NEW WORLD RESTAURANT GROUP INC
Form 10-Q
November 08, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 27, 2005

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 0-27148

New World Restaurant Group, Inc.

(Name of Registrant as Specified in its Charter)

Delaware	**13-3690261**
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1687 Cole Blvd., Golden, Colorado 80401

(Address of principal executive offices, including zip code)

(303) 568-8000

(Registrant s telephone number, including area code)

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

None

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes o No ý

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of November 2, 2005, 9,868,623 shares of Common Stock of the registrant were outstanding.

NEW WORLD RESTAURANT GROUP, INC.

September 27, 2005

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NEW WORLD RESTAURANT GROUP, INC.

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 27, 2005 AND DECEMBER 28, 2004

(in thousands, except share information)

(unaudited)

	September 27, 2005	December 28, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,827	$ 9,752
Restricted cash	789	1,269
Franchise and other receivables, net of allowance of $1,098 and $2,475	6,263	7,123
Inventories	5,205	4,941
Prepaid expenses and other current assets	2,500	1,643
Total current assets	21,584	24,728
Restricted cash long-term	901	2,526
Property, plant and equipment, net	33,685	41,855
Trademarks and other intangibles, net	69,825	77,219
Goodwill	4,875	4,875
Debt issuance costs and other assets	5,766	7,253
Total assets	$ 136,636	$ 158,456
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 7,134	$ 8,243
Accrued expenses	28,460	34,836
Short term debt and current portion of long-term debt	280	295
Current portion of obligations under capital leases	16	16
Total current liabilities	35,890	43,390
Senior notes and other long-term debt	160,840	160,840
Obligations under capital leases	18	31
Other liabilities	8,593	9,678
Mandatorily redeemable, Series Z Preferred Stock, $.001 par value, $1,000 per share liquidation value; 2,000,000 shares authorized; 57,000 shares issued and outstanding	57,000	57,000
Total liabilities	262,341	270,939
Commitments and contingencies		
Stockholders deficit:		
Common stock, $.001 par value; 15,000,000 shares authorized; 9,868,623 and 9,848,713 shares issued and outstanding	10	10
Additional paid-in capital	175,818	175,797
Unamortized stock compensation	(85)	(137)
Accumulated deficit	(301,448)	(288,153)
Total stockholders deficit	(125,705)	(112,483)
Total liabilities and stockholders deficit	$ 136,636	$ 158,456

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

NEW WORLD RESTAURANT GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THIRD QUARTER AND YEAR TO DATE PERIODS ENDED SEPTEMBER 27, 2005 AND SEPTEMBER 28, 2004

(in thousands, except earnings per share and related share information)

(unaudited)

	Third quarter ended:		Year to date ended:	
	Sept 27, 2005	Sept 28, 2004	Sept 27, 2005	Sept 28, 2004
Revenues:				
Retail sales	$ 87,937	$ 84,763	$ 265,912	$ 256,982
Manufacturing revenues	5,270	4,913	14,905	15,270
Franchise and license related revenues	1,575	1,503	4,373	4,287
Total revenues	94,782	91,179	285,190	276,539
Cost of sales:				
Retail costs	73,941	70,315	219,141	213,805
Manufacturing costs	4,980	4,603	13,880	13,623
Total cost of sales	78,921	74,918	233,021	227,428
Gross profit	15,861	16,261	52,169	49,111
Operating expenses:				
General and administrative expenses	8,868	8,442	26,857	25,260
Depreciation and amortization	5,798	7,005	19,583	20,882
Loss (gain) on sale, disposal or abandonment of assets, net	104	(70)	269	1,395
Charges (adjustments) of integration and reorganization cost	1	(44)	6	(843)
Impairment charges and other related costs	205	402	1,484	402
Income from operations	885	526	3,970	2,015
Other expense (income):				
Interest expense, net	5,805	5,723	17,497	17,426
Other	(106)	(98)	(232)	(197)
Loss before income taxes	(4,814)	(5,099)	(13,295)	(15,214)
Provision (benefit) for state income taxes		(147)		92
Net loss	$ (4,814)	$ (4,952)	$ (13,295)	$ (15,306)
Net loss per common share Basic and Diluted	$ (0.49)	$ (0.50)	$ (1.35)	$ (1.56)
Weighted average number of common shares outstanding:				
Basic and Diluted	9,868,623	9,842,385	9,859,407	9,842,169

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

NEW WORLD RESTAURANT GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEAR TO DATE PERIODS ENDED SEPTEMBER 27, 2005 AND SEPTEMBER 28, 2004

(in thousands)

(unaudited)

	Sept 27, 2005	Sept 28, 2004
OPERATING ACTIVITIES:		
Net loss	$ (13,295)	$ (15,306)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	19,583	20,882
Stock based compensation expense	52	51
Loss, net of gains, on disposal of assets	269	1,395
Impairment charges and other related costs	1,484	402
Charges (adjustments) of integration and reorganization costs	6	(843)
Provision for (reduction of) losses on accounts receivable, net	(78)	266
Amortization of debt issuance and debt discount costs	1,386	1,387
Changes in operating assets and liabilities:		
Franchise and other receivables	938	(796)
Cash overdraft		1,978
Accounts payable and accrued expenses	(7,587)	(10,279)
Other assets and liabilities	3	445
Net cash provided by (used in) operating activities	2,761	(418)
INVESTING ACTIVITIES:		
Purchase of property and equipment	(5,775)	(5,605)
Proceeds from the sale of equipment	97	134
Net cash used in investing activities	(5,678)	(5,471)
FINANCING ACTIVITIES:		
Proceeds from line of credit	5,445	15,745
Repayments of line of credit	(5,460)	(16,745)
Repayment of other borrowings	(14)	(825)
Proceeds upon warrant exercise	21	1
Net cash used in financing activities	(8)	(1,824)
Net decrease in cash and cash equivalents	(2,925)	(7,713)
Cash and cash equivalents, beginning of period	9,752	9,575
Cash and cash equivalents, end of period	$ 6,827	$ 1,862
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest	$ 21,411	$ 20,958
Cash paid for income taxes	$	$ 572

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

NEW WORLD RESTAURANT GROUP, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY (DEFICIT)

FOR THE YEAR TO DATE PERIOD ENDED SEPTEMBER 27, 2005

(in thousands, except share information)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Unamortized Stock Compensation	Accumulated Deficit Amount	Total
Balance, December 28, 2004	9,848,713	$ 10	$ 175,797	$ (137)	$ (288,153)	$ (112,483)
Net loss					(13,295)	(13,295)
Common stock issued upon exercise of warrants	19,910		21			21
Amortization of stock compensation expense				52		52
Balance, September 27, 2005	9,868,623	$ 10	$ 175,818	$ (85)	$ (301,448)	$ (125,705)

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

NEW WORLD RESTAURANT GROUP, INC.

Notes to Consolidated Financial Statements (Unaudited)

Third Quarter and Year to Date Periods Ended September 27, 2005 and September 28, 2004

1. Basis of Presentation

The accompanying consolidated financial statements of New World Restaurant Group, Inc. and its wholly-owned subsidiaries (collectively, the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). As of September 27, 2005, the Company owns, franchises or licenses various restaurant concepts under the brand names of Einstein Bros. Bagels (Einstein Bros.), Einstein Bros. Café, Noah s New York Bagels (Noah s), Manhattan Bagel Company (Manhattan), Chesapeake Bagel Bakery (Chesapeake) and New World Coffee (New World). Our business is subject to seasonal trends. Generally, our revenues in the first fiscal quarter are somewhat lower than in the other three fiscal quarters.

The accompanying consolidated financial statements as of September 27, 2005 and for the third quarter and year to date periods ended September 27, 2005 and September 28, 2004 have been prepared without audit. The balance sheet information as of December 28, 2004 has been derived from our audited financial statements. The information furnished herein reflects all adjustments (consisting only of normal recurring accruals and adjustments), which are, in our opinion, necessary to fairly state the interim operating results for the respective periods. However, these operating results are not necessarily indicative of the results expected for the full fiscal year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States have been omitted pursuant to SEC rules and regulations. The notes to the consolidated financial statements (unaudited) should be read in conjunction with the notes to the consolidated financial statements contained in our annual report on Form 10-K for the fiscal year ended December 28, 2004. We believe that the disclosures are sufficient for interim financial reporting purposes.

Certain reclassifications have been made to conform previously reported data to the current presentation. These reclassifications have no effect on our net loss or financial position as previously reported.

During the third quarter ended September 27, 2005, we corrected an overstatement of depreciation expense of approximately $0.6 million related to the first and second quarters in fiscal 2005. Amounts in the year to date period ended September 27, 2005 are properly reflected.

2. Stock Based Compensation

We apply the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for our fixed award stock options to our employees. As such, compensation expense is recorded only if the current market price of the underlying common stock exceeded the exercise price of the option on the date of grant. We apply the fair value-basis of accounting as prescribed by Statements of Financial Accounting Standard (SFAS) No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123) in accounting for our fixed award stock options to our consultants. Under SFAS No. 123, compensation expense is recognized based on the fair value of stock options granted.

Had compensation cost for stock options granted to employees been determined on the basis of fair value using the following assumptions, net loss and loss per share would have been increased to the following pro forma amounts (in thousands of dollars, except per share amounts):

	Third quarter ended:		Year to date ended:	
	Sept 27, 2005	**Sept 28, 2004**	**Sept 27, 2005**	**Sept 28, 2004**
Net loss, as reported	$ (4,814)	$ (4,952)	$ (13,295)	$ (15,306)
Deduct: fair value based compensation expense	(199)	(183)	(538)	(628)
Pro forma net loss	(5,013)	(5,135)	(13,833)	(15,934)
Basic and diluted loss per common share:				
As reported	$ (0.49)	$ (0.50)	$ (1.35)	$ (1.56)
Pro forma	$ (0.51)	$ (0.52)	$ (1.40)	$ (1.62)
Assumptions:				
Expected life of options from date of grant			4.0 years	4.0 years
Risk-free interest rate			3.6 - 3.9%	3.1%
Volatility			100.0%	100.0%
Assumed dividend yield			0.0%	0.0%

There were no stock options granted during third quarters ended 2005 and 2004.

Based on options granted and various assumptions used to calculate stock based compensation expense as of September 27, 2005, we believe that the adoption of SFAS No. 123 (revised 2004) will result in an increase in expense of approximately $0.4 million and $0.1 million during fiscal 2006 and 2007, respectively. If actual events differ from our assumptions used to calculate the expense or if we grant additional options, our financial results could be impacted.

3. Goodwill, Trademarks and Other Intangibles

Intangible assets include both goodwill and identifiable intangibles arising from the allocation of the purchase prices of assets acquired. Goodwill represents the excess of cost over fair value of net assets acquired in the acquisition of Manhattan. Other intangibles consist mainly of trademarks, trade secrets and patents.

Goodwill and other intangible assets with indefinite lives are not subject to amortization but are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. SFAS No. 142, Goodwill and Other Intangible Assets requires a two-step approach for testing impairment. First, the estimated fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, then the second step of the impairment test is performed; the fair value of the reporting unit s goodwill is determined by allocating the unit s fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying amount over its fair value. Intangible assets not subject to amortization consist primarily of the Einstein Bros. and Manhattan trademarks.

Intangible assets with lives restricted by contractual, legal or other means are amortized over their useful lives and consist primarily of patents used in our manufacturing process. Amortization expense is calculated using the straight-line method over the estimated useful lives of approximately 5 years. Intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Intangible assets subject to amortization consist of the Chesapeake trademarks.

During the second quarter ended 2004, we began an evaluation of whether each of our brands should be a part of our overall strategic business plan. As a result of this evaluation, we determined that the Chesapeake brand did not fit within our long-term business model. Accordingly, we performed an interim impairment analysis and determined that no impairment existed. We also performed a longevity analysis and determined that the brand had an estimated useful life of four years. The trademarks were previously treated as a non-amortizing intangible and were reclassified to an amortizing intangible at June 29, 2004. During the second quarter ended 2005, we re-visited the long term strategic fit of Chesapeake utilizing the recommendations of a third party consultant previously engaged to present viable alternatives for the brand. Based upon the consultant s recommendations, we began forming an exit strategy that we believed could be completed within one year. Because there had been a change in circumstances, it was necessary to review the asset for impairment. The analysis indicated that the carrying amount of the Chesapeake trademarks was greater than its fair value and accordingly we recorded an impairment charge of $1.2 million during the quarter ended June 28, 2005. Currently, we are working with our remaining franchisees on an exit strategy that we anticipate completing by the end of fiscal year 2005. We also continue to review the carrying amount of the assets in relation to their fair value. For the year to date period ended September 27, 2005, we have recorded impairment charges of approximately $1.3 million related to the Chesapeake trademarks.

Trademarks and other intangibles consist of the following (in thousands of dollars):

	September 27, 2005	December 28, 2004
Amortizing intangibles:		
Trade secrets	$ 5,385	$ 5,385
Trademarks	743	2,062
Patents-manufacturing process	33,741	33,741
	39,869	41,188
Less accumulated amortization:		
Trade secrets	4,563	3,770
Trademarks	703	387
Patents-manufacturing process	28,584	23,618
	33,850	27,775
Total amortizing intangibles, net	$ 6,019	$ 13,413
Non-amortizing intangibles:		
Trademarks	63,806	63,806
Total trademarks and other intangibles, net	$ 69,825	$ 77,219

4. Debt

		September 27, 2005		December 28, 2004
$160 Million Notes	$	160,000	$	160,000
AmSouth Revolver				15
New Jersey Economic Development				
Authority Note Payable		1,120		1,120
		161,120		161,135
Less current portion of debt		280		295
Long-term debt	$	160,840	$	160,840

Debt consists of the following (in thousands of dollars):

$160 Million Notes

On July 8, 2003, we issued $160 million of 13% senior secured notes maturing on July 1, 2008 ($160 Million Notes).

The $160 Million Notes are guaranteed, fully and unconditionally, jointly and severally, by us and all present and future subsidiaries of ours and are collateralized by substantially all of our assets in which we have an interest. Pursuant to an Intercreditor Agreement, the $160 Million Notes are subordinate to the AmSouth Revolver as described below.

The $160 Million Notes contain certain covenants, which, among others, include certain financial covenants such as limitations on capital expenditures and minimum EBITDA as defined in the agreement. The covenants also preclude the declaration and payment of dividends or other distributions to holders of our common stock. These covenants are measured on a rolling twelve-month period and fiscal quarter basis, respectively. This debt contains usual and customary default provisions. As of September 27, 2005, we were in compliance with all our financial and operating covenants.

Interest payments under the $160 Million Notes are payable in arrears at the rate of 13% per year on July 1 and January 1, commencing January 1, 2004. The notes are redeemable, at our option, in whole or in part at any time after July 1, 2004 at the following redemption prices (as expressed in percentages of the principal amount):

Commencing on July 1,	Percentage
2005	103.0%

2006	102.0%
2007	101.0%
2008 and thereafter	100.0%

Debt issuance costs are capitalized and amortized using the effective interest method over the term of the $160 Million Notes.

AmSouth Revolver

On July 8, 2003, we entered into a three-year, $15 million senior secured revolving credit facility with AmSouth Bank (AmSouth Revolver). The AmSouth Revolver was subsequently amended to make technical corrections, clarify ambiguous terms and provide for increased limits with respect to letters of credit. Effective February 11, 2005, the AmSouth Revolver was amended again to increase our letter of credit sub-facility from $5 million to $7.5 million.

The AmSouth Revolver is collateralized by substantially all of our assets in which we have an interest and is senior to the $160 Million Notes pursuant to an Intercreditor Agreement.

The AmSouth Revolver contains certain covenants, which, among others, include certain financial covenants such as limitations on capital expenditures, operating lease obligations, minimum EBITDA as defined in the agreement, operating cash flow coverage ratio and minimum net worth. The covenants also preclude the declaration and payment of dividends or other distributions to holders of our common stock. These covenants are measured on a rolling twelve-month period at each fiscal quarter or annually at year-end. Additional covenant restrictions exist if the total borrowings, including outstanding letters of credit exceed $10.0 million. This debt also contains usual and customary default provisions. As of September 27, 2005, we are in compliance with all of our financial and operating covenants.

Interest payments under the AmSouth Revolver are payable in arrears on the first of each month. The net borrowings under the AmSouth Revolver bear an interest rate equal to the base rate plus an applicable margin with the base rate being the AmSouth Bank prime rate and the applicable margin being based on our fixed charge coverage ratio with a minimum and maximum applicable margin of 0.5% and 2.5% respectively. As of September 27, 2005, the prime interest rate under the AmSouth Revolver was 6.75%.

We are required to pay an unused credit line fee of 0.50% per annum on the average daily unused amount. The unused line fee is payable monthly in arrears. Additionally, we are required to pay a letter of credit fee based on the average daily undrawn face amount for each letter of credit issued, of an applicable margin being based on our fixed charge coverage ratio with a minimum and maximum applicable margin of 2.0% and 4.5% respectively. Letters of credit reduce our availability under the AmSouth Revolver. At September 27, 2005, we had $7.1 million of letters of credit outstanding. The letters of credit expire on various dates during 2006, are automatically renewable for one additional year and are payable upon demand in the event that we fail to pay certain workers compensation claims. Our availability under the AmSouth Revolver was $7.9 million at September 27, 2005.

Debt issuance costs are capitalized and amortized using the effective interest method over the term of the AmSouth Revolver.

New Jersey Economic Development Authority Note Payable

In December 1998, Manhattan Bagel Company, Inc. entered into a note payable in the principal amount of $2,800,000 with the New Jersey Economic Development Authority (NJEDA) at an interest rate of 9% per annum. Principal is paid annually and interest is paid quarterly. The note matures on December 1, 2008 and is secured by the assets of Manhattan Bagel Company, Inc.

On July 3, 2003, we placed an advanced funding of the note in escrow to enact a debt defeasance as allowed for in the agreement. This advanced funding is shown as restricted cash and the note is included in both current portion and long-term portion of debt in the September 27, 2005 and December 28, 2004 consolidated balance sheets in accordance with the payment terms. This classification will continue until the note is fully paid from the escrow amount proceeds.

5. Net Loss Per Common Share

In accordance with SFAS No. 128, Earnings per Share, we compute basic net loss per common share by dividing the net loss for the period by the weighted average number of shares of common stock outstanding during the period.

Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock and potential common stock equivalents outstanding during the period, if dilutive. Potential common stock equivalents include incremental shares of common stock issuable upon the exercise of stock options. The effects of potential common stock equivalents have not been included in the computation of diluted net loss per share as their effect is anti-dilutive.

The following table summarizes the weighted average number of common shares outstanding, as well as sets forth the computation of basic and diluted net loss per common share for the periods indicated (in thousands of dollars, except share and per share data):

	Third quarter ended:		Year to date ended:	
	Sept 27, 2005	**Sept 28, 2004**	**Sept 27, 2005**	**Sept 28, 2004**
Weighted average shares outstanding	9,868,623	9,842,385	9,859,407	9,842,169
Net loss	$ (4,814)	$ (4,952)	$ (13,295)	$ (15,306)
Basic and diluted net loss per share	$ (0.49)	$ (0.50)	$ (1.35)	$ (1.56)

Stock options and warrants to purchase an aggregate of 1,841,062 and 1,802,120 shares of common stock were outstanding as of September 27, 2005 and September 28, 2004, respectively. These stock options and warrants were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive.

6. Income Taxes

We record deferred tax assets and liabilities based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted statutory tax rate. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period. The recorded deferred tax assets are reviewed for impairment on a quarterly basis by reviewing our internal estimates for future net income. If we determine it to be more likely than not that the recovery of the asset is in question in the immediate, foreseeable future, we record a valuation allowance. On September 27, 2005 and December 28, 2004, we recorded a full valuation allowance against our net deferred tax asset. We will continue to record valuation allowances against additional deferred tax assets until such time that it is more likely than not that some portion or all of the deferred tax assets will be realized.

7. Loss (Gain) on Sale, Disposal or Abandonment of Assets

During the second quarter ended 2004, we recorded a loss of approximately $1.3 million primarily due to the disposal of menu boards as a result of new product offerings and due to the abandonment of leasehold improvements related to closed restaurants and our administrative facilities located in New Jersey.

8. Charges (Adjustments) of Integration and Reorganization Cost

Charges (adjustments) of integration and reorganization cost primarily represents adjustments to previously recorded liabilities associated with the closing and corporate consolidation of our Eatontown facilities during 2002. During April 2004, we reached an agreement with the landlord of our Eatontown facility to settle outstanding litigation. Previously recorded integration and reorganization estimates associated with closing this facility resulted in a benefit of $700,000 during the first quarter ended 2004 as a result of this settlement.

9. Impairment Charges and Other Related Costs

In accordance with Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, impairment losses are recorded on long-lived assets on a restaurant-by-restaurant basis whenever impairment indicators are determined to be present. We consider a history of cash flow losses to be the primary indicator of potential impairment for individual restaurant locations. We determine whether a restaurant location is impaired based on expected undiscounted future cash flows, considering location, local competition, current store management performance, existing pricing structure and alternatives available for the site. If impairment exists, the amount of impairment is measured as the excess of the carrying amount of the asset over its fair value as determined utilizing the estimated discounted future cash flows or the expected proceeds, net of costs to sell, upon sale of the asset.

For the year to date period ended September 27, 2005, we recorded approximately $0.1 million in impairment charges related to company-owned stores and approximately $0.1 million in exit costs from the decision to close one restaurant. Additionally, as further explained in Note 3, we recorded approximately $1.3 million in impairment charges related to the Chesapeake trademarks.

10. Litigation and Contingencies

We are subject to claims and legal actions in the ordinary course of our business, including claims by our franchisees, licensees and employees or former employees. We do not believe that an adverse outcome in any currently pending or threatened matter would have a material adverse effect on our business, results of operations or financial condition.

On July 31, 2002, Tristan Goldstein and Valerie Bankhordar, former store managers, filed a putative class action against Einstein and Noah Corp. (ENC) in the Superior Court for the State of California, County of San Francisco. The plaintiffs alleged that ENC failed to pay overtime wages to managers and assistant managers of its California stores who were improperly designated as exempt employees. In April 2004, we reached an agreement in principle to settle the litigation, subject to final court approval. The final hearing on the fairness of the settlement has been scheduled for January 4, 2006. Amounts representing our estimate to settle this litigation were previously recorded in general and administrative expenses during fiscal 2003 and did not have a material adverse effect on our consolidated financial condition or results of operations.

On September 14, 2004, Atlantic Mutual Insurance Company brought an action in the Superior Court of New Jersey Law Division: Morris County, against the Company, Anthony Wedo, William Nimmo, Jerold Novack, Ramin Kamfar, Lexington Insurance Company, and XL Specialty Insurance Company seeking declaratory judgment on insurance coverage issues in previously resolved litigation against Novack, our former Chief Financial Officer, and Kamfar, our former Chairman of the Board and Chief Executive Officer. Mr. Kamfar cross-claimed against us, claiming a right to be indemnified and for certain costs and attorneys fees incurred by him. The Company has put National Union, the Company s officers and directors liability insurer for the applicable time period, on notice that the Company believes that Kamfar s advancement and indemnity claims are an insured loss under the Company s policy with National Union. The parties have resolved matters with Mr. Kamfar and have reached an agreement in principle as to the other issues. The resolution of this lawsuit did not have a material effect on our consolidated financial condition or results of operations.

Guarantees

Prior to 2001, we would occasionally guarantee leases for the benefit of certain of our franchisees. None of the guarantees have been modified since their inception and we have since discontinued this practice. Current franchisees are the primary lessees under the vast majority of these leases. Under the lease guarantees, we may be required by the lessor to make all of the remaining monthly rental payments or property tax and common area maintenance payments if the franchisee does not make the required payments in a timely manner. However, we believe that most, if not all, of the franchised locations could be subleased to third parties minimizing our potential exposure. Additionally, we have indemnification agreements with our franchisees under which the franchisees would be obligated to reimburse us for any amounts paid under such guarantees. Historically, we have not been required to make such payments in significant amounts. We record a liability for our exposure under the guarantees in accordance with SFAS No. 5, Accounting for Contingencies, following a probability related approach. In the event that trends change in the future, our financial results could be impacted. As of September 27, 2005, we had outstanding guarantees of indebtedness under certain leases of approximately $0.7 million. Approximately $163,000 is reflected in accrued expenses in our consolidated balance sheet at September 27, 2005.

Insurance

We are insured for losses related to health, general liability and workers compensation under large deductible policies. The insurance liability represents an estimate of the ultimate cost of claims incurred and unpaid as of the balance sheet date. The estimated liability is established based on actuarial estimates, is discounted at 10% based upon a discrete analysis of actual claims and historical data and is reviewed on a quarterly basis to ensure that the liability is appropriate. If actual trends, including the severity or frequency of claims differ from our estimates, our financial results could be favorably or unfavorably impacted.

11. Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004) entitled Share-Based Payment that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for a) equity instruments of the enterprise or b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The Statement eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees, and generally would require instead that such transactions be accounted for using a fair-value-based method. This Statement is to be implemented at the beginning of the next fiscal year that begins after June 15, 2005. Based on options granted and various assumptions used to calculate stock based compensation expense as of September 27, 2005, we believe that the adoption will result in an increase in expense of approximately $0.4 million and $0.1 million during fiscal 2006 and 2007, respectively. If actual events differ from our assumptions used to calculate the expense or if we grant additional options, our financial results could be impacted.

We have considered all other recently issued accounting pronouncements and do not believe that the adoption of such pronouncements will have a material impact on our financial statements.

12. Related Party Transactions

Greenlight Capital, L.L.C. and its affiliates beneficially own approximately 97 percent of our common stock on a fully diluted basis. As a result, Greenlight has sufficient voting power without the vote of any other stockholders to determine what matters will be submitted for approval by our stockholders, to approve actions by written consent without the approval of any other stockholders, to elect all of our board of directors, and among other things, to determine whether a change in control of our company occurs.

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

The following discussion and analysis supplements the management s discussion and analysis in our Annual Report on Form 10-K for the year ended December 28, 2004 and presumes that readers have read or have access to the discussion and analysis in our Annual Report. The following discussion and analysis includes historical and certain forward-looking information that should be read together with the accompanying consolidated financial statements, related footnotes and the discussion below of certain risks and uncertainties that could cause future operating results to differ materially from historical results or from the expected results indicated by forward looking statements.

Business Overview

We are a leader in the quick casual segment of the restaurant industry. With 639 locations in 34 states and the District of Columbia as of September 27, 2005, we operate and license locations primarily under the Einstein Bros. and Noah s brand names, and franchise locations primarily under the Manhattan and Chesapeake brand names. We also operate a dough production facility. We view our business as a single segment with a focus on our company-operated restaurants. Our manufacturing and franchise operations are either supportive or ancillary to our main business focus.

The restaurant industry, in which we operate, is intensely competitive. The industry is often affected by changes in demographics, consumers eating habits and preferences, local and national economic conditions affecting consumer spending habits, population trends and local traffic patterns. Key elements of competition in the industry are price, quality and value of products offered, quality and speed of service, advertising effectiveness, brand name identification, restaurant locations and attractiveness of facilities.

Our financial focus is on long term, sustainable growth in free cash flow. Free cash flow represents net cash provided by operations less the investment in our facilities and fixed assets. By achieving free cash flow, we will be more capable of paying down debt, saving cash for future use and building shareholder value. We also believe free cash flow may give us the ability to pursue new opportunities and/or acquire other businesses. Increasing our operating profit and efficiently managing working capital and capital expenditures primarily drive free cash flow.

In measuring our overall growth and progress, we focus on various key performance indicators. Such key performance indicators include:

- same-store sales growth, comprised of average check and transactions,
- restaurant level and concept level margins,
- cash generated by operations,
- Adjusted EBITDA (as defined in our loan agreements),
- number of company-owned restaurant openings and closings, and
- number of franchise and licensed restaurant openings and closings.

Our progress against some of these key performance indicators is discussed throughout the Management s Discussion and Analysis.

Significant Known Events, Trends or Uncertainties Expected to Impact 2005 Results

The following factors represent currently known trends or uncertainties that may impact the comparability of operating performance or could cause reported financial information not to be necessarily indicative of future operating results or future financial condition.

Revenue Trends

In an effort to strengthen the performance of our company-operated Einstein Bros. locations, we developed a brand refresh strategy that will include updates of restaurant interiors and improvements to service through new menu boards and a pay first ordering system. Some of these enhancements reflect learning from our Einstein Bros. Café concept, comprising eight restaurants in the Denver and Colorado Springs, Colorado markets.

We believe that dietary trends and negative publicity on products high in carbohydrate content may have had an adverse impact on our sales historically. Accordingly, we began addressing the issue with modifications to our menu beginning in 2004. Additionally, we introduced limited time offerings featuring seasonal menu items and implemented modifications to our customer service system. We strengthened our catering programs in certain markets and initiated advertising campaigns during the fourth quarter ended 2004. We believe that changes in the products sold at our restaurants, price increases and shifts in product mixes to higher priced items coupled with initiatives in customer service and overall appearance at our restaurants, and advertising programs that build consumer awareness, have contributed to positive comparable store sales during 2005. We are continuing to strengthen our existing catering programs, build catering programs in new markets, increase customer awareness of our retail products, emphasize bundling products such as Sweeten the Deal, and highlight favorite products such as our egg sandwiches. We believe these initiatives will positively impact revenue in future periods.

Hurricane Wilma caused many of our Florida restaurants to be temporarily closed due to evacuations and power shortages. At this time, we cannot estimate the negative impact this event will have on our revenue and margins for the fourth quarter of 2005.

Expense Trends

Our expense trends are generally affected by the following major categories:

Changing prices for agricultural commodities,

Rising energy costs and increasing costs of other natural resources, Increasing labor costs, and

Increasing tax rates and costs of compliance with regulatory requirements.

In fiscal 2004, prices for agricultural commodities such as dairy, cheese and butter increased substantially. We have experienced slight decreases in dairy prices during 2005, but the decrease has been offset by increases in commodity costs for coffee, flour and packaging. Because flour represents the most significant raw ingredient we purchase, we implemented new cost reduction solutions during the later half of the first quarter 2005 to offset the impact of increases in commodity costs and have begun to see the benefit when comparing consecutive quarter s performance.

Rising energy costs and the increasing costs of other natural resources affect our utility bills, the cost of packaging that is derived from petroleum products and the cost of distribution to our restaurants. We have experienced increases in the cost for energy and packaging materials during 2005 and believe such costs will continue to increase on average for the remainder of 2005. Our distribution partners and common freight carriers passed on fuel surcharges to us during fiscal 2004 and 2005. In addition, we are currently negotiating contract terms with a new distribution partner to improve quality and service. As a result, we anticipate increased distribution costs beginning in the fourth quarter of 2005. We have also experienced increases in our utility costs due to the heat wave impacting most of the United States during third quarter of 2005. This trend negatively impacted retail sales and costs during the third quarter of 2005 but we do not anticipate a significant impact during the fourth quarter of 2005.

Due to competition for personnel, limited availability in the labor pool, and changes in the federal overtime regulations of the Fair Labor Standards Act which went into effect on August 23, 2004, we anticipate that we may experience an increase in hourly wages during the remainder of 2005 contingent upon the number of overtime hours worked.

Certain states and local governments have increased both the rate and nature of taxes on businesses in their regions in an effort to offset budget shortfalls. These increased taxes include real estate and property taxes, state and local income taxes, and various employment taxes.

Changes in any of the aforementioned categories could directly impact the profitability of our company-owned locations, manufacturing operations or distribution channels. Increases in any of these expense trends in the near future may contribute to degradation in our profit margins until such time as we are able to pass on increased costs to our consumers.

Impact of Inflation

We have not experienced a significant overall impact from inflation. As operating expenses increase, we recover increased costs through pricing increases, to the extent permitted by competition. We also review and implement alternative products or processes.

Store Portfolio Strategy

In mid-2004, we began an in-depth strategic review of all brands and the likelihood of providing additional capital and other resources to grow each independent brand. Additionally, we focused on individual store performance and compliance at each of our company operated, franchised and licensed stores. For the Einstein Bros. brand, we engaged Birchwood Resultants, independent consultants, to build market level and individual site level models to allow for strategic growth and portfolio rationalization decisions based on sound metrics. These models were built based on consumer research conducted at our company operated Einstein Bros. locations and external demographic, psychographic and competitive databases. We considered various factors such as local market conditions, distribution and supply chain channels, competition, comparable store sales, store-level cash flows and existing lease terms. Based on the store-level considerations, we then reviewed the economic and financial costs of exiting poorly performing locations (where the leases permitted cessation of operations) or sub-leasing the location to a third party. We also considered the long-term options of locations that perform at break-even or slightly above break-even. As a result of our strategic review, we have deliberately reduced our store count based on business decisions supported by quantitative data in an effort to improve our overall profitability. We also believe these efforts will identify markets for future store growth, allow us to better focus our time and resources, re-invest in our existing business and contribute to long-term sustainable growth in free cash flow (cash generated from opreations less capital expenditures).

We believe we have a solid platform for growth through store licensing of our Einstein Bros. and Noah s brands. The licensing program is available to qualified foodservice operators and typically requires an upfront license fee that is fully earned at the time the licensee commences operations. Stores are developed on college campuses, hospitals, airports, military installations and other locations. The licensed stores are generally opened during the third and fourth calendar quarters consistent with the timing of many government and higher education projects and federal funding. We typically receive continuing royalties on sales from each licensed store location. Our licensees are not required to buy all of their non-proprietary products directly from us, but rather their product sources must be approved by us.

We have a franchise base primarily in our Manhattan brand that generates a recurring revenue stream through fee and royalty payments. Our franchise base provides us with the ability to grow our brand with minimal commitment of capital by us, and creates a built-in customer base for our manufacturing operations. We continue to look for franchisee candidates with appropriate operational experience and financial stability, including specific net worth and liquidity requirements. During 2004 and 2005, we have worked to improve our relationship and communication with performing franchisees. In an effort to strengthen the brand, we have terminated certain relationships with franchisees that are not performing in accordance with their franchise agreements. We believe that active involvement in and management of restaurant operations will result in a successful franchise strategy.

We continually assess the financial and operational alignment of our Manhattan, Chesapeake and New World brands. As the Manhattan brand represents the majority of our franchise operations, revitalizing and strengthening this brand remains a challenge for our management team. In 2004, we recognized that our historic franchise model was not consistent with future operating plans for all of our brands due to geographic separation from core markets. As a result, we exited certain markets during the second quarter ended 2005. We believe that by focusing on core markets, we will continue to build stronger brand awareness, consistent levels of performance and customer loyalty.

During the second quarter ended 2005, we reviewed the long term strategic fit of Chesapeake utilizing the recommendations of a third party consultant previously engaged to present viable alternatives for the brand. Based upon the consultant s recommendations, we began forming an exit strategy that we believed could be completed within one year. Because there had been a change in circumstances, it was necessary to review the asset for impairment. The analysis indicated that the carrying amount of the Chesapeake trademarks was greater than its fair value and accordingly we recorded an impairment charge of $1.2 million during the second quarter ended June 28, 2005. Currently, we are working with our remaining franchisees on an exit strategy that we anticipate completing by the end of fiscal year 2005. We also continue to review the carrying amount of the assets in relation to their fair value. For the year to date period ended September 27, 2005, we have recorded impairment charges of approximately $1.3 million related to the Chesapeake trademarks.

The following table details the total restaurants open at the end of the respective third quarter:

	Company owned	**Licensed**	**Franchised**	**Total**
Einstein Bros Bagels:				
2005	353	64		417
2004	371	53		424
Einstein Bros Cafe:				
2005	8			8
2004				
Noah s:				
2005	74	3		77
2004	78	3		81
Manhattan:				
2005			119	119
2004			154	154
Chesapeake:				
2005			12	12
2004			32	32
New World Coffee/Willoughby s*:				
2005	2		4	6
2004	7		9	16
Total Restaurants:				
2005	437	67	135	639
2004	456	56	195	707

* On October 6, 2004, we sold Willoughby sThe Willoughby s business consisted of a coffee roasting plant, three retail locations and office space.

Results of Operations

The table below sets forth, for the periods indicated, certain amounts included in our consolidated statements of operations, the relative percentage that those amounts represent to total revenue (unless otherwise indicated), and the percentage change in those amounts from period to period. All percentages are calculated using actual amounts rounded to the nearest thousand.

	Third quarter ended: (in thousands of dollars)		**Increase (Decrease) 2005**	**Year to date ended: (in thousands of dollars)**		**Increase (Decrease) 2005**	**Third quarter ended: (percent of total revenue)**		**Year to date ended: (percent of total revenue)**	
	9/27/05	**9/28/04**	**vs. 2004**	**9/27/05**	**9/28/04**	**vs. 2004**	**9/27/05**	**9/28/04**	**9/27/05**	**9/28/04**
Revenues:										
Retail sales	87,937	84,763	3.7%	265,912	256,982	3.5%	92.8%	93.0%	93.2%	92.9%
Manufacturing revenues	5,270	4,913	7.3%	14,905	15,270	(2.4)%	5.6%	5.4%	5.2%	5.5%
Franchise and license related revenues	1,575	1,503	4.8%	4,373	4,287	2.0%	1.7%	1.6%	1.5%	1.6%
Total revenues	94,782	91,179	4.0%	285,190	276,539	3.1%	100.0%	100.0%	100.0%	100.0%
Cost of sales (percentage of corresponding revenue stream):										
Retail costs	73,941	70,315	5.2%	219,141	213,805	2.5%	84.1%	83.0%	82.4%	83.2%
Manufacturing costs	4,980	4,603	8.2%	13,880	13,623	1.9%	94.5%	93.7%	93.1%	89.2%
Total cost of sales	78,921	74,918	5.3%	233,021	227,428	2.5%	83.3%	82.2%	81.7%	82.2%
Gross profit (percentage of corresponding revenue stream):										
Retail	13,996	14,448	(3.1)%	46,771	43,177	8.3%	15.9%	17.0%	17.6%	16.8%
Manufacturing	290	310	(6.5)%	1,025	1,647	(37.8)%	5.5%	6.3%	6.9%	10.8%
Franchise and license	1,575	1,503	4.8%	4,373	4,287	2.0%	100.0%	100.0%	100.0%	100.0%
Total gross profit	15,861	16,261	(2.5)%	52,169	49,111	6.2%	16.7%	17.8%	18.3%	17.8%
General and administrative expenses	8,868	8,442	5.0%	26,857	25,260	6.3%	9.4%	9.3%	9.4%	9.1%
Depreciation and amortization	5,798	7,005	(17.2)%	19,583	20,882	(6.2)%	6.1%	7.7%	6.9%	7.6%
Loss (gain) on sale, disposal or abandonment of assets, net	104	(70)	*	269	1,395	(80.7)%	0.1%	(0.1)%	0.1%	0.5%
Charges (adjustments) of integration and reorganization cost	1	(44)	*	6	(843)	*	0.0%	(0.0)%	0.0%	(0.3)%
Impairment charges and other related costs	205	402	(49.0)%	1,484	402	*	0.2%	0.4%	0.5%	0.1%
Income from operations	885	526	68.3%	3,970	2,015	97.0%	0.9%	0.6%	1.4%	0.7%
Other expense (income):										
Interest expense, net	5,805	5,723	1.4%	17,497	17,426	0.4%	6.1%	6.3%	6.1%	6.3%

Other	(106)	(98)	8.2%	(232)	(197)	17.8%	(0.1)%	(0.1)%	(0.1)%	(0.1)%
Loss before income taxes	(4,814)	(5,099)	(5.6)%	(13,295)	(15,214)	(12.6)%	(5.1)%	(5.6)%	(4.7)%	(5.5)%

* not meaningful

Revenues

Total revenues for the third quarter and year to date period ended September 27, 2005 were consistent with our expectations. Our total revenues increased 4.0% and 3.1% when compared to the third quarter and year to date period ended 2004, respectively. This increase primarily resulted from a dollar increase in retail sales (e.g. company-operated store sales, which represent the most significant component of revenue). Our retail comparable store sales increase of 5.9% consisted of a 5.5% increase in average check and a 0.4% increase in transactions during the third quarter ended 2005. We also experienced a 5.6% increase in comparable store sales for the year to date period ended September 27, 2005 which consisted of 6.0% increase in average check partially offset by 0.3% decrease in transactions. Comparable store sales represent sales at stores that were open for one full year and have not been relocated or closed during the current year. Comparable store sales are also referred to as same-store sales and as comp sales within the restaurant industry.

Throughout fiscal 2004, the trend of lower comparable store sales began to reverse and ultimately became positive during the fourth quarter of 2004. The following table summarizes the elements of comparable store sales for each quarter in fiscal 2004 and 2005:

Period	**Comparable Store Sales**	**Average Check**	**Transactions**
First quarter, fiscal 2004	(4.8)%	0.7%	(5.5)%
Second quarter, fiscal 2004	(3.7)%	3.9%	(7.3)%
Third quarter, fiscal 2004	(1.6)%	5.0%	(6.3)%
Fourth quarter, fiscal 2004	2.6%	5.2%	(2.5)%
First quarter, fiscal 2005	4.6%	6.4%	(1.7)%
Second quarter, fiscal 2005	6.3%	6.0%	0.3%
Third quarter, fiscal 2005	5.9%	5.5%	0.4%

We believe the positive trend in comparable store sales is a result of price increases coupled with a shift in the product mix to higher priced items, improvements in the operation of our restaurants including initiatives in customer service and overall store appearance, the introduction of new menu items, further development of catering programs in selected markets, and advertising campaigns that were initiated in the fourth quarter ended 2004 and second and third quarters ended 2005 that strengthened consumer awareness.

Gross Profit

Our total gross profit decreased 2.5% for the third quarter ended 2005 when compared to the same period in 2004 and increased 6.2% for the year to date period ended 2005 when compared to the same period in 2004. The fluctuations were primarily due to a decrease of 3.1% and an increase of 8.3% in our retail margins (e.g. company-operated store margins, which contribute the most significant component of gross profit) during the third quarter and year to date periods ended 2005, respectively. Our retail margins are impacted by various store-level operating expenses such as the cost of products sold, salaries and benefits, insurance, supplies, repair and maintenance expenses, advertising, rent, utilities and property taxes. Similarly, our manufacturing margins are impacted by various manufacturing-level operating expenses such as the cost of products sold, salaries and benefits, insurance, supplies, repair and maintenance expenses, rent, utilities and property taxes. Depreciation, amortization and income taxes do not impact our retail or manufacturing margins.

For the third quarter ended 2005, the increase in retail sales over the comparable period contributed approximately $2.2 million of store contribution margin related to the increased sales. This margin increase was partially offset by approximately $1.5 million in additional marketing spend, $0.4 million in increased energy and utility costs impacting our restaurants located in warmer climates, and $0.2 million due to the timing of repair and maintenance expenditures. In the comparable 2004 quarter, we intentionally reduced marketing spend as we focused on modifications to our customer service system, menu offerings and the look and feel of our restaurants. Additionally in the comparable 2004 quarter, we recognized benefits in our group insurance IBNR (incurred but not recognized) estimates of approximately $0.6 million due to favorable claims experience.

For the year to date period ended September 27, 2005, the increase in retail sales over the comparable period contributed approximately $8.5 million of store contribution margin related to the increased sales. This margin increase was partially offset by approximately $2.2 million in additional marketing spend, $0.6 million in increased bank charges and credit card fees, $0.4 million in increased energy and utility costs impacting our restaurants located in warmer climates, $0.5 million due to the timing of repair and maintenance expenditures and $0.5 million in increased real estate taxes and a real estate dispute. In the comparable year to date period ended 2004, we recognized benefits in our group insurance IBNR (incurred but not recognized) estimates of approximately $0.7 million due to favorable claims experience. Because certain elements of cost of sales are fixed in nature such as rent, utilities, property taxes and manager salaries, incremental sales positively impact gross profit.

Our manufacturing operations are ancillary to our company-operated stores. For the third quarter and year to date periods ended 2005 and 2004, our manufacturing margins represented less than 1.0% of total revenues. Our manufacturing margins decreased 6.5% and 37.8% for the third quarter and year to date periods ended 2005, respectively, when compared to the same periods in 2004. Manufacturing margins for the year to date period ended September 27, 2005 were predominately impacted by increases in labor and commodity costs. During the later half of first quarter 2005, we implemented new cost reduction solutions to offset the impact of increases in commodity costs and have begun to see the benefit when comparing consecutive quarter s performance.

Other Operating Expenses

Our general and administrative expenses increased 5.0% for the third quarter ended 2005 when compared to the same period in 2004. The increase was primarily due to an additional $0.3 million in bonuses payable to corporate office staff and management due to improved operating performance.

Our general and administrative expenses increased 6.3% for the year to date period ended September 27, 2005 when compared to the same period in 2004. For the year to date period ended 2005, approximately $1.6 million was the result of an increase in bonuses payable to corporate office staff and management due to improved operating performance. Also contributing to the increase was approximately $0.3 million in severance wages payable, $0.4 million in additional vacation wages, $0.5 million in additional recruiting and relocation expenses, offset by approximately $1.2 million in reduced legal spending related to former employee matters that were resolved in early 2005.

Depreciation and amortization expenses decreased 17.2% and 6.2%, respectively, for the third quarter and year to date period ended September 27, 2005, when compared to the same periods in 2004. The decrease is partly due to a portion of our asset base becoming fully depreciated. Additionally affecting the third quarter ended September 27, 2005 is a correction of an overstatement of the first and second quarters depreciation expense of approximately $0.6 million that is properly reflected in the year to date period ended September 27, 2005.

During the second quarter ended 2004, we recorded a loss of approximately $1.3 million primarily due to the disposal of menu boards as a result of new product offerings and due to the abandonment of leasehold improvements related to closed restaurants and our administrative facilities located in New Jersey.

The adjustment of integration and reorganization cost primarily represents adjustments to previously recorded liabilities associated with the closing and corporate consolidation of our Eatontown facilities during 2002. During April 2004, we reached an agreement with the landlord of our Eatontown facility to settle outstanding litigation. Previously recorded integration and reorganization estimates associated with closing this facility resulted in a benefit of $700,000 during the first quarter ended 2004 as a result of this settlement.

As more fully discussed in note 3 to our consolidated financial statements, we recorded approximately $1.3 million in impairment charges related to the Chesapeake trademarks during the year to date period ended September 27, 2005. We also recorded approximately $0.1 million in impairment charges related to company-owned stores and approximately $0.1 million in exit costs from the decision to close one restaurant.

Liquidity and Capital Resources

The restaurant industry is predominantly a cash business where cash is received at the time of the transaction. We generate sufficient cash flow and we have sufficient availability under our AmSouth Revolver to fund operations, capital expenditures and required debt and interest payments. Our inventory turns frequently and accordingly our investment in inventory is minimal since our products are perishable. Our accounts payable are on terms that we believe are consistent with those of other companies within the industry.

The primary driver of our operating cash flow is our restaurant operations, specifically the gross margin from our company-operated restaurants. Therefore, we focus on the elements of those operations including comparable store sales and cash flows to ensure a steady stream of operating profits that enable us to meet our cash obligations. On a weekly basis, we review our company-operated store performance compared with the same period in the prior year and our operating plan. We are continuously identifying and implementing cost reduction initiatives, not only at the store operations level, but also within other disciplines such as supply chain, manufacturing operations and overhead. During 2005, we have continued to identify cost reduction initiatives, including but not limited to: menu optimization to remove and/or modify slow moving products and thus reduce waste, reductions in cost of goods sold through purchasing efficiencies, a focus on labor costs and efficiencies, and further refinement of programs that monitor theoretical food cost.

Credit Facility

Our AmSouth Revolver is a $15 million senior secured revolving credit facility, which matures on July 8, 2006. On September 27, 2005, our unused credit facility totaled approximately $7.9 million, net of outstanding letters of credit of $7.1 million. Our credit facility contains financial covenants relating to the maintenance of leverage and coverage ratios. The credit facility also contains affirmative and negative covenants including, among other things, limitations on certain additional indebtedness, capital expenditures and minimum EBITDA as defined in the AmSouth agreement. We were in compliance with all covenants at September 27, 2005 and do not anticipate that the covenants will impact our ability to borrow under our credit facility for its remaining term.

Based upon our projections for fiscal 2005 and beyond, we believe that the cash flow from operations coupled with the continued availability of our AmSouth Revolver will be adequate to fund our operations, capital expenditures and required debt and interest repayments for the foreseeable future.

In the first quarter of 2005, we announced the engagement of Bear Stearns, investment bankers, to assist in the potential refinancing of our $160 Million Notes and AmSouth Revolver. Due to the instability of the high yield market during the second quarter of 2005 and under advisement from Bear Stearns, we temporarily suspended further refinancing activity until just recently. Currently, market conditions appear to have improved and we are reviewing our options regarding refinancing with Bear Sterns. We believe that refinancing our debt at favorable interest rates could increase our letter of credit capacity, reduce interest expense and provide additional flexibility for future store growth.

Operating Activities

For the year to date period ended September 27, 2005, operations generated $2.8 million of cash. We continue to see improvements in our cash flow from operations and believe that such cash flow will be adequate to fund operating costs. Due to the timing of interest payments under our $160 Million Notes, which are due January 1 and July 1, we generally consume cash from operations during the first and third fiscal quarters of each year. During the second and fourth fiscal quarters of each year, we generally generate cash from operations. Historically, our fourth quarter is our strongest quarter for generating cash due to seasonality and gift card promotions.

Investing Activities

For the year to date period ended September 27, 2005, we used approximately $5.8 million of cash to purchase additional property and equipment which included $0.4 million for new stores, $0.7 million for remodeling existing stores, $3.1 million for replacement and new equipment at our existing company-operated stores, $0.7 million for our manufacturing operations and less than $0.9 million for general corporate purposes.

Contractual Obligations

There were no material changes to our contractual obligations during the third quarter ended 2005. For information regarding our contractual obligations at December 28, 2004, see our Annual Report on Form 10-K for the fiscal year ended December 28, 2004.

Guarantees

Prior to 2001, we would occasionally guarantee leases for the benefit of certain of our franchisees. None of the guarantees have been modified since their inception and we have since discontinued this practice. Current franchisees are the primary lessees under the vast majority of these leases. Under the lease guarantees, we may be required by the lessor to make all of the remaining monthly rental payments or property tax and common area maintenance payments if the franchisee does not make the required payments in a timely manner. However, we believe that most, if not all, of the franchised locations could be subleased to third parties minimizing our potential exposure. Additionally, we have indemnification agreements with our franchisees under which the franchisees would be obligated to reimburse us for any amounts paid under such guarantees. Historically, we have not been required to make such payments in significant amounts. We record a liability for our exposure under the guarantees in accordance with SFAS No. 5, Accounting for Contingencies, following a probability related approach. In the event that trends change in the future, our financial results could be impacted. As of September 27, 2005, we had outstanding guarantees of indebtedness under certain leases of approximately $0.7 million. Approximately $163,000 is reflected in accrued expenses in our consolidated balance sheet at September 27, 2005.

Insurance

We are insured for losses related to health, general liability and workers compensation under large deductible policies. The insurance liability represents an estimate of the ultimate cost of claims incurred and unpaid as of the balance sheet date. The estimated liability is established based on actuarial estimates, is discounted at 10% based upon a discrete analysis of actual claims and historical data and is reviewed on a quarterly basis to ensure that the liability is appropriate. If actual trends, including the severity or frequency of claims differ from our estimates, our financial results could be favorably or unfavorably impacted.

Non-GAAP Financial Measures

Adjusted EBITDA is a typical non-GAAP measurement for companies that issue debt and a measure used by our lenders. Adjusted EBITDA, as defined in our Indenture Agreement relating to the $160 Million Notes and the revolving credit facility with AmSouth Bank (collectively referred to herein as our loan agreements) represents earnings before interest, taxes, depreciation and amortization, and is further adjusted by various items including: (1) integration and reorganization charges and credits, (2) cumulative change in fair value of derivatives, (3) gain/loss on the investment, sale, disposal or exchange of assets, (4) impairment and other related charges and (5) other expense (income). Adjusted EBITDA may also be further adjusted by certain legal, financing and advisory fees, acquisition and integration expenses, and other charges. Our loan agreements require that Adjusted EBITDA be measured on a twelve month period ending on the last day of each fiscal quarter and be greater than $33 million. We present Adjusted EBITDA because it relates to a covenant contained in each of our loan agreements which are material to us, our financial condition and liquidity. If we do not comply with the Adjusted EBITDA covenant, an Event of Default (as defined in our loan agreements) would occur and, subject to the applicable notice and cure periods, the lenders could declare all amounts outstanding immediately due and payable and pursue all available remedies for payment of such amounts. As of September 27, 2005, we were in compliance with the Adjusted EBITDA covenant and we do not anticipate that the covenant will impact our ability to borrow under the AmSouth revolving credit facility.

Data regarding Adjusted EBITDA is provided as additional information to help our bondholders understand our compliance with the Adjusted EBITDA covenant. We also believe Adjusted EBITDA is useful to our bondholders as an indicator of earnings available to service debt. Adjusted EBITDA is not a recognized term under GAAP and does not purport to be an alternative to income (loss) from operations, an indicator of cash flow from operations or a measure of liquidity. Because not all companies calculate Adjusted EBITDA identically, this presentation may not be comparable to similarly titled measures of other companies. We believe Adjusted EBITDA is a more meaningful indicator of earnings available to service debt when certain charges (such as the gain or loss from the disposal of assets, impairment of assets and cumulative change in the fair value of derivatives) are excluded from income (loss) from continuing operations. Adjusted EBITDA is not intended to be a measure of free cash flow for management s discretionary use, as it does not consider certain cash requirements such as interest expense, income taxes, debt service payments and cash costs arising from integration and reorganization activities.

The following tables reconcile Adjusted EBITDA to net loss and cash flows used in operating activities, respectively:

	First quarter ended:		Second quarter ended:		Third quarter ended:		Year to date:	
	Mar 29, 2005	Mar 30, 2004	Jun 28, 2005	Jun 29, 2004	Sept 27, 2005	Sept 28, 2004	Sept 27, 2005	Sept 28, 2004
Reconciliation of Net Loss to Adjusted EBITDA:								
Net loss	$ (4,198)	$ (4,130)	$ (4,283)	$ (6,224)	$ (4,814)	$ (4,952)	$ (13,295)	$ (15,306)
Adjustments as defined in the loan agreements:								
Interest expense, net	5,919	5,799	5,773	5,904	5,805	5,723	17,497	17,426
Taxes		55		184		(147)		92
Depreciation and amortization	6,708	6,819	7,077	7,058	5,798	7,005	19,583	20,882
Loss (gain) on sale, disposal or abandonment of assets, net	4	(7)	161	1,472	104	(70)	269	1,395
Charges (adjustments) of integration and reorganization cost	5	(760)		(39)	1	(44)	6	(843)
Impairment charges and other related costs	97		1,182		205	402	1,484	402
Other expense (income)	(57)	(63)	(69)	(36)	(106)	(98)	(232)	(197)
Certain legal, financing and advisory fees		75	526	688	99	494	625	1,257
Certain corporate expenses		225				174		399
Certain other charges		25	700		25		725	25
Adjusted EBITDA	$ 8,478	$ 8,038	$ 11,067	$ 9,007	$ 7,117	$ 8,487	$ 26,662	$ 25,532

	First quarter ended:		Second quarter ended:		Third quarter ended:		Year to date:	
	March 29, 2005	March 30, 2004	June 28, 2005	June 29, 2004	Sept 27, 2005	Sept 28, 2004	Sept 27, 2005	Sept 28, 2004
Reconciliation of Net Cash Used in Operating Activities to Adjusted EBITDA:								
Net cash generated by (used in) operating activities	$ (6,288)	$ (4,175)	$ 14,353	$ 9,610	$ (5,304)	$ (5,853)	$ 2,761	$ (418)
Adjustments as defined in the loan agreements:								
Changes in operating assets and liabilities	9,292	6,560	(9,784)	(6,768)	7,138	8,860	6,646	8,652
Reduction in (provision for) losses on accts receivable	91		47	(94)	(60)	(172)	78	(266)
Amortization of debt issue costs	(462)	(462)	(462)	(446)	(462)	(479)	(1,386)	(1,387)
Stock based compensation expense	(17)		(17)	(35)	(18)	(16)	(52)	(51)
Interest expense, net	5,919	5,799	5,773	5,904	5,805	5,723	17,497	17,426
Other income	(57)	(64)	(69)	(36)	(106)	(97)	(232)	(197)
Provision (benefit) for state income taxes		55		184		(147)		92
Certain legal, financing and advisory fees		75	526	688	99	494	625	1,257
Certain corporate expenses		225				174		399
Certain other charges		25	700		25		725	25
Adjusted EBITDA	$ 8,478	$ 8,038	$ 11,067	$ 9,007	$ 7,117	$ 8,487	$ 26,662	$ 25,532

Risk Factors

We caution our readers that the following important factors, among others, could cause the actual results to differ materially from those indicated by forward-looking statements made in this report and from time to time in news releases, reports, proxy statements, registration statements and other written communications, as well as verbal forward-looking statements made from time to time by representatives of the company. Such forward-looking statements involve risks and uncertainties that may cause our actual results, performance or achievements to be materially different from any future performance or achievements expressed or implied by these forward-looking statements. Factors that might cause actual events or results to differ materially from those indicated by these forward-looking statements include, but are not limited to (i) future economic performance, (ii) success of cost reduction initiatives, (iii) the possibility of refinancing of our debt, (iv) restaurant openings or closings, (v) our ability to identify new markets and locations, (vi) refreshing our existing locations, (vii) our ability to incorporate elements of Einstein Bros. Café to improve performance of existing Einstein Bros. Bagels, (viii) our ability to execute our franchise and licensing strategy, (ix) operating margins, (x) the availability of acceptable real estate locations, (xi) the success and consumer acceptance of our innovations and changes to our restaurants, (xii) our ability to appropriately allocate capital expenditures to our restaurants, (xiii) the sufficiency of our cash balances, (xiv) cash generated from operating and financing activities for our future liquidity and capital resource needs, (xv) the reliability of our distribution partners and channels, (xvi) costs of utilities and fuel; costs and availability of commodities and products and (xvii) other matters, and are generally accompanied by words such as: believes, anticipates, estimates, predicts, expects, projects, and similar expressions that convey the uncertainty of future events or outcomes. An expanded discussion of some of these risks factors follows. You should also refer to the other information set forth in our Annual Report on Form 10-K for the fiscal year ended December 28, 2004, including our consolidated financial statements and the related notes.

We may not be successful in implementing any or all of the initiatives of our business strategy.

Our success depends in part on our ability to understand our customers needs. We believe successful deployment of our current business strategy will address customers needs and contribute to overall company growth. While we believe our refresh strategy will strengthen the performance of our Einstein Bros. brand, its success is dependent upon various factors, including customer acceptance of new menu offerings and pricings, the look and feel of the restaurants, and the new service system. In addition, the availability of capital and opportunities to make modifications to existing stores will be significant factors in the success of our business strategy. If we improperly perceive customers needs and/or are not successful in implementing any or all of the initiatives of our business strategy, it could have a material adverse effect on our business, results of operations, and financial condition.

We have and expect to continue to have a substantial amount of debt.

We have a high level of debt and are highly leveraged. In addition, we may, subject to certain restrictions, incur substantial additional indebtedness in the future. Our high level of debt, among other factors, could:

- make it difficult for us to satisfy our obligations under our indebtedness;
- limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions and general corporate purposes;
- increase our vulnerability to downturns in our business or the economy generally; and

limit our ability to withstand competitive pressures from our less leveraged competitors.

Our AmSouth Revolver and $160 Million Notes expire in July 2006 and July 2008, respectively. In first quarter 2005, we engaged Bear Stearns, investment bankers, to assist us in refinancing our $160 Million Notes and the AmSouth Revolver. Due to the instability of the high yield market during the second quarter of 2005 and under advisement from Bear Stearns, we temporarily suspended further refinancing activity until just recently. Currently, market conditions appear to have improved and we are reviewing our options regarding refinancing with Bear Sterns. We believe that refinancing our debt at favorable interest rates could increase our letter of credit capacity, reduce interest expense and provide additional flexibility for future store growth. We cannot provide any assurance that we will be successful in refinancing this debt or that any refinancing will be on terms more favorable to us.

We have certain covenants inherent in our debt agreements with which we must be in compliance.

Our debt agreements contain certain covenants, which, among others, include certain financial covenants such as limitations on capital expenditures, maintenance of the business, use of proceeds on sales of assets and minimum Adjusted EBITDA as defined in the agreements. The covenants also preclude the declaration and payment of dividends or other distributions to holders of our common stock.

We are subject to multiple economic, financial, competitive, legal and other risks that are beyond our control and could harm our future financial results. Any adverse effect on our business or financial results could affect our ability to maintain compliance with our debt covenants. A failure by us to comply with the covenants in the instruments and agreements governing our indebtedness could result in an event of default that, if not cured or waived, could result in all of our indebtedness becoming immediately due and payable, which could render us insolvent.

We may not be able to generate sufficient cash flow to make payments on our indebtedness.

Economic, financial, competitive, legislative and other factors beyond our control may affect our ability to generate cash flow from operations to make payments on our indebtedness, including the $160 Million Notes, and to fund necessary working capital. A significant reduction in operating cash flow would likely increase the need for alternative sources of liquidity. If we are unable to generate sufficient cash flow to make payments on our debt, we will have to pursue one or more alternatives, such as reducing or delaying capital expenditures, refinancing our debt on terms that are not favorable to us, selling assets or raising equity. We may not be able to accomplish any of these alternatives on satisfactory terms, if at all, and even if accomplished, they may not yield sufficient funds to service our debt.

We are vulnerable to changes in consumer preferences and economic conditions that could harm our financial results.

Food service businesses are often affected by changes in consumer tastes, dietary trends, national, regional and local economic conditions and demographic trends. Factors such as traffic patterns, local demographics and the type, number and location of competing restaurants may adversely affect the performance of individual locations. Shifts in consumer preferences away from our type of cuisine and/or the quick casual style could have a material adverse affect on our results of operations. We believe that the trend toward consumption of food low in carbohydrate content may have had a negative impact on our sales and revenues. In addition, increased food, labor and energy costs have affected our results and may, in the future, together with inflation, harm the restaurant industry in general and our locations in particular. Adverse changes in any of these factors could reduce consumer traffic or impose practical limits on pricing, which could harm our business prospects, financial condition, operating results and cash flow. Our continued success will depend in part on our ability to anticipate, identify and respond to changing consumer preferences and economic conditions.

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There is intense competition in the restaurant industry for personnel, real estate, advertising space, and customers, among other things.

Our industry is intensely competitive and there are many well-established competitors with substantially greater financial and other resources than we have. In addition to current competitors, one or more new major competitors with substantially greater financial, marketing and operating resources could enter the market at any time and compete directly against us. In addition, in virtually every major metropolitan area in which we operate or expect to enter, local, regional or national competitors already exist. This may make it more difficult to obtain real estate, advertising space, and retain customers and personnel.

We are vulnerable to fluctuations in the cost, availability and quality of our raw ingredients.

The cost, availability and quality of the ingredients we use to prepare our food are subject to a range of factors, many of which are beyond our control. Fluctuations in economic and political conditions, weather and demand could adversely affect the cost of our ingredients. We have limited control over fluctuations in the price and quality of commodities, and we may not be able to pass through any cost increases to our customers. We are dependent on frequent deliveries of fresh ingredients, thereby subjecting us to the risk of shortages or interruptions in supply. All of these factors could adversely affect our business and financial results.

We heavily depend on our suppliers and distributors.

We currently purchase our raw materials from various suppliers. We purchase a majority of our frozen bagel dough from one supplier (who utilizes our proprietary processes), which we are dependent upon in the short-term. Additionally, we purchase all of our cream cheese from a single source. Though to date we have not experienced significant difficulties with our suppliers, our reliance on our suppliers subjects us to a number of risks, including possible delays or interruption in supplies, diminished control over quality and a potential lack of adequate raw material capacity. Any disruption in the supply or degradation in the quality of the materials provided by our suppliers could have a material adverse effect on our business, operating results and financial condition. In addition, such disruptions in supply or degradations in quality could have a long-term detrimental impact on our efforts to develop a strong brand identity and a loyal consumer base.

We depend on our network of six regional custom distributors to distribute frozen bagel dough and other materials to our locations. If any one or more of these distributors fails to perform as anticipated, or if there is any disruption in any of our distribution relationships for any reason, it could have a material adverse effect on our business, financial condition and results of operations. We are currently negotiating contract terms with a new distribution partner to improve quality and service. As a result, we anticipate increased distribution costs beginning in the fourth quarter of 2005.

Increasing labor costs could adversely affect our continued profitability.

We are dependent upon an available labor pool of employees, many of whom are hourly employees whose wages may be affected by an increase in the federal or state minimum wage. Numerous proposals have been made on federal, state and local levels to increase minimum wage levels. Although few, if any, of our employees are paid at the minimum wage level, an increase in the minimum wage may create pressure to increase the pay scale for our employees, which would increase our labor costs and those of our franchisees and licensees. A shortage in the labor pool or other general inflationary pressures or changes could also increase labor costs. In addition, changes in labor laws or reclassifications of employees from management to hourly employees could affect our labor cost. For example, federal overtime regulations under the Fair Labor Standards Act, which went into effect on August 23, 2004, impacted the classification of several of our positions. A significant increase in the number of overtime hours worked could have a material adverse effect on our income from operations and decrease our profitability and cash available to service our debt obligations if we are unable to recover these increases by raising the prices we charge our customers.

We face the risk of adverse publicity and litigation in connection with our operations.

We are from time to time the subject of complaints or litigation from our consumers alleging illness, injury or other food quality, health or operational concerns. Adverse publicity resulting from these allegations may materially adversely affect us, regardless of whether the allegations are valid or whether we are liable. In addition, employee claims against us based on, among other things, discrimination, harassment or wrongful termination may divert financial and management resources that would otherwise be used to benefit our future performance. We have been subject to claims from time to time, and although these claims have not historically had a material impact on our operations, a significant increase in the number of these claims or the number that are successful could materially adversely affect our business, prospects, financial condition, operating results or cash flows.

We rely in part on our franchisees and licensees.

We rely in part on our franchisees and licensees and the manner in which they operate their locations to develop and promote our business. Although we have developed criteria to evaluate and screen prospective candidates, the candidates may not have the business acumen or financial resources necessary to operate successful locations in their respective areas. In addition, franchisees and licensees are subject to business risks similar to what we face such as competition, consumer acceptance, fluctuations in the cost, availability and quality of raw ingredients, and increasing labor costs. The failure of franchisees or licensees to operate successfully could have a material adverse effect on us, our ability to collect royalties, our reputation, our brands and our ability to attract prospective candidates.

We face risks associated with government regulation.

Each of our locations is subject to licensing and regulation by the health, sanitation, safety, labor, building and fire agencies of the respective states and municipalities in which it is located. A failure to comply with one or more regulations could result in the imposition of sanctions, including the closing of facilities for an indeterminate period of time, or third-party litigation, any of which could have a material adverse effect on us and our results of operations.

In addition, our franchising operations are subject to regulation by the Federal Trade Commission. Our franchisees and we must also comply with state franchising laws and a wide range of other state and local rules and regulations applicable to our business. The failure to comply with federal, state and local rules and regulations would have an adverse effect on our franchisees and us.

Under various federal, state and local laws, an owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on or in such property. Such liability may be imposed without regard to whether the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. Although we are not aware of any environmental conditions that require remediation by us under federal, state or local law at our properties, we have not conducted a comprehensive environmental review of our properties or operations. We may not have identified all of the potential environmental liabilities at our properties, and any such liabilities that are identified in the future may have a material adverse effect on our financial condition.

We may not be able to protect our trademarks, service marks and other proprietary rights.

We believe that our trademarks, service marks and other proprietary rights are important to our success and our competitive position. Accordingly, we devote substantial resources to the establishment and protection of our trademarks, service marks and proprietary rights. However, the actions we take may be inadequate to prevent imitation of our products and concepts by others or to prevent others from claiming violations of their trademarks and proprietary rights by us. In addition, others may assert rights in our trademarks, service marks and other proprietary rights.

We have a majority stockholder.

Greenlight Capital, L.L.C. and its affiliates beneficially own approximately 97 percent of our common stock on a fully diluted basis. As a result, Greenlight has sufficient voting power, without the vote of any other stockholders, to determine what matters will be submitted for approval by our stockholders, to approve actions by written consent without the approval of any other stockholders, to elect all of our board of directors, and among other things, to determine whether a change in control of our company occurs. Greenlight s interests on matters submitted to stockholders may be different from those of other stockholders. Greenlight is not involved in our day-to-day operations, but Greenlight has voted its shares to elect our current board of directors. The chairman of our board of directors is a current employee of Greenlight.

Our common stock is not currently listed on any stock exchange or Nasdaq. As a result, we are not subject to corporate governance rules adopted by the New York Stock Exchange, American Stock Exchange and Nasdaq requiring a majority of directors to be independent and requiring compensation and nominating committees that are composed solely of independent directors. However, we are subject to rules requiring that the audit committee consist entirely of independent directors. Under the rules of these stock exchanges and Nasdaq, if a single stockholder holds more that 50% of the voting power of a listed company, that company is considered a controlled company, and except for the rules relating to independence of the audit committee, is exempt from the above-mentioned independence rules. Because Greenlight beneficially owns approximately 97 percent of our common stock, we may take advantage of the controlled company exemption if our common stock becomes listed on an exchange or Nasdaq in the future. As a result, our stockholders currently do not have, and may never have, the protections that these rules are intended to provide.

Future sales of shares of our common stock by our stockholders could cause our stock price to fall.

If a substantial number of shares of our common stock are sold in the public market, the market price of our common stock could fall. The perception among investors that these sales will occur could also produce this effect. Our majority stockholder Greenlight beneficially owns approximately 97 percent of our common stock and sales by Greenlight or a perception that Greenlight will sell could cause a decrease in the market price of our common stock. Additionally, holders of outstanding warrants may convert and sell the underlying shares in the public market. Pursuant to our obligations under registration rights agreements, we have registered 957,872 shares of common stock underlying certain warrants, of which Greenlight owns warrants to purchase approximately 493,683 shares of our common stock. Sales of shares or a perception that there will be sales of the underlying shares could also cause a decrease in the market price of our common stock.

Holders may find it difficult to effect transactions in our common stock.

Our common stock is currently quoted on the pink sheets under the symbol NWRG.PK. Since our common stock is not listed on Nasdaq, the American Stock Exchange or the New York Stock Exchange, holders of our common stock may find that the liquidity of our common stock is impaired not only in the number of securities that can be bought and sold, but also through delays in the timing of transactions, reduction in security analysts and the news media s coverage of us, and lower prices for our securities than might otherwise be attained.

Securities that are not listed on a stock exchange, the Nasdaq National Market or the Nasdaq SmallCap Market are subject to an SEC rule that imposes special requirements on broker-dealers who sell those securities to persons other than their established customers and accredited investors. The broker-dealer must determine that the security is suitable for the purchaser and must obtain the purchaser s written consent prior to the sale. These requirements may make it more difficult for stockholders to sell our stock than the stock of some other companies. It may also affect our ability to raise more capital if and when necessary.

Item 3. Qualitative and Quantitative Disclosures About Market Risk

During the third quarter ended 2005 and 2004, our results of operations, financial position and cash flows were not affected by changes in the relative values of non-U.S. currencies to the U.S. dollar. We do not use derivative financial instruments to limit our foreign currency risk exposure since virtually all of our business is conducted in the United States.

Our debt at September 27, 2005 and December 28, 2004 was principally comprised of the $160 Million Notes due July 1, 2008 and the AmSouth Revolver. A 100 basis point increase in market interest rates would have an immaterial effect on our borrowing costs, since the interest rate on the $160 Million Notes is fixed. The interest rate on the AmSouth Revolver fluctuates with changes in the prime rate, but is immaterial in relation to interest expense under the $160 Million Notes and to our results of operations and financial condition.

We purchase certain commodities such as butter, cheese, coffee and flour. These commodities are generally purchased based upon market prices established with vendors. These purchase arrangements may contain contractual features that limit the price paid by establishing certain price floors or caps. We do not use financial instruments to hedge commodity prices because these purchase arrangements help control the ultimate cost paid and any commodity price aberrations are generally short-term in nature.

This market risk discussion contains forward-looking statements. Actual results may differ materially from this discussion based upon general market conditions and changes in domestic and global financial markets.

Item 4. Controls and Procedures

An evaluation was carried out under the supervision and with the participation of company management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of September 27, 2005. Based upon that evaluation, our chief executive officer and our chief financial officer have concluded that the design and operation of our disclosure controls and procedures were effective in timely making known to them material information relating to the Company required to be disclosed in reports that we file or submit under the Exchange Act rules.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable assurance regarding management s control objectives. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

During the quarter ended September 27, 2005, there were no changes to our internal controls over financial reporting that were identified in connection with the evaluation of our disclosure controls and procedures required by the Exchange Act rules and that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

NEW WORLD RESTAURANT GROUP, INC.

Item 1. Legal Proceedings.

Information regarding legal proceedings is incorporated by reference from Note 10 to our Consolidated Financial Statements set forth in Part I of this report.

Item 6. Exhibits

31.1 Certification by Chief Executive Officer pursuant to Exchange Act Rule 13a-15(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification by Chief Financial Officer pursuant to Exchange Act Rule 13a-15(e), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		NEW WORLD RESTAURANT GROUP, INC.
Date:	November 8, 2005	By: /s/ PAUL J.B. MURPHY, III Paul J.B. Murphy, III Chief Executive Officer
Date:	November 8, 2005	By: /s/ RICHARD P. DUTKIEWICZ Richard P. Dutkiewicz Chief Financial Officer and Principal Accounting Officer