interest rate 5.28% 5.5% 6.0% Expected life 10 years 10 years 10 years Expected volatility 20% 26% 26% Expected dividend yield 0% 0% 0% The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. The granting of additional stock options in future years is anticipated. NOTE 15 - SUBSEQUENT EVENTS Effective May 7, 2002, the Company executed asset purchase and franchise agreements with Southern Oregon Elmer's LLC (the Buyer), refranchising three of the Company's Elmer's restaurants located in Grants Pass, Medford, and Roseburg, Oregon. The Company has sold substantially all the assets of those locations in consideration for $1,385,500 in cash and promissory notes valued at $349,500. The Buyer has signed 25-year franchise agreements for each location and will operate the locations under the Elmer's Breakfast. Lunch. DinnerTM name. The Buyer has also signed a development agreement to open two additional restaurants within seven years. The Buyer expects to open the first restaurant before December 2002. As a result of this transaction, the Company will report a one-time gain of approximately $475,000 (net of tax effect) in the Company's first quarter ending July 22, 2002. The Company has agreed to provide a limited amount of seller financing. The Company accepted a $270,000 note bearing interest at 9% per year, payable in 84 equal monthly payments; an approximately $79,500 note bearing interest at 9%, payable in 24 equal monthly payments; and an approximately $106,000 inventory note bearing interest at 12% and due in 90 days. The Company has assigned its rights and obligations under the occupancy leases for the Medford and Roseburg locations. The Company remains a guarantor of the Medford lease until April 2007. The Company's guarantee of the Roseburg lease could extend until 2018 if the Buyer exercises its options in 2003, 2008, and 2013. The Company has subleased the Grants Pass location to the Buyer for five years under substantially the same terms and conditions as the underlying lease. Provided all parties are in good standing under the lease at the end of the sublease, the Grants Pass landlord has agreed to lease directly to the Buyer under substantially similar terms. In an unrelated transaction, the Company has acquired an Elmer's restaurant located in Vancouver, Washington, from a franchisee and former Board member, for approximately $250,000 in cash and assumed liabilities. The Company has entered into a long-term occupancy lease at the same location, and will continue to operate the location as an Elmer's restaurant. The Company expects to spend approximately $100,000 on renovating this location. F-21
