WILD OATS MARKETS INC
Form 10-K/A
May 02, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 3)

(**X**) ANNUAL REPORT PURSUANT TO SECTION 13 OR SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED JANUARY 1, 2005

OR

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

Commission file number 0-21577

WILD OATS MARKETS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**84-1100630**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification Number)

3375 Mitchell Lane

Boulder, Colorado 80301

(Address of principal executive offices, including zip code)

(303) 440-5220

(Registrant's telephone number, including area code)

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

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

-

Title of Each Class

Common Stock, $.001 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 ( )

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2):

Yes (**X**) No ( )

The aggregate market value of the voting and non-voting common stock of the registrant held by non-affiliates of the registrant based on the closing price at which such stock was sold as reported by NASDAQ National Market on June 25, 2004 was approximately $156,871,356. For purposes of this calculation, executive officers, directors and 5% or greater stockholders are deemed to be affiliates of the registrant.

As of February 26, 2005, the registrant had outstanding 28,560,698 shares of common stock, par value $.001 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held on May 17, 2005, have been incorporated by reference into Part III of this report.

EXPLANATORY NOTE

- On March 17, 2005 we filed our Annual Report on Form 10-K for the fiscal year ended January 1, 2005. That filing, pursuant to an extension under Rule 12b-25, only included Items 1, 2, 3, 4, 5, 9, 10, 11, 12, 13 and 14.

- On April 1, 2005, within the 15 day extension period under Rule 12b-25, we filed Amendment No. 1 on Form 10-K/A to include Items 6, 7, 7A, 8 (including our Consolidated Statements of Operations, Comprehensive Income (Loss), Changes in Stockholders' Equity and Cash Flows and related disclosures for the fiscal years 2004, 2003 and 2002, and the Consolidated Balance Sheets and related disclosures for fiscal years ended 2004 and 2003, and the reports of independent registered public accounting firms), 9A, 9B and the principal executive officer and principal financial officer certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and the certifications by the principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- On April 4, 2005 we filed Amendment No. 2 on Form 10-K/A to reflect clerical corrections made to conform Note 2 to the Consolidated Financial Statements, to the Consolidated Statement of Cash Flows for Fiscal Years Ended 2003 and 2002.

- We are filing this Amendment No. 3 on Form 10-K/A to include our independent registered public accounting firm s report on management s assessment of the effectiveness of internal control over financial reporting and on the effectiveness of internal control over financial reporting and to amend Note 16 to the consolidated financial statements, included under Item 8 of Part II and Item 9A of Part II. The amendment to Note 16 provides additional quarterly financial information related to the restatement of our quarterly results for the first three quarters of fiscal 2004 and Item 9A now includes Management s Report on Internal Control over Financial Reporting. Management s and our independent registered public accounting firm s reports on our internal control over financial reporting were previously omitted pursuant to the U. S. Securities and

Exchange Commission s ("SEC") November 30, 2004 Exemptive Order under Section 36 of the Securities Exchange Act of 1934. The required certifications from our Chief Executive Officer and our Chief Financial Officer required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 are attached to this Form 10-K/A as Exhibits 31.1, 31.2, 32.1 and 32.2. This amendment also includes the consents of our independent registered public accounting firms as Exhibits 23.1 and 23.2.

This Amendment No. 3 does not change any information contained in the other items of the Company s Form 10-K/A, Amendment No. 2, as filed on April 4, 2005. This Amendment No. 3 also does not reflect events that have occurred after the filing of the Form 10-K/A, Amendment No. 2.

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Item 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Wild Oats Markets, Inc.:

We have audited the accompanying consolidated balance sheet of Wild Oats Markets, Inc. as of January 1, 2005, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the year ended January 1, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wild Oats Markets, Inc. at January 1, 2005, and the consolidated results of its operations and its cash flows for the year ended January 1, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Denver, Colorado

March 31, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Wild Oats Markets, Inc.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Wild Oats Markets, Inc. and its subsidiaries (the "Company") at December 27, 2003, and the results of their operations and their cash flows for each of the two years in the period ended December 27, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, to the Consolidated Financial Statements, the Company has restated its financial statements as of and for the years ended December 21, 2003 and December 28, 2002.

/s/ PricewaterhouseCoopers LLP

Denver, Colorado

WILD OATS MARKETS, INC

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CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per-share amounts)

FISCAL YEAR	2004	2003	2002
		(as restated, see Note 2)	
Sales	$ 1,048,164	$ 969,204	$ 919,130
Cost of goods sold and occupancy costs	751,314	683,480	643,769
Gross profit	296,850	285,724	275,361
Operating expenses:			
Direct store expenses	235,425	208,908	198,379
Selling, general and administrative expenses	62,454	64,659	55,186
Loss on disposal of assets, net	187	2,087	21
Pre-opening expenses	5,265	3,490	2,737
Restructuring and asset impairment charges (income), net	2,461	(1,259)	(775)
Income (loss) from operations	(8,942)	7,839	19,813
Loss on early extinguishment of debt	-	(186)	-
Interest income	1,070	780	778
Interest expense	(6,309)	(5,746)	(11,855)
Income (loss) before income taxes	(14,181)	2,687	8,736
Income tax expense	25,838	1,094	3,666
Net income (loss)	$ (40,019)	$ 1,593	$ 5,070

Net income (loss) per common share:			
Basic	$ (1.37)	$ 0.05	$ 0.19
Diluted	$ (1.37)	$ 0.05	$ 0.19
Weighted average number of common shares outstanding	29,219	29,851	26,481
Weighted average number of common shares outstanding assuming dilution	29,219	30,258	27,082

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

WILD OATS MARKETS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

FISCAL YEAR	2004	2003	2002
		(as restated, see Note 2)	
Net income (loss)	$ (40,019)	$ 1,593	$ 5,070
Other comprehensive income (loss):			
Foreign currency translation adjustments	681	697	(61)

Unrealized gain/loss on available-for-sale securities	37	-	-
Recognition of hedge results to interest expense during the period, net of tax of $0, $367 and $705, respectively	-	613	1,176
Change in market value of cash flow hedge during the period, net of tax of $0, $12 and $208, respectively	-	(20)	(348)
Other comprehensive income	718	1,290	767
Comprehensive income (loss)	$ (39,301)	$ 2,883	$ 5,837

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

WILD OATS MARKETS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

		2003
FISCAL YEAR ENDED	2004	(as restated, see Note 2)

ASSETS		
Current assets:		
Cash and cash equivalents	$ 30,671	$ 17,400
Short-term investments	11,144	-
Inventories (net of reserves of $815 and $685, respectively)	54,960	46,621
Accounts receivable (net of allowance for doubtful accounts of $153 and $208, respectively)	3,860	4,038
Prepaid expenses and other current assets	5,741	5,438
Deferred tax asset	-	12,795
Total current assets	106,376	86,292
Property and equipment, net	177,830	157,444
Goodwill, net	106,084	106,404
Other intangible assets, net	6,491	6,707
Deposits and other assets	8,361	2,932
Deferred tax asset	418	13,649
	$ 405,560	$ 373,428
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 54,428	$ 50,514
Book overdraft	23,325	26,727
Accrued liabilities	53,154	44,316
Current portion of debt, capital leases and financing obligations	405	293
Total current liabilities	131,312	121,850

Long-term debt, capital leases and financing obligations	148,675	64,042
Other long-term obligations	24,472	25,163
	304,459	211,055
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding		
Common stock; $0.001 par value; 60,000,000 shares authorized; 30,466,701 and 30,063,421 issued; 28,488,901 and 30,063,421 outstanding, respectively	30	30
Treasury stock, at cost: 1,977,800 shares as of January 1, 2005	(24,999)	-
Additional paid-in capital	221,029	217,400
Note receivable, related party	(11,416)	(10,815)
Accumulated deficit	(84,509)	(44,490)
Accumulated other comprehensive income	966	248
Total stockholders' equity	101,101	162,373
	$ 405,560	$ 373,428

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

WILD OATS MARKETS, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share and per-share amounts)

	Common Stock	Treasury Stock	Add'l Paid-In Capital	Note Receivable	(Accum. Deficit)	Accumul Other Co Income(L

	Shares	Amount	Amount				
Balance, December 29, 2001 (previously reported)	24,766,409	$ 25	$ -	$ 160,736	$ (9,660)	$ (42,277)	$ (1
Cumulative prior years adjustment (Note 2)	-	-	-	-	-	(8,876)	
Balance at December 29, 2001 (as restated, see Note 2)	24,766,409	25	-	160,736	(9,660)	(51,153)	(1
Accrued interest on note receivable					(540)		
Issuance of common stock ($7.91 to $11.50 per share), net of issuance costs	4,641,692	4	-	50,327	-	-	
Common stock options exercised ($3.13 to $12.56 per share), including tax benefit	250,559	1	-	2,419	-	-	
Net income (as restated, see Note 2)	-	-	-	-	-	5,070	
Foreign currency translation adjustment	-	-	-	-	-	-	
Recognition of hedge results to interest expense during the period, net of tax	-	-	-	-	-	-	1
Change in market value of cash flow hedge during the period, net of tax	-	-	-	-	-	-	(

Balance at December 28, 2002 (as restated, see Note 2)	29,658,660	30		213,482	(10,200)	(46,083)	(1,
Accrued interest on note receivable					(615)		
Issuance of common stock ($8.77 to $9.11 per share), net of issuance costs.	88,595	-	-	1,186			
Common stock options exercised ($3.13 to $10.86 per share), including tax benefit	316,166		-	2,732			
Net income (as restated, see Note 2)	-	-	-			1,593	
Foreign currency translation adjustment	-	-	-				
Recognition of hedge results to interest expense during the period, net of tax	-	-	-				
Change in market value of cash flow hedge during the period, net of tax	-	-	-				
Balance at December 27, 2003 (as restated, see Note 2)	30,063,421	30	-	217,400	(10,815)	(44,490)	
Accrued interest on note receivable	-	-			(601)		
Issuance of common stock ($9.37 to $10.92 per share), net of issuance costs.	76,676	-		771			
Common stock options exercised ($4.25 to $12.56 per share)	326,604	-		2,858			

Net loss	-	-				(40,019)	
Foreign currency translation adjustment	-	-					
Purchase of outstanding shares	(1,977,800)	-	$ (24,999)				
Unrealized gain on available-for-sale securities	-	-					
Balance at January 1, 2005	28,488,901	$ 30	$ (24,999)	$ 221,029	$ (11,416)	$ (84,509)	$

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

WILD OATS MARKETS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

FISCAL YEAR	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		(as restated, see Note 2)	
Net income (loss)	$ (40,019)	$ 1,593	$ 5,070
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	27,917	27,851	24,653
Loss on disposal of property and equipment	187	2,087	21
Income tax benefit from	-	238	479

employee option exercises			
Deferred tax expense	26,851	295	2,942
Non-cash restructuring and asset impairment charges (income), net	2,461	(1,099)	(824)
Interest on related party note	(601)	(615)	(540)
Stock compensation	710	392	240
Change in assets and liabilities:			
Inventories, net	(8,223)	755	6,886
Receivables, net and other assets	(1,831)	(855)	4,293
Accounts payable	3,844	10,001	(6,869)
Accrued liabilities and other liabilities	5,301	5,743	(1,068)
Net cash provided by operating activities	16,597	46,386	35,283
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(49,105)	(34,062)	(14,169)
Purchase of short-term investments	(26,797)	-	-
Sale of short-term investments	15,653	-	-
Proceeds from sale of property and equipment	1,012	346	229
Net cash used in investing activities	(59,237)	(33,716)	(13,940)

CASH FLOWS FROM FINANCING ACTIVITIES:			
Net repayments under line of credit	(30,179)	(13,800)	(69,200)
Net (decrease) increase in book overdraft	(3,402)	3,949	425
Proceeds from long term debt	115,150	37,879	-
Repayments on notes payable, long-term debt and capitalized leases	(226)	(37,346)	(10,892)
Payment of debt issuance costs	(3,717)	(721)	-
Proceeds from issuance of common stock, net	2,858	3,288	50,822
Repurchase of common stock	(24,999)	-	-
Net cash (used in) provided by financing activities	55,485	(6,751)	(28,845)
Effect of exchange rates on cash	426	114	29
Net (decrease) increase in cash and cash equivalents	13,271	6,033	(7,473)
Cash and cash equivalents at beginning of year	17,400	11,367	18,840
Cash and cash equivalents at end of year	$ 30,671	$ 17,400	$ 11,367
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest, net of amounts capitalized	$ 2,108	$ 3,168	$ 8,549
Cash paid (received) for income taxes	$ 161	$ 67	$ (3,473)

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:	
Stock issued in partial payment of note payable	$ 1,210
Partial settlement of note payable against accounts receivable	$ 200

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

WILD OATS MARKETS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization.

Wild Oats Markets, Inc. ("Wild Oats" or the "Company"), headquartered in Boulder, Colorado, owns and operates natural and organic foods supermarkets in the United States and Canada. The Company also operates bakeries, commissary kitchens, and warehouses that supply the retail stores. The Company's operations are concentrated in one market segment, grocery stores, and are geographically concentrated in the western and central parts of the United States.

Basis of presentation. Certain amounts in the prior years' financial statements have been restated to conform to appropriate accounting guidance related to leases. See Note 2 for further discussion. Certain amounts in the prior years' financial statements have been reclassified to conform to the current year presentation. These reclassifications had no impact on net income (loss) or cash flows.

Principles of consolidation. The Company's consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Fiscal year. The Company reports its financial results on a 52- or 53-week fiscal year ending on the Saturday closest to December 31. Fiscal years for the consolidated financial statements included herein ended on January 1, 2005, December 27, 2003 and December 28, 2002. Fiscal 2004 was a 53-week year, while both fiscal 2003 and fiscal 2002 were 52-week years.

Cash and cash equivalents. The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Financial instruments which potentially subject the Company to concentration of credit risk consist principally of cash and temporary cash investments. At times, cash balances held at financial institutions were in excess of Federal Deposit Insurance Corporation insurance limits. The Company places its temporary cash investments with high-credit quality financial institutions. The Company believes no significant concentration of credit risk exists with respect to these cash investments.

Short-term investments. These are investments made by the Company that mature within one year from the date of purchase. The amortized cost of debt securities are adjusted for amortization of premiums and accretion of discounts to maturity computed under the effective interest method. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in interest income. The cost of securities sold is based on the specific identification method. Income and dividends on securities classified as available-for-sale are included in interest income. Investments classified as available-for-sale are marked to market each reporting period with the unrealized gain or loss reflected as a component of other comprehensive income.

Available-for-sale investments as of January 1, 2005 consist of the following (*in thousands*):

Investment Type	Adjusted Cost	Gross Unrealized Gains	Estimated Fair Value
Mortgage backed securities	$ 7,240	$ 27	$ 7,267
Corporate debt securities	2,490	10	2,500
Other debt securities	4,949	-	4,949

Total available-for-sale investments	$ 14,679	$ 37	$ 14,716

Of the short term investments, $11.1 million are classified as short term investments and the remaining balance is considered cash and cash equivalents because they mature within 90 days. The Company recorded $50,000 in realized gains in interest income during fiscal 2004 on short-term investments reaching maturity.

Inventories. Store inventories are valued principally at the lower of cost or market, with cost primarily determined under the retail method on a first in, first out ("FIFO") basis. FIFO cost is determined using the retail method for approximately 80% of inventories and using the item cost method for highly perishable products representing approximately 20% of inventories. Under the retail inventory method, the valuation of inventories at cost and the resulting gross margins are determined by applying a cost-to-retail ratio for various categories of similar items to the retail value of inventories. Inherent in the retail inventory method calculations are certain management judgments and estimates, including shrinkage, which could impact the ending inventory valuation at cost as well as the resulting gross margins. Certain other highly perishable inventories are valued primarily at the lower of cost or market on a specific item basis, with cost determined on a FIFO basis.

Property and equipment. Property and equipment are recorded at cost and shown net of accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of machinery and equipment (three to 10 years). Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the asset or the appropriate lease term. Eligible internal-use software development costs incurred subsequent to the completion of the preliminary project state are capitalized and amortized over the estimated useful life of the software which is five years. Major renewals and improvements are capitalized, while maintenance and repairs are expensed as incurred. Upon sale or retirement of assets, the cost and related accumulated depreciation or amortization are eliminated from the respective accounts and any resulting gains or losses are reflected in operations. Applicable interest charges incurred during the construction of assets are capitalized as one of the elements of cost and are amortized over the assets' estimated useful lives. All internal direct costs associated with store construction are capitalized. Site specific development costs are capitalized. Development costs related to a potential site subsequently determined to be unfeasible are expensed when the determination is made.

Goodwill. Goodwill consists of the excess cost of acquired companies over the sum of the fair market value of their underlying tangible and identifible intangible assets acquired and liabilities assumed. Prior to 2002, goodwill was recorded at the store-level, and amortized over 40 years. With the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets", the Company allocates goodwill to one reporting unit. It is no longer amortized but is tested for impairment annually, or more frequently, if certain indicators of impairment exist. The Company's annual evaluation for impairment was made during the second quarter of 2004 and 2003, with the result being no impairment. This evaluation requires management to exercise a high degree of judgment in developing assumptions and fair value estimates used in the calculation, which have the potential of significantly impacting the results.

O*ther intangible assets.* Other intangible assets consist primarily of leasehold interests and liquor licenses. Amortization of leasehold interests is computed on a straight-line basis over the appropriate lease term. Certain liquor licenses, purchased at significant expense, in limited issue jurisdictions subject only to minimal renewal costs are not amortized.

Debt issuance costs. Costs related to the issuance of debt are capitalized and amortized to interest expense using the effective interest method over the period the debt is outstanding.

Impairment of long-lived assets. The Company monitors the carrying value of its long-lived assets, including finite lived intangible assets, for potential impairment whenever changes in circumstance indicate a potential for impairment may exist. The triggering events for evaluations of finite lived intangible assets include a significant decrease in the market value of an asset, acquisition and construction costs in excess of budget, or current store operating losses combined with a history of losses or a projection of continuing losses. If an impairment is identified, based on undiscounted future cash flows, the Company compares the asset's future cash flows, discounted to present value using a risk-adjusted discount rate, to its current carrying value and records a provision for impairment as appropriate. With respect to equipment and leasehold improvements associated with closed stores, the value of these assets is adjusted to reflect recoverable values estimated based on the Company's previous efforts to dispose of similar assets, with consideration for current economic conditions.

Restructuring and asset impairment costs. The Company plans to complete store closures or sales within a one-year period following the commitment date. Costs related to store closures and sales are reflected in the income statement as "*Restructuring and Asset Impairment Charges*." For stores the Company intends to sell, the Company actively markets the stores to potential buyers. Stores held for disposal are reduced to their estimated net realizable value. Prior to 2003, when the Company commited to close a store, a lease-related liability was recorded for the present value of the estimated remaining non-cancelable lease payments after the anticipated closing date, net of estimated subtenant income, or for estimated lease settlement costs. The value of equipment and leasehold improvements related to a closed store was reduced to reflect recoverable values based on the Company's previous efforts to dispose of similar assets and current economic conditions. In accordance with the new requirements of SFAS No. 146 (see "*New*

Accounting Pronouncements" later in this note), as of fiscal 2003, the Company recognized such lease related costs at the time of the actual store closing. As of the date of the commitment to close or relocate a store, depreciation of store assets is accelerated over the remaining months of operation as necessary in order to bring their net carrying cost down to net realizable value as of the date of closure.

Severance costs incurred in connection with store closings are recorded when the employees have been identified and notified of the termination benefits to be made to the employees.

Lease-related liabilities and the recoverability of assets to be disposed of are reviewed quarterly, and changes in previous estimates are reflected in operations. Significant cash payments associated with closed stores relate to ongoing payments of rent, common area maintenance, insurance charges, and real property taxes as required under continuing lease obligations.

Leases. The Company is the lessee of land and buildings under long-term operating, capital, and financing leases which include scheduled increases in minimum rents and renewal provisions at the option of the Company. For certain leases, the Company also receives reimbursements from landlords to compensate for costs incurred by the Company in the construction of stores. The lease term used in all lease accounting calculations begins with the date the Company takes possession of the space, and ends on the later of the expiration of the primary lease term or the expiration of any renewal periods that are deemed to be reasonably assured at the inception of the lease. The Company amortizes leasehold improvements and leasehold interests over the shorter of the economic useful life of the asset or the lease term. The expense associated with leases that have rent holidays and escalating payment terms is recognized on a straight-line basis over the lease term. In evaluating the capital versus operating classification of the lease, the Company uses the same lease term defined above in performing the tests required by SFAS No. 13, *Accounting for Leases.* Tenant improvement allowances received from a lessor are recorded as a deferred rent liability and recognized evenly as a reduction to rent expense over the lease term.

Pre-opening expenses. Pre-opening expenses are recognized as incurred and typically include labor, rent, advertising, utilities, supplies and certain other costs incurred prior to a store's opening.

Concentration of risk. In fiscal 2004, the Company purchased 38% of its cost of goods sold from its primary distributor, UNFI. The Company's reliance on this supplier could be shifted, over a period of time, to alternative sources of supply, should such changes be necessary. However, if the Company obtain products from this supplier for factors beyond its control, the Company's operations would be disrupted in the short term while alternative sources of product were secured. The Company's receivables consist primarily of volume discounts and other vendor incentive programs. Write-offs of accounts receivable in the three fiscal years ending January 1, 2005 were $174,000, $136,000 and $435,000 for the three years 2004, 2003 and 2002, respectively. The Company establishes an allowance for doubtful accounts based upon the age of the outstanding receivables and as well as specific facts and circumstances surrounding known collection issues. This allowance is deducted from the related receivables and reflected net in the accompanying financial statements.

Revenue recognition. Revenue for sales of the Company's products is recognized at the point of sale to the retail customer. Revenue from the sale of gift cards is deferred until the card is presented for purchase of goods. Returns are not significant. 97% of the Company's sales are attributable to the United States, and 3% to Canada.

Cost of goods sold and occupancy costs. Cost of goods sold includes all product and shipping costs associated with inventory sold during the period, net of their related vendor rebates, credits, and promotional allowances, and occupancy costs. In accordance with Emerging Issues Task Force ("EITF") Issue No. 02-16, *Accounting By a Customer (Including a Reseller) for Cash Consideration Received from a Vendor*, payments from a vendor other than reimbursements for specific services such as advertising, are accounted for as a reduction of the inventory carrying cost and are recorded in cost of goods sold when the inventory is sold.

Advertising. Advertising is expensed as incurred. Advertising expense was $12.1 million, $14.5 million and $13.3 million for fiscal 2004, fiscal 2003 and fiscal 2002, respectively. These amounts are net of vendor reimbursements received for advertising of $6.8 million, $6.3 million and $5.3 million for fiscal years 2004, 2003, and 2002, respectively

Fair value of financial instruments. The carrying amounts of the Company's financial instruments, including cash and cash equivalents, short term investments, trade receivables and payables, approximate their fair values due to the short-term nature of the instruments. The fair value of the Company's long-term debt approximates its carrying value due to the variable interest rate feature of the instrument. Capital lease obligations approximate fair value, considering the rate at which we present value those obligations have remained consistent over time and our ability to borrow currently approximates that at which we entered into those obligations.

Derivative financial instruments. Prior to August 1, 2003, the Company used an interest rate swap agreement to manage a portion of its interest costs and the risk associated with changing interest rates. As interest rates changed, the differential paid or received was recognized in interest expense of the related period. The interest rate swap was carried at fair value and changes in fair value are reported in other comprehensive income. As of January 1, 2005, the Company had no derivative financial instruments.

Use of estimates. The preparation of these financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign currency translation. The functional currency for the Company's Canadian subsidiary is the Canadian dollar. Translation into U.S. dollars is performed for assets and liabilities at the exchange rate as of the balance sheet date. Income and expense accounts are translated at average exchange rates for the year. Adjustments resulting from the translation are reflected as a separate component of other comprehensive income. Translation adjustments are not tax-effected as they relate to investments that are permanent in nature.

Self-insurance. The Company is self-insured for certain losses relating to worker's compensation claims, general liability and employee medical and dental benefits. The Company has purchased stop-loss coverage in order to limit its exposure to any significant levels of claims. Self-insured losses are accrued based upon the Company's estimates of the aggregate uninsured claims incurred using certain actuarial assumptions followed in the insurance industry and the Company's historical experiences. A high degree of management judgment is required in developing these estimates and assumptions, which have the potential for significantly impacting the required reserve amounts.

Earnings per share. Earnings per share are calculated in accordance with the provisions of SFAS No. 128, *Earnings Per Share*. SFAS No. 128 requires the Company to report both basic earnings per share, which is based on the weighted-average number of common shares outstanding, and diluted earnings per share, which is based on the weighted-average number of common shares outstanding and all dilutive potential common shares outstanding, except where the effect of their inclusion would be antidilutive (i.e., in a loss period). Antidilutive stock options of 591,559, 1,120,319 and 933,935 for the fiscal years ended January 1, 2005, December 27, 2003 and December 28, 2002, respectively, were not included in the earnings per share calculations. The debentures, issued in May 2004, are contingently convertible into shares of common stock unless an irrevocable election to settle the debentures in cash is made by the Company's Board of Directors. The debentures currently are not convertible and are anti-dilutive. They represent 3,790,019 anti-dilutive shares as of January 1, 2005.

A reconciliation of the basic and diluted per-share computations is as follows (*in thousands, except per-share data*):

FISCAL YEAR	2004	2003 (As Restated)	2002 (As Restated)
Basic and diluted earnings per common share computation:			
Net income (loss)	$ (40,019)	$ 1,593	$ 5,070
Net income (loss) per common share:			
Basic	$ (1.37)	$ 0.05	$ 0.19
Diluted	$ (1.37)	$ 0.05	$ 0.19
Weighted average number of common shares outstanding, basic	29,219	29,851	26,481
Incremental shares from assumed conversions:			
Stock options	-	407	601
Weighted average number of common shares outstanding assuming dilution	29,219	30,258	27,082

Income taxes

. The Company provides deferred tax expense or benefit, net of valuation allowances equal to the change in the deferred tax asset during the year in accordance with SAFS No. 109 "Accounting for Income Taxes." Deferred tax represents tax credit carryforwards and future net tax effects resulting from temporary differences between the financial statement and tax basis as assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse, net of tax valuation allowances.

Stock-based compensation. At January 1, 2005, the Company has six stock-based employee compensation plans, which are described more fully in *Note 9 Stock Plans and Options*. The Company accounts for those plans in accordance with the intrinsic value based method in APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Some stock-based employee compensation cost is reflected in net income (loss) for options issued at a discount as Board of Directors compensation. All other options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant; therefore, no other employee compensation cost is reflected in net income. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

FISCAL YEAR	2004	2003 (As Restated)	2002 (As Restated)
Net income (loss), as reported	$ (40,019)	$ 1,593	$ 5,070
Add: Stock-based employee compensation expense included in reported net income (loss), net of tax of $0, $77, and $50, respectively	457	205	133
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax of $0, $975, and $802, respectively	(1,829)	(2,587)	(2,128)
Pro forma net income (loss)	$ (41,391)	$ (789)	$ 3,075
Earnings (loss) per share:			
Basic as reported	$ (1.37)	$ 0.05	$ 0.19
Basic pro forma	$ (1.42)	$ (0.03)	$ 0.12

Diluted	as reported	$ (1.37)	$ 0.05	$ 0.19
Diluted	pro forma	$ (1.42)	$ (0.03)	$ 0.11

Derivatives and hedging activities. In accordance with the Company's interest rate risk-management strategy and as required by the terms of the Company's credit facility at the time, in September 2000, the Company entered into a swap agreement to hedge the interest rate on $32.5 million of its borrowings. The swap agreement expired in August 2003.

The Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, on December 31, 2000. In accordance with the transition provisions of SFAS No.133, as of December 31, 2000, the Company recorded a net-of-tax cumulative loss adjustment to other comprehensive income totaling $631,000 that relates to the fair value of the previously described cash flow hedging relationship in 2003.

On the date that the Company entered into the derivative contract, it designated the derivative as a hedge of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge). The Company does not enter into derivative contracts for trading or non-hedging purposes. The Company's swap agreement was designated as a cash flow hedge and was recognized in the balance sheet at its fair value. Changes in the fair value of the Company's cash flow hedge, to the extent that the hedge was highly effective, was recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction through interest expense. Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows being hedged) was recorded in current period earnings.

The Company's policy is to formally document all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value, cash flow, or foreign currency hedges to (1) specific assets and liabilities on the balance sheet or (2) specific firm commitments or forecasted transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument is no longer appropriate.

New accounting pronouncements. In March of 2004, the FASB approved the consensus reached on the EITF 03-1, "The Meaning of Other-than-Temporary Impairment and Its Application to Certain Investments." The Issue's objective is to provide guidance for identifying other-than-temporarily impaired investments. EITF 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. In September of 2004, the FASB issued a FASB Staff Position (FSP) EITF 03-1-1 that delays the effective date of the measurement and recognition guidance in EITF 03-1 until further notice. The disclosure requirements of EITF 03-1 are effective with this report for fiscal 2004. The Company does not have any investments that it believes are impaired on an other than temporary basis.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment." SFAS No. 123 (revised 2004) is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." The new standard, which will be effective for the Company beginning in the third quarter of 2005, establishes accounting standards for transactions in which an entity exchanges its equity instruments for goods or services, including stock option and restricted stock grants. The Company is evaluating the impact on its results from adopting SFAS No. 123 (revised 2004), but expects it to be comparable to the pro forma effects of applying the original SFAS No. 123 as disclosed in Note 1 and Note 10.

During October of 2004, the American Jobs Creation Act of 2004 ("Jobs Act") was signed into law. The Jobs Act provides certain domestic companies a temporary opportunity to repatriate previously undistributed earnings of controlled foreign subsidiaries at a reduced federal tax rate, approximating 5.25%. The reduced rate is achieved via an 85% dividends received deduction on earnings repatriated during a one-year period. Accounting and disclosure guidance was provided in December 2004 in FASB Staff Position No. SFAS No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004." The Company is in the process of evaluating whether it will repatriate foreign earnings under the repatriation provisions of the Jobs Act, and if so, the amount that will be repatriated, and the Company's policy on tax effecting cumulative translation adjustment.

During November of 2004, the FASB issued SFAS No. 151, "Inventory Costs an amendment of ARB No. 43, Chapter 4." SFAS No. 151 requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) to be recognized as current-period charges. It also requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred beginning with fiscal 2006. The Company believes that SFAS No. 151 will not have a material effect on its financial position or results of operations.

2. Restatement of Financial Statements

On February 7, 2005, the Office of the Chief Accountant of the SEC issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain lease accounting issues and their application under generally accepted accounting principles ("GAAP") in the United States of America. In light of this letter, the Company's management initiated a review of its lease accounting and determined that its accounting for (1) amortization of leasehold improvements and leasehold interests, (2) straight-line rent expense, (3) landlord incentives and allowances, (4) sale leaseback transactions, and (5) classification of leases as capital or operating in accordance with FAS 13 were not consistent with GAAP. As a result, the Company has restated its consolidated financial statements for the fiscal years ended December 27, 2003 and December 28, 2002 that appear in this Report.

The Company had previously followed an accounting policy to assess the treatment of leases as operating versus capital under the provisions of SFAS No. 13, "Accounting for Leases" using the initial lease term while utilizing the initial lease term plus available extensions for amortizing leasehold improvements, or the economic useful life of the leasehold improvements, whichever was shorter. Management determined that the appropriate interpretation of SFAS No. 13 requires a use of the same assumptions as to duration and thus the Company reassessed each lease it has been making payments on at any time during the last five years for capital or operating treatment using the initial term plus available extensions. As a result of this analysis, the Company has determined that six leases previously accounted for as operating leases should have been treated as capital. In addition, the Company had incorrectly accounted for two sale leaseback transactions as sales versus financing. Due to continuing involvement in the properties by the Company at the sale leaseback date, sales accounting is precluded. Also, the amortizable lives of all leasehold improvements have been reduced to the shorter of the appropriate lease term or their useful lives. These adjustments result in the capitalization of the leased assets and creation of associated debt on the consolidated balance sheets for the present value of the future minimum lease payments of leases considered capital or financing, while the increase in amortization of the leasehold improvements results in an increase in the "Cost of goods sold and occupancy costs" in the consolidated statements of operations. Therefore, interest expense on those considered capital is reflected in the "Interest Expense" line item. Further discussion of the capital and financing lease obligations is in Notes 6 and 11 of these consolidated financial statements.

The Company had historically accounted for tenant improvement allowances as reductions to the related leasehold improvement asset on the consolidated balance sheets and capital expenditures in investing activities on the consolidated statements of cash flows. Management determined that the appropriate interpretation of FASB Technical bulletin No. 88-1, "Issues Relating to Accounting for Leases," requires these allowances to be recorded as deferred rent liabilites on the consolidated balance sheets and the related amortization as a component of operating activities on the consolidated statements of cash flows. Additionally, this adjustment results in an increase in depreciation expense and a decrease in rent expense, both of which are within the "Cost of goods sold and occupancy costs" in the consolidated statements of operations.

The Company had historically recognized rent holiday periods and escalating rent payments on a straight-line basis over the original lease term commencing with the initial occupancy date. The store opening date coincided with the commencement of business operations, which is the intended use of the property. Management re-evaluated FASB Technical Bulletin No. 85-3, "Accounting for Operating Leases with Scheduled Rent Increases," and determined that the lease term should commence on the date the Company takes possession of the leased space for construction purposes or was legally allowed access to the space, which is generally two to six months prior to a store opening date. Excluding tax impacts, the correction of the accounting requires the Company to record additional deferred rent in "Accrued liabilities" and "Other long-term obligations" and to adjust "Accumulated deficit" on the consolidated balance sheets as well as to correct amortization in "Costs of sales including occupancy costs" and "Pre-opening expenses" on the consolidated statements of operations for each of the two years in the period ended December 27, 2003.

The cumulative effect of these accounting changes is an increase to accumulated deficit of $8.9 million as of the beginning of fiscal 2002 and a decrease to net income of $1.8 million and $2.0 million for the fiscal years ended 2002 and 2003, respectively.

Following is a summary of the effects of these changes on the Company's Consolidated Statements of Operations for fiscal years 2003 and 2002, Consolidated Balance Sheets as of December 27, 2003, as well as the effects of these changes on the Company's consolidated statements of cash flows for fiscal years 2003 and 2002 (*in thousands, except share data*):

	Consolidated Statement of Operation		
Fiscal Year Ended December 27, 2003	As Previously Reported	Adjustments	As Restated
Cost of goods sold and occupancy costs	$ 683,592	$ (112)	$ 683,480
Gross profit	$ 285,612	$ 112	$ 285,724
Pre-opening expense	$ 2,890	$ 600	$ 3,490
Restructuring and asset impairment income	$ (892)	$ (367)	$ (1,259)
Income from operations	$ 7,960	$ (121)	$ 7,839

Interest expense	$ (2,661)	$ (3,085)	$ (5,746)
Income before income taxes	$ 5,893	$ (3,206)	$ 2,687
Income tax expense	$ 2,302	$ (1,208)	$ 1,094
Net income	$ 3,591	$ (1,998)	$ 1,593
Net income per common share-basic	$ 0.12	$ (0.07)	$ 0.05
Net income per common share - diluted	$ 0.12	$ (0.07)	$ 0.05

	Consolidated Statement of Operation		
Fiscal Year Ended December 28, 2002	As Previously Reported	Adjustments	As Restated
Cost of goods sold and occupancy costs	$ 644,862	$ (1,093)	$ 643,769
Gross profit	$ 274,268	$ 1,093	$ 275,361
Pre-opening expense	$ 1,897	$ 840	$ 2,737
Restructuring and asset impairment income	$ (832)	$ 57	$ (775)
Income from operations	$ 19,617	$ 196	$ 19,813
Interest expense	$ (8,753)	$ (3,102)	$ (11,855)
Income before income taxes	$ 11,642	$ (2,906)	$ 8,736
Income tax expense	$ 4,733	$ (1,067)	$ 3,666
Net income	$ 6,909	$ (1,839)	$ 5,070

Net income per common share-basic	$ 0.26	$ (0.07)	$ 0.19
Net income per common share - diluted	$ 0.26	$ (0.07)	$ 0.19

	Consolidated Balance Sheet		
Fiscal Year Ended December 27, 2003	As Previously Reported	Adjustments	As Restated
Deferred tax asset	$ 18,778	$ 7,666	$ 26,444
Property, plant and equipment, net	$ 130,989	$ 26,455	$ 157,444
Other intangibles	$ 6,976	$ (269)	$ 6,707
Total Assets	$ 339,576	$ 33,852	$ 373,428
Accrued liabilities	$ 42,998	$ 1,318	$ 44,316
Current portion of debt and capital leases	$ 14	$ 279	$ 293
Long-term debt and capital leases	$ 30,179	$ 33,863	$ 64,042
Other long-term liabilities	$ 14,058	$ 11,105	$ 25,163
Accumulated deficit	$ (31,777)	$ (12,713)	$ (44,490)
Total stockholders' equity	$ 175,086	$ (12,713)	$ 162,373
Total liabilities and shareholder's equity	$ 339,576	$ 33,852	$ 373,428

	Consolidated Statements of Cash Flows		
Fiscal Year Ended December 27, 2003	As Previously Reported	Adjustments	As Restated
Net cash provided by operating activities	$ 43,816	$ 2,510	$ 46,386
Net cash (used by) investing activities	$ (31,385)	$ (2,331)	$ (33,716)
Net cash (used in) financing activities	$ (6,512)	$ (239)	$ (6,751)

	Consolidated Statements of Cash Flows		
Fiscal Year Ended December 28, 2002	As Previously Reported	Adjustments	As Restated
Net cash provided by operating activities	$ 34,698	$ 585	$ 35,283
Net cash used by investing activities	$ (13,449)	$ (491)	$ (13,940)
Net cash (used in) financing activities	$ (28,751)	$ (94)	$ (28,845)

Additionally, the Company has determined that an error existed in its unaudited quarterly results for the quarters ended June 29, 2003 and December 27, 2003 as it relates to the accounting for litigation and lease obligations for a closed location. A description of the error and the resulting restated quarterly financial results are included in Note 16.

3. Property and Equipment

Property and equipment consist of the following (*in thousands*):

FISCAL YEAR ENDED	2004	2003 (As Restated)
Machinery and equipment	$ 125,592	$ 103,014
Buildings and leasehold improvements	156,829	144,125
Software	5,541	3,390
Construction in progress	14,283	16,880
	302,245	267,409
Less accumulated depreciation	(124,415)	(109,965)
	$ 177,830	$ 157,444

Depreciation expense related to property and equipment totaled approximately $27.8 million, $27.3 million and $24.3 million in fiscal 2004, fiscal 2003 and fiscal 2002, respectively. Property and equipment includes approximately $424,000, $439,000 and $129,000 of interest capitalized during the fiscal years 2004, 2003 and 2002, respectively. The amounts shown above include, for each year presented, $20.5 million of primarily buildings and leasehold improvements which are accounted for as capital and financing leases, and which have accumulated amortization of $5.5 million and $4.8 million at January 1, 2005 and December 27, 2003, respectively. Increases in construction related accounts payable of $2.9 million and $2.7 million for 2004 and 2003, respectively, are excluded from the statement of cash flows as non-cash items.

As a result of anticipated store closures, the Company accelerated depreciation of its in-store assets $4.0 million and $3.8 million for the fiscal years ended 2004 and 2003, respectively.

4. Goodwill and Other Intangible Assets

Goodwill consists of the following (*in thousands*):

FISCAL YEAR ENDED	2004	2003 (As Restated)
Goodwill	$117,042	$ 117,394
Less accumulated amortization	(10,958)	(10,990)
	$106,084	$ 106,404

Amortization expense related to goodwill was $0 for fiscal years 2004, 2003 and 2002, respectively. In January 2004, the Company sold a retail store located in New York City that did not fit the Company's real estate strategy or format for $900,000 in cash. Goodwill net of accumulated amortization associated with this store of $320,000 was written off and included in the calculation of the gain on disposal of this business. No other changes in the carrying amount of goodwill occurred.

Other intangible assets include the following (*in thousands*):

FISCAL YEAR ENDED	2004	2003 (As Restated)
Leasehold interests and other (amortizable)	$ 8,319	$ 8,326
Less accumulated amortization	(2,049)	(1,790)
Leasehold interests, net	6,270	6,536
Liquor licenses (indefinite lived)	221	171
	$ 6,491	$ 6,707

Amortization expense related to finite lived intangible assets was $259,000, $194,000 and $188,000 in fiscal 2004, fiscal 2003 and fiscal 2002, respectively.

The estimated amortization of finite lived intangible assets for each of the five fiscal years ending in fiscal 2009 is as follows (*in thousands*):

Fiscal Year	Amortization Expense

2005	$ 410
2006	$ 381
2007	$ 381
2008	$ 381
2009	$ 381

5. Accrued Liabilities

Accrued liabilities consist of the following (*in thousands*):

FISCAL YEAR ENDED	2004	2003 (As Restated)
Wages and employee costs	$ 20,979	$ 18,418
Self insurance liabilities	14,123	7,696
Sales and personal property taxes	4,598	4,397
Real estate costs	8,447	7,472
Deferred charges and other accruals	5,007	6,333
	$ 53,154	$ 44,316

6. Long Term Debt

Long-term debt and capital leases outstanding consists of the following (*in thousands*):

FISCAL YEAR	2004	2003 (As Restated)
Capital leases	$ 20,225	$ 20,204
Financing lease obligations	13,705	13,952
Bank line of credit due February 26, 2006, bearing interest at one month LIBOR plus 2.75% (5.17 at January 1, 2005)	-	30,179
Contingent convertible senior debentures due May 15, 2034, bearing interest at an annual rate of 3.25% issued at a premium	115,150	-
	149,080	64,335
Less current portion	(405)	(293)
	$ 148,675	$ 64,042

The maturities of long-term debt, financing lease obligations, and capital leases are as follows (*in thousands*):

Fiscal Year	Maturities

2005	$ 405
2006	441
2007	385
2008	409
2009 and thereafter	147,440
Total	$ 149,080

Financing Lease Obligations (Restated). The Company previously owned retail space in two separate locations which it subsequently sold and leased back from the buyers in fiscal 1999. The lease term for both leases is 25 years with four five-year optional renewal periods. The Company is and has been operating a retail store in each location and has been subleasing or attempting to sublease a substantial portion of the leased space to other parties. Since the subleasing activity for these locations is considered to be more than minor, the Company is prevented from applying normal sale leaseback accounting treatment in accordance with SFAS No. 98, "Accounting for Leases". As a result, the original cost basis of the properties remains on the balance sheet and continues to be depreciated. The proceeds received in connection with the sales of the properties have been recorded as financing leases obligations with interest expense calculated using the effective interest method.

Contingent convertible senior debentures. In June 2004, the Company issued $115 million aggregate principal amount of its 3.25% Convertible Senior Debentures due May 15, 2034 in a private placement. The debentures bear regular interest at the annual rate of 3.25%, payable semiannually on May 15 and November 15 of each year until May 15, 2011, after which date, no regular interest will be due. Commencing May 20, 2011 and ending November 14, 2011, and for any six-month period thereafter, contingent interest will be due and payable in the amount of 0.25% of the average trading price of the debentures during a specified period, if the average trading price of the debentures equals or exceeds 125% of the principal amount of the debentures. Refer to Note 1 for the potentially dilutive impact of the convertible debentures on future periods.

The debentures are callable and convertible into the Company's common stock prior to maturity at the option of the holders under the following circumstances: (1) during any calendar quarter commencing after June 30, 2004 and before March 31, 2029, if the last reported sale price of our common stock is greater than or equal to 130% of the conversion price of $17.70 per share; (2) at any time on or after April 1, 2029 if the last reported sale price of our common stock on any date on or after March 31, 2029 is greater than or equal to 130% of the conversion price;

(3) subject to certain limitations, during the five business-day period after any five consecutive trading-day period in which the trading price per debenture for each day of that period was less than 98% of the product of the conversion rate and the last reported sale price of the Company's common stock; (4) if the Company calls the debentures for redemption; (5) upon the occurrence of certain corporate transactions; or (6) if the Company obtains credit ratings for the debentures, at any time when the credit ratings assigned to the debentures are below specified levels. The debentures are initially convertible into 56.5099 shares of the Company's common stock per $1,000 principal amount, which is equivalent to $17.70 per share, for total initial underlying shares of 6,498,639. The conversion rate will be subject to adjustment upon the occurrence of specified events. Upon conversion, the Company has the right to deliver, in lieu of common stock, cash or any combination of cash and common stock. Pursuant to the underwriting agreement and within 90 days of issuance, the Company was to file a shelf registration statement covering resales of the debentures and the common stock issuable upon conversion thereof.

On or after May 20, 2011, the Company may redeem for cash some or all of the debentures at any time and from time to time, for a price equal to 100% of the principal amount of the debentures plus accrued and unpaid contingent interest, if any. Holders have the right to require the Company to repurchase any or all debentures for cash, at a repurchase price equal to 100% of the principal amount of the debentures, plus accrued and unpaid interest on: (1) May 15, 2011, May 15, 2014, and May 15, 2024; and (2) the occurrence of change in control (as defined in the debenture).

The debentures are unsecured and un-subordinated obligations, and rank equal in priority with all of the Company's existing and future unsecured and un-subordinated indebtedness and senior in right of payment to all of its subordinated indebtedness. The debentures will effectively rank junior to any of the Company's secured indebtedness and any of its indebtedness that is guaranteed by its subsidiaries. Payment of principal and interest on the debentures will be structurally subordinated to the liabilities of the Company's subsidiaries.

There are no financial covenants within the debenture agreement, however, the Company will be paying penalty interest of 0.25% for the first 90 days of 2005 and 0.50% thereafter until the resale of the debentures are publicly registered.

Total proceeds from the issuance were $115.2 million. The Company used $25.0 million of the net proceeds to repurchase 1,977,800 outstanding shares of its common stock, $31.2 million to pay the outstanding balance on its credit facility, and approximately $3.7 million to pay related debt issuance costs.

Credit facility. The Company's credit facility has a $95.0 million limit, and a three-year term with a one-year renewal option. Under the credit facility, the Company has the option to increase the total facility to $135.0 million through the addition of new lenders and through the agreement of the current lending group to increase their total commitments.

The interest rate on the facility is currently either prime plus 1.25% or one-month LIBOR plus 2.75% at the Company's election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on the Company's quarterly compliance certificate. Additionally, the Company is charged a commitment fee on the unused portion of the line ranging from 0.625% to 0.75% based on performance objectives as defined in the credit agreement. The outstanding balance on the credit facility, other than for outstanding letters of credit, was repaid in June 2004 from the proceeds of the private debt issuance. There is no outstanding credit facility balance as of January 1, 2005. The balance outstanding, other than outstanding letters of credit, on the credit facility as of December 27, 2003 was $30.2 million. See Note 20 - Subsequent Event.

Through February 26, 2003, the Company had a $125.0 million credit facility under which borrowing was limited to $115.0 million. The facility had two separate lines of credit, a revolving line of up to $86.2 million and a term loan of up to $28.8 million, each with a three-year term expiring on August 1, 2003. The interest rate on the facility was initially either prime plus 2.25% or one-month LIBOR plus 3.75% at the Company's election, and the rates increased by 0.5% starting January 1, 2002 and each six months thereafter through January 2003. In February 2003, the Company refinanced its credit facility and reduced the total amount of the facility to a revolving line of $75.0 million with a three-year term expiring February 26, 2006, and a one-year renewal at the parties' option. The amount of the line was increased to $95 million effective December 12, 2003. The interest rate on the facility is currently either prime plus 1.25% or one-month LIBOR plus 2.75% at the Company's election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on our quarterly compliance certificate. Additionally, the Company was charged a commitment fee on the unused portion of the line ranging from 0.25% to 0.5% based on performance objectives as defined in the credit agreement. The line of credit has certain financial covenants, including restrictions on the payment of dividends, and is collateralized by the Company's cash, fixed assets, equipment and leasehold mortgages in certain of its leases. In conjunction with the debt refinancing, the Company incurred a non-cash charge of approximately $186,000 to write off the remaining unamortized debt issuance cost from its prior credit facility and capitalized debt issuance costs of approximately $721,000 in the first quarter of fiscal 2003, to be amortized over the life of the agreement using the effective interest method.

As part of the credit facility, the Company has given its lenders collateral in the form of cash, equipment and fixtures, inventory and other assets. The Company has also granted leasehold mortgages in those leasehold interests previously mortgaged to secure its former credit facility, although it has no obligation to provide a security interest in any new leaseholds. There are various financial covenants included as part of the original credit agreement which are as follows: (1) maximum allowable leverage ratio, (2) minimum fixed charge coverage ratio, (3) maximum allowable annual capital expenditures and (4) a minimum permitted stockholders' equity balance. Amendments to the credit agreement have been made during 2004 to (a) modify the adjusted leverage and the fixed charge ratios, (b) increase the maximum interest rate, and (c) require the Company to maintain through June 2005 minimum cash and cash equivalents balances (as defined per the agreement) of $25 million, net of letters of credit and outstanding borrowings under the credit facility, with the minimum required balances decreasing to $10 million beginning July 2005 and continuing through the remaining term of the agreement. The Company is obligated to comply with the following: an adjusted leverage ratio (as described above); a fixed charge coverage ratio, which is the ratio of EBITDAR for the last four fiscal quarters minus certain maintenance capital expenditures and taxes to fixed charges for the four fiscal quarters; a minimum stockholders' equity of $125 million plus a portion of cumulative net income, adjusted for stock issuances and repurchase; a limitation on new leases per fiscal year; a cap on capital expenditures per fiscal year, and a minimum cash balance as of each compliance period.

The interest rate on the facility is currently either prime plus 1.0% or one-month LIBOR plus 2.75% at the Company's election, and the rates modify depending on the ratio of average total funded debt, as defined under the credit facility, plus six times rent expense, to EBITDAR for the four fiscal quarter periods then ended, as calculated on the Company's quarterly compliance certificate. Additionally, the Company is charged a commitment fee on the unused portion of the line ranging from 0.625% to 0.75% based on performance objectives as defined in the credit agreement. The outstanding balance on the credit facility, other than for outstanding letters of credit, was repaid in June 2004 from the proceeds of the private debt issuance. There is no outstanding credit facility balance as of January 1, 2005. As the Company's new store growth accelerates, it expects its cash requirements for 2005 will be satisfied from the proceeds of the private debenture issuance as well as cash generated from operations.

Due to the restatement discussed in Note 2 to these Consolidated Financial Statements, for the period ended January 1, 2005, the Company has violated three of the financial covenants to the credit facility. The Company has obtained a waiver of compliance from the requisite lenders under our credit facility. Even if the Company was in compliance with its monetary covenants, a technical default could result due to a breach of the financial covenants. In the absence of a waiver or amendment to such financial covenants, such non-compliance would constitute a default under the credit agreement, and the lenders would be entitled to accelerate the maturity of the indebtedness outstanding thereunder. However, there can be no assurance that future amendments or waivers will be obtained.

In September 2000, as required by the Company's former credit facility, the Company entered into an interest rate swap to hedge its exposure on variable rate debt positions. Variable rates were predominantly linked to LIBOR as determined by one-month intervals. The interest rate provided by the swap fixed one-month LIBOR at 6.7%. The interest rate swap agreement expired in August 2003. There is no obligation to renew the swap under the refinanced facility. The notional amount is the amount used for the calculation of interest payments that are exchanged over the life of the swap transaction on the amortized principal balance.

7. Income Taxes

Income (loss) before income taxes consists of the following (in thousands):

		2003	2002
FISCAL YEAR	2004	(As Restated)	
Domestic	$ (15,388)	$ 2,005	$ 8,906

Foreign	1,207	682	(170)
	$ (14,181)	$ 2,687	$ 8,736

Income tax expense (benefit) consists of the following (in thousands):

		2003	2002
FISCAL YEAR	2004	(As Restated)	
Current:			
Federal	$ -	$ 294	$ -
State and foreign	247	505	$ 677
	247	799	677
Deferred:			
Federal	23,498	(86)	3,434
State and foreign	2,093	381	(445)
	25,591	295	2,989
	$ 25,838	$ 1,094	$ 3,666

The differences between the U.S. federal statutory income tax rate and the Company's effective tax rate are as follows:

		2003	2002
FISCAL YEAR	2004	(As Restated)	
Statutory tax rate	(35.0)%	35.0%	35.0%
State income taxes, net of federal income tax expense and valuation allowance	(2.8)	2.7	3.6
Foreign income taxes	0.3	-	3.6
Expired tax attributes	1.7	1.8	-
Valuation allowance	216.1	-	-
Other, net	1.9	1.2	(0.2)
Effective tax rate	182.2%	40.7%	42.0%

The effective tax rate for the fiscal years ended January 1, 2005 was 182.2% as compared to 40.7% for fiscal 2003 and 42.0% for fiscal 2002. The Company recorded no reversals of its valuation allowance in the years ending 2004, 2003 and 2002, respectively.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows (in thousands):

		2003
FISCAL YEAR	2004	(As Restated)

Deferred tax assets:		
Inventory-related	$ 309	$ 248
Vacation accrual	2,659	2,657
Real estate accruals	12,127	10,516
Net operating loss carry-forward	20,376	17,139
Contribution and credit carry-forward	2,429	1,910
Mark-to-market swap accrual	-	-
Worker's compensation	2,720	1,501
Other	2,128	580
Valuation allowance	(33,800)	(2,202)
Total deferred tax assets	8,948	32,349
Deferred tax liabilities:		
Property-related	(7,282)	(5,905)
Mark-to-market of short-term investments	(14)	-
Convertible debt	(1,234)	-
Total deferred tax liabilities	(8,530)	(5,905)
Net deferred tax asset	$ 418	$ 26,444

During fiscal 2004, fiscal 2003 and fiscal 2002, the Company recognized $0, $238,000 and $479,000, respectively, as a tax benefit directly to additional paid-in-capital related to non-compensatory stock plans. If the valuation allowance provided for is utilized in future periods, $1.0 million of it would not offset income tax expense as it represents amounts taken directly to additonal paid in capital.

As of January 1, 2005, the Company has net operating losses related to the following tax jurisdictions and expiration periods that are available to offset future taxable income: U.S. federal income tax loss carryforwards of approximately $35.5 million begin to expire in 2021; various state income tax loss carryforwards of approximately $11.4 million begin to expire in 2005.

The Company performs assessments of the realization of its net deferred tax assets considering all available evidence, both positive and negative. As a result of this assessment, the Company concluded that it was more likely than not that its net tax assets would not be realized and therefore established a valuation allowance against its net deferred tax assets for the year ended January 1, 2005. The valuation allowance was recorded as a result of the Company's analysis of the facts and circumstances, including an evaluation of its pre-tax income and losses for historical periods, which led the Company to conclude that it could no longer forecast taxable income utilizing the more likely than not theory present in SFAS No. 109.

8. Capital Stock

Authorized preferred stock consists of 5,000,000 shares of which none was outstanding during 2004, 2003 or 2002. Authorized common stock consists of 60,000,000 shares at $0.001 par value. Common stock outstanding at year end 2004 was 28.5 million (net of 2.0 million shares of treasury stock). As of January 1, 2005, total common shares reserved for issuance under the Company's six stock-based employee compensation plans described in Note 9 was 6,236,851.

In September 2002, the Company raised net proceeds of $48.3 million in an offering of the Company's equity securities to provide additional liquidity. The Company filed a registration statement on Form S-3 to register 3.25 million shares of the Company's common stock in connection with such placement, the balance consisting of 1.2 million shares having been previously registered by the Company. In June 2004, the Company issued $115 million aggregate principal amount of its 3.25% Convertible Senior Debentures due May 15, 2034 in a private placement. The debentures are callable and convertible into the Company's common stock prior to maturity at the option of the holders. The debentures are initially convertible into 56.5099 shares of the Company's common stock per $1,000 principal amount, which is equivalent to $17.70 per share, for total initial underlying shares of 6,479,175. Upon conversion, the Company has the right to deliver, in lieu of common stock, cash or any combination of cash and common stock. The Company filed a shelf registration statement covering resales of the debentures and the common stock issuable upon conversion thereof in August 2004, and is currently in the review phase with the Securities and Exchange Commission.

Treasury stock. In connection with the convertible debenture issuance, the Board of Directors of the Company authorized the repurchase of 1,977,800 outstanding shares for $25.0 million. The average price per share was $12.64 on the date of purchase. There is no plan in place to purchase further outstanding shares.

9. Stock Plans and Options

Employee Stock Purchase Plan. In August 1996, the Company's board of directors approved and adopted an Employee Stock Purchase Plan ("Purchase Plan") reserving 287,307 shares of common stock. The Purchase Plan is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Internal Revenue Code. Under the Purchase Plan, the board of directors may authorize participation by eligible employees, including officers, in periodic offerings. The offering period for any offering will be no more than 27 months. The board authorized an offering commencing on the initial public offering date of October 22, 1996 and ending June 30, 1997, and sequential six-month offerings thereafter. The Company obtained shareholder approval in May 2001 to increase the pool of reserved stock by 500,000 shares. As of January 1, 2005, 787,307 of shares are reserved, and 182,246 are available for issuance.

Employees are eligible to participate in the currently authorized offerings if they have been employed by the Company or an affiliate of the Company incorporated in the United States for at least six months. Employees can have up to 15% of their earnings withheld pursuant to the Purchase Plan and applied on specified purchase dates (currently the last day of each authorized offering) to the purchase of shares of common stock. The price of common stock purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the common stock on the commencement date of each offering or the relevant purchase date. During the year ended January 1, 2005, there were approximately $846,000 of payroll deductions of which $771,000 were used to purchase 76,676 shares of common stock.

1996 Equity Incentive Plan. The Company's Wild Oats Markets, Inc. 1996 Equity Incentive Plan (the "1996 Plan") was adopted by the board of directors in August 1996. As of January 1, 2005, 4,650,220 shares of common stock were reserved for issuance under the 1996 Plan, and 524,921 shares were available for grant. The 1996 Plan provides for the grant of incentive stock options to employees (including officers and employee-directors) and nonqualified stock options, restricted stock and restricted stock units (RSUs) and stock bonuses to employees, directors and consultants. The exercise price of options granted under the 1996 Plan is determined by the board of directors, provided that the exercise price for an incentive stock option cannot be less than 100% of the fair market value of the common stock on the grant date and the exercise price for a nonqualified stock option cannot be less than 85% of the fair market value of the common stock on the grant date. Outstanding options generally vest over a period of four years and generally expire 10 years from the grant date.

In March 2004, the Board approved issuance of RSUs as a new alternative compensation arrangement for non-employee board members' annual service grants and compensation for meeting attendance. RSUs issued in lieu of cash compensation vest immediately, while those issued as an annual grant vest over a one-year period. The Company records compensation expense based on the date upon which an RSU is granted, equal to the fair market value of stock underlying the RSU on the date granted and recognizes the expense over the vesting period.

2001 Non-Officer/Non-Director Equity Incentive Plan. In 2001, the Company created the Wild Oats Markets, Inc. 2001 Nonofficer/Nondirector Equity Incentive Plan, a nonqualified stock option plan (the "2001 Plan"). As of January 1, 2005, 486,000 shares of common stock were reserved for issuance under the 2001 Plan, and options for 83,952 shares were available for grant. The 2001 Plan provides for the grant of nonqualified stock options to employees of the Company who are not officers or directors. The exercise price of options granted under the 2001 Plan is determined by the board of directors, provided that the exercise price for a nonqualified stock option cannot be less than 85% of the fair market value of the common stock on the grant date. Outstanding options generally vest over four years and generally expire 10 years from the grant date.

Individual stock option plans. Currently a total of four individual nonqualified stock option plans exist. These individual stock option plans were created during 2001 and 2003 as inducements to certain executives to accept offers of employment with the Company. The total amount of shares reserved for issuance and total options granted under the four plans is 390,000 shares. Under each plan, the exercise price of the stock options is determined by the board of directors, provided that the exercise price cannot be less than 85% of fair market value of the common stock on the grant date. Outstanding options vest over a four-year period with an expiration date 10 years from the date of grant.

Fair values. The fair value of the employees' purchase rights for the employee stock purchase plan was estimated using the Black-Scholes model with the following weighted-average assumptions:

FISCAL YEAR	2004	2003	2002
Estimated dividends	None	None	None
Expected volatility	73%	75%	69%
Risk-free interest rate	3.11%	1.0%	1.2%
Expected life (years)	0.5	0.5	0.5

Weighted-average fair value per share	$2.10	$4.40	$2.74

The fair value of each option grant under the Company's aggregated incentive and nonqualified stock option plans is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

FISCAL YEAR	2004	2003	2002
Estimated dividends	None	None	None
Expected volatility	73%	75%	69%
Risk-free interest rate	2.86%	2.47%	3.02%
Expected life (years)	4.0	4.1	4.2
Weighted-average fair value per share	$5.90	$5.92	$5.94

The fiscal 2004, fiscal 2003 and fiscal 2002 weighted-average grant date per share fair values and weighted-average exercise prices of options granted equal to and below market value on the date of grant are as follows:

	Number of Options	Weighted Average Fair Value	Weighted Average Exercise Price
Options granted below market value	32,213	$ 7.67	$ 9.68
Options granted equal to market value	380,125	$ 5.45	$ 11.86
Total options granted fiscal 2004	412,338	$ 5.62	$ 11.50
Options granted below market value	112,890	$ 6.10	$ 8.79

Options granted equal to market value	524,008	$ 5.88	$ 10.25
Total options granted fiscal 2003	636,898	$ 5.92	$ 9.99
Options granted below market value	105,502	$ 6.48	$ 9.35
Options granted equal to market value	583,225	$ 5.84	$ 10.67
Total options granted fiscal 2002	688,727	$ 5.94	$ 10.47

A summary of the status of the Company's aggregated incentive and nonqualified stock options plans as of the 2004, 2003 and 2002 fiscal year ends and changes during the years ending on those dates is presented below:

	Number of Options	Weighted Average Exercise Price
Outstanding as of December 29, 2001	3,355,933	$ 10.36
Granted	688,727	$ 10.47
Forfeited	(362,665)	$ 11.90
Exercised	(250,559)	$ 7.66
Outstanding as of December 28, 2002	3,431,436	$ 10.30
Granted	636,898	$ 9.99
Forfeited	(405,883)	$ 11.70

Exercised	(316,166)	$ 7.90
Outstanding as of December 27, 2003	3,346,285	$ 10.30
Granted	412,338	$ 11.50
Forfeited	(469,312)	$ 11.85
Exercised	(326,604)	$ 8.19
Outstanding as of January 1, 2005	2,962,707	$ 10.55

The following table summarizes information about incentive and nonqualified stock options outstanding and exercisable at January 1, 2005:

OPTIONS OUTSTANDING				OPTIONS EXERCISABLE	
Range Of Exercise Prices	Number Outstanding	Remaining Contractual Life (years)	Weighted-Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 4.25 7.00	291,016	6.44	$6.53	265,906	$6.52
$ 7.01 8.50	618,832	7.14	$7.99	487,470	$7.92
$ 8.51 10.00	749,417	7.00	$9.37	595,876	$9.33
$ 10.01 12.00	738,833	7.51	$10.85	510,381	$10.86
$ 12.01 16.00	308,154	7.99	$13.03	112,069	$13.69
$ 16.01 26.50	256,455	4.46	$19.94	252,573	$19.99

2,962,707	6.99	$10.55	2,224,275	$10.46

At January 1, 2005, 541,921 shares were available for future grant under the 1996 Plan, and 83,952 shares were available for future grant under the 2001 Plan. At January 1, 2005, December 27, 2003 and December 28, 2002 options for 2,224,275, 2,081,800 and 1,581,424 shares with weighted average exercise prices of $10.46, $10.42 and $10.79, respectively, were exercisable. During 2004, 38,065 shares were granted out of the 1996 Equity Incentive Plan as RSUs. All grants remain outstanding and 10,065 shares were vested as of January 1, 2005. Those grants are not considered in the above tables as outstanding options, but reduce the amount available for grant from the 1996 Plan.

10. Litigation

Wild Oats Markets Canada, Inc., as successor to Alfalfa's Canada, Inc., a Canadian subsidiary of the Company, is a defendant in Helen Fakhri and Ady Aylon, as Representative Plaintiffs v. Alfalfa's Canada, Inc., a class action suit for monetary damages brought in the Supreme Court of British Columbia, Canada by the representative plaintiffs on behalf of two groups of claimants - those who claim to have contracted Hepatitis A allegedly through the consumption of food purchased at a Capers Community Market in the spring of 2002, and those who were inoculated against Hepatitis A in March and April, 2002, after handling and/or consuming food products from Capers that were or might have been contaminated with Hepatitis A. In the fourth quarter of 2003, the action was certified as a class action by the court. The Company filed an appeal and a hearing was held in September 2004. The appeal was denied in October 2004. In December 2004, the Plaintiffs brought a motion for a summary trial of certain issues, and such motion was denied in January 2005. The Company intends to vigorously defend the suit. The Company is not able to estimate the potential outcome of the suit at this time. The Company's insurers have acknowledged coverage for defense costs and liability, and the Company has exhausted its deductible.

In April 2000, the Company was named as defendant in S/H Ahwatukee, LLC and YP - Ahwatukee LLC v. Wild Oats Markets, Inc., Superior Court of Arizona, Maricopa County, by a landlord alleging Wild Oats breached a continuous operations clause arising from the closure of a Phoenix, Arizona store. Plaintiff claimed damages for diminution of value of the shopping center plus accelerated rent, fees and attorneys' fees and costs. After trial in November 2001, the judge awarded the plaintiff an aggregate $536,000 in damages and attorneys' fees. The Company's appeal of judgment was denied in the first quarter of fiscal 2004, and the Company filed a motion for reconsideration, which was denied. The Company filed a petition for review with the Arizona Supreme Court, which was denied. As of the end of fiscal 2004, the Company has accrued $790,000, which the Company believes to be adequate to fully satisfy the judgment, including interest.

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Auchterlonie, individually and on behalf of all others similarly situated and the general public, and Roes 1 to 1000 vs. Wild Oats Markets, Inc. and Does 1 through 100, is a purported class action suit brought in August 2004 in the Superior Court, County of Los Angeles, for payment of overtime and damages relating to alleged violations of the California Business and Professions Code by a former managerial employee, on behalf of himself and all other similarly situated California employees, claiming that store directors at the Company's California stores should have been classified as non-exempt employees and paid on an hourly basis. Plaintiff also alleges that the Company's incentive bonus program is illegal based upon deductions for items outside of the employee's control. The Company believes that the employee, a former store director, was properly classified as an exempt employee based upon his job duties, and intends to vigorously defend the suit. At this time, the Company does not have sufficient facts to estimate any potential damages. The case has been designated non-complex and trial has been scheduled for October 2005.

The Company also is named as defendant in various actions and proceedings arising in the normal course of business. In all of these cases, the Company is denying the allegations and is vigorously defending against them and, in some cases, has filed counterclaims. Although the eventual outcome of the various lawsuits cannot be predicted, it is management's opinion that these lawsuits will not result in liabilities that would materially affect the Company's consolidated results of operations, financial position, or cash flows.

11. Leases and Other Commitments and Contingencies

The Company has numerous leases related to facilities and store equipment. The initial lease term is usually between 10 and 20 years, and generally includes renewal options for varying terms thereafter, as well as rent escalation clauses. Certain store leases may require additional rental payments contingent upon sales volume for the particular store ("contingent rentals").

Future minimum lease payments under noncancelable leases as of January 1, 2005 are summarized as follows (*in thousands*):

FISCAL YEAR	Operating Leases	Capital Leases	Financing Leases
2005	$ 34,589	$ 2,025	$ 1,443
2006	33,480	1,980	1,443
2007	32,444	1,899	1,443
2008	30,193	1,890	1,443

2009	27,862	1,911	1,485
Thereafter	231,363	41,691	22,659
Total minimum lease payments	$ 389,931	51,396	29,916
Less amount representing interest		(31,207)	(16,175)
Present value of net minimum lease payments		20,189	13,741
Less current portion		(187)	(218)
Long term portion		$ 20,002	$ 13,523

Minimum rentals shown above do not include contingent rental payments. Total rent expense (consisting of minimum rent and contingent rent) under these leases was $35.6 million, $33.9 million and $32.2 million during fiscal 2004, fiscal 2003, and fiscal 2002, respectively. Total contingent rentals paid during these same periods was $1.0 million, $1.0 million, and $949,000, respectively. Sublease income received for fiscal years 2004, 2003, and 2002 was $2.0 million, $1.9 million, and $1.9 million, respectively.

Included in the $389.9 million of minimum lease payments is $32.4 million, which is related to lease costs for closed stores. The Company is actively working to defease these payments through assignments, subleases or terminations of the lease obligations.

Future minimum sublease rental income payments to be received as of January 1, 2005 are as follows (*in thousands*):

Fiscal Year	Sublease Rental Income

2005	$ 2,310
2006	2,268
2007	2,193
2008	1,922
2009	1,787
Thereafter	7,314
Total	$ 17,794

As of January 1, 2005, the Company had commitments under construction contracts totaling $4.4 million. The Company is self-insured for certain losses relating to worker's compensation claims, general liability, and employee medical and dental benefits. The Company has purchased stop-loss coverage in order to limit its exposure to any significant levels of claims. Self-insured losses are accrued based upon the Company's estimates of the aggregate uninsured claims incurred using certain actuarial assumptions followed in the insurance industry and the Company's historical experiences. If the Company experiences an increase in claims, if actuarial assumptions are inaccurate, or insurance industry costs increase beyond current expectations, then additional reserves may be required.

12. Restructuring and Asset Impairment Charges (Income)

Fiscal 2004

During fiscal 2004, the Company recorded restructuring and asset impairment expense of $2.5 million consisting of the following components (*in thousands*):

Changes in estimate related to lease-related liabilities for sites previously identified for closure (including accretion)	$ 104

Estimate related to lease-related liabilities for sites identified for closure during fiscal 2004	566
Severance for employees	754
Asset impairments	1,037
Total restructuring and asset impairment expense	$ 2,461

Details of the significant components are as follows:

- *Changes in estimates related to lease-related liabilities for sites previously identified for closure.*

During 2004, the Company incurred changes in estimates for locations closed during previous fiscal years, such as the addition or loss of a subtenant, brokerage fees for obtaining a subtenant, or if expected subtenancy arrangements take additional time to complete than originally expected. Throughout 2004, we determined that additional time to dispose of vacant sites would require adjusting our estimates for changes in facts and circumstances by $104,000. The $104,000 consists of the following: Accretion expense for lease terms estimated using the present value of future minimum lease terms of $531,000; additional time estimated for obtaining viable subtenants of $1.1 million; and the procurement of viable subtenants producing a reversal of previously accounted for reserves of approximately $1.5 million, net of brokerage fees.

- *Estimates related to lease-related liabilities for sites identified for closure during 2004.*

Throughout 2004, we closed store locations in Washington, Oregon, Florida and Arizona. Certain locations had remaining lease periods for which we are responsible for paying future rent. We accrued $566,000 related to those store locations based on our best estimate of the future lease periods during which we will be obligated to pay rent.

- Severance for employees notified of termination during 2004. During the fiscal year, 162 employees were terminated in conjunction with the closing of stores and a reorganization of our Home Office functions. The employees were notified of their involuntary termination approximately one month before the store closure. The costs of termination for the year were $754,000. As of January 1, 2005, $556,000 of involuntary termination benefits had been paid to terminated employees.

- *Asset Impairments.*

In addition to the restructuring income described above, management also identified asset impairment charges of $1,037,000 in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* for three stores held for use. These assets became impaired during our quarterly assessments during fiscal 2004 because the projected cash flows of each store at the time were not sufficient to fully recover the carrying value of the stores' long-lived assets. In determining whether an impairment exists, the Company estimates the stores' future cash flows on an undiscounted basis, and if the cash flows are not sufficient to recover the carrying value, then the Company uses a discounted cash flow based on a risk-adjusted discount rate, to adjust its carrying value of the assets and records a provision for impairment as appropriate. The Company believes the weak performance from the stores included in the asset impairment charge was caused by depressed markets and increased competition. The Company continually reevaluates its stores' performance to monitor the carrying value of its long-lived assets in comparison to projected cash flows.

During 2004 and 2003, the Company incurred $4.0 million and $3.8 million, respectively, of charges for accelerated depreciation for planned store closures. The costs are included in "Costs of Goods Sold and Occupancy Costs" in the Statements of Operations.

Fiscal 2003 (As Restated)

During fiscal 2003, the Company recorded restructuring and asset impairment income of ($1.3) million consisting of the following components (*in thousands*):

Changes in estimates related to lease-related liabilities for sites closed during 2003	$ 188
Change in estimate related to lease-related liabilities for sites previously identified for closure or sale	(2,376)
Insurance settlement received for impaired assets previously written off	(250)
Severance for employees terminated during fiscal 2003	232
Asset impairment charges	947
Total restructuring and asset impairment income	$ (1,259)

Details of the significant components are as follows:

- *Changes in estimates related to lease-related liabilities for sites closed during 2003.*

During 2003, the Company determined that a store in Tennessee should be closed. The store location had future lease-related obligations totaling $188,000.

- *Changes in estimates related to lease-related liabilities for sites previously identified for closure.*

During 2003, the Company incurred changes in estimates for locations closed during previous fiscal years, such as the addition or loss of a subtenant, brokerage fees for obtaining a subtenant, or if expected subtenancy arrangements take additional time to complete than originally expected. Throughout 2003, we determined that additional time to dispose of vacant sites would require adjusting our estimates for changes in facts and circumstances by $(2,376,000). The $2.4 million consists of the following: The Company secured viable subtenants for locations in Arizona, California (4), Oregon and Tennessee. As a result, the Company recorded restructuring income of $(3,451,000) to reduce the accruals to the estimated required amounts. Additionally, the Company was able to secure agreements with the landlords to reduce required rents already recorded for resulting in $(893,000) of additional income. This was offset by a restructuring charge of $87,000 for the costs associated with restoring a space to its original condition for a location previously included in a restructuring charge, and additional time estimate adjustments for obtaining viable subtentants of $1,881,000.

- ♦ *Severance for employees notified of termination during 2003.*
  In conjunction with the closings of stores or support facilities, we involuntarily terminated 77 people during fiscal 2003. The closing of a store in Tucson, Arizona, a warehouse in San Diego, California and a restaurant operating within a store in West Vancouver, British Columbia, resulted in 40 employees being notified of their involuntary termination. The closure of two stores in Irvine and Los Angeles, California resulted in 37 employees being notified of their involuntary termination. As of January 1, 2005, all of the involuntary termination benefits accrued had been paid to terminated employees.
- ♦ *Insurance settlement received for impaired assets previously written off.*

The Company received $250,000 in insurance proceeds as partial reimbursement for property losses and incremental expenses incurred during the first quarter of 2003 caused by a roof collapse at a support facility in Federal Heights, Colorado. The support facility had been previously identified for closure during fiscal 2001, and the carrying value of its fixed assets were written off as an impairment charge at that time. Therefore, the Company recorded a gain in the amount of the insurance proceeds received of $250,000.

- ♦ In addition to the restructuring income described above, management also identified asset impairment charges of $947,000 in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* for two stores held for use. These assets became impaired during the third quarter of fiscal 2003 because the projected cash flows of each store at the time were not sufficient to fully recover the carrying value of the stores' long-lived assets. In determining whether an impairment exists, the Company estimates the stores' future cash flows on an undiscounted basis, and if the cash flows are not sufficient to recover the carrying value, then the Company uses a discounted cash flow based on a risk-adjusted discount rate, to adjust its carrying value of the assets and records a provision for impairment as appropriate. The Company believes the weak performance from the stores included in the asset impairment charge was caused by depressed markets and increased competition. The Company continually reevaluates its stores' performance to monitor the carrying value of its long-lived assets in comparison to projected cash flows.

Fiscal 2002 (As Restated)

During fiscal 2002, the Company recorded restructuring and asset impairment income of $(0.8) million consisting of the following components (*in thousands*):

Gain on sale of assets	$ (462)
Change in estimate related to lease-related liabilities for sites previously identified for closure	(4,713)
Lease-related liabilities stores identified to be closed or sold during the year	3,531
Severance for employees	420
Fixed asset impairments for store construction project discontinuation	449
Total restructuring and asset impairment income	$ (775)

Details of the significant components are as follows:

- ♦ *Gain on sale of assets*

. The Company sold a liquor license for a closed location in Mission Viejo, California for a higher price than originally estimated and sold a closed kitchen facility in Santa Fe, New Mexico for a higher price than originally estimated. Additionally, the Company received an insurance settlement for a claim relating to the location in Madison, New Jersey, where the assets had previously been written off. The Company also sold one store in Victoria, British Columbia, Canada. The sale agreement included payment for fixed assets. Based on this change in facts and circumstances, the Company recorded the gain on the sale of the fixed assets and therefore recognized asset disposal income.

- ♦ *Changes in estimates related to lease-related liabilities for sites previously identified for closure.*

During 2002, the Company incurred changes in estimates for locations closed during previous fiscal years, such as the addition or loss of a subtenant, brokerage fees for obtaining a subtenant, or if expected subtenancy arrangements take additional time to complete than originally expected. Throughout 2002, we determined that additional time to dispose of vacant sites would require adjusting our estimates for changes in facts and circumstances by $(4.7) million. The $(4.7) million consists of the following: the Company negotiated the early termination of leases in West Hollywood, California and San Antonio, Texas. The Company also secured viable subtenants for locations in Vancouver, Washington and Boulder, Colorado. Additional information received in fiscal 2002 resulted in a revision in the total rent allocated to one vacant location in Albuquerque, New Mexico, previously included within a restructuring charge; therefore, the Company revised the estimate for future lease obligations. The Company negotiated the early termination of a lease in Tempe, Arizona, and also terminated lease obligations for a site in Denver, Colorado. The total changes in estimate for these items approximated $3.4 million of accrual reversals.

The Company negotiated the early termination of a lease of property at which the Company had operated a kitchen in Los Angeles, California. Also, the Company subleased a closed location in Hartford, Connecticut for the remaining lease term and provided a subsidy for the sublessee; the previously estimated lease-related liabilities in excess of the subsidy were reversed. Additionally, the Company subleased a site in Vancouver, British Columbia, Canada, for the remaining lease term and consequently reversed the previously estimated lease-related liabilities. For space adjacent to the Company's operating store in West Hartford, Connecticut, the Company negotiated a lease amendment with the landlord and, as a result, was removed from the lease in the first quarter of fiscal 2003; therefore, the Company reversed the excess lease-related liabilities previously recorded. The Company sold one store in Victoria, British Columbia, Canada. The purchaser assumed the lease-related obligations associated with this store. Based on this change in facts and circumstances, the Company reversed the remaining lease-related liabilities previously recorded for this store. The Company completed payment obligations for terminated lease obligations for sites in Boca Raton, Florida; Santa Fe, New Mexico and Framingham, Massachusetts; and therefore reversed the remaining lease-related liabilities previously recorded for these stores. The Company determined the likelihood of securing a subtenant for certain space in Tempe, Arizona was now remote due to the Company's obligation being at above-market rates, the unattractive site characteristics, and increasingly difficult real estate market conditions. With this change in facts and circumstances, the Company decided to fully reserve the remaining lease obligations of the site. The net impact of the transactions was $1.3 million.

♦ *Estimates related to lease-related liabilities for sites identified for closure during 2002.*

Throughout 2002, we decided to close or sell three locations due to lower than anticipated operational performance. The lease-related liabilities for these locations represent the Company's estimate to dispose of these lease obligations based on current disposition efforts, and is attributable to deteriorating real estate markets in certain regions, existing lease obligations at above-market rates, and unattractive site characteristics. The charge for exit costs assumes, based on the Company's current results at disposition efforts that the Company will be successful in disposing of these long-term lease obligations within five years. Additionally, the Company exercised the right of early lease termination with 90 days' notice to the landlord for a small location in El Paso, Texas. The aggregate charge to the restructuring reserve for these closures was $3,531,000.

♦ *Severance for employees terminated during fiscal 2002*

. In conjunction with the closure or relocation of stores or support facilities throughout the year, 170 employees were involuntarily terminated. The details are as follows: two employees were terminated with the sale of one Vitamin Expo location; 65 employees were terminated in conjunction with the closure of one store in Cleveland, Ohio, and the closure of the bakery operations within one support facility in Denver, Colorado; 103 employees were terminated in conjunction with the closure of two stores in Boca Raton, Florida and Chesterfield, Missouri. The employees were notified of their involuntary termination within 60 days of their respective termination date. As of January 1, 2005, all termination benefits had been paid to terminated employees.

♦ Fixed asset impairments. The Company decided to close two locations, one operated under the "Vitamin Expo" tradename as part of brand consolidation, and the other did not fit the future expectations of the Company and had an expiring lease.

The Company determined that certain fixed assets were not compatible with the Company's new store design. Due to the implementation of the new store design, such assets could not be relocated as contemplated under the original restructuring plan. As a result, the Company determined it could not recover the previously estimated carrying value of these assets, and therefore recognized an asset impairment charge of approximately $170,000. The assets were fully disposed by the end of fiscal 2002. Additionally, the Company determined that it could partially recover the carrying value of certain fixed assets used in store front-end operations that were previously written off in 2001; therefore, the Company reversed $135,000 of asset impairment expense recognized in the second quarter of fiscal 2002.

The Company determined that a new store design was required and construction of new stores based on the previously developed designs would be abandoned to incorporate the new store design changes. Assets in this charge included abandoned construction in progress (primarily leasehold improvements). The Company determined that it could not recover the carrying value of these fixed assets, and therefore recognized an asset impairment charge and disposed of the assets during 2002.

Total asset impairment charges, net for 2002 were $449,000.

Sales and store contribution to profit (sales less cost of goods sold, occupancy costs, and direct store expenses) for the fiscal years ended January 1, 2005, December 27, 2003 and December 28, 2002 for stores that were held for disposal are as follows (*in thousands*):

FISCAL YEAR	2004	2003 (As Restated)	2002 (As Restated)
Sales	$13,043	$ 10,562	$ 24,229
Store contribution to profit	$ (999)	$ (1,899)	$ (1,576)

The effect of suspending depreciation for assets held for disposal was $0 for fiscal 2004, $0 for fiscal 2003 and approximately $34,000 fiscal year ended December 28, 2002, respectively.

Restructuring Activity By Store Count (Unaudited)

A summary of restructuring activity by store count is as follows:

	RESTRUCTURING STORE COUNT		
	Fiscal Year Ending		
	2004	2003	2002
Stores remaining at commencement of period	8	3	6
Stores identified in fiscal 2002 for closure		-	6
Stores identified in fiscal 2003 for closure		5	-
Stores identified in fiscal 2004 for closure	7	-	-
Support facilities identified for closure	2	4	-
Identified stores closed or abandoned	(6)	(4)	(5)
Identified stores sold	(1)		(4)
Identified support facilities closed	(4)		
Identified stores remaining at period end	6	8	3

As of December 27, 2003, all six stores identified in fiscal 2002 for closure have been sold or closed. Of the five stores and four support facilities identified in fiscal 2003 for closure, one had been relocated as of December 27, 2003, one was sold in January 2004, and the remainder were closed in 2004. Of the seven stores and two support facilities identified in 2004 for closure, four stores and the support facilities remained open as of year end, with two stores closing before February 26, 2005.

The following table summarizes accruals related to the Company's restructuring activities during fiscal 2004, fiscal 2003 and fiscal 2002 (in thousands):

EXIT PLANS	2001 And Prior	Q4 2002	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004	TOTAL
BALANCE, 12-27-03 (As Restated)	$ 8,615	$ 421	$224					$ 9,260
New accruals:								
Severance				$28				28
Lease-related liabilities	190	46						236
Cash paid :								
Severance		-	(39)	(15)				(54)
Lease-related liabilities	(250)	(467)	(35)					(752)
BALANCE, 03-27-04	8,555	0	150	13				8,718
New accruals:								
Severance					$63			63
Lease Related Liabilities	(1,140)	298	70		43			(729)
Cash paid:								
Severance		(7)	(14)	(11)	-			(32)
Lease-related liabilities	(344)	(27)	(35)					(406)

BALANCE, 06-24-04	7,071	264	171	2	106			7,614
New Accruals:								
Severance						$ 614		614
Lease Related Liabilities	310					555		865
Cash Paid:								
Severance			(6)		(53)	(251)		(310)
Lease Related Liabilities	(446)	(225)	(35)		(34)	-		(740)
BALANCE, 09-25-04	6,935	39	130	2	19	918		8,043
New accruals								
Severance						3	$ 46	49
Lease-related liabilities	118					2		120
Cash paid:								
Severance						(199)	(15)	(214)
Lease-related liabilities	(389)	(38)	(130)		(14)	-		(571)
BALANCE, 01-05-2005	$ 6,664[1]	$ 1[1]	$ 0[1]	$ 2	5	$ 724[2]	$ 31[3]	$ 7,427

1

The restructuring accrual balance consists of lease related liabilities.

2

The restructuring accrual balance consists of lease related liabilities and $167,000 for employee termination benefits.

3

The restructuring accrual balance consists of $31,000 for employee termination benefits.

As of January 1, 2005, the Company's restructuring balances consist of $2.9 million in accrued liabilities and other long-term obligations of $4.5 million

13. 401(k) Plan

The Company maintains a tax-qualified employee savings and retirement plan (the "401(k) Plan") covering the Company's employees. Pursuant to the 401(k) Plan, eligible employees may elect to reduce their current compensation by up to the lesser of 15% of their annual compensation or the statutorily prescribed annual limit ($13,000 in fiscal 2004) and have the amount of such reduction contributed to the 401(k) Plan. Employees over age 50 may also contribute an additional $2,000 "catch-up" contribution. The 401(k) Plan provides for additional matching contributions to the 401(k) Plan by the Company in an amount determined by the Company prior to the end of each plan year. Total Company contributions during fiscal 2004, 2003 and fiscal 2002 were approximately $1.2 million, $1.3 million and $1.2 million, respectively. The trustees of the 401(k) Plan, at the direction of each participant, invest the assets of the 401(k) Plan in designated investment options. The 401(k) Plan is intended to qualify under Section 401 of the Internal Revenue Code.

In January 2002, the Company was notified by its 401(k) trustee that effective April 1, 2002, the trustee would no longer provide trustee services for 401(k) plans. The Company selected a new plan administrator and a new trustee after extensive research and interviews. In the fourth quarter of fiscal 2002, the Company was notified by its new plan administrator that it was selling its business without the Company's consent (as required by the then-current contract). The Company elected to terminate its contract and selected Milliman USA as its new plan administrator. The plan accounts were transferred to Milliman and Company employees were notified that they would be unable to make withdrawals from or change the investment designations of their accounts until the transfer was completed. The transfer was completed in January 2003. The Company also amended its 401(k) Plan in fiscal 2003 and fiscal 2004 to modify the eligibility requirements. In fiscal 2003, the Company completed an audit of one of the record keeping practices of one of its past plan administrators. The Company completed its comprehensive review of past administrative practices of its 401(k) Plan during the third quarter of fiscal 2004. As a result, in November 2004, the Company filed a voluntary correction plan with the Internal Revenue Service related to the 401(k) Plan. Pursuant to the Company's audit, the Company has determined that it was obligated to contribute an estimated $1.2 million, inclusive of earnings, to the 401(k) Plan to correct certain past administrative practices dating back to 1999, of which $1.0 million has been included in direct store expense and $0.2 million in selling, general and administrative expense.

14. Stockholder Rights Plan

The Company has a stockholder rights plan having both "flip-in" and "flip-over" provisions. Stockholders of record as of May 22, 1998 received the right ("Right") to purchase a fractional share of preferred stock at a purchase price of $145 for each share of common stock held. In addition, until the Rights become exercisable as described below and in certain limited circumstances thereafter, the Company will issue one Right for each share of common stock issued after May 22, 1998. For the "flip-in provision," the Rights would become exercisable only if a person or group acquires beneficial ownership of 15% (the "Threshold Percentage") or more of the outstanding common stock. Holdings of certain existing affiliates of the Company are excluded from the Threshold Percentage. In that event, all holders of Rights other than the person or group who acquired the Threshold Percentage would be entitled to purchase shares of common stock at a substantial discount to the then-current market price. This right to purchase common stock at a discount would be triggered as of a specified number of days following the passing of the Threshold Percentage. For the "flip-over" provision, if the Company was acquired in a merger or other business combination or transaction, the holders of such Rights would be entitled to purchase shares of the acquiror's common stock at a substantial discount. In February 2002, the rights plan was amended to remove certain provisions related to continuing control of modification and operation of the rights plan by certain directors.

15. Deferred Compensation Plan

Effective in fiscal 1999, the Company maintains a nonqualified Deferred Compensation Plan (the "DCP") for certain members of management. Eligible employees may contribute a portion of base salary or bonuses to the plan annually. The DCP provides for additional matching contributions by the Company in an amount determined by the Company prior to the end of each plan year. Total Company matching contributions to the DCP during fiscal 2004, 2003 and 2002 were approximately $85,000, $84,000 and $39,000, respectively. On December 31, 2004, in response to the Jobs Act, which mandated modifications to Treasury regulations applicable to deferred compensation, the Company froze the then-existing DCP participants' accounts, and created new participants' accounts, effective January 1, 2005. The Company anticipates implementing a new DCP in compliance with the new rules promulgated under the Jobs Act once such rules are issued.

16. Quarterly Information (Unaudited)

The following interim financial information presents the fiscal 2004 and fiscal 2003 consolidated results of operations on a quarterly basis (*in thousands*, except per-share amounts):

	QUARTER ENDED			
Statement of Operations Data	March 27, 2004	June 26, 2004	Sept 25, 2004	Jan 1, 2005
Sales	$ 263,795	$ 251,697	$ 250,739	$ 281,933
Gross profit	$ 77,406	$ 73,434	$ 68,828	$ 77,182
Net income (loss)	$ 2,069	$ (331)	$ (7,052)	$ (34,705)
Basic net income (loss) per common share	$0.07	$(0.01)	$(0.25)	$(1.18)
Diluted net income (loss) per common share	$0.07	$(0.01)	$(0.25)	$(1.18)
Basic weighted average number of common shares	30,184	29,788	28,458	28,469
Diluted weighted average number of common shares	31,034	29,788	28,458	28,469

QUARTER ENDED (As Restated)

Statement of Operations Data	March 29, 2003	June 28, 2003	Sept 27, 2003	Dec 27, 2003
Sales	$235,987	$242,248	$237,028	$ 253,941
Gross profit	$ 71,490	$ 70,930	$ 68,675	$ 74,629
Net income (loss)	$ 829	$ 1,082	$ (1,452)	$ 1,134
Basic net income (loss) per common share	$0.03	$0.04	$(0.05)	$0.04
Diluted net income (loss) per common share	$0.03	$0.04	$(0.05)	$0.04
Basic weighted average number of common shares	29,704	29,775	29,898	30,068
Diluted weighted average number of common shares	29,916	30,262	29,898	30,596

In accounting for the restructuring reserves for the quarter ended June 28, 2003, the Company understated its charge to accrue for the remaining lease obligation for a closed store site in Phoenix, Arizona, in the amount of $500,000 due to the commingling of litigation and lease-related reserves for this store in the supporting reserve schedules. During the quarter ended December 27, 2003, the Company recorded a charge to accrue for additional litigation related restructuring reserves for this closed store site, which was overstated by the $500,000 due to the commingling of litigation and lease-related reserves noted above. As a result of the restatement, restructuring expense has been increased $500,000 ($304,000 net of tax) for the quarter ended June 28, 2003 and decreased $500,000 for the quarter ended December 27, 2003. This restatement decreased earnings per share $0.01 in the quarter ended June 28, 2003 and increased earnings per share by the same in the quarter ended December 27, 2003. There is no net income, accrual or cash flow impact on fiscal year 2003 as a whole.

As discussed in Note 2, and in the foregoing paragraph, the first three quarters of 2004 and each quarter of 2003 are being restated. The presentation below tracks the effects of the restatement compared with the As Recorded consolidated results of operations on a quarterly basis (*in thousands*, except per-share amounts):

	QUARTER ENDED March 29, 2003		
Statement of Operations Data	**As Recorded**	**Adjustment**	**As Restated**
Sales	$ 235,987	$ -	$ 235,987
Gross profit	$ 70,859	$ 631	$ 71,490
Net income (loss)	$ 1,440	$ (611)	$ 829
Basic net income (loss) per common share	$ 0.05	$ (0.02)	$ 0.03
Diluted net income (loss) per common share	$ 0.05	$ (0.02)	$ 0.03

	QUARTER ENDED June 28, 2003		
Statement of Operations Data	**As Recorded**	**Adjustment**	**As Restated**
Sales	$ 242,248	$ -	$ 242,248
Gross profit	$ 71,222	$ (292)	$ 70,930

Net income (loss)	$ 2,183	$ (1,101)	$ 1,082
Basic net income (loss) per common share	$ 0.07	$ (0.03)	$ 0.04
Diluted net income (loss) per common share	$ 0.07	$ (0.03)	$ 0.04

	QUARTER ENDED September 27, 2003		
Statement of Operations Data	**As Recorded**	**Adjustment**	**As Restated**
Sales	$ 237,028	$ -	$ 237,028
Gross profit	$ 68,870	$ (195)	$ 68,675
Net income (loss)	$ (861)	$ (591)	$ (1,452)
Basic net income (loss) per common share	$ (0.03)	$ (0.02)	$ (0.05)
Diluted net income (loss) per common share	$ (0.03)	$ (0.02)	$ (0.05)

	QUARTER ENDED December 27, 2003		
Statement of Operations Data	**As Recorded**	**Adjustment**	**As Restated**

Sales	$ 253,941	$ -	$ 253,941
Gross profit	$ 74,661	$ (32)	$ 74,629
Net income (loss)	$ 829	$ 305	$ 1,134
Basic net income (loss) per common share	$ 0.03	$ 0.01	$ 0.04
Diluted net income (loss) per common share	$ 0.03	$ 0.01	$ 0.04

	QUARTER ENDED March 27, 2004		
Statement of Operations Data	**As Recorded**	**Adjustment**	**As Restated**
Sales	$ 263,795	$ -	$ 263,795
Gross profit	$ 77,114	$ 292	$ 77,406
Net income (loss)	$ 2,357	$ (288)	$ 2,069
Basic net income (loss) per common share	$ 0.08	$ (0.01)	$ 0.07
Diluted net income (loss) per common share	$ 0.08	$ (0.01)	$ 0.07

QUARTER ENDED June 26, 2004

Statement of Operations Data	As Recorded	Adjustment	As Restated
Sales	$ 251,697	$ -	$ 251,697
Gross profit	$ 73,172	$ 262	$ 73,434
Net income (loss)	$ 363	$ (694)	$ (331)
Basic net income (loss) per common share	$ 0.01	$ (0.02)	$ (0.01)
Diluted net income (loss) per common share	$ 0.01	$ (0.02)	$ (0.01)

	QUARTER ENDED September 25, 2004		
Statement of Operations Data	As Recorded	Adjustment	As Restated
Sales	$ 250,739	$ -	$ 250,739
Gross profit	$ 68,875	$ (47)	$ 68,828
Net income (loss)	$ (6,065)	$ (987)	$ (7,052)
Basic net income (loss) per common share	$ (0.21)	$ (0.04)	$ (0.25)
Diluted net income (loss) per common share	$ (0.21)	$ (0.04)	$ (0.25)

	QUARTER ENDED January 1, 2005
Statement of Operations Data	Recorded
Sales	$ 281,933
Gross profit	$ 77,182
Net income (loss)	$ (34,705)
Basic net income (loss) per common share	$ (1.18)
Diluted net income (loss) per common share	$ (1.18)

17. Comprehensive Income

The components of other comprehensive income consist of unrealized gains and losses on available-for-sale securities, adjustments related to a cash flow hedge, and foreign currency translation adjustments, all reported net of tax. Comprehensive income has been disclosed in the statement of stockholders' equity for all periods presented.

The components of accumulated other comprehensive income for fiscal years ending 2004, 2003, and 2002 are as follows (in thousands):

	Foreign Currency Translation Adjustments	Unrealized Gain On Available-For Sale Securities	Cash Flow Hedge Adjustments	Total
Balance at December 29, 2001	$ (388)	-	$ (1,421)	$ (1,809)
Foreign currency translation adjustment	(61)	-	-	(61)

Recognition of hedge results to interest expense during the period			1,176	1,176
Change in market value of cash flow hedge during the period			(348)	(348)
Balance at December 28, 2002	$ (449)	-	$ (593)	$ (1,042)
Foreign currency translation adjustment	697	-	-	697
Recognition of hedge results to interest expense during the period	-	-	613	613
Change in market value of cash flow hedge during the period	-		(20)	(20)
Balance at December 27, 2003	$ 248	-	-	$ 248
Foreign currency translation adjustment	681	-	-	681
Unrealized gain on available-for-sale securities	-	$ 37	-	37
Balance at January 1, 2005	$ 929	$ 37	-	$ 966

18. Related Party Transactions

Michael C. Gilliland, Elizabeth Cook and Patrick Gilliland. Elizabeth C. Cook and Michael C. Gilliland, former officers and directors and greater than 5% stockholders of the Company, each own a one-third interest in Pretty Good Groceries, Inc. ("PGG"), which in the past operated two grocery stores, and currently operates one store in Boulder, Colorado. Through January 2002, PGG purchased certain items through the Company's volume purchase discount programs with its distributors, and also purchased items from the Company's commissaries and warehouses at cost. The Company had a receivable of approximately $80,000 at December 29, 2001 related to the purchases by PGG of goods from the Company or its suppliers. At December 29, 2001, the Company also had a receivable for certain personal expenses of Mr. Gilliland and Ms. Cook, the amount of which was in dispute. All receivables related to these items were paid as part of the March 2002 settlement of litigation described below.

Ms. Cook and Mr. Gilliland are trustees of Wild Oats Community Foundation ("Foundation"), a non-profit organization formed by Ms. Cook and Mr. Gilliland to provide health-related services. During fiscal 1998 and fiscal 1999, the Foundation entered into sublease arrangements with the Company for space adjacent to three of the Company's stores leased by the Company. In fiscal 2001, the sublease obligations between the Foundation and the Company were terminated, and other subtenants were placed in two of the three wellness center locations. The third primary lease for space sublet by the Foundation expired by its own terms. The Company had a small receivable related to subtenant rent due from the Foundation, which was paid as part of the March 2002 settlement of the litigation described below.

In May 1998, PGG II, a limited liability company two-thirds owned by Mr. Gilliland and Ms. Cook purchased a small under-performing store in Boulder, Colorado from the Company. PGG II paid the wholesale cost of the inventory in the store at time of transfer. PGG II disputed whether there was consideration due for equipment transferred to PGG II as part of the original purchase transaction, and in March of 2002 the parties reached a settlement on the value of the equipment as part of the settlement of the litigation described below.

In January 2001, the Company borrowed $2.0 million from Ms. Cook and Mr. Gilliland. The loan was evidenced by a demand note that bears interest at 9.0% per annum and default rate interest at 15% per annum. Mr. Gilliland and Ms. Cook filed suit against the Company in January 2002 for payment of the note after demand was made but payment was not received. In March 2002, the parties settled the litigation through execution of a settlement agreement under which the plaintiffs agreed to a $200,000 offset against the principal balance of the loan in settlement of certain identified receivables alleged to be due to the Company, and the Company agreed to repayment of the balance of the loan, together with interest at 9% per annum, over a five-month period from cash and proceeds of equity securities.

In fiscal 2000, the Company recorded a note receivable in the amount of approximately $75,000 from Bacchus Beverage Corporation, an entity owned by Patrick Gilliland, Mr. Gilliland's brother, which was a subtenant in excess space located adjacent to one of the Company's stores. In March 2002, the Company agreed to extinguish the remaining balance on the note in exchange for a $35,000 cash payment.

In September 2002, the Company filed suit against Michael Gilliland and Elizabeth Cook, former officers and directors and greater than 5% stockholders of the Company, together with two individuals and three limited liability corporations, for a temporary restraining order and damages related to a breach of Mr. Gilliland's non-competition covenant, contained in his 1996 employment agreement, arising from the opening of a competitive grocery store in New Mexico. The lawsuit was captioned Wild Oats Markets, Inc. v. Michael C. Gilliland, Elizabeth C. Cook, Mark R. Clapp; Patrick Gilliland, Westside Farmer's Market LLC, Westside Liquors LLC and Milagro Cafe LLC. A related suit was filed against Mr. Gilliland and his brother, Patrick Gilliland, for misappropriation of trade secrets and insider trading related to Patrick Gilliland's postings on a financial chat board. The parties agreed to settle these two lawsuits in July 2004. The settlement includes the disclosure to the Company of sources of certain information obtained by defendants, a return of proprietary information to the Company, mutual release of claims and the dismissal of the two suits.

Perry D. Odak. In May 2002, the Company's Board of Directors amended the employment agreement of Perry D. Odak, the Company's CEO and President, to extend through December 2002 the period during which the issuance by the Company of additional securities as part of an equity financing would entitle Mr. Odak to receive up to 300,000 stock options exercisable for the Company's common stock. In March 2002, Mr. Odak was issued options to purchase 5,856 shares of common stock under a provision of his employment agreement that provided for the maintenance of his 5% equity position in the event of a capital-raising transaction, based upon the issuance of 111,269 shares of common stock, the resale of which was registered on Form S-3 filed in April 2002. In August 2002, the Company's Board of Directors approved a third amendment to Mr. Odak's employment agreement, pursuant to which up to 70,000 of the stock options to which Mr. Odak would be entitled under his employment agreement as a result of the closing of a capital-raising transaction could be granted to other employees of the Company designated by Mr. Odak. The options would only be granted upon the closing of the capital-raising transaction, have a 10-year term, vest over four years and have an exercise price equal to the closing price of the Company's stock on the date the capital-raising transaction was concluded. An equal number of options would be granted simultaneously to Mr. Odak, provided that the options granted to Mr. Odak would only be exercisable as the options granted to other employees terminated (as opposed to expired) without exercise.

As a result of the completion of an equity offering of 4.45 million shares of the Company's common stock in September 2002, the Company issued options exercisable for 164,211 shares of the Company's stock to Mr. Odak pursuant to the terms of his employment agreement. An additional 70,000 options, to which Mr. Odak would have been entitled under his employment agreement, were issued to executives of the Company designated by Mr. Odak. The Company also issued an additional 70,000 options to Mr. Odak, provided that the options granted to Mr. Odak are only exercisable as the options granted to the designated executives under the third amendment to Mr. Odak's employment agreement terminate (as opposed to expire) without exercise. The Company also made a matching grant of 70,000 additional options from the Company's 1996 Equity Incentive Plan to the same executives. The Company may incur quarterly compensation expense, based on any increase in the then-current stock price over the exercise price, as a result of the issuance of the initial 70,000 options (as opposed to the Company's matching grant of 70,000 additional options) to the designated executives and Mr. Odak.

In 2004, the Compensation Committee of the Board of Directors recommended to the Company's Board, which approved in concept, a modification to Mr. Odak's employment agreement to provide for the payment of the existing $9.2 million supplemental bonus in the event of Mr. Odak's death or disability while employed by the Company. Subsequently, the Compensation Committee recommended, and the Board approved in concept a modification to the employment agreement to provide for a payment of a bonus of approximately $1.6 million: (i) in the event Mr. Odak terminates his employment for Good Reason, as defined in his employment agreement; (ii) in the event Mr. Odak is terminated without Cause, as defined in the agreement; or (iii) in the event his employment agreement is not renewed at the end of its initial term in 2006. The Company has acquired an insurance policy for the benefit of the Company to cover Mr. Odak's death or disability in the approximate amount of the supplemental bonus.

In March 2001, Mr. Odak purchased 1,332,649 shares of Common Stock for $6.969 per share for an aggregate purchase price of $9.28 million. Mr. Odak paid $13,326 in cash and executed a full recourse, five-year promissory note for the balance of $9,273,905 to the Company, with interest accruing at 5.5% per annum, compounding semiannually.

As part of Mr. Odak's employment agreement, the Company agreed to purchase his home in York, Pennsylvania if he was unable to sell it within a specific period of time. In July 2001, the Company arranged for a relocation service to purchase the home from Mr. Odak for $1.6 million. Despite substantial marketing efforts, the relocation service was unable to sell the house for a reasonable price. In November 2002, Mr. Odak offered to repurchase the house for the original $1.6 million he had received. At December 28, 2002, Mr. Odak had remitted $1.35 million to the Company as partial consideration to fund the purchase and the remaining funds were funded by Mr. Odak's fiscal 2002 bonus of $250,000 to which he was contractually entitled. On March 6, 2003, the Company remitted the $1.6 million to the relocation service.

Other related parties. Mark A. Retzloff is a current member of the Company's Board of Directors, and sits on its Real Estate Committee. Mr. Retzloff is Chief Organic Officer of Aurora Organic Dairy, which derives 8% of its total revenues from sales of organic milk to the Company under the Company's private label brand. Mr. Retzloff has sat on the boards of directors of several other natural or organic companies that derive 5% of their revenues from sales of products to the Company. Stacey J. Bell, a current member of the Company's Board of Directors, is an employee of Ideasphere, Inc., which manufactures certain SKU's for the Company's private label vitamins and supplements. Total purchases from these vendors for the fiscal years ending 2004, 2003 and 2002 are $1,805,000, $905,000 and $657,000, respectively. A majority of these purchases are made primarily through our primary distributor, UNFI and therefore are indirect in nature. These costs are all for inventory and the related costs of goods sold. As of the fiscal years ending 2004 and 2003, the associated accounts payable balances were $54,000 and $54,000.

19. Change in Primary Distributor

During fiscal 2002, the Company changed its primary distributor from UNFI to Tree of Life, Inc. ("TOL"). A transition fee is referenced in the Company's June 2002 distribution agreement with TOL. In the second, third and fourth quarters of fiscal 2002, the Company used a portion of the transition fee to offset the transition costs incurred during the transition of the Company's primary distribution relationship to TOL. These costs include, but are not limited to, the cost of retagging store shelves, modification of product inventory, disposal of discontinued products, resetting of products on store shelves and training of store personnel in new procedures, and legal and consulting expenses. The portion of the transition support fee used to defray transition expenses incurred had no material impact on the Company's results of operations for the twelve months ended December 28, 2002.

During the fourth quarter of 2003, the Company and TOL agreed to terminate their primary distribution relationship, and in January 2004, the Company signed a five year primary distribution agreement with UNFI. The UNFI agreement states that UNFI will pay the Company a conversion fee to cover the costs of the transition to UNFI, which is payable over the period of the contract, subject to the Company meeting certain minimum purchase requirements. These transition costs include, but are not limited to, the cost of retagging store shelves, modification of product inventory, disposal of discontinued products, resetting of products on store shelves and training of store personnel in new procedures. The Company completed the process of transitioning to UNFI from its prior primary distributor in the first quarter of 2004.

20. Subsequent Event

On March 31, 2005, the Company entered into a five-year revolving secured credit facility with Bank of America, N.A. The new credit facility will allow borrowings and letters of credit up to a maximum of $40 million, with an option to increase up to $100 million, subject to a "borrowing base" determined by inventory levels, credit card receivables, invested cash and mortgaged leaseholds. The facility is secured by the Company's assets including, but not limited to, cash, inventory and fixed assets. Borrowings under the new credit facility bear interest, at the Company's election, at LIBOR plus 1.25% or prime. The applicable margin for LIBOR rate borrowings is variable, ranging from 1.00%, based upon the availability calculation made in accordance with the agreement. The Company is charged a 0.25% commitment fee on the unused portion of the line. There are no financial covenant requirements, except that the Company must maintain minimum excess availability (as defined in the agreement) at all times. The new credit facility also contains limitations on incurring additional indebtedness, making additional investments and permitting a change of control and cash management provisions.

Item 9A.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report due to material weaknesses in establishing restructuring reserve, lease accounting controls and insufficient personnel resources in our finance and accounting function as set forth below.

Restructuring Reserves. In 2004, management determined that the restructuring reserves for the quarter ended June 28, 2003, were understated by $500,000. An accrual had not been made for the remaining lease obligation for a closed store site in Phoenix, Arizona. The error occurred as a result of unrelated accruals relating to litigation and lease reserves that were incorrectly combined in the restructuring analysis. During the quarter ended December 27, 2003, a $500,000 adjustment was recorded to accrue for additional litigation related restructuring reserves for this closed store site. On February 11, 2005, we reported the error in previously issued quarterly financial statements on Form 8-K. We have restated our interim financial statements and related disclosures for fiscal year ended December 27, 2003 in this report to correctly report these adjustments. There was no net effect on the annual financial statements for the period ended December 27, 2003.

Lease Accounting. On February 15, 2005, management of the Company discussed with the Chairman of the Audit Committee of the Board of Directors a February 7, 2005 summary of existing GAAP applicable to lease accounting articulated by the Office of the Chief Accountant of the SEC, as well as recent restatements by several other issuers related to the same accounting issue. The Chairman of the Audit Committee instructed management to review the Company's accounting practices. On February 17, 2005, based upon the preliminary results of this review, management upon discussion with the Audit Committee concluded that our previously issued consolidated financial statements should no longer be relied upon because of lease accounting errors, and we disclosed the same on Form 8-K filed on February 18, 2005. Management has since completed its review of its lease accounting, and determined that the controls over the selection of appropriate assumptions and factors affecting its lease accounting were not effective as of January 1, 2005, as those selections were not consistent with GAAP in regards to the following areas (1) amortization of leasehold improvements and leasehold interests, (2) straight-line rent expense, (3) landlord incentives and allowances, (4) sale leaseback transactions, and (5) classification of leases as capital or operating in accordance with SFAS No. 13. We have restated our financial statements for the fiscal years ended December 27, 2003 and December 28, 2002 and the first three quarters of 2004 as presented in our Form 10-K, as amended, for the year ended January 1, 2005.

Accounting and Finance Personnel.

In conjunction with filing the Form 10-K/A, which included the restatement concerning the treatment of lease accounting as discussed above, management concluded that the Company did not have sufficient personnel with technical tax and accounting expertise to review and resolve non-routine and/or complex accounting matters within the framework of the Company s internal control structure, as designed. The Company identified a material weakness in the operation of controls over the review and oversight of its tax accounts. Specifically, due to the lack of technical expertise related to accounting for taxes, the controls, as designed, were not operating effectively to adequately reduce potential misstatements and ensure appropriate tax disclosures were being made in the Company s consolidated financial statements. Additionally, due to the lack of sufficient technical resources related to accounting and financial statement disclosure matters and as a result of errors identified by our independent auditors in the disclosures and amounts in our annual report on Form 10-K/A, the Company concluded that controls over the financial reporting process were not effective. All identified adjustments were made to the consolidated financial statements for the year ended January 1, 2005.

Internal Control over Financial Reporting

During the fourth quarter of fiscal 2004, there were no significant changes in the Company's internal control over financial reporting that materially affected or are reasonably likely to materially affect internal control over financial reporting.

During the fiscal quarter ended April 2, 2005, we corrected the deficiency in our internal controls over financial reporting for the restructuring reserve error described above by reconstructing the supporting detailed restructuring reserve schedule by specific site and type of restructuring reserve. This detailed schedule will be utilized in management's quarterly evaluation of restructuring reserves to correct this control deficiency.

The errors related to improper lease accounting resulted from the Company's incorrect interpretation of existing GAAP. To remediate this material weakness, we developed controls to strengthen our ongoing compliance with generally accepted accounting principles related to leasing issues, as well as implemented additional review procedures over the selection and monitoring of appropriate assumptions and estimates affecting lease accounting practices. These controls included reviews of all lease terms and the associated lives of additions to the Company s capitalized assets and straight-line calculations, two independent and separate capital versus operating analyses to validate the accounting treatment, regular communication between the accounting and capital asset groups to validate occupancy dates for accounting purposes and reviews of every new or modified lease undertaken by two people within the accounting function to ensure all components were accounted for consistently and in accordance with GAAP.

The Company has hired a tax consultant with requisite knowledge to ensure the deficiencies noted above related to taxes will be addressed going forward The work of the consultant will be reviewed and monitored by a member of the finance department with knowledge of tax accounting matters.

The Company has also hired three additional Certified Public Accountants into the accounting and finance departments to ensure both the controls over financial reporting are operating effectively as well as to ensure the Company s internal controls continue to be appropriately assessed. The Company has ongoing efforts to recruit and retain qualified personnel to staff the Company s finance and accounting departments.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. Control systems can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

Management s Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company s internal control over financial reporting is a process designed, under the supervision of the Company s chief executive officer and chief financial officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company has conducted an evaluation of the effectiveness of its internal controls over financial reporting as of January 1, 2005. This evaluation was based on the framework in *"Internal Control Integrated Framework"* issued by the Committee of Sponsoring Organizations of the Treadway Commission. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

As of January 1, 2005, the Company s management concluded that material weaknesses existed in its internal control over financial reporting, based on criteria in *Internal Control Integrated Framework.* A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements may not be prevented or detected. Management believes that the Company did not maintain effective controls over the financial reporting process because of the facts and circumstances that led to the two restatements of the Company s financial statements relating to restructuring reserves and lease accounting, and because the Company lacked a sufficient complement of personnel with a level of technical accounting and tax expertise that was commensurate with the Company s financial reporting requirements. As a result of these material weaknesses in the Company s internal control over financial reporting management has concluded that, as of January 1, 2005, the Company s internal control over financial reporting was not effective.

Management s assessment of the effectiveness of the Company s internal control over financial reporting as of January 1, 2005, has been audited by Ernst and Young LLP, the Company s independent registered public accounting firm, as stated in their report which appears herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Wild Oats Markets, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Wild Oats Markets, Inc. did not maintain effective internal control over financial reporting as of January 1, 2005, because of the effect of material weaknesses identified relating to accounting for restructuring reserves, lease accounting errors, and the lack of a sufficient complement of personnel with a level of technical accounting and tax expertise that was commensurate with the Company s financial reporting requirements, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Wild Oats Markets, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management s assessment: 1. under accrual of restructuring reserves due to lack of effective monitoring controls to identify this error timely, 2. insufficient controls over the selection and monitoring of appropriate assumptions and factors affecting lease accounting, and 3. the lack of a sufficient complement of personnel with a level of technical accounting and tax expertise that was commensurate with the Company s financial reporting requirements to adequately reduce potential misstatements and address the completeness and accuracy of disclosures or ensure appropriate procedures are being followed. These material weaknesses resulted in adjustments to restructuring reserves, depreciation and amortization expense, interest expense, asset impairment charges, financing lease obligations, capital leases, rent abatement liability, property, plant, and equipment, net, income tax accounts, as well as changes to required financial statement footnote disclosures. As a result of the material weaknesses related to restructuring reserves and lease accounting, Wild Oats Markets, Inc. concluded the Company s previously issued financial statements should be restated. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 financial statements, and this report does not affect our report dated March 31, 2005 on those financial statements.

In our opinion, management s assessment that Wild Oats Markets, Inc. did not maintain effective internal control over financial reporting as of January 1, 2005, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Wild Oats Markets, Inc. has not maintained effective internal control over financial reporting as of January 1, 2005, based on the COSO control criteria.

/s/ Ernst & Young LLP

Denver, Colorado
April 29, 2005

PART IV.

Item 15.

EXHIBITS AND FINANCIAL STATEMENT

SCHEDULES

(a) **Financial Statements and Financial Statement Schedules**. The following are filed as a part of this Report on Form 10-K/A:

(1)	Reports of Independent Registered Public Accounting Firms
	Consolidated Statements of Operations
	Consolidated Statements of Comprehensive Income (Loss)
	Consolidated Balance Sheets
	Consolidated Statements of Changes in Stockholders' Equity
	Consolidated Statements of Cash Flows
	Notes to Consolidated Financial Statements
(2)	Financial Statement Schedules No schedules are required.
(3)	**Exhibits**. The following exhibits to this Form 10-K/A are filed pursuant to the requirements of Item 601 of Regulation S-K:

Exhibit Number	**Description of Document**
3(i).1.(a)**	Amended and Restated Certificate of Incorporation of the Registrant. (1)
3(i).1.(b)**	Certificate of Correction to Amended and Restated Certificate of Incorporation of the Registrant. (1)
3(i).1.(c)**	Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Registrant. (2)
3(ii).1**	Amended and Restated By-Laws of the Registrant. (1)
4.1**	Reference is made to Exhibits 3(i) through 3(ii).1.
4.2**	Specimen stock certificate. (3)
4.3**	Rights Agreement dated May 22, 1998 between Registrant and Norwest Bank Minnesota. (10)
4.4**	Amendment No. 1 to Rights Agreement dated February 26, 2002 between Registrant and Wells Fargo Bank, N.A. (5)
10.1**	Form of Indemnity Agreement between the Registrant and its directors and executive officers, with related schedule. (3)

10.2#**	1996 Equity Incentive Plan, including forms of Options granted to employees and non-employee directors thereunder. (3)
10.3#**	Amendment to 1996 Equity Incentive Plan. (4)
10.4#**	Second Amendment to 1996 Equity Incentive Plan. (5)
10.5#**	1996 Employee Stock Purchase Plan. (3)
10.6#**	Amendment to 1996 Employee Stock Purchase Plan. (5)
10.7#**	1993 Stock Option Plan. (3)
10.8#**	1991 Stock Option Plan. (3)
10.9#**	Employee Stock Ownership Plan. (3)
10.10#**	Wild Oats Markets, Inc. Deferred Compensation Plan. (6)
10.11#**	Employment Agreement dated March 6, 2001 between Perry D. Odak and the Registrant. (7)
10.12#**	Amendment to Employment Agreement dated March 6, 2001 between Perry D. Odak and the Registrant. (5)
10.13#**	Stock Purchase Agreement dated March 6, 2001 between Perry D. Odak and the Registrant. (7)
10.14#**	Stephen Kaczynski Equity Incentive Plan. (8)
10.15#**	Employment Agreement dated April 24, 2001 between Stephen A. Kaczynski and the Registrant. (8)
10.16#**	Employment Agreement dated May 21, 2001 between Bruce Bowman and the Registrant. (8)
10.17#**	Amendment to Employment Agreement dated May 21, 2001 between Bruce Bowman and the Registrant. (5)
10.18#**	Bruce Bowman Equity Incentive Plan. (8)
10.19#**	Edward F. Dunlap Equity Incentive Plan. (5)
10.20#**	Gary Rawlings Equity Incentive Plan. (13)
10.21#**	Employment Agreement dated December 17, 2001 between Edward F. Dunlap and the Registrant. (5)
10.22#**	Severance Agreement dated November 7, 2002 between Bruce Bowman and the Registrant. (12)
10.23#**	Severance Agreement dated November 7, 2002 between Freya Brier and the Registrant. (12)
10.24#**	

	Severance Agreement dated November 7, 2002 between Edward Dunlap and the Registrant. (12)
10.25#**	Severance Agreement dated November 7, 2002 between Stephen Kaczynski and the Registrant. (12)
10.26#**	Severance Agreement dated November 7, 2002 between Peter Williams and the Registrant. (12)
10.27**	Wild Oats Markets, Inc. 2001 Non-officer/Non-director Equity Incentive Plan. (5)
10.28**	Amended and Restated Stockholders Agreement between the Registrant and certain parties named therein dated August 1996. (3)
10.29**	Registration Rights Agreement between the Registrant and certain parties named therein dated July 12, 1996. (3)
10.30#**	Second Amendment to Employment Agreement between Wild Oats Markets, Inc. and Perry D. Odak, dated June 19, 2002. (9)
10.31#**	Third Amendment to Employment Agreement between Wild Oats Markets, Inc. and Perry D. Odak, dated August 12, 2002. (9)
10.32**	Assignment of Kaczynski Employment Agreement dated June 29, 2002, between Registrant and Sparky, Inc. (9)
10.33**	Assignment of Dunlap Employment Agreement dated June 29, 2002, between Registrant and Wild Oats Financial, Inc. (9)
10.34**	Second Amended and Restated Credit Agreement dated as of February 26, 2003, among Registrant, the lenders named therein and Wells Fargo Bank National Association, as Administrative Agent. Portions have been omitted pursuant to a request for confidential treatment. (12)
10.35**	Joinder Agreement dated as of December 12, 2003, among Bank of America, N.A., to the Second Amended and Restated Credit Agreement among Registrant, the lenders named therein and Wells Fargo Bank National Association, Registrant and Wells Fargo. (13)
10.36**	First Amendment to Second Amended and Restated Credit Agreement, dated as of May 21, 2004, by and among Wild Oats Markets, Inc., the lenders identified therein and Wells Fargo Bank National Association, as administrative agent. (14)
10.37**	Second Amendment to Second Amended and Restated Credit Agreement, dated as of August 3, 2004, by and among Wild Oats Markets, Inc., the lenders identified therein and Wells Fargo Bank National Association, as administrative agent. (15)

10.38**	Third Amendment to Second Amended and Restated Credit Agreement dated as of November 4, 2004, by and among Wild Oats Markets, Inc., the lenders identified therein and Wells Fargo Bank, National Association, as administrative agent. Portions have been omitted pursuant to a request for confidential treatment. (17)
10.39**	Agreement for Distribution of Product between Wild Oats Markets, Inc. and United Natural Foods, Inc. dated January 9, 2004. Portions have been omitted pursuant to a request for confidential treatment. (13)
10.40**	Memorandum of Understanding between Tree of Life, Inc. and Wild Oats Markets, Inc. dated November 19, 2003. Portions have been omitted pursuant to a request for confidential treatment. (13)
10.41**	Amended Certificate of Designations of Series A Junior Participating Preferred Stock of Wild Oats Markets, Inc. (14)
10.42**	Indenture, dated as of June 1, 2004, between Wild Oats Markets, Inc. and U.S. Bank National Association, as Trustee, and Form of 3.25% Senior Convertible Debenture due 2034 of Wild Oats Markets, Inc. (16)
10.43**	Registration Rights Agreement, dated as of June 1, 2004, between Wild Oats Markets, Inc. and J. P. Morgan Securities Inc., as representative of the initial purchasers of the debentures. (16)
10.44**	Form of Restricted Stock Unit Agreement used to evidence Restricted Stock Units granted under the Wild Oats Markets, Inc. 1996 Equity Incentive Plan. (17)
21.1**	List of subsidiaries. (13)
23.1+	Consent of Ernst & Young LLP.
23.2+	Consent of PricewaterhouseCoopers LLP.
31.1+	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) / 15d-14(a) under the Securities Exchange Act of 1934, as amended.
31.2+	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) / 15d-14(a) under the Securities Exchange Act of 1934, as amended.
32.1+	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.2+	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

Management Compensation Plan.

** Previously filed.

+ Included herewith.

(1) Incorporated by reference from the Registrant's Form 10-K for the year ended December 28, 199 (File No. 0-21577).

(2) Incorporated by reference from the Registrant's Amendment No. 2 to the Registration Statement on Form S-3 filed with the Commission on November 10, 1999 (File No. 333-88011).

(3) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (File No. 333-11261) filed on August 30, 1996.

(4) Incorporated by reference from the Registration Statement on Form S-8 (File No. 333-66347) filed on October 30, 1998.

(5) Incorporated by reference from the Registrant s Form 10-K for the year ended December 29, 2001 (File No. 0-21577), filed on March 27, 2002.

(6) Incorporated by reference from the Registrant s Form 10-K for the year ended January 1, 2000 (File No. 0-21577).

(7) Incorporated by reference from the Registrant s Form 10-Q for the period ended March 31, 2001 (File No. 0-21577).

(8) Incorporated by reference from the Registrant s Form 10-Q for the period ended June 30, 2001(File No. 0-21577).

(9) Incorporated by reference from the Registrant s Form 10-Q for the period ended June 29, 2002 (File No. 0-21577).

(10) Incorporated by reference from the Registrant s Form 8-K filed on May 5, 1998 (File No. 0-21577).

(11) Incorporated by reference from the Registrant s Form 10-Q for the period ended June 28, 2003 (File No. 0-21577).

(12) Incorporated by reference from the Registrant s Form 10-K for the year ended December 28, 2002 (File No. 0-21577).

(13) Incorporated by reference from the Registrant s Form 10-K for the year ended December 27, 2003 (File No. 0-21577).

(14) Incorporated by reference from the Registrant s report dated May 25, 2004 on Form 8-K (File No. 0-21577).

(15) Incorporated by reference from the Registrant s Form 10-Q for the period ended June 26, 2004 (File No. 0-21577).

(16) Incorporated by reference from the Registrant s Registration Statement on Form S-3 filed with the Commission on August 20, 2004 (File No. 333-18406).

(17) Incorporated by reference from the Registrant s Form 10-Q for the period ended September 25, 2004 (File No. 0-21577).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Wild Oats Markets, Inc.

(Registrant)

Date: April 27, 2005

By: /s/ Edward F. Dunlap

Edward F. Dunlap

Executive Officer and Chief Financial Officer

(Principal Financial and Accounting Officer)