MORTONS RESTAURANT GROUP INC
Form 10-Q
August 15, 2005

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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

For the quarterly period ended July 3, 2005

OR

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

For the transition period from **to**

Commission file number 1-12692

MORTON S RESTAURANT GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**13-3490149** (I.R.S. employer identification no.)
3333 New Hyde Park Road, Suite 210, New Hyde Park, New York (Address of principal executive offices)	**11042** (Zip code)

516-627-1515
(Registrant s telephone number, including area code)

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 or No o.

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

As of August 15, 2005, the registrant had 1,000 shares of its Common Stock, $0.01 par value, outstanding.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

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Part I - Financial Information

Item 1. Financial Statements

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(amounts in thousands)

		July 3, 2005 (unaudited)		January 2, 2005
Assets				
Current assets:				
Cash and cash equivalents	$	9,479	$	10,179
Restricted cash		417		548
Marketable securities		4,183		4,112
Accounts receivable		3,950		4,346
Inventories		9,026		9,302
Prepaid expenses and other current assets		5,517		6,600
Deferred income taxes		2,999		5,237
Total current assets		35,571		40,324
Property and equipment, at cost:				
Furniture, fixtures and equipment		18,897		16,499
Buildings and leasehold improvements		52,578		45,139
Land		8,474		8,474
Construction in progress		1,819		5,234
		81,768		75,346
Less accumulated depreciation and amortization		17,267		13,859
Net property and equipment		64,501		61,487
Intangible asset		92,000		92,000
Goodwill		61,528		61,789
Other assets and deferred expenses, net		8,459		8,836
	$	262,059	$	264,436

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets, Continued

(amounts in thousands, except share and per share amounts)

		July 3, 2005 (unaudited)		January 2, 2005
Liabilities and Stockholder s Equity				
Current liabilities:				
Accounts payable	$	5,313	$	6,390
Accrued expenses		28,089		30,902
Current portion of obligations to financial institutions		109		521
Accrued income taxes		217		379
Total current liabilities		33,728		38,192
7.5% senior secured notes, net of unamortized discount of $12,362 and $13,283 at July 3, 2005 and January 2, 2005		92,638		91,717
Obligations to financial institutions, less current maturities		3,525		6,636
Deferred income taxes		23,004		23,004
Other liabilities		9,832		7,546
Total liabilities		162,727		167,095
Commitments and contingencies				
Stockholder s equity:				
Common stock, $0.01 par value per share. Authorized, issued and outstanding 1,000 shares at July 3, 2005 and January 2, 2005				
Additional paid-in capital		97,077		97,077
Accumulated other comprehensive income		100		189
Retained earnings		2,155		75
Total stockholder s equity		99,332		97,341
	$	262,059	$	264,436

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(amounts in thousands)

	Three month periods ended July 3, 2005	Three month periods ended July 4, 2004	Six month periods ended July 3, 2005	Six month periods ended July 4, 2004
	(unaudited)			
Revenues	$ 72,940	$ 64,911	$ 150,278	$ 137,892
Food and beverage costs	24,047	21,988	50,049	46,462
Restaurant operating expenses	34,954	31,453	69,730	64,049
Pre-opening costs, depreciation and amortization	2,031	1,746	4,755	3,380
General and administrative expenses	5,438	4,662	10,638	9,548
Marketing and promotional expenses	1,481	2,240	2,904	4,869
Costs associated with the repayment of certain debt			174	264
Gain on sale of investment	(16)		(664)	
Interest expense, net	2,699	2,866	5,379	5,937
Management fee paid to related party	700	700	1,400	1,400
Income (loss) before income taxes	1,606	(744)	5,913	1,983
Income tax expense (benefit)	685	(223)	2,838	595
Net income (loss)	$ 921	$ (521)	$ 3,075	$ 1,388

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(amounts in thousands)

	Six month periods ended July 3, 2005 (unaudited)	Six month periods ended July 4, 2004 (unaudited)
Cash flows from operating activities:		
Net income	$ 3,075	$ 1,388
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash charges	5,352	5,338
Deferred income taxes	2,499	553
Change in assets and liabilities:		
Accounts receivable	392	784
Inventories	265	(399)
Prepaid expenses and other assets	923	(792)
Accounts payable, accrued expenses and other liabilities	(2,108)	(4,158)
Accrued income taxes	(176)	(254)
Net cash provided by operating activities	10,222	2,460
Cash flows from investing activities:		
Purchases of property and equipment	(6,454)	(3,638)
Increase in marketable securities	(71)	(1,741)
Net cash used in investing activities	(6,525)	(5,379)
Cash flows from financing activities:		
Principal reduction on obligations to financial institutions	(3,523)	(5,532)
Payment of deferred financing costs		(550)
Dividends paid	(995)	(6,789)
Decrease in restricted cash	131	79
Net cash used in financing activities	(4,387)	(12,792)
Effect of exchange rate changes on cash	(10)	(8)
Net decrease in cash and cash equivalents	(700)	(15,719)
Cash and cash equivalents at beginning of period	10,179	17,997
Cash and cash equivalents at end of period	$ 9,479	$ 2,278

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

July 3, 2005 and July 4, 2004

1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Morton s Restaurant Group, Inc. and its subsidiaries (the Company, we, us and our) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the Annual Report on Form 10-K for the fiscal year ended January 2, 2005.

The accompanying consolidated financial statements are unaudited and include all adjustments (consisting of normal recurring adjustments and accruals) that management considers necessary for a fair presentation of its financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates and assumptions relating to the reported amount of assets, liabilities, revenues and expenses reported during the period. Actual results could differ from those estimates.

The Company uses a 52/53 week fiscal year which ends on the Sunday closest to January 1. Approximately every six or seven years, a 53rd week will be added.

Morton s Restaurant Group, Inc. (MRG) was incorporated as a Delaware corporation on October 3, 1988 and is a wholly-owned subsidiary of Morton s Holding Company, Inc. (MHCI), which was incorporated as a Delaware corporation on March 10, 2004 and became the direct parent of MRG on June 4, 2004. MHCI is a wholly owned subsidiary of Morton s Holdings, LLC (MHLLC), a Delaware limited liability company formed on April 4, 2002.

2) Recent Events

During 2005, the Company received proceeds of approximately $674,000 from the sale of stock in Charlie Brown s Acquisition Corp., an affiliate of Castle Harlan, Inc., and recorded a gain on the sale of its investment of approximately $664,000 in the consolidated statement of operations for the six month period ended July 3, 2005.

3) Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, the Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. The Company paid cash interest of approximately $4,315,000 (which includes capitalized interest of approximately $108,000) and $4,811,000, and income taxes, net of refunds, of approximately $525,000 and $318,000, for the six month periods ended July 3, 2005 and July 4, 2004, respectively.

4) **Restricted Cash**

Restricted cash of $417,000 and $548,000 as of July 3, 2005 and January 2, 2005, respectively, represents cash collateral relating to an interest rate swap agreement with Bank of America, formerly Fleet National Bank (B of A). See Note 6.

5) **Intangible Asset and Goodwill**

The identifiable intangible asset acquired represents the Company s trade name Morton s, which has an indefinite life and accordingly is not subject to amortization, but is subject to impairment testing. The trade name is used in the advertising and marketing of the restaurants and is widely recognized and accepted by consumers in its respective market as an indication of and recognition of service, value and quality. Goodwill represents the excess of costs over fair value of assets of the business acquired. During fiscal 2005, goodwill was reduced by $261,000 which represents an adjustment in purchase accounting as a result of a revision to a deferred tax asset valuation allowance assumed at the time of purchase.

6) **Derivative Financial Instruments**

The Company accounts for its derivative financial instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. As of July 3, 2005, the Company s derivative financial instrument consists of one interest rate swap agreement with a notional amount of $20,000,000. Additionally, one interest rate swap agreement with a notional amount of $20,000,000 expired in October 2004. The Company s interest rate swap agreements are accounted for as speculative instruments and resulting changes in fair market value have been charged or credited to interest expense, net in the consolidated statements of operations. As of July 3, 2005, in accordance with SFAS No. 133 the receivable was approximately $26,000. As of January 2, 2005, in accordance with SFAS No. 133, the liability was approximately $77,000.

7) **Comprehensive Income**

The components of comprehensive income for the six month periods ended July 3, 2005 and July 4, 2004 are as follows (amounts in thousands):

	Six month periods ended			
		July 3, 2005		**July 4, 2004**
Net income	$	3,075	$	1,388
Other comprehensive income (loss):				
Foreign currency translation		(89)		(58)
Total comprehensive income	$	2,986	$	1,330

8) **Dividend**

On June 4, 2004, MHCI completed a $40,000,000 14% senior secured notes offering. The notes are secured by the assets of MHCI, which include the stock of MRG. The notes are not secured by the assets of, nor are they guaranteed by, MRG or any of its subsidiaries.

Pursuant to the MHCI notes, if at the end of a fiscal quarter the Company has cash and cash equivalents and marketable securities in excess of $5,000,000, excluding up to $750,000 of cash and cash equivalents held by one or more of the Company s foreign subsidiaries, and is permitted to pay a dividend under the Restricted Payments covenant of the 7.5% senior secured notes (defined therein), the Company is required to pay a dividend, to the extent permitted, to MHCI to repay outstanding PIK notes. The dividend will be in the amount of the lesser of the excess cash and cash equivalents and marketable securities over the

$5,000,000 threshold or the aggregate outstanding PIK notes. On May 12, 2005, the Company paid such a dividend of approximately $995,000 to MHCI.

9) Employee Subscription Agreements

Certain of our executives and other employees have been granted common units of MHLLC, which represent an ownership interest in MHLLC, pursuant to employee subscription agreements. MHLLC s Board approved 1,711,344 common units available for grant of which 1,497,585, 28,600, 20,800 and 1,600 were granted in fiscal 2003, fiscal 2004, on January 25, 2005 and on May 24, 2005, respectively. The fair value of each common unit granted during fiscal 2003, fiscal 2004, on January 25, 2005 and on May 24, 2005 was $0.01. Common units granted to an employee pursuant to employee subscription agreements are granted at no cost to the employee. These common units are subject to vesting. Fifty percent of the granted common units vest upon certain dates if the employee is employed as of such date. However, if the employee has been continuously employed by the Company from the date of grant to the date of a change of control, any unvested time vesting units will immediately vest simultaneously with the consummation of the change of control. In addition, fifty percent of the common units will vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30% and the employee is employed as of such date. Upon termination of employment, unvested common units will be forfeited and vested common units will be subject to repurchase pursuant to the terms of MHLLC s operating agreement. Stock-based employee compensation expense related to this plan is charged to the Company based on the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, the Company recognized compensation expense relating to the vesting of common units granted in our consolidated statements of operations for the three and six month periods ended July 3, 2005 and July 4, 2004. The compensation expense recorded during the three and six month periods ended July 3, 2005 and July 4, 2004, represents the straight-line amortization of the difference between the fair value at the date of grant of $0.01 per common unit and the exercise price (which is zero) of the common units of the outstanding time-vesting common units for the respective period. The remaining compensation expense that was measured at the date of grant will be amortized on a straight-line basis over the remaining vesting period. Compensation expense relating to the other 50% of common units granted, which vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30%, will be measured and recognized if and when these events occur.

Activity relating to the common units granted pursuant to employee subscription agreements is as follows:

Unvested common units outstanding as of January 4, 2004	1,482,385
Granted units	28,600
Vested units	
Forfeited units	(17,600)
Unvested common units outstanding as of January 2, 2005	1,493,385
Granted units	22,400
Vested units	
Forfeited units	(172,734)
Unvested common units outstanding as of July 3, 2005	1,343,051

As of July 3, 2005, there were 368,293 common units available for grant.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by SFAS No. 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the

method used on reported results. The transitional requirements of SFAS No. 148 are effective for all financial statements for fiscal years ending after December 15, 2002. Due to the fact that the compensation expense on the unvested common units is based on the fair value of the common units of MHLLC at the date of grant, there is no difference between reported net income and the pro forma net income that would be recognized under SFAS No. 123.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires all stock-based employee compensation to be recorded as an expense in the consolidated statement of operations and that such cost be measured according to the fair value of stock options. SFAS No. 123(R) will be effective the first annual reporting period that begins after June 15, 2005. As the Company already charges stock-based employee compensation expense related to units issued pursuant to employee subscription agreements based on the fair value of such units, the adoption of this statement will not have any effect on the Company s consolidated financial statements.

10) Financial Information about Geographic Areas

Income (loss) before income taxes for the Company s domestic and foreign operations are as follows (amounts in thousands):

	Three month periods ended		Six month periods ended	
	July 3, 2005	**July 4, 2004**	**July 3, 2005**	**July 4, 2004**
Domestic	$ 994	$ (1,020)	$ 4,738	$ 1,324
Foreign	612	276	1,175	659
Total	$ 1,606	$ (744)	$ 5,913	$ 1,983

11) Restaurant Activity

During July 2004, a new Morton s steakhouse was opened in White Plains, New York. During the first quarter of 2005, new Morton s steakhouses were opened in Bethesda, Maryland; Charlotte, North Carolina and Chicago, Illinois. During August 2005, a new Morton s steakhouse opened in Atlantic City, New Jersey. No restaurants were closed during the six month periods ended July 3, 2005 and July 4, 2004. The Company has signed leases to open new Morton s steakhouses in Troy, Michigan, Coral Gables, Florida and Fort Lauderdale, Florida.

The Company records rental expense on a straight-line basis from the date that the Company takes control of the premises over the lease term. Any difference between the calculated expense and the amounts actually paid are reflected as a deferred rent liability included in other liabilities in the consolidated balance sheets. The Company also includes landlord allowances for leasehold improvements, furniture, fixtures and equipment in the deferred rent liability. These amounts are amortized as a reduction of rent expense on a straight-line basis from the date that the Company takes control of the premises over the lease term. The Company has a policy of capitalizing the portion of deferred rent during the construction period in leasehold improvements.

12) Legal Matters and Contingencies

Since August 2002, a number of the Company s current and former employees in New York, Boston and Florida have initiated arbitrations with the American Arbitration Association in their respective states alleging that the Company has violated state (Boston arbitration), state and federal (New York arbitrations) and federal (Florida arbitrations) wage and hour laws regarding the sharing of tips with other employees and failure to pay for all hours worked. There are two group arbitrations pending in Florida. One is proceeding in West Palm Beach as a collective action (hereafter referred to as West Palm Beach arbitration) with approximately thirty claimants. The second is proceeding in Miami as a consolidated action (hereafter Miami arbitration) with approximately six claimants. Potential class members in the West Palm Beach arbitration were sent notices notifying them of the arbitration and advising them if they wish to participate in the arbitration they must sign and return a consent form. In addition, there are two individual demands for arbitration pending in Florida which may ultimately be joined to the Miami arbitration.

In general, the complainants are seeking restitution of tips, the difference between the tip credit wage and the minimum wage, payment for hours worked off the clock (in the Miami arbitration and in the individual Florida arbitrations only), liquidated damages and attorneys fees and costs. The arbitrator in the New York arbitrations has permitted the complainants to consolidate their arbitrations into one action and proceed as a collective action. The Miami claimants are also seeking to consolidate their arbitrations. The arbitrator has ruled that the claims cannot be consolidated but is allowing the case to proceed as a collective action. The Boston arbitrator has ruled that the claimants may proceed as a class, but to date there are only three people in the class and no class has been certified. The Company intends to and is contesting these matters vigorously. Management believes an adverse opinion in any one of these cases would not have a material adverse impact on the Company s financial condition.

In November 2004, current and former employees of the Sacramento Morton s steakhouse commenced a federal lawsuit asserting individual, representative and class claims against the Sacramento Morton s steakhouse and several other Morton s steakhouses. The plaintiffs asserted claims based on the Company s alleged failure to provide them with meal and rest periods, and for unlawful tip sharing and unfair competition. The plaintiffs seek restitution of tips, meal and break period compensation and attorneys fees. Dismissals with prejudice for all defendants, except the Sacramento Morton s steakhouse, were granted. The claims against the Sacramento Morton s steakhouse have been moved to arbitration.

In May 2005, a former employee of the Boston restaurant filed a nationwide class action complaint in federal court in Massachusetts alleging that the tip out violates the Fair Labor Standards Act. The Company moved to dismiss the complaint and compel arbitration. While the motion was pending, the plaintiff filed a nationwide collective action demand for arbitration with the American Arbitration Association. The demand for arbitration alleges the same facts as the lawsuit filed in federal court. The motion to dismiss is still pending in federal court.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate resolution of these actions will have a material adverse effect on the Company s consolidated financial position, results of operations, liquidity and capital resources.

13) Supplemental Condensed Consolidating Financial Information

The obligations of Morton s Restaurant Group, Inc. (the Issuer) related to the 7.5% senior secured notes are fully and unconditionally guaranteed on a joint and several basis and on a senior basis by certain of the Company s wholly-owned domestic subsidiaries (the Guarantors). These guarantees are senior secured obligations of the Guarantors, subject to liens permitted under the indenture governing the 7.5% senior secured notes, rank senior in right of payment to all subordinated indebtedness of the Guarantors and rank *pari passu* in right of payment with all existing and future senior indebtedness of the Guarantors. There are no restrictions on the Company s ability to obtain cash dividends or other distributions of funds from the Guarantors, except those imposed by applicable law and certain contractual restrictions, which do not exceed 25% of consolidated net assets of any Guarantor, that are permitted under the indenture governing the 7.5% senior secured notes. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for the Issuer, domestic subsidiaries of the Company that are Guarantors and foreign subsidiaries and domestic subsidiaries of the Company that are not Guarantors (collectively, the Non-Guarantor Subsidiaries). The Company has not presented separate financial statements and other disclosures concerning the Guarantor Subsidiaries because management has determined that such information is not material to investors.

Supplemental Consolidating Balance Sheet

July 3, 2005

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 6,863	$ 2,313	$ 303	$	$ 9,479
Restricted cash	417				417
Marketable securities	4,183				4,183
Accounts receivable		3,768	182		3,950
Inventories		8,500	526		9,026
Prepaid expenses and other current assets	392	5,074	51		5,517
Deferred income taxes	(3,230)	6,229			2,999
Total current assets	8,625	25,884	1,062		35,571
Property and equipment, net	134	63,560	807		64,501
Intangible asset		92,000			92,000
Goodwill		61,528			61,528
Other assets and deferred expenses, net	7,215	3,466	298	(2,520)	8,459
Amounts due from affiliates	109,510		1,583	(111,093)	
	$ 125,484	$ 246,438	$ 3,750	$ (113,613)	$ 262,059

Supplemental Consolidating Balance Sheet

July 3, 2005

(unaudited)

(amounts in thousands, except share and per share amounts)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 3,717	$ 28,701	$ 984	$	$ 33,402
Current portion of obligations to financial institution		109			109
Accrued income taxes	(8,139)	9,120	(764)		217
Amounts due to affiliates		111,093		(111,093)	
Total current liabilities	(4,422)	149,023	220	(111,093)	33,728
7.5% senior secured notes, net of unamortized discount of $12,362	92,638				92,638
Obligations to financial institution, less current maturities		3,525			3,525
Deferred income taxes		23,004			23,004
Other liabilities	(38)	9,768	102		9,832
Total liabilities	88,178	185,320	322	(111,093)	162,727
Commitments and contingencies					
Stockholder s equity:					
Common stock, $0.01 par value per share. Authorized, issued and outstanding 1,000 shares					
Additional paid-in capital	97,077	2,520		(2,520)	97,077
Accumulated other comprehensive income (loss)		292	(192)		100
(Accumulated deficit) retained earnings	(59,771)	58,306	3,620		2,155
Total stockholder s equity	37,306	61,118	3,428	(2,520)	99,332
	$ 125,484	$ 246,438	$ 3,750	$ (113,613)	$ 262,059

Supplemental Consolidating Balance Sheet

January 2, 2005

(Amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 9,014	$ 535	$ 630	$	$ 10,179
Restricted cash	548				548
Marketable securities	4,112				4,112
Accounts receivable	1	4,172	173		4,346
Inventories		8,717	585		9,302
Prepaid expenses and other current assets	677	5,866	57		6,600
Deferred income taxes	(991)	6,228			5,237
Total current assets	13,361	25,518	1,445		40,324
Property and equipment, net	147	60,227	1,113		61,487
Intangible asset		92,000			92,000
Goodwill		61,789			61,789
Other assets and deferred expenses, net	7,774	3,297	285	(2,520)	8,836
Amounts due from affiliates	119,894		179	(120,073)	
	$ 141,176	$ 242,831	$ 3,022	$ (122,593)	$ 264,436

Supplemental Consolidating Balance Sheet

January 2, 2005

(Amounts in thousands, except share and per share amounts)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 4,348	$ 31,698	$ 1,246	$	$ 37,292
Current portion of obligations to financial institutions		521			521
Accrued income taxes	(3,850)	4,827	(598)		379
Amounts due from affiliates		120,073		(120,073)	
Total current liabilities	498	157,119	648	(120,073)	38,192
7.5% senior secured notes, net of unamortized discount of $13,283	91,717				91,717
Obligations to financial institutions, less current maturities		6,636			6,636
Deferred income taxes		23,004			23,004
Other liabilities	(42)	7,493	95		7,546
Total liabilities	92,173	194,252	743	(120,073)	167,095
Commitments and contingencies					
Stockholder s equity:					
Common stock, $0.01 par value per share. Authorized, issued and outstanding 1,000 shares					
Additional paid-in capital	97,077	2,520		(2,520)	97,077
Accumulated other comprehensive income (loss)		355	(166)		189
(Accumulated deficit) retained earnings	(48,074)	45,704	2,445		75
Total stockholder s equity	49,003	48,579	2,279	(2,520)	97,341
	$ 141,176	$ 242,831	$ 3,022	$ (122,593)	$ 264,436

Supplemental Consolidating Statement of Operations

Three month period ended July 3, 2005

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 4,361	$ 69,228	$ 3,712	$ (4,361)	$ 72,940
Food and beverage costs		22,840	1,207		24,047
Restaurant operating expenses		33,273	1,681		34,954
Pre-opening costs, depreciation and amortization	15	1,861	155		2,031
General and administrative expenses	5,438	4,361		(4,361)	5,438
Marketing and promotional expenses		1,424	57		1,481
Gain on sale of investment	(16)				(16)
Interest expense, net	2,616	83			2,699
Management fee paid to related party	700				700
(Loss) income before income taxes	(4,392)	5,386	612		1,606
Income tax expense	685				685
Net (loss) income	$ (5,077)	$ 5,386	$ 612	$	$ 921

Supplemental Consolidating Statement of Operations

Three month period ended July 4, 2004

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 3,887	$ 61,745	$ 3,166	$ (3,887)	$ 64,911
Food and beverage costs		20,929	1,059		21,988
Restaurant operating expenses		29,855	1,598		31,453
Pre-opening costs, depreciation and amortization	3	1,600	143		1,746
General and administrative expenses	4,662	3,887		(3,887)	4,662
Marketing and promotional expenses		2,150	90		2,240
Interest expense, net	2,693	173			2,866

Management fee paid to related party	700				700
(Loss) income before income taxes	(4,171)	3,151	276		(744)
Income tax benefit	(223)				(223)
Net (loss) income	$ (3,948)	$ 3,151	$ 276	$	$ (521)

Supplemental Consolidating Statement of Operations

Six month period ended July 3, 2005

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 8,984	$ 143,046	$ 7,232	$ (8,984)	$ 150,278
Food and beverage costs		47,734	2,315		50,049
Restaurant operating expenses		66,395	3,335		69,730
Pre-opening costs, depreciation and amortization	30	4,429	296		4,755
General and administrative expenses	10,638	8,984		(8,984)	10,638
Marketing and promotional expenses		2,793	111		2,904
Costs associated with the repayment of certain debt	174				174
Gain on sale of investment	(664)				(664)
Interest expense, net	5,270	109			5,379
Management fee paid to related party	1,400				1,400
(Loss) income before income taxes	(7,864)	12,602	1,175		5,913
Income tax expense	2,838				2,838
Net (loss) income	$ (10,702)	$ 12,602	$ 1,175	$	$ 3,075

Supplemental Consolidating Statement of Operations

Six month period ended July 4, 2004

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 8,258	$ 131,449	$ 6,443	$ (8,258)	$ 137,892
Food and beverage costs		44,334	2,128		46,462
Restaurant operating expenses		60,800	3,249		64,049
Pre-opening costs, depreciation and amortization	6	3,148	226		3,380
General and administrative expenses	9,548	8,258		(8,258)	9,548

Marketing and promotional expenses		4,688	181		4,869
Costs associated with the repayment of certain debt	264				264
Interest expense, net	5,481	456			5,937
Management fee paid to related party	1,400				1,400
(Loss) income before income taxes	(8,441)	9,765	659		1,983
Income tax expense	595				595
Net (loss) income	$ (9,036)	$ 9,765	$ 659	$	$ 1,388

Supplemental Consolidating Statement of Cash Flows

Six month period ended July 3, 2005

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
Cash flows from operating activities:				
Net (loss) income	$ (10,702)	$ 12,602	$ 1,175	$ 3,075
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:				
Depreciation, amortization and other non-cash charges	1,500	3,545	307	5,352
Deferred income taxes	2,239	260		2,499
Change in assets and liabilities:				
Accounts receivable	1	403	(12)	392
Inventories		220	45	265
Prepaid expenses and other assets	10,679	(8,356)	(1,400)	923
Accounts payable, accrued expenses and other liabilities	(627)	(1,247)	(234)	(2,108)
Accrued income taxes	(4,289)	4,294	(181)	(176)
Net cash (used in) provided by operating activities	(1,199)	11,721	(300)	10,222
Cash flows from investing activities:				
Purchases of property and equipment	(17)	(6,420)	(17)	(6,454)
Increase in marketable securities	(71)			(71)
Net cash used in investing activities	(88)	(6,420)	(17)	(6,525)
Cash flows from financing activities:				
Principal reduction on obligations to financial institutions		(3,523)		(3,523)
Dividends paid	(995)			(995)
Decrease in restricted cash	131			131
Net cash used in financing activities	(864)	(3,523)		(4,387)
Effect of exchange rate changes on cash			(10)	(10)
Net (decrease) increase in cash and cash equivalents	(2,151)	1,778	(327)	(700)
Cash and cash equivalents at beginning of period	9,014	535	630	10,179
Cash and cash equivalents at end of period	$ 6,863	$ 2,313	$ 303	$ 9,479

Supplemental Consolidating Statement of Cash Flows

Six month period ended July 4, 2004

(unaudited)

(amounts in thousands)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
Cash flows from operating activities:				
Net (loss) income	$ (9,036)	$ 9,765	$ 659	$ 1,388
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:				
Depreciation, amortization and other non-cash charges	1,394	3,664	280	5,338
Deferred income taxes	2,525	(1,972)		553
Change in assets and liabilities:				
Accounts receivable	(55)	826	13	784
Inventories		(437)	38	(399)
Prepaid expenses and other assets	10,360	(10,293)	(859)	(792)
Accounts payable, accrued expenses and other liabilities	(385)	(3,567)	(206)	(4,158)
Accrued income taxes	(12,968)	12,798	(84)	(254)
Net cash (used in) provided by operating activities	(8,165)	10,784	(159)	2,460
Cash flows from investing activities:				
Purchases of property and equipment	(50)	(3,564)	(24)	(3,638)
Increase in marketable securities	(1,741)			(1,741)
Net cash used in investing activities	(1,791)	(3,564)	(24)	(5,379)
Cash flows from financing activities:				
Principal reduction on obligations to financial institutions		(5,532)		(5,532)
Payment of deferred financing costs	(550)			(550)
Dividends paid	(6,789)			(6,789)
Decrease in restricted cash	79			79
Net cash used in financing activities	(7,260)	(5,532)		(12,792)
Effect of exchange rate changes on cash			(8)	(8)
Net (decrease) increase in cash and cash equivalents	(17,216)	1,688	(191)	(15,719)
Cash and cash equivalents at beginning of period	17,911	(614)	700	17,997
Cash and cash equivalents at end of period	$ 695	$ 1,074	$ 509	$ 2,278

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Our net income for the three month period ended July 3, 2005 was $0.9 million compared to a net loss of $0.5 million for the three month period ended July 4, 2004. The increase is primarily due to an increase in comparable restaurant revenues and the impact of new restaurants, net of the related food and beverage costs, partially offset by an increase in income tax expense as discussed below. Net income increased $1.7 million, or 121.5%, to $3.1 million for the six month period ended July 3, 2005 from $1.4 million for the six month period ended July 4, 2004. The increase is primarily due to an increase in comparable restaurant revenues and the impact of new restaurants, net of the related food and beverage costs, and a decrease in marketing and promotional expenses partially offset by increases in pre-opening costs and income tax expense as discussed below.

Revenues increased $8.0 million, or 12.4%, to $72.9 million for the three month period ended July 3, 2005 from $64.9 million for the three month period ended July 4, 2004. Revenues increased $3.0 million due to an increase in comparable revenues from restaurants open all of both fiscal years. Revenues increased $5.0 million due to the opening of four new restaurants (three in fiscal 2005 and one in fiscal 2004). Average revenue per restaurant open all of either period increased 6.0%. Revenues for the three month period ended July 3, 2005 also reflect the impact of an aggregate menu price increase of approximately 0.5% in May 2005.

Revenues increased $12.4 million, or 9.0%, to $150.3 million for the six month period ended July 3, 2005 from $137.9 million for the six month period ended July 4, 2004. Revenues increased $3.5 million due to an increase in comparable revenues from restaurants open all of both fiscal years. Revenues increased $8.9 million due to the opening of four new restaurants (three in fiscal 2005 and one in fiscal 2004). Average revenue per restaurant open all of either period increased 7.2%. Revenues for the six month period ended July 3, 2005 also reflect the impact of aggregate menu price increases of approximately 3% in February 2004 and approximately 0.5% in May 2005.

Percentage changes in comparable restaurant revenues for the three and six month periods ended July 3, 2005 versus July 4, 2004 for restaurants open all of both periods are as follows:

	Three month period ended July 3, 2005 vs. July 4, 2004 Percentage Change	**Six month period ended July 3, 2005 vs. July 4, 2004 Percentage Change**
Morton s	4.7%	2.6%
Bertolini s	3.7%	2.3%
Total	4.6%	2.6%

Our business is somewhat seasonal in nature, with revenues generally being less in the third quarter primarily due to our reduced summer volume. We believe we may incur a net loss in the third quarter of fiscal 2005.

Food and beverage costs increased $2.1 million, or 9.4%, to $24.0 million for the three month period ended July 3, 2005 from $22.0 million for the three month period ended July 4, 2004. These costs increased $3.6 million, or 7.7%, to $50.0 million for the six month period ended July 3, 2005 from $46.5 million for the six month period ended July 4, 2004. This increase was primarily due to the opening of three additional restaurants in fiscal 2005. These costs as a percentage of revenues decreased by 0.9 % to 33.0% for the three month period ended July 3, 2005 from 33.9% for the three month period ended July 4, 2004 and decreased by 0.4% to 33.3% for the six month period ended July 3, 2005 from 33.7% for the six month period ended July 4, 2004. During fiscal 2004 high demand for U.S. beef products decreased the availability of USDA prime beef which resulted in increased food costs. We were generally able to offset such cost increases with the benefit of menu price increases, which resulted in a slight increase in food and beverage costs as a percentage of revenues for fiscal 2004.

Restaurant operating expenses, which include labor, occupancy and other operating expenses, increased $3.5 million, or 11.1%, to $35.0 million for the three month period ended July 3, 2005 from $31.5 million for the three month period ended July 4, 2004. These costs increased $5.7 million, or 8.9%, to $69.7 million for the six month period ended July 3, 2005 from $64.0 million for the six month period ended July 4, 2004. These increases were primarily due to the opening of three additional restaurants in fiscal 2005 and increases in labor and benefit costs. Restaurant operating expenses as a percentage of revenues decreased 0.6% to 47.9% for the three month period ended July 3, 2005 from 48.5% for the three month period ended July 4, 2004 and remained consistent at 46.4% for the six month periods ended July 3, 2005 and July 4, 2004. Included in the three month periods ended July 3, 2005 and July 4, 2004 is non-cash rent recorded in accordance with SFAS No. 13 of $0.2 million and $0.4 million, respectively. Included in the six month periods ended July 3, 2005 and July 4, 2004 is non-cash rent recorded in accordance with SFAS No. 13 of $0.5 million and $0.8 million, respectively.

Pre-opening costs, depreciation and amortization increased $0.3 million, or 16.3%, to $2.0 million for the three month period ended July 3, 2005 from $1.7 million for the three month period ended July 4, 2004. These costs as a percentage of revenues increased by 0.1% to 2.8% for the three month period ended July 3, 2005 from 2.7% for the three month period ended July 4, 2004. These costs increased $1.4 million, or 40.7%, to $4.8 million for the six month period ended July 3, 2005 from $3.4 million for the six month period ended July 4, 2004. These costs as a percentage of revenues increased by 0.7% to 3.2% for the six month period ended July 3, 2005 from 2.5% for the six month period ended July 4, 2004. We expense all costs incurred during start-up activities, including pre-opening costs, as incurred. Pre-opening costs incurred and recorded as expense remained consistent at $0.2 million for the three month periods ended July 3, 2005 and July 4, 2004 and increased $1.1 million to $1.3 million for the six month period ended July 3, 2005 from $0.2 for the six month period ended July 4, 2004. The number of restaurants opened, the timing of restaurant openings and the costs per restaurant opened affected the amount of these costs.

General and administrative expenses increased $0.8 million, or 16.6%, to $5.4 million for the three month period ended July 3, 2005 from $4.7 million for the three month period ended July 4, 2004. These costs increased $1.1 million, or 11.4%, to $10.6 million for the six month period ended July 3, 2005 from $9.5 million for the six month period ended July 4, 2004. These costs as a percentage of revenues increased 0.3% to 7.5% for the three month periods ended July 3, 2005 from 7.2% for the three month period ended July 4, 2004 and increased 0.2% to 7.1% for the six month period ended July 3, 2005 from 6.9% for the six month period ended July 4, 2004. These increases were primarily due to increased legal and professional costs and salary, bonus and benefit costs.

Marketing and promotional expenses decreased $0.8 million, or 33.9%, to $1.5 million for the three month period ended July 3, 2005 from $2.2 million for the three month period ended July 4, 2004. These costs decreased $2.0 million, or 40.4%, to $2.9 million for the six month period ended July 3, 2005 from $4.9 million for the six month period ended July 4, 2004. These costs as a percentage of revenues decreased 1.5% to 2.0% for the three month period ended July 3, 2005 from 3.5% for the three month period ended July 4, 2004 and decreased 1.6% to 1.9% for the six month period ended July 3, 2005 from 3.5% for the six month period ended July 4, 2004. These decreases were primarily due to decreased spending for print media advertising.

Costs associated with the repayment of certain debt of $0.2 million and $0.3 million for the six month periods ended July 3, 2005 and July 4, 2004, respectively, represent prepayment penalties that were incurred with the early repayment of certain mortgages.

Gain on sale of investment of $0.7 million for the six month period ended July 3, 2005 represents a gain from the sale of stock in a privately owned company.

Interest expense, net, decreased $0.2 million, or 5.8%, to $2.7 million for the three month period ended July 3, 2005 from $2.9 million for the three month period ended July 4, 2004 and decreased $0.6 million, or 9.4%, to $5.4 million for the six month period ended July 3, 2005 from $5.9 million for the six month period ended July 4, 2004. These decreases are primarily due to the repayment of certain mortgages in April 2004 and February 2005. Interest income was not significant in any of these periods.

Management fee paid to related party was $0.7 million for the three month periods ended July 3, 2005 and July 4, 2004 and $1.4 million for the six month periods ended July 3, 2005 and July 4, 2004. We paid this fee pursuant to MHLLC s management agreement with Castle Harlan, Inc.

Provision for income taxes consisted of income tax expense of $2.8 million and $0.6 million for the six month periods ended July 3, 2005 and July 4, 2004, respectively. Our 2005 effective tax rate differs from the statutory rate due to non-deductible interest relating to our 7.5% senior secured notes and other non-deductible items. Our 2005 effective tax rate differs from our 2004 effective tax rate due to the fact that during the third quarter of fiscal 2004, the Company determined it would elect to treat certain of its employee-portion FICA tax payments as current income tax deductions rather than income tax credits.

Liquidity and Capital Resources

Our principal liquidity requirements are to service our debt and meet our working capital and capital expenditure needs. Subject to our operating performance, which, if significantly adversely affected, would adversely affect the availability of funds, we expect to be able to meet our liquidity requirements for the foreseeable future through cash provided by operations and through borrowings available under our working capital facility. We cannot be sure, however, that this will be the case. As of July 3, 2005, we had cash and cash equivalents of $9.5 million compared to $10.2 million as of January 2, 2005.

Working Capital and Cash Flows

In the past we have had, and in the future we may have, negative working capital balances. We do not have significant receivables and we receive trade credit based upon negotiated terms in purchasing food and supplies. Funds available from cash sales not needed immediately to pay for food and supplies or to finance receivables or inventories historically have typically been used for noncurrent capital expenditures and or payments of long-term debt balances under our prior revolving credit agreement.

Operating Activities. Cash flows provided by operating activities for the six month period ended July 3, 2005 were $10.2 million, consisting primarily of a net increase in cash of $8.4 million resulting from net income before depreciation, amortization and other non-cash charges, a change in deferred income taxes of $2.5 million and a decrease in prepaid expenses and other current assets of $0.9 million partially offset by a decrease in accounts payable, accrued expenses and other liabilities of $2.1 million.

Investing Activities. Cash flows used in investing activities for the six month period ended July 3, 2005 were $6.5 million primarily due to purchases of property and equipment of $6.5 million, which include capital expenditures related to the three Morton s steakhouses opened during the first quarter of fiscal 2005.

Financing Activities. Cash flows used in financing activities for the six month period ended July 3, 2005 were $4.4 million primarily consisting of net principal reduction on obligations to financial institutions of $3.5 million, primarily due to the early repayment of two mortgages aggregating $3.4 million, and the payment of a dividend of $1.0 million.

Debt and Other Obligations.

7.5% Senior Secured Notes. On July 7, 2003, we completed a private offering of $105.0 million in aggregate principal amount at maturity of 7.5% senior secured notes due July 1, 2010. The notes were issued at a discount of 15% and a yield to maturity of 12.005% including the accretion of the discount and the amortization of the related deferred financing costs. The notes are fully and unconditionally guaranteed on a senior secured basis by all of our present and future domestic restricted subsidiaries. On December 22, 2003, we filed a registration statement with the Securities and Exchange Commission with respect to notes having substantially identical terms as the original notes, as part of an offer to exchange registered notes for the privately-issued original notes. The new notes evidence the same debt as the original notes, are entitled to the benefits of the indenture governing the original notes and are treated under the indenture as a single class with the original notes. The exchange offer was completed on January 28, 2004. We refer to these notes as our 7.5% senior secured notes.

Our domestic restricted subsidiaries presently consist of all of our domestic subsidiaries that either own restaurants or own subsidiaries that own restaurants. As restricted subsidiaries, each of these guarantors of the 7.5% senior secured notes is subject to all of the terms, conditions and covenants contained in the indenture governing the 7.5% senior secured notes that apply to restricted subsidiaries. The 7.5% senior secured notes are not guaranteed by our foreign subsidiaries due to the tax implications of providing such guarantees, or by our unrestricted subsidiaries, which presently consist of subsidiaries that have no material assets. Our unrestricted subsidiaries are not subject to the terms, conditions or covenants contained in the indenture, and must interact with MRG and our restricted subsidiaries on the same basis as unrelated third parties. From time to time, we may designate other subsidiaries as unrestricted subsidiaries subject to the terms and conditions set forth in the indenture.

The 7.5% senior secured notes and the guarantees are secured by substantially all of our, and our domestic restricted subsidiaries , tangible and intangible assets, as well as by a pledge of a portion of the stock of the subsidiaries owned by us and by our domestic restricted subsidiaries, in each case subject to the prior ranking claims on such assets by the lender under our working capital facility and holders of any capital lease obligations and certain other secured indebtedness. The indenture governing the 7.5% senior secured notes permits us to incur other senior secured indebtedness and to grant liens on our assets under certain circumstances.

We pay interest on the 7.5% senior secured notes semi-annually in cash, in arrears, on January 1 and July 1 at an annual rate of 7.5%. The indenture governing the 7.5% senior secured notes contains various affirmative and negative covenants, subject to a number of important limitations and exceptions, including but not limited to those limiting our ability to incur additional indebtedness or enter into sale and leaseback transactions; pay dividends, redeem stock or make other distributions; issue stock of our subsidiaries; make certain investments or acquisitions; grant liens on assets; enter into transactions with affiliates; merge, consolidate or transfer substantially all of our assets; and transfer and sell assets. Our indenture has a covenant that limits our incurrence of additional indebtedness other than Permitted Indebtedness (defined therein) unless on the date of the incurrence of additional indebtedness our Consolidated Fixed Charge

Coverage Ratio (defined therein) will be, after giving effect to the incurrence thereof and the application of the proceeds thereof, greater than 2.25 to 1.0. The indenture defines Consolidated Fixed Charge Coverage Ratio as the ratio of Consolidated EBITDA to Consolidated Fixed Charges (defined therein).

The indenture governing the 7.5% senior secured notes contains various events of default, including but not limited to those related to non-payment of principal, interest or fees; violations of certain covenants; certain bankruptcy-related events; invalidity of liens; non-payment of certain legal judgments; and cross defaults with certain other indebtedness. As of July 3, 2005, we were in compliance with all of our financial covenants.

We can redeem the 7.5% senior secured notes on or after July 1, 2007, except we may redeem up to 35% of the 7.5% senior secured notes prior to July 1, 2006 with the proceeds of one or more public equity offerings. We are required to redeem the 7.5% senior secured notes under certain circumstances involving changes of control. Additionally, if we or any of our domestic restricted subsidiaries engage in asset sales, we generally must either invest the net cash proceeds from such sales in our business within 360 days, prepay the debt under our working capital facility or certain other secured debt or make an offer to purchase a portion of the 7.5% senior secured notes having an accreted value equal to the excess net cash proceeds.

Working Capital Facility. On July 7, 2003, we entered into a $15.0 million senior secured working capital facility with Wells Fargo Foothill, Inc. Our working capital facility matures on July 7, 2007. Availability under our working capital facility is limited to the lesser of (i) $15.0 million and (ii) the borrowing base amount, in each case, less the sum of (a) the revolving loans then outstanding (including letters of credit) and (b) reserves required by the lender. The borrowing base amount is defined as the lesser of (A) 80% of our twelve-month trailing EBITDA, as determined in accordance with the most recently delivered financial statements, or (B) 25% of our enterprise value, determined to be $168.0 million as of July 7, 2003, and thereafter to be the amount determined by a third party appraiser. We are permitted to repay and reborrow such advances until the maturity date. As of July 3, 2005, we had no borrowings outstanding under our working capital facility. At our option, up to $7.5 million of the facility can consist of one or more letters of credit issued by the lender. As of July 3, 2005, $1.0 million was restricted for letters of credit under our working capital facility. Our working capital facility is guaranteed by all of our domestic restricted subsidiaries and secured by a first priority perfected security interest in all of the collateral securing the 7.5% senior secured notes. Interest will accrue on borrowings under our working capital facility at a floating rate of interest per annum equal to the rate of interest announced from time to time within the lender s principal office in San Francisco as its prime rate plus 1.75%, or a LIBOR-based equivalent thereof. Interest is calculated on the basis of a 360-day year and will be payable monthly for base rate loans and at the end of each interest period for LIBOR loans (but not less frequently than quarterly). Our working capital facility contains certain customary fees, including a closing fee, anniversary fees, servicing fees and pre-payment fees.

Our working capital facility contains various affirmative and negative covenants customary for similar working capital facilities, including but not limited to covenants pertaining to mergers and sales of assets outside the ordinary course of business; use of proceeds; granting of liens; incurrence of indebtedness; restricted payments; voluntary prepayment of indebtedness, including the 7.5% senior secured notes; payment of dividends; business activities; investments and acquisitions; transactions with affiliates; certain restrictions affecting subsidiaries; fundamental changes; and amendments or modifications to instruments governing certain indebtedness. Our working capital facility also requires us to achieve and maintain a twelve-month trailing EBITDA (as defined therein) of not less than $16.0 million. As of July 3, 2005, we were in compliance with all of our financial covenants.

Our working capital facility contains customary events of default, including but not limited to those related to non-payment of principal, interest or fees; violations of certain covenants; change of control;

certain bankruptcy-related events; inaccuracy of representations and warranties in any material respect; and cross defaults with certain other indebtedness and agreements, including without limitation the indenture governing the 7.5% senior secured notes.

CNL Loan. In March 1997, one of our subsidiaries entered into a $2.5 million loan agreement with CNL Financial I, Inc. (CNL). We repaid this loan in February 2005. This loan was scheduled to mature on April 1, 2007 and bore interest at 10.002% per annum. This loan was secured by a security interest in the assets of the Morton s steakhouses located in Chicago (State Street) and Denver (downtown). Principal and interest payments were due monthly over the term of the loan. On January 2, 2005, the outstanding principal balance of the CNL loan was approximately $0.8 million, of which approximately $0.3 million of principal was included in Current portion of obligations to financial institutions in the accompanying consolidated balance sheet.

Mortgages. During 1998 and 1999, certain of our subsidiaries entered into a total of six mortgage loans with GE Capital Franchise Finance aggregating $18.9 million, the proceeds of which were used to fund the purchases of land and construction of restaurants. The loans generally require monthly payments of principal and interest. On July 3, 2005 and January 2, 2005 the aggregate outstanding principal balance due on these loans was approximately $3.6 million and $6.4 million, respectively, of which approximately $0.1 million and $0.2 million, respectively, of principal is included in Current portion of obligations to financial institutions in the accompanying consolidated balance sheets. We repaid one mortgage in May 2003, one in September 2003, two mortgages in April 2004 and one mortgage in February 2005. The remaining mortgage outstanding as of July 3, 2005 bears interest at 8.98% and is scheduled to mature in March 2021.

Restaurant Operating Leases. Our obligations for restaurant operating leases include certain restaurant operating leases for which we, or one of our subsidiaries guarantees, for a portion of the lease term, the performance of the lease by the operating company that is a party thereto.

Contractual Commitments. The following table represents our contractual commitments associated with our debt and other obligations disclosed above as of July 3, 2005:

	Remainder of 2005	2006	2007	2008	2009	Thereafter	Total
				(amounts in thousands)			
7.5% senior secured notes, including interest	$ 3,937	$ 7,875	$ 7,875	$ 7,875	$ 7,875	$ 108,938	$ 144,375
Mortgage loan with GE Capital Franchise Finance, including interest	218	436	436	435	435	4,888	6,848
Subtotal	4,155	8,311	8,311	8,310	8,310	113,826	151,223
Operating leases	9,628	19,181	19,606	19,351	18,857	112,451	199,074
Purchase commitments	17,815						17,815
Construction commitment	149						149
Letters of credit	1,000						1,000
Total	$ 32,747	$ 27,492	$ 27,917	$ 27,661	$ 27,167	$ 226,277	$ 369,261

During the first six months of fiscal 2005, our net investment in fixed assets and related investment costs, including pre-opening costs, approximated $7.8 million. We estimate that we will spend up to approximately $19.0 million in fiscal 2005, including the $7.8 million recorded in the first six months of fiscal 2005, to finance ordinary refurbishment of existing restaurants and capital expenditures for new restaurants, which is expected to be reduced by landlord development allowances of approximately $3.0 million. We anticipate that funds generated through operations and through borrowings under our working capital facility will be sufficient to fund planned expansion. We cannot be sure, however, that this will be the case.

New Accounting Standards

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123(R) requires all stock-based employee compensation to be recorded as an expense in the consolidated statement of operations and that such cost be measured according to the fair value of stock options. SFAS No. 123(R) will be effective the first annual reporting period that begins after June 15, 2005. As the Company already charges stock-based employee compensation expense related to units issued pursuant to employee subscription agreements based on the fair value of such units the adoption of this statement will not have any effect on the Company s consolidated financial statements. See Note 8 to our unaudited consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of non-monetary assets. It eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of Accounting Principles Board (APB) Opinion No. 29 Accounting for Non-monetary Transactions and replaces it with an exception for exchanges that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this statement will not have any effect on the Company s consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51. FIN 46 was subject to significant interpretation by the FASB, and was revised and reissued in December 2003 (FIN 46R). FIN 46R states that if an entity has a controlling financial interest in a variable interest entity, the assets, the liabilities and results of activities of the variable interest entity should be included in the consolidated financial statements to the entity. The adoption of FIN 46 and FIN 46R did not have any effect on the Company s consolidated financial statements, as the Company does not have any special purpose entities and no other arrangements that meet the definition of a variable interest entity which would require consolidation.

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations. FIN 47 clarifies that a conditional asset retirement obligation, as used in SFAS 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of the settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. FIN 47 is effective January 1, 2006, with early adoption allowed. We have not yet determined the impact, if any, FIN 47 will have on the Company s consolidated financial statements.

In June 2005, the FASB issued Emerging Issues Task Force (EITF) 05-06 Determining the Amortization Period for Leasehold Improvements. EITF 05-06 addresses the amortization period for leasehold improvements in operating leases that are either placed in service significantly after and not contemplated at or near the beginning of the initial lease term or acquired in a business combination. The adoption of EITF 05-06 will not have a material effect on the Company s consolidated financial statements.

Forward-Looking Statements

This quarterly report contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements, written, oral or otherwise made, represent the Company s expectation or belief concerning future events. Without limiting the foregoing, the words believes, thinks, anticipates, plans, expects, and similar expressions are intended to identify forward-looking statements. The Company cautions that these statements are further qualified by important economic and competitive factors that could cause actual results to differ materially, or otherwise, from those in the forward-looking statements, including, without limitation, risks of the restaurant industry, including a highly competitive environment and industry with many well-established competitors with greater financial and other resources than the Company, and the impact of changes in consumer tastes, local, regional and national economic and market conditions, restaurant profitability levels, expansion plans, demographic trends, traffic patterns, employee availability and benefits, cost increases, product safety and availability, government regulation and other risks detailed from time to time in the Company s reports filed with the Securities and Exchange Commission. In addition, the Company s ability to expand is dependent upon various factors, such as the availability of attractive sites for new restaurants, the ability to negotiate suitable lease terms, the ability to generate or borrow funds to develop new restaurants and obtain various government permits and licenses and the recruitment and training of skilled management and restaurant employees. Accordingly, such forward-looking statements do not purport to be predictions of future events or circumstances and therefore there can be no assurance that any forward-looking statement contained herein will prove to be accurate. The Company assumes no obligation to update the forward-looking statements.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The inherent risk in market risk sensitive instruments and positions primarily relates to potential losses arising from adverse changes in foreign currency exchange rates and interest rates.

As of July 3, 2005, we owned and operated four international restaurants, one in Hong Kong, one in Singapore, one in Toronto, Canada and one in Vancouver, Canada. As a result, we are subject to risk from changes in foreign exchange rates. These changes result in cumulative translation adjustments, which are included in accumulated other comprehensive income (loss). We do not consider the potential loss resulting from a hypothetical 10% adverse change in quoted foreign currency exchange rates, as of July 3, 2005, to be material.

We also are subject to market risk from exposure to changes in interest rates based on our financing activities. This exposure relates to borrowings under our working capital facility that will be payable at floating rates of interest. Our other indebtedness, our 7.5% senior secured notes and our mortgage, are payable at a fixed rate of interest. As of July 3, 2005, there were no borrowings outstanding under our floating rate working capital facility. As a result, a hypothetical 10% fluctuation in interest rates would not have any impact on earnings for the six month period ended July 3, 2005.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined under the Securities and Exchange Commission rules) was carried out under the supervision and with the participation of the Company s management, including our Chief Executive Officer and Chief Financial Officer. The Company s disclosure controls and procedures are designed to ensure that information that the Company must disclose

in its reports filed under the Securities Exchange Act of 1934 is communicated and processed in a timely manner. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. No significant changes were made in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Part II - Other Information

Item 1. Legal Proceedings

Since August 2002, a number of the Company s current and former employees in New York, Boston and Florida have initiated arbitrations with the American Arbitration Association in their respective states alleging that the Company has violated state (Boston arbitration), state and federal (New York arbitrations) and federal (Florida arbitrations) wage and hour laws regarding the sharing of tips with other employees and failure to pay for all hours worked. There are two group arbitrations pending in Florida. One is proceeding in West Palm Beach as a collective action (hereafter referred to as West Palm Beach arbitration) with approximately thirty claimants. The second is proceeding in Miami as a consolidated action (hereafter Miami arbitration) with approximately six claimants. Potential class members in the West Palm Beach arbitration were sent notices notifying them of the arbitration and advising them if they wish to participate in the arbitration they must sign and return a consent form. In addition, there are two individual demands for arbitration pending in Florida which may ultimately be joined to the Miami arbitration.

In general, the complainants are seeking restitution of tips, the difference between the tip credit wage and the minimum wage, payment for hours worked off the clock (in the Miami arbitration and in the individual Florida arbitrations only), liquidated damages and attorneys fees and costs. The arbitrator in the New York arbitrations has permitted the complainants to consolidate their arbitrations into one action and proceed as a collective action. The Miami claimants are also seeking to consolidate their arbitrations. The arbitrator has ruled that the claims cannot be consolidated but is allowing the case to proceed as a collective action. The Boston arbitrator has ruled that the claimants may proceed as a class, but to date there are only three people in the class and no class has been certified. The Company intends to and is contesting these matters vigorously. Management believes an adverse opinion in any one of these cases would not have a material adverse impact on the Company s financial condition.

In November 2004, current and former employees of the Sacramento Morton s commenced a federal lawsuit asserting individual, representative and class claims against the Sacramento Morton s and several other Morton s restaurants. The plaintiffs asserted claims based on the Company s alleged failure to provide them with meal and rest periods, and for unlawful tip sharing and unfair competition. The plaintiffs seek restitution of tips, meal and break period compensation and attorney s fees. Dismissals with prejudice for all defendants, except the Sacramento Morton s, were granted. The claims against the Sacramento Morton s steakhouse have been move to arbitration.

In May 2005, a former employee of the Boston restaurant filed a nationwide class action complaint in federal court in Massachusetts alleging that the tip out violates the Fair Labor Standards Act. The Company moved to dismiss the complaint and compel arbitration. While the motion was pending, the plaintiff filed a nationwide collective action demand for arbitration with the American Arbitration Association. The demand for arbitration alleges the same facts as the lawsuit filed in federal court. The motion to dismiss is still pending in federal court.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate resolution of these actions will have a material adverse effect on the Company s consolidated financial position, results of operations, liquidity and capital resources.

Item 6. Exhibits

Exhibit No.	**Description**
31.1	Certification of Allen J. Bernstein Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Thomas J. Baldwin Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Allen J. Bernstein Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Thomas J. Baldwin 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, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORTON S RESTAURANT GROUP, INC.
(Registrant)

Date	August 15, 2005	By:	/s/ ALLEN J. BERNSTEIN Allen J. Bernstein Chairman of the Board, President and Chief Executive Officer
Date	August 15, 2005	By:	/s/ THOMAS J. BALDWIN Thomas J. Baldwin Executive Vice President, Chief Financial Officer and Director