ELMERS RESTAURANTS INC
Form 10-Q
February 19, 2003

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JANUARY 6, 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 0-14837

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

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

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

Securities registered pursuant to Section 2(b) of the Act:
None

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

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

Number of shares of Common Stock outstanding at February 17, 2003: 2,041,709

ELMER'S RESTAURANTS, INC.

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PART I: FINANCIAL INFORMATION

PART II: OTHER INFORMATION AND SIGNATURES

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

	January 6, 2003 (Unaudited)
ASSETS	
Current assets:	
Cash and cash equivalents	$ 1,495,213
Marketable securities	1,241,975
Accounts receivable	309,851
Notes receivable - franchisees and related parties, current portion	76,972
Inventories	413,838
Prepaid expenses and other	507,293
Income taxes receivable	--
Total current assets	4,045,142

Notes receivable - franchisees and related parties, net of current portion	234,413
Property, buildings and equipment, net	7,113,576
Goodwill	4,872,487
Intangible assets	602,709
Principal debt service account for convertible debt	193,452
Other assets	397,053
Total assets	$ 17,458,832

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:	
Notes payable, current portion	$ 332,308
Accounts payable	1,529,531
Accrued expenses	221,570
Accrued payroll and related taxes	610,266
Accrued income tax	91,366
Total current liabilities	2,785,041
Notes payable, net of current portion	4,504,357
Deferred income taxes	693,875
Total liabilities	7,983,273
Commitments and contingencies	
Shareholders' equity	
Common stock, no par value; 10,000,000 shares authorized, 2,041,709 and 2,058,034 shares issued and outstanding at January 6, 2003 and April 1, 2002 respectively	7,283,155
Retained earnings	2,200,556
Accumulated other comprehensive loss, net of taxes	(8,152)
Total shareholders' equity	9,475,559
Total liabilities and shareholders' equity	$ 17,458,832

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

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

	For the forty weeks ended		Fo
	January 6, 2003	January 7, 2002	Janu 2
	(Unaudited)	(Unaudited)	(Una
REVENUES	$ 24,399,010	$ 26,366,999	$ 7,

COSTS AND EXPENSES:			
Cost of restaurant sales:			
Food and beverage	6,940,314	7,489,687	2,
Labor and related costs	8,620,142	9,418,484	2,
Restaurant operating costs	3,366,526	3,643,203	1,
Occupancy costs	1,573,461	1,643,527	
Depreciation and amortization	562,210	592,099	
Restaurant opening and closing expenses	9,717	68,338	
General and administrative expenses	1,761,557	1,899,471	
	22,833,927	24,754,809	7,
INCOME FROM OPERATIONS	1,565,083	1,612,190	
OTHER INCOME (EXPENSE):			
Interest income	126,314	78,995	
Interest expense	(334,887)	(442,621)	(
Loss on debt extinguishment	(97,500)	--	
Loss on sale of marketable securities	(55,934)	--	
Net gain (loss) on disposition of property	736,197	(5,764)	
Income before provision for income taxes	1,939,273	1,242,800	
Income tax provision	(667,983)	(428,766)	(
Net Income	$ 1,271,290	$ 814,034	$
PER SHARE DATA:			
Net income per share - Basic	$ 0.62	$ 0.40	$
Weighted average number of common shares outstanding - Basic	2,048,722	2,059,211	2,
Net income per share - Diluted common shares outstanding	$ 0.60	$ 0.39	$
Weighted average number of common shares outstanding - Diluted	2,119,193	2,083,413	2,

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

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

For the forty weeks ende

	January 6, 2003 (Unaudited)	January 200 (Unaudi
Cash flows from operating activities:		
Net income	$ 1,271,290	$ 814
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	562,210	592
Net gain on disposition of property	(735,910)	5
Loss on sale of marketable securities	55,934	
Loss on debt extinguishment	97,500	
Changes in assets and liabilities:		
Current assets	(327,162)	80
Other assets	(10,898)	(66
Accounts payable and accrued expenses	274,579	69
Income taxes	207,634	(49
Net cash provided by operating activities	1,395,177	1,445
Cash flows from investing activities:		
Acquisitions of property, buildings and equipment	(542,614)	(774
Restaurant acquisitions	(314,263)	
Proceeds from restaurant dispositions	1,303,176	906
Purchased goodwill	--	(143
Net purchases of available for sale securities	(145,316)	(1,175
Issuance of note receivable	(129,488)	(110
Principal collected on note receivables	341,331	123
Net cash provided by (used in) investing activities	512,826	(1,173
Cash flows from financing activities:		
Repurchase of convertible notes	(747,500)	
Issuance of ten year term notes	--	2,806
Retirement of term debt	--	(3,224
Payments on notes payable	(231,256)	(244
Repurchase of common stock	(88,245)	(9
Net cash used in financing activities	(1,067,001)	(671
Net change in cash and cash equivalents	841,002	(400
Cash and cash equivalents, beginning of period	654,211	1,141
Cash and cash equivalents, end of period	$ 1,495,213	$ 740
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 321,110	$ 442

Income taxes	$ 462,500	$ 478
Supplemental disclosures of non cash transactions:		
Sale of property and equipment for notes receivable	$ 455,631	$
Forgiveness of notes receivable as partial consideration for purchase of property, equipment and goodwill	175,625	
Notes payable issued or assumed in conjunction with acquisition of certain restaurants	74,538	

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

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim financial statements do not include all the information and footnotes necessary for a fair presentation of financial position and results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. These condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended April 1, 2002. Operating results reflected in the interim consolidated financial statements are not necessarily indicative of the results that may be expected for the year ended March 31, 2003.

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

The Company has included additional detail in the Statement of Operations. Restaurant operating expenses are now broken out on a separate line. These costs include such items as advertising, repairs and maintenance and credit card discounts. Historically, most of these items have been included under general and administrative. All information presented herein has been reclassified to conform to the new format. The Company believes that this new format will improve comparability between the Company and its peers.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles have been evaluated against this new criteria and no changes were considered necessary to the previously recorded intangibles. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles (those deemed to have an indefinite life) will be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles are determined to be more than their fair value. The Company's intangible assets are tested for impairment in the third quarter of each fiscal year. Testing was completed for the year ended April 1, 2002 and no impairment was found. Management does not anticipate that testing in the current year will show any impairment of the intangible assets.

The Company adopted SFAS No. 142 effective April 3, 2001. The changes in the carrying value of goodwill and intangible assets for the 40 weeks ended January 6, 2003, are as follows:

	Goodwill	Intangibles
Balance as of April 1, 2002	$4,699,164	$ 602,709
Acquired during the year	212,929	--
Disposed during the year	(39,606)	--
Balance as of January 6, 2003	$4,872,487	$ 602,709

Since the Company utilized the early application provision of SFAS No. 142 the Company adopted the provisions of SFAS No. 142 beginning April 3, 2001 thus provisions of SFAS No. 142 have been implemented on both years of financial statements presented. These standards only permit prospective application of the new accounting; accordingly adoption of these standards will not affect

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previously reported financial information. The principal effect of implementing SFAS No. 142 was the cessation of the amortization of goodwill.

All net income per share amounts and weighted average number of common shares outstanding have been retroactively adjusted to reflect a 5% stock dividend, which had a record date in March 2002. No dividends were declared in the 40 weeks ended January 6, 2003.

RECENT TRANSACTIONS

Sale of Southern Oregon Elmer's

As previously reported on the Company's Form 8-K filed on May 17, 2002, effective May 7, 2002 Elmer's Restaurants, Inc. (the "Company") executed asset purchase and franchise agreements with Southern Oregon Elmer's LLC (the "Buyer"), refranchising three of the Company's Elmer's restaurants located in Grants Pass, Medford and Roseburg, Oregon. The Company sold substantially all the assets of those locations in consideration for $1,385,500 in cash and promissory notes valued at $349,500. The Buyer has signed 25-year franchise agreements for each location and will operate the locations under the Elmer's Breakfast o Lunch o Dinner (TM) name.

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

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

As a result of this transaction, the Company posted a one-time gain of approximately $504,000 or 25 cents per share, (net of tax effect) in the quarter ending July 22, 2002. For the 40 weeks ended January 7, 2002, revenues from the three restaurants were $3.8 million, contributing $253,000 in earnings before taxes and interest expense. If these three restaurants had been franchised during the 40 weeks ended January 7, 2002, pro forma franchise fee income would have been approximately $191,000. The franchise fee income from these three restaurants for the 40 weeks ended January 6, 2003 was approximately $213,000.

The Company agreed to provide a limited amount of seller financing. The Company issued 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. To assist with the development of the Klamath Falls restaurant, the Company granted an extension of the inventory note, which has now been paid in full.

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

The Company has assigned its rights and obligations under the occupancy leases for the Medford and Roseburg locations. The Company remains a guarantor of the Medford lease until April 2007. The Company's guarantee of the Roseburg lease could extend until 2018 if the Buyer exercises its options in 2003, 2008 and 2013. The Company has subleased the Grants Pass location to the Buyer for five years under substantially the same terms and conditions as the underlying master lease. Provided all parties are in good standing under the lease at the end of the sublease, the Grants Pass landlord has agreed to lease directly to the Buyer under substantially similar terms.

The Buyer has indemnified the Company against all losses incurred as a result of the Company's obligations as a Guarantor. This indemnification is personally guaranteed by Mssrs. Brutke and Thomason and their spouses. However, in the event of default by the Buyer of the terms of the occupancy leases, and the failure of Mssrs. Brutke and Thomason to make good on their personal guarantees, the Company could be required to pay all rent

and other amounts due under the terms of the lease for the remainder of the guarantee term. In the event of default, the Company expects it would exercise its right to reoccupy and continue to operate the restaurants as Elmer's Breakfast o Lunch o Dinner (TM).

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

Purchase of Vancouver Washington Elmer's

April 15, 2002 the Company acquired an Elmer's restaurant located in Vancouver, Washington from franchisee and former board member, Paul Welch for approximately $250,000 in cash and assumed liabilities. The Company has entered into a long-term occupancy lease at the same location, and continues to operate the location as an Elmer's restaurant. The purchase price was allocated to the tangible assets of the restaurant. As of January 6, 2003, the Company has spent approximately $125,000 remodeling the facility.

Relocation of Richard's Deli & Pub

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

Repurchase of convertible debt

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

Purchase of Cooper's Deli and Pub

July 1, 2002, the Company acquired three Cooper's Deli units located in Salem, Oregon from Cooper's Inc. The Cooper's units are substantially similar to the Company's existing deli operations. Purchase consideration included $100,000 cash, a $66,500, two-year promissory note, $11,500 assumed liabilities and the forgiveness of a $155,000 promissory note due to the Company. The acquisition cost of $334,000 included $120,000 in tangible assets and $214,000 in goodwill.

Purchase of Cornell Oaks Property

January 6, 2003 the Company entered into a Sales and Purchase Agreement for a one acre site in Beaverton, Oregon. The Company has placed a $30,000 deposit on the property and the balance of the purchase price, $745,000, is due and payable at closing which is expected to be in July, 2003. If the Company is able to obtain the necessary land use and other governmental approvals prior to July 7, 2003, the Company plans on building a prototype restaurant at this location.

RECENTLY ISSUED ACCOUNTING STANDARDS

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

condensed consolidated financial statements. Additional required disclosures will be included in future financial statements.

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

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

In November 2002, FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation elaborates on the disclosures to be made by a guarantor about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing a guarantee. The Company has complied with the disclosure requirements of FIN 45. The initial recognition and initial measurement provisions shall be applied on a prospective basis to guarantees issued or modified after December 31, 2002. Management does not expect that the application of the provisions of this interpretation will have a material impact on the Company's condensed consolidated financial statements.

PART I - FINANCIAL INFORMATION

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

Elmer's Restaurants, Inc. (the "Company" or "Elmer's") (NASDAQ Small Cap Market symbol: ELMS), located in Portland, Oregon, is a franchisor and operator of full-service, family oriented restaurants under the names "Elmer's Breakfast o Lunch o Dinner." and "Mitzel's American Kitchen" and an operator of delicatessen restaurants under the names "Ashley's" and "Richard's Deli and Pub." The Company is an Oregon corporation and was incorporated in 1983. Walter Elmer opened the first Elmer's restaurant in Portland, Oregon in 1960, and the first franchised restaurant opened in 1966. The Company acquired the Elmer's franchising operation in January 1984 from the Elmer family.

The Company reached a termination agreement with the Twin Falls franchisee in December 2002 and the Longview franchisee in January 2003. For the 40 weeks ended January 6, 2003, the Company recorded less than $10,000 in franchise fee revenues from these locations.

The Company franchises or operates a total of 35 full-service, family-oriented restaurants, with a warm, friendly atmosphere and comfortable furnishings. Most of the restaurants are decorated in a home style, with fireplaces in the dining rooms. The restaurants are primarily freestanding buildings, ranging in size from 4,600 to approximately 9,000 square feet with seating capacities ranging from 120 to 220. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. The menu offers an extensive selection of items for breakfast, lunch and dinner.

CRITICAL ACCOUNTING POLICIES

The Company's reported results are affected by the application of certain accounting policies that require subjective or complex judgments. These judgments involve estimates that are inherently uncertain and may have a significant impact on our quarterly or annual results of operations and financial condition. Changes in these

estimates and judgments could have significant effects on the Company's results of operations and financial condition in future years. We believe the Company's most critical accounting policies cover accounting for long-lived assets - specifically property, buildings and equipment depreciation thereon and the valuation of intangible assets. Additional critical accounting policies govern revenue recognition and accounting for stock options.

Property, Buildings and Equipment

When the Company purchases property, buildings and equipment, the assets are recorded at cost. However, when the Company acquires an operating restaurant or business, the Company must allocate the purchase price between the fair market value of the tangible assets acquired and any excess to goodwill. The fair market value of restaurant equipment fixtures and furnishings in an operating restaurant is difficult to separate from the going concern value of the restaurant. Most of the value of the equipment is due to the fact that it is in the restaurant and working. The Company values in place equipment with reference to replacement cost, age and condition, and utility in its intended use.

Intangible Assets

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

Depreciation

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

Revenue Recognition

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

Stock Options

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

HIGHLIGHTS OF HISTORICAL RESULTS. The Company reported net income of $268,145 and $1,271,290 or $.13 and $.62 in basic earnings per share for the 12 and 40 week periods ended January 6, 2003. These results are compared to reported net income of $242,942 and $814,034, or $.12 and $.40 per share for the 12 and 40 week periods ended January 7, 2002. The approximately $25,000 increase in net income for the 12 weeks ended January 6, 2003 is the result of reduced general and administrative expense as well as reduced interest expense due to reductions in the company's interest bearing debt. The $457,000 increase in net income for the 40 weeks ended

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January 6, 2003 is largely attributable to the gain of $.25 per share, net of tax, on sale of the three Southern Oregon restaurants in the first quarter, partially offset by losses totaling $.07 per share on the debt repurchase, relocation and losses on the sale of investments. The Company's total assets as of January 6, 2003 were $17.4 million, which is an increase of approximately $652,000, over total assets as of April 1, 2002. In the 40 weeks ended January 6, 2003, working capital increased approximately $449,000 while notes payable (net of current portion) decreased $862,000. Cash provided by operating activities totaled $1,395,177 for the 40 weeks ended January 6, 2003 compared to $1,445,897 for the 40 weeks ended January 7, 2002. The Company has also placed a temporary $350,000 deposit with the Company's primary food vendor in exchange for improved pricing. The Company is developing an electronic funds transfer (EFT) invoicing system with this vendor. Once the EFT is in place the deposit will be returned or offset by future purchases. The paydowns and deposit increased prepaid expenses and reduced cash provided by operations.

COMPARISON OF RESULTS OF OPERATIONS. The following discussion and analysis presents the Company's results of operations for the 12 and 40 weeks ended January 6, 2003 and the 12 and 40 weeks ending January 7, 2002 respectively.

For the 12 and 40 week periods ended January 6, 2003, the Company's net income increased 10.3% and 56.2% from the comparable periods in 2002. The Company posted a net after tax gain of approximately $.18 per share in the first fiscal quarter of this year, accounting for much of the $.22 per share improvement in earnings per share. Excluding the net gain posted in the first quarter, the Company's earnings have increased approximately 11% for the forty weeks ended January 6, 2003. Net income as a percentage of total revenue increased from 3.1% for the 40-week period ended January 7, 2002, to 5.2% for the 40 weeks ended January 6, 2003. Net income as a percentage of total revenue increased from 3.1% for the 12-week period ended January 7, 2002, to 3.5% for the 12 weeks ended January 6, 2003.

Dollar amounts in thousands except per share data	RESULTS OF OPERATIONS FOR THE 40 WEEKS ENDED JANUARY 6, 2003		RESULTS O FOR THE 4 JANUA
	Amount	Percent of Revenues	Amount
Revenues	$24,399	100.0%	$26,367
Restaurant costs and expenses	21,072	86.4	22,856
General and administrative expenses	1,762	7.2	1,899
Operating income	1,565	6.4	1,612
Non operating income (expense)	374	1.5	(369)

Net income	1,271	5.2	814
Basic earnings per share	$0.62		$0.40

Dollar amounts in thousands except per share data	RESULTS OF OPERATIONS FOR THE 12 WEEKS ENDED JANUARY 6, 2003		RESULTS FOR THE JANUA
	Amount	Percent of Revenues	Amount
Revenues	$7,575	100.0%	$7,906
Restaurant costs and expenses	6,572	86.8	6,812
General and administrative expenses	519	6.9	614
Operating income	484	6.4	480
Non operating income (expense)	(75)	(1.0)	(109)
Net income	268	3.5	243
Basic earnings per share	$0.13		$0.12

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REVENUES. Revenues for the 12 and 40 weeks ended January 6, 2003 were 4.2% and 7.5% less, respectively, than the comparable period in 2002, reflecting fewer operating restaurants for most of the current year. Revenues from same store restaurant operations showed an increase of 3.9% and 1.8% for the 12 and 40 weeks ended January 6, 2003 respectively, over the comparable period in 2002. Same store sales at the core Elmer's brand increased 5.7% and 3.8% for the 12 and 40 weeks ended January 6, 2003.

Dollar amounts in thousands	REVENUES FOR THE 40 WEEKS ENDED JANUARY 6, 2003		REVENUES FOR THE 40 WEEKS ENDED JANUARY 7, 2002	
	Amount	Percent of Revenues	Amount	Percent of Revenues
Restaurant operations:				
Restaurant sales	$20,624	84.6%	$22,785	86.4%
Lottery	2,865	11.7	2,638	10.0
	23,489	96.3	25,423	96.4
Franchise operations	910	3.7	944	3.6
Total revenue	$24,399	100.0%	$26,367	100.0%

Dollar amounts in thousands	REVENUES FOR THE 12 WEEKS ENDED JANUARY 6, 2003		REVENUES FOR THE 12 WEEKS ENDED JANUARY 7, 2002	
	Amount	Percent of Revenues	Amount	Percent of Revenues

Restaurant operations:				
Restaurant sales	$6,359	84.0%	$6,818	86.2%
Lottery	926	12.2	803	10.2
	7,285	96.2	7,621	96.4
Franchise operations	290	3.8	285	3.6
Total revenue	$7,575	100.0%	$7,906	100.0%

RESTAURANT COSTS AND EXPENSES. A comparison of restaurant costs and expenses as a percent of revenue for the 40 weeks and 12 weeks ended January 6, 2003 and January 7, 2002 are as follows:

	FOR THE FORTY WEEKS ENDED		FOR THE TWELVE WEEKS ENDED	
	January 6, 2003	January 7, 2002	January 6, 2003	January 7, 2002
Cost of restaurant sales:				
Food and beverage	28.4%	28.4%	29.0%	28.3%
Labor and related costs	35.5%	35.8%	34.9%	35.1%
Restaurant operating costs	13.8%	13.8%	14.1%	14.0%
Occupancy costs	6.4%	6.2%	6.5%	6.3%
Depreciation and amortization	2.3%	2.2%	2.3%	2.5%
Restaurant opening and closing expenses	0.0%	0.3%	0.0%	0.0%
Total Cost of Restaurant Sales	86.4%	86.7%	86.8%	86.2%

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GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative ("G&A") expenses were 6.9% and 7.2% of total revenue for the 12 and 40 weeks ended January 6, 2003 compared to 7.8% and 7.2% of revenues in the comparable period in 2002. Following the sale of the three Southern Oregon restaurants, the Company has worked to reduce G&A expense in conjunction with the reduction in the number of Company owned restaurants. The time required to achieve these cost savings accounts for the increase in G&A expense as a percentage of sales in the first half of the year. These savings and reductions in the cost of the administrative services contract have resulted in a reduction in G&A expense as a percentage of sales in the most recent quarter.

NON-OPERATING (INCOME)/EXPENSE. Non-operating expense was 1.0% of total revenues for the 12 weeks ended January 6, 2003 compared to 1.4% of total revenues in the comparable period in 2002. For the 40 week period ending January 6, 2003, Non-operating income was 1.5% of sales compared to an expense of 1.4% for the comparable period in 2002. The change reflects a net gain of 2.4% of sales on the sale of restaurants, sale of securities and repurchase of debt discussed earlier.

LIQUIDITY AND CAPITAL RESOURCES. As of January 6, 2003, the Company had cash and equivalents of approximately $1,495,000 representing an increase from April 1, 2002 of approximately $841,000. Cash provided by operations was $1.4 million. Cash provided by investing activities was $513,000. Proceeds of $1.3 million from the sale of the Southern Oregon units were offset by capital expenditures of $543,000 and cash used to purchase the Vancouver Elmer's and the Cooper's delis of $314,000. Cash used in financing activities totaled $1.1 million, including $747,500 spent for the repurchase of 10% convertible notes.

The Company repurchased 16,225 shares of its common stock during the quarter ended October 14, 2002 for $88,245. These purchases were made in the NASDAQ market through the Company's broker. The board of directors has authorized the Company to repurchase shares valued, in aggregate, at less than $300,000 annually. This authorization is ongoing and the Company may make additional purchases from time to time.

The Company's primary liquidity needs arise from debt service on indebtedness, operating lease requirements and the funding of capital expenditures. The Company's primary source of liquidity during the year is the operation of its restaurants, franchise fees earned from its franchisees, cash on hand, and borrowings. As of January 6, 2003, the Company's primary indebtedness was $2.5 million with GE Capital, $1.6 million in real estate debt with Wells Fargo Bank and $650,000 in convertible notes.

In April 2002, the Company granted non-executive incentive stock options for 34,000 shares to employees of the Company. The options vest over five years and have a ten-year term. The exercise price of $5.00 was equal to the market value of the Company's stock on the grant date.

In August 2002, the Company elected to fix the interest rate on the $925,000 portion of the GE Capital loan that had a variable interest rate. The new rate is 7.1% per annum.

The remaining Wells Fargo real estate debt has a weighted-average maturity of 7.1 years, bears interest at an average of 8.2%, requires monthly payments of principal and interest, and is collateralized by three real estate assets.

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

Certain of the Company's debt agreements require compliance with debt covenants. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.25 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. Management believes that the Company is in

compliance with such requirements. The Company obtained a waiver from Wells Fargo Bank permitting the repurchase of the convertible notes.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS:
Certain statements in this Form 10-Q constitute "forward-looking statements" which we believe are reasonable and within the meaning of the Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors relating to the Company's business, financial condition, and operations which may cause the actual results, performance, or achievements of Elmer's Restaurants, Inc. (individually and collectively with its subsidiaries, herein the "Company") to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; the ability to accomplish stated goals and objectives; successful integration of acquisitions; the impact of competitive products and pricing; success of operating initiatives; development and operating costs; advertising and promotional efforts; adverse publicity; acceptance of new product offerings; consumer trial and frequency; availability, locations, and terms of sites for restaurant development; changes in business strategy or development plans; changes in regulations effecting lottery commissions; quality of management; availability, terms and deployment of capital; the results of financing efforts; business abilities and judgment of personnel; availability of qualified personnel; food, labor and employee benefit costs; changes in, or the failure to comply with, government regulations; continued NASDAQ listing; weather conditions; construction and remodeling schedules; and other factors referenced in this Form 10-Q.

Market Risks

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

Certain of the Company's outstanding financial instruments are subject to market risks, including interest rate risk. Such financial instruments are not currently subject to foreign currency risk or commodity price risk. A rise in prevailing interest rates could have adverse effects on the Company's financial condition and results of operations. The fair value of financial instruments approximate the book value at January 6, 2003.

ITEM 4. CONTROLS AND PROCEDURES

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

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

PART II - OTHER INFORMATION

ITEM 5. OTHER INFORMATION

As previously reported in the Company's Form 8-K dated October 15, 2002, William W. Service, Chief Executive Officer of the registrant, has resigned his current position for personal reasons. The Board granted the request effective November 1, 2002. Bruce Davis, the Company's President and Chairman, has assumed the responsibilities of the C.E.O. Mr. Service remains an active member of the Board and continues to serve as a strategic advisor to the Company.

In accordance with amendments adopted on May 21, 1998 to Rule 14a-4 under the Securities and Exchange Act of 1934, if notice of a shareholder proposal to be raised at the annual meeting of shareholders is received at the principal executive offices of the Company after May 15, 2003 (45 days prior to the month and date in 2003 corresponding to the date on which the Company mailed its proxy materials for the 2002 annual meeting), proxy voting on that proposal when and if raised at the 2003 annual meeting will be subject to the discretionary voting authority of the designated proxy holders. Any shareholder proposal to be considered for inclusion in proxy materials for the Company's 2003 annual meeting must be received at the principal executive office of the Company no later than January 21, 2003.

ITEM 6. EXHIBITS AND REPORTS OF FORM 8-K

a) Exhibits:

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

b) Reports on Form 8-K:

None.

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SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Elmer's Restaurants, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Elmer's Restaurants, Inc.

By: /s/ BRUCE N. DAVIS

Bruce N. Davis
President

Dated: February 19, 2003

CERTIFICATION

I, Bruce N. Davis, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Elmer's Restaurants, Inc.;

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respect the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

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

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

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

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

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

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

/s/ Bruce N. Davis

Bruce N. Davis
President
February 19, 2003

CERTIFICATION

I, Dennis R. Miller, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Elmer's Restaurants, Inc.;

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respect the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

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

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

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

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

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

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

/s/ Dennis R. Miller

Dennis R. Miller
Corporate Controller
February 19, 2003

EXHIBIT INDEX

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

pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Corporate Controller.