ELMERS RESTAURANTS INC
Form 10-Q
September 02, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JULY 19, 2004

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-14837

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

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

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

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section12(g) of the Act:
Common Stock, no par value

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

Number of shares of Common Stock outstanding at September 1, 2004: 1,828,463

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

	July 19, 2
	(Unaudite
ASSETS	
Current assets:	
Cash and cash equivalents	$ 2,0
Marketable securities	7
Accounts receivable	2
Notes receivable - franchisees and related parties, current portion	
Inventories	3
Prepaid expenses and other	4
Income taxes receivable	
Total current assets	4,0
Notes receivable - franchisees and related parties, net of current portion	1
Property, buildings and equipment, net	8,9
Goodwill	4,8
Intangible assets	6
Market value of interest rate swap agreement	
Other assets	2
Total assets	$ 18,8
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Notes payable, current portion	$ 4
Accounts payable	1,3
Accrued expenses	4
Accrued payroll and related taxes	4
Total current liabilities	2,6
Notes payable, net of current portion	4,8
Deferred income taxes	1,3
Obligation under interest rate swap	
Total liabilities	8,8
Commitments and contingencies	
Shareholders' equity	
Common stock, no par value; 10,000,000 shares authorized, 1,816,335 shares issued and outstanding	6,2
Retained earnings	3,7
Accumulated other comprehensive gain, net of taxes	
Total shareholders' equity	9,9

Total liabilities and shareholders' equity	$ 18,8

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

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

	For the sixteen weeks ended	
	July 19, 2004	July 21, 2003
	(Unaudited)	(Unaudited)
REVENUES	$ 9,804,684	$ 10,05
COSTS AND EXPENSES:		
Cost of restaurant sales:		
Food and beverage	2,843,050	3,09
Labor and related costs	3,417,091	3,39
Restaurant operating costs	1,383,053	1,37
Occupancy costs	619,454	63
Depreciation and amortization	267,140	25
General and administrative expenses	731,586	67
(Gain) loss on sale of land, buildings and equipment	(145,303)	
Loss on impairment of equipment	140,000	
	9,256,071	9,44
INCOME FROM OPERATIONS	548,613	61
OTHER INCOME (EXPENSE):		
Interest income	17,798	2
Interest expense	(109,546)	(11
Gain (loss) on sale of marketable securities	1,974	
Income before provision for income taxes	458,839	53
Income tax provision	(147,000)	(16
NET INCOME	$ 311,839	$ 36
PER SHARE DATA:		

Net income per share - Basic	$ 0.17	$
Weighted average number of common shares outstanding - Basic	1,816,335	2,04
Net income per share - Diluted	$ 0.16	$
Weighted average number of common shares outstanding - Diluted	1,947,823	2,13

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

ELMER'S RESTAURANTS, INC., AND SUBSIDIARIES
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock			Accumula comprehe
	Shares	Amount	Retained earnings	(lo
BALANCE, March 29, 2004	1,816,335	$ 6,216,136	$ 3,391,413	$
Comprehensive income:				
Net Income	-	-	311,839	
Change in net unrealized gain (loss) on available for sale securities, net of taxes				
Change in fair market value of interest rate swap agreement, net of taxes				
Total comprehensive income			311,839	
BALANCE, July 19, 2004 (Unaudited)	1,816,335	$ 6,216,136	$ 3,703,252	$

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

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

	F
	JULY 19, 2004
	(Unaudited)
Cash flows from operating activities:	
Net income	$ 3
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	2
(Gain) loss on disposition of equipment	(1
Loss of impairment of equipment	1
Gain on sale of marketable securities	
Changes in assets and liabilities:	
Current assets	
Other assets	(
Accounts payable	(1
Accrued expenses	(
Accrued payroll and related taxes	(2
Income taxes	1
Net cash provided by (used in) operating activities	1
Cash flows from investing activities:	
Additions to property, buildings and equipment	(2
Purchases of available-for-sale securities	(1
Proceeds from sale of available-for-sale securities	3
Principal collected on note receivables	
Proceeds from sale of assets	4
Net cash provided by (used in) investing activities	3
Cash flows from financing activities:	
Issuance of notes payable	
Net change in principal debt service accounts	
Payments on notes payable	(1

Net cash provided by (used in) financing activities	(
Net change in cash and cash equivalents	4
Cash and cash equivalents, beginning of period	1,6
Cash and cash equivalents, end of period	$ 2,0
Supplemental disclosures of cash flow information:	
Cash paid during the period for:	
Interest	$ 1
Income taxes	$
Supplemental disclosures of non-cash transactions:	
Change in unrealized (gain) loss on available-for-sale securities, net of taxes	$ (
Change in fair market value of interest rate swap agreement, net of taxes	$
Note receivable issued for franchise fee receivable	$

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

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim financial statements do not include all the information and footnotes necessary for a fair presentation of financial position and results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. These condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended March 29, 2004. Operating results reflected in the interim consolidated financial statements are not necessarily indicative of the results that may be expected for the year ending April 4, 2005.

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

The Company had comprehensive income of $312,481 for the sixteen weeks ended July 19, 2004. This was composed of net income of $311,839 and an increase in the market value an interest rate swap agreement of $20,429 (net of taxes), which was partially offset by a decline in the market value of available-for-sale securities of $19,787 (net of taxes).

INTEREST RATE SWAP AGREEMENT - In June 2003, and in conjunction with the modification of the Wells Fargo Bank real estate debt agreement discussed below, the Company entered into an interest rate swap agreement with Wells Fargo Bank to reduce the impact of changes in interest rates on its floating rate mortgage. The debt modification and related swap agreement effectively changes the Company's interest rate exposure on the Wells Fargo Bank real estate debt to a fixed percentage of 6.17%. The notional amount of the swap agreement as of July 19, 2004 was $1.0 million. The interest rate swap agreement matures May 24, 2010.

Under the terms of the swap agreement, the Company has committed to paying or receiving interest on the spread between 30-day LIBOR and a fixed rate of 3.92%. If 30-day LIBOR exceeds 3.92%, the Company receives interest income from the bank equal to the spread. If 30-day LIBOR is less than 3.92%, the Company makes interest payments to the bank equal to the spread. The 30-day LIBOR rate is fixed on a monthly basis by the bank.

The swap is inversely correlated to the related hedged long-term debt and is therefore considered an effective cash flow hedge of the underlying long-term debt. The level of effectiveness of the hedge is measured by changes in the fair value of the hedged long-term debt resulting from fluctuations in interest rates. As a matter of policy, the Company does not enter into derivative transactions for trading or speculative purposes.

The interest rate swap agreement qualifies as a cash flow hedge under Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 requires that the fair value of derivative instruments be recorded and changes in the fair value of the derivative instruments be recognized in other comprehensive income. As of July 19, 2004 the fair market value of this agreement was $1,043 and results in the recognition of $20,429 (net of tax effect) in other comprehensive gain during the quarter then ended.

STOCK OPTIONS - SFAS No. 123, Accounting for Stock-Based Compensation, defines a fair value-based method of accounting for employee stock options and similar equity instruments, and encourages all companies to adopt that method of accounting for all of their employee stock compensation plans. It encourages, but does not require, companies to record compensation costs for stock-based employee compensation plans at fair value. The Company has chosen to account for stock-based compensation using the intrinsic value method prescribed in

Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations.

Under SFAS No. 123 no compensation cost has been recognized for the plan. Had compensation cost for the stock-based compensation plan been determined, based on the fair value of options at the date of grant consistent with the provisions of SFAS No. 123, the Company's pro forma net income and pro forma earnings per share would have been as follows:

	July 19, 2004 16 weeks	July 21, 2003 16 weeks
Net income - as reported	$311,839	$363,105
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	9,655	24,435
Net income - pro forma	$302,184	$338,670

Basic earnings per share - as reported	$0.17	$0.18
Diluted earnings per share - as reported	$0.16	$0.17
Basic earnings per share - pro forma	$0.17	$0.17
Diluted earnings per share - pro forma	$0.16	$0.16

As of July 19, 2004 the Company had outstanding option grants for 450,638 shares, of which 327,116 were vested. As of July 21, 2003 the Company had outstanding grants for 459,624 shares with 295,330 shares vested.

GUARANTEES - As a result of the sale of three Elmer's restaurants to Southern Oregon Elmer's LLC (the "Buyer") in May 2002, the Company is a guarantor on Grants Pass and Medford real estate leases until April 2007 and on a Roseburg real estate lease which could extend until 2018 if all options are exercised by the Buyer. The Company is also a guarantor on a franchisee lease in Nampa, Idaho until 2007. The Company is a guarantor of the lease on the Company's recently refranchised Palm Springs location until April 2007 and on a rolling twelve-month basis thereafter until 2020. In all cases, the franchisees have indemnified the Company against all losses incurred as guarantor. In addition, the franchisees' principals and their spouses have personally guaranteed the franchisee's indemnification.

In the event of default by the franchisee, the Company could be required to pay all rent and other payments due under the terms of the leases. As of July 19, 2004, the maximum potential liability under these guarantees is $1,186,069. In the event of default, the Company expects it would exercise its right to reoccupy and continue to operate the restaurants.

SUBSEQUENT EVENTS

Receipt of Going Private Offer

August 6, 2004, the Company announced that it had received a non-binding proposal for a going private transaction from a purchaser group led by Bruce N. Davis, the Company's Chairman of the Board, Chief Executive Officer and President, and consisting of the Company's Board of Directors and 12 additional shareholders. A copy of the proposal was attached to the Press Release dated August 6, 2004 and available in the 8-K filed with the SEC on August 6, 2004. The 8-K is also available on the Company's website www.elmers-restaurants.com.

RECENT TRANSACTIONS

Impairment Loss On Future Store Closing

The Company recognized a $140,000 impairment loss this quarter on the write down of property and equipment with a carrying value of approximately $155,000 to a fair value of $15,000. The loss arises from the anticipated closure of a restaurant when the lease will not be renewed.

Sale of Palm Springs Restaurant

March 30, 2004, the Company refranchised the Company's Elmer's Restaurant in Palm Springs, California. The buyer executed a 25-year franchise agreement and assumed the Company's operating lease obligations. The Company remains a guarantor of the lease until April 2007 and on a rolling twelve-month basis thereafter until 2020. The sales price of $415,000 was received in cash and resulted in a pretax gain of approximately $145,000. Assets sold included prepaids and inventory of approximately $28,000 and equipment of approximately

$242,000.

Franchise Opening

Elmer's newest franchised restaurant opened on March 15, 2004. The 4,500 square foot restaurant in Corvallis, Oregon occupies a converted Lyons restaurant site.

On July 21, 2003 a 5,000 square foot franchise restaurant in Coeur d'Alene, Idaho opened. It occupies a converted Village Inn site.

Lottery Commission

March 31, 2004, the Oregon Lottery Commission approved a new six-year retailer contract effective June 27, 2004. The impact of this contract is discussed further under Revenues on page 12.

RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period after June 15, 2003. The Company's adoption of FASB No. 150 did not have a material effect on the Company's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends and clarifies financial accounting and reporting for derivative instruments including certain derivatives embedded in other contracts. This statement is effective for contracts entered into or modified after June 30, 2003. The Company's adoption of the provisions of this statement did not have a material effect on the Company's consolidated financial statements.

In January 2003, FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. This interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, and requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. This interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate the entities. In December 2003, FASB issued FIN 46R, which made revisions and delayed implementation of certain provisions of FIN 46. As a public entity that is not a "Small Business Issuer," the Company is now required to apply FIN 46R to all unconsolidated variable interest entities no later than March 29, 2004, with the exception of unconsolidated special purpose entities, which had an implementation deadline of December 31, 2003. The Company's adoption of the provisions of this interpretation had no impact on the Company's consolidated financial statements.

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting for Stock-Based Compensation--Transition and Disclosure--an Amendment of FASB Statement No. 123. This statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported

results. The Company's adoption of the provisions of this statement did not have a material impact on the Company's consolidated financial statements.

PART I - FINANCIAL INFORMATION

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

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

The Company franchises or operates a total of 37 full-service, family-oriented restaurants, with a warm, friendly atmosphere and comfortable furnishings. Most of the restaurants are decorated in a home style, with fireplaces in the dining rooms. The restaurants are primarily freestanding buildings, ranging in size from 4,600 to approximately 9,000 square feet with seating capacities ranging from 120 to 220. A portion of the dining room in most restaurants may also be used for private group meetings by closing it off from the public dining areas. The menu offers an extensive selection of items for breakfast, lunch and dinner.

CRITICAL ACCOUNTING POLICIES

The Company's reported results are affected by the application of certain accounting policies that require subjective or complex judgments. These judgments involve estimates that are inherently uncertain and may have a significant impact on our quarterly or annual results of operations and financial condition. Changes in these estimates and judgments could have significant effects on the Company's results of operations and financial condition in future years. We believe the Company's most critical accounting policies cover accounting for long-lived assets - specifically property, buildings and equipment depreciation thereon and the valuation of intangible assets. Additional critical accounting policies govern revenue recognition and accounting for stock options.

Property, Buildings and Equipment

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

Intangible Assets

The Company reviews the valuation of its intangible assets annually based on its third quarter financial statements and assesses for events occurring in the interim indicating possible impairment. If the fair values of the intangibles were less than their recorded values, an impairment loss would be recognized. The fair values of the reporting units are estimated using multiples of earnings

before interest, taxes, depreciation and amortization. The market for these

intangibles is limited and the realizable value will differ from the fair values estimated by using a multiple of earnings.

Depreciation

Property, buildings and equipment are depreciated using the straight-line method over their estimated useful lives. The useful lives of the individual assets are estimated by the Company's management based upon their experience in the restaurant industry. Generally buildings are depreciated over 35 years and equipment is depreciated over a range of 3 to 10 years. Leasehold improvements are amortized on a straight-line method over their estimated useful lives or the term of the related lease, whichever is shorter. Periodically the Company reviews the net book value of its depreciable assets to determine if there is any possible impairment of value. The Company recognized a $140,000 impairment loss on the write down of property and equipment with a carrying value of approximately $155,000 to a fair value of $15,000. Differences between the realized lives and the estimated lives could result in changes to the Company's results from operations in future years as well as changes in the rate of recurring capital expenditures.

Revenue Recognition

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

Stock Options

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

In Section 1 Basis of Presentation, we provide pro forma disclosures of net income and earnings per share as if the method prescribed by SFAS No. 123, Accounting for Stock-Based Compensation, had been applied in measuring compensation expense. A change to recognize compensation expense for all options granted using a fair value approach in regularly reported financial results would have a significant impact on our results of operations.

HIGHLIGHTS OF HISTORICAL RESULTS. The Company reported net income of $311,839 or $.17 per share for the quarter ended July 19, 2004, on sales of $9.8 million as compared to reported net income of $363,105 or $.18 per share on sales of $10.1 million for the first quarter ended July 21, 2003. The Company's total assets at July 19, 2004 were $18.8 million, a decrease of $260,000 from March 29, 2004. During the sixteen weeks ended July 19, 2004, working capital increased $612,000. Cash provided by operating activities totaled $193,000 for the quarter ended July 19, 2004 compared to $511,000 for the quarter ended July 21,2003. The decrease in cash provided from operations is primarily attributable to the timing of payroll tax and worker's compensation insurance payments as well as pay down of negative working capital attributable to the sale of the Palm Springs restaurant. The franchised Pocatello, Idaho restaurant was sold. The franchisee signed a new 25-year franchise agreement at the current 4% franchise fee. The $35,000 initial franchise fee was recorded in the quarter.

COMPARISON OF RESULTS OF OPERATIONS. The following discussion and analysis

presents the Company's results of operations for the 16 weeks ended July 19, 2004 and July 21, 2003.

For the period ended July 19, 2004, the Company's net income and earnings per share decreased 14.1% and 5.6%, respectively, from the comparable period in 2003. Net income as a percentage of total revenue decreased from 3.6% for the period ended July 21, 2003, to 3.2% for the period ended July 19, 2004.

Dollar amounts in thousands except per share data (unaudited)	RESULTS OF OPERATIONS FOR THE SIXTEEN WEEKS ENDED JULY 19, 2004		RESULTS OF O FOR THE SIXTEEN JULY 21,
	Amount	Percent of Revenues	Amount
Revenues	$9,805	100.0%	$10,059
Restaurant costs and expenses	8,530	87.0%	8,765
General and administrative expenses	731	7.5%	671
Loss (Gain) on sale of land buildings and equipment and loss on impairment	(5)	(.1)%	4
Income from operations	549	5.6%	619
Non operating income (expense)	(90)	(.9)%	(88)
Net income	312	3.2%	363
Basic earnings per share	$0.17		$0.18
Weighted average shares outstanding	1,816,335		2,041,728

	REVENUE FOR THE SIXTEEN WEEKS ENDED JULY 19, 2004		REVENUE FOR THE SIXTEEN WEEKS ENDED JULY 21, 2003	
	Amount	Percent of Revenues	Amount	Percent of Revenues
Restaurant operations:				
Restaurant sales	$8,243	84.1%	$8,547	85.0%
Lottery	1,140	11.6%	1,128	11.2%
	9,383	95.7%	9,675	96.2%
Franchise operations	422	4.3%	384	3.8%
Total revenue	$9,805	100.0%	$10,059	100.0%

REVENUES. Revenues for the period ended July 19, 2004 were 2.5% less than for the comparable period in 2003. Revenues from same store restaurant operations were up .2% compared to the sixteen weeks ended July 21, 2003. Same store sales at the Company's Elmer's restaurants were down 1.7%. The Company defines same

store sales as restaurants that were Company owned and operating continuously from April 1, 2003 through July 19, 2004. Revenue from franchise operations increased $38,000 attributable to increases in initial franchise fees as well as increases in royalty income.

March 31, 2004, the Oregon Lottery Commission approved a new six-year retailer contract effective June 27, 2004. If the new commission structure had been applied to sales for the year ended March 29, 2004, it would have reduced commissions by approximately $435,000, or 10%. The following table shows the expected impact by quarter.

Quarter ended :	Adverse impact
July 19, 2004	$93,000
October 11, 2004	250,000
January 3, 2005	96,000
April 4, 2005	(10,000)
July 4, 2005	6,000

The Lottery has installed additional terminals in most Company locations and the Company expects year over year sales increases to reduce, but not eliminate, the impact of the new lower rates. The $93,000 impact in the quarter ended July 19, 2004 was more than offset by increased sales prior to the contracts effective date of June 27, 2004. As a result of timing features of the new contract, most of the adverse impact will be felt in the Company's second quarter ending the second Monday in October.

RESTAURANT COSTS AND EXPENSES. A comparison of restaurant costs and expenses as a percent of revenue for the 16 weeks ended July 19, 2004 and July 21, 2003 are as follows:

	RESTAURANT COSTS AND EXPENSES FOR THE SIXTEEN WEEKS ENDED		RESTAURANT COS FOR THE SIXTE
	JULY 19, 2004		JULY 2
Cost of restaurant sales:			
Food and beverage	$2,843	29.0%	$3,100
Labor and related costs	3,417	34.9%	3,398
Restaurant operating costs	1,383	14.1%	1,379
Occupancy costs	620	6.3%	636
Depreciation and amortization	267	2.7%	252
Restaurant opening and closing expenses	--	--	--
Total cost of restaurant sales	$8,530	87.0%	$8,765

The Company was operating 15 restaurants and 13 delis in 2003 and 2004. Deli operations typically experience higher food costs and lower labor costs as a percentage of sales, than the Company's full service Elmer's and Mitzel's concepts. A decline in revenues from deli operations was principally in low margin products. In spite of decreased revenue, deli gross profits increased 2%. This increase in gross margins accounts for the decline in food and beverage costs of 1.8% and increase in labor costs of 1.1% as a percentage of sales. Food and beverage costs at the Company's Elmer's restaurants increased 0.8% of sales while labor and related costs declined 1.0%

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative ("G&A") expenses

were 7.5% of total revenue for the 16 weeks ended July 19, 2004 compared to 6.7% in the comparable period in 2003. Accounting fees increased $21,000 in the first quarter over the previous year and corporate wages were up $39,000 due to additional marketing and franchise support expenses.

LOSS (GAIN) ON LAND BUILDINGS AND EQUIPMENT. Gain on sale of land, buildings and equipment increased from (.1%) of sales for the quarter ended July 21, 2003 to 0.1% for the current quarter. The Company sold the Palm Springs restaurant to a franchisee for a net gain of approximately $145,000. The Company recognized a $140,000 impairment loss on the write down of property and equipment from a carrying value of approximately $155,000 to a fair value of $15,000. The loss arises from the anticipated closure of a restaurant when the lease will not be renewed.

INCOME FROM OPERATIONS. Income from operations decreased $70,000 to $549,000.

NON-OPERATING INCOME/(EXPENSE). Non-operating expense was 0.9% of total revenues for the 16 weeks ended July 19, 2004 compared to .9% of total revenues in the comparable period in 2003.

LIQUIDITY AND CAPITAL RESOURCES. As of July 19, 2004 the Company had cash and cash equivalents of approximately $2.0 million representing an increase from March 29, 2004 of approximately $461,000. Cash provided by operations was $193,000. Cash provided by investing activities was $311,000, principally from the sale of the Palm Springs restaurant.

The Company's primary liquidity needs arise from debt service on indebtedness, operating lease requirements and the funding of capital expenditures. The Company's primary source of liquidity during the year is the operation of its restaurants, franchise fees earned from its franchisees, cash on hand, and borrowings. As of July 19, 2004, the Company had outstanding indebtedness of $3.8 million with GE Capital and $1.5 million in real estate debt with Wells Fargo Bank.

On January 14, 2004 the Company purchased 204,255 shares of its Common Stock, representing approximately 10% of the then outstanding shares, at a purchase price of $6.43 per share in accordance with the terms of a tender offer. The aggregate price of the shares purchased by the Company through the tender offer was approximately $1,313,000. Fees and expenses associated with the tender offer were approximately $17,000, which was expensed in the Company's 4th Quarter ended March 29, 2004.

The Wells Fargo Bank real estate debt agreement was amended in June 2003 to change the fixed interest rate of 8% to a variable interest rate based on LIBOR. In conjunction with this modification, the Company entered into an interest rate swap agreement, which effectively fixed the interest rate at 6.17%. The mortgages now have a weighted-average maturity of 7.5 years, bear interest at an average of 6.0%, require monthly payments of principal and interest, and are collateralized by three real estate assets. As of July 19, 2004 the fair market value of this agreement was $1,043 and results in the recognition of $20,429 (net of tax effect) in other comprehensive gain.

Certain of the Company's debt agreements require compliance with debt covenants. The most restrictive covenants require the Company to maintain a maximum ratio of total liabilities, excluding subordinated debt, to tangible net worth plus subordinated debt of 3.5 to 1.0, and a ratio of cash generation (defined as net income before taxes, interest expense, depreciation and amortization) to total interest expense plus the prior period current maturities of long-term debt of at least 2.0 to 1.0. Management believes that the Company is in compliance with such requirements.

Elmer's Restaurants, Inc., like most restaurant businesses, is able to operate

with nominal or deficit working capital because sales are for cash and inventory turnover is rapid. Renovation and/or remodeling of existing restaurants is either funded directly from available cash or, in some instances, is financed through outside lenders. Construction or acquisition of new restaurants is generally, although not always, financed by outside lenders.

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

CONTRACTUAL OBLIGATIONS

The Company makes a range of contractual commitments in the ordinary course of business and in conjunction with the acquisition and sale of restaurants. The following table shows the Company's contractual obligations:

		Commitment expiration period		
	Total amount committed	1 year or less	1-3 years	4-5 years
Term debt	$5,288,981	$429,889	$989,336	$1,389,
Operating Leases	4,873,662	1,277,158	1,763,240	1,089,
Guarantees	1,186,069	385,846	729,019	71,
Totals	$11,348,712	$2,092,893	$3,481,595	$2,550,

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS:

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

Market Risks

The Company invests excess cash beyond its working capital requirements in

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

Certain of the Company's outstanding financial instruments are subject to market risks, including interest rate risk. Such financial instruments are not currently subject to foreign currency risk or commodity price risk. A rise in prevailing interest rates could have adverse effects on the Company's financial condition and results of operations. The fair value of financial instruments approximated the book value at July 19, 2004.

ITEM 4. CONTROLS AND PROCEDURES

The Company's President and its Corporate Controller, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c) and 15d-14(c)) as of July 19, 2004 on Form 10-Q (the "Evaluation Date"), have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this quarterly report on Form 10-Q was being prepared.

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

PART II - OTHER INFORMATION

ITEM 5. OTHER INFORMATION

In accordance with amendments adopted on May 21, 1998 to Rule 14a-4 under the Securities and Exchange Act of 1934, if notice of a shareholder proposal to be raised at the annual meeting of shareholders is received at the principal executive offices of the Company after May 15, 2005 (45 days prior to the month and date in 2005 corresponding to the date on which the Company mailed its proxy materials for the 2004 annual meeting), proxy voting on that proposal when and if raised at the 2005 annual meeting will be subject to the discretionary voting authority of the designated proxy holders. Any shareholder proposal to be considered for inclusion in proxy materials for the Company's 2005 annual meeting must be received at the principal executive office of the Company no later than January 21, 2005.

ITEM 6. EXHIBITS AND REPORTS OF FORM 8-K

a) Exhibits:

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

b) Reports on Form 8-K:

June 23, 2004 reporting fiscal year end financial results.

August 6, 2004 reporting going private proposal.

SIGNATURES

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

Elmer's Restaurants, Inc.

By: /s/ BRUCE N. DAVIS

Bruce N. Davis
Chief Executive Officer and President

Dated: September 2, 2004

EXHIBIT INDEX

Exhibit No.	Description	Sequential Page No.
3(i)*	Restated Articles of Incorporation of the Company (Incorporated herein by reference from Exhibit No. 3.1 to the Company's Annual Report on Form 10-K for the year ended March 31, 1988.)	
3(ii)*	By-Laws of the Company, as amended. (Incorporated herein by reference from Exhibit 3.2 of the Company's Annual Report on Form 10-K for the year ended March 31, 1990.)	
31.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Chief Executive Officer and President.	18
31.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Secretary and Corporate Controller.	19
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Chief Executive Officer and President.	20
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Secretary and Corporate Controller.	21