

WETZEL'S PRETZELS, LLC FINANCIAL STATEMENTS

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February 24, 2006

**FORTHCOMING 2005 AUDITED FINANCIAL
STATEMENTS**

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WETZEL'S PRETZELS, LLC

FINANCIAL STATEMENTS
JANUARY 2, 2005 AND DECEMBER 28, 2003

**White
Zuckerman
Warsavsky
Luna
Wolf
Hunt LLP**

Certified Public Accountants

February 25, 2005

To the Members of
Wetzel's Pretzels, LLC
Pasadena, California

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We have audited the accompanying balance sheets of Wetzel's Pretzels, LLC as of January 2, 2005 and December 28, 2003 and the related statements of operations, members' and economic interest holders' capital, and cash flows for the years then ended. 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 in accordance with generally accepted auditing standards in the United States of America. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Wetzel's Pretzels, LLC as of January 2, 2005 and December 28, 2003, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles in the United States of America.

White, Zuckerman, Warsavsky, Luna, Wolf & Hunt, LLP

WETZEL'S PRETZELS, LLC
BALANCE SHEETS
JANUARY 2, 2005 AND DECEMBER 28, 2003

ASSETS	<u>2004</u>	<u>2003</u>
Current assets		
Cash (Note 2)	\$1,576,875	\$1,815,912
Accounts receivable, net of allowance for doubtful accounts of \$17,369 in 2004 and \$21,812 in 2003	99,633	154,679
Inventories	34,993	61,099
Stores held for sale	38,660	38,660
Advertising fund (Note 3)	25,541	7,986
Prepaid and other current assets	<u>40,749</u>	<u>41,592</u>
Total currents assets	1,816,451	2,119,928
Property and equipment, net of accumulated depreciation (Note 4)	1,078,517	1,251,411
Deposits and other assets	<u>24,596</u>	<u>28,429</u>
Total assets	<u>\$2,919,564</u>	<u>\$3,399,768</u>
 LIABILITIES AND CAPITAL		
Current liabilities		
Accounts payable	\$ 164,056	\$ 185,808
Accrued liabilities (Note 5)	259,084	194,091
Deferred revenue	<u>100,000</u>	<u>70,000</u>
Total current liabilities	523,140	449,899
Deposits	<u>79,686</u>	<u>77,186</u>
Total liabilities	602,826	527,085
Commitments, contingencies and other comments (Notes 5 and 7)		
Members' and economic interest holders' capital (Note 6)	<u>2,316,738</u>	<u>2,872,683</u>
Total liabilities and capital	<u>\$2,919,564</u>	<u>\$3,399,768</u>

See accompanying notes to financial statements.

WETZEL'S PRETZELS, LLC
 STATEMENTS OF OPERATIONS
 FOR THE YEARS ENDED JANUARY 2, 2005 AND DECEMBER 28, 2003

	<u>2004</u>	<u>2003</u>
Revenues		
Company store retail sales	\$4,175,928	\$3,851,091
Wholesale food and sundry sales	773,105	695,375
Initial franchise fees	1,102,500	882,000
Franchise royalties	<u>2,206,956</u>	<u>1,818,017</u>
Total revenue	<u>8,258,489</u>	<u>7,246,483</u>
Cost of revenues		
Company store operating costs	3,383,954	3,118,546
Wholesale food and sundry costs	430,379	457,290
Franchise origination costs	683,469	608,673
Franchise operating costs	<u>657,725</u>	<u>550,088</u>
Total cost of revenues	<u>5,155,527</u>	<u>4,734,597</u>
Gross profit	3,102,962	2,511,886
Selling, general and administrative expenses	<u>1,122,745</u>	<u>1,017,241</u>
Income from operations	1,980,217	1,494,645
Other income (expenses)		
Interest income	682	3,580
Taxes on revenues (Note 1)	(120,098)	(92,002)
Gain/(loss) on disposal of assets	233,975	(9,808)
Interest expense (Note 6)	<u>(22,061)</u>	<u>(21,084)</u>
Net income	<u>\$2,072,715</u>	<u>\$1,375,331</u>

See accompanying notes to financial statements.

WETZEL'S PRETZELS, LLC
 STATEMENTS OF MEMBERS' AND
 ECONOMIC INTEREST HOLDERS' CAPITAL
 FOR THE YEARS ENDED JANUARY 2, 2005 AND DECEMBER 28, 2003
 (NOTE 6)

	<u>Preferred Members</u>	<u>Common Members</u>	<u>Economic Interest Holders</u>	<u>Total</u>
Capital balance December 29, 2002	\$1,098,594	\$ 784,886	\$ 82,443	\$1,965,923
Allocation of income	458,438	825,199	91,694	1,375,331
Distributions	(156,188)	(281,143)	(31,240)	(468,571)
Capital balance December 28, 2003	<u>1,400,844</u>	<u>1,328,942</u>	<u>142,897</u>	<u>2,872,683</u>
Allocation of income	696,660	1,236,571	139,484	2,072,715
Equity contributions (Note 7)	12,500			12,500
Transfer of interest		(6,752)	6,752	0
Distributions (Note 6)	(1,209,182)	(1,288,774)	(143,204)	(2,641,160)
Capital balance January 2, 2005	<u>\$ 900,822</u>	<u>\$1,269,987</u>	<u>\$145,929</u>	<u>\$2,316,738</u>

See accompanying notes to financial statements.

WETZEL'S PRETZELS, LLC
 STATEMENTS OF CASH FLOWS
 FOR THE YEARS ENDED JANUARY 2, 2005 AND DECEMBER 28, 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities		
Net income	\$2,072,715	\$1,375,331
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization	203,646	206,641
(Gain) loss on disposal of assets	(233,975)	9,808
Changes in operating assets and liabilities		
Decrease (increase) in accounts receivable	55,046	(72,269)
Decrease in inventories	26,106	48,579
(Increase) in advertising fund	(17,555)	(4,537)
Decrease (increase) in prepaid expenses	843	(15,882)
Decrease (increase) in deposits and other assets	3,833	(9,936)
(Decrease) increase in accounts payable	(21,752)	5,347
Increase (decrease) in accrued liabilities	48,792	(41,272)
Increase (decrease) in deferred revenue	30,000	(5,000)
Increase (decrease) in deposits	<u>2,500</u>	<u>(10,000)</u>
Net cash flows provided by operating activities	<u>2,170,199</u>	<u>1,486,810</u>
Cash flows from investing activities		
Purchase of property and equipment	(50,576)	(997,096)
Proceeds from sale of property and equipment	<u>270,000</u>	<u>-</u>
Net cash used in investing activities	<u>219,424</u>	<u>(997,096)</u>
Cash flows from financing activities		
Contribution from member	12,500	
Distribution to members	(2,641,160)	(468,572)
Net cash used in financing activities	<u>(2,628,660)</u>	<u>(468,572)</u>
Net (decrease) increase in cash	(239,037)	21,142
Cash, beginning of year	<u>1,815,912</u>	<u>1,794,770</u>
Cash, end of year	<u>\$1,576,875</u>	<u>\$1,815,912</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for:		
Interest	\$ 22,061	\$ 21,084

See accompanying notes to financial statements.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Activity

Wetzel's Pretzels, LLC (the Company) is a California limited liability company established on October 21, 1995. During 1997, the Company's Operating Agreement was amended and restated and certain Preferred Members were admitted (see Note 6). At January 2, 2005 and December 28, 2003, equity interests were held by Preferred Members, Common Members, and nonvoting Economic Interest Holders. Profits and losses are allocated among the equity interest holders according to their respective percentage interests in the Company; the allocation of losses is limited to each equity interest holder's capital contribution. Preferred Members are entitled to a priority return (see Note 6).

The Company is engaged in the business of retail and wholesale sales of hand-rolled pretzels and the development of franchise operations in the same line of business. Retail sales are made through company owned stores. Wholesale sales are made to various retail concerns who purchase frozen pretzel product and to companies licensed to sell fresh pretzel product who purchase mix from the Company. During 2004 and 2003, twenty-four and fourteen domestic franchise stores, respectively, were sold and opened. In addition, during 2004 and 2003, five foreign franchise stores were sold and opened. At January 2, 2005 and December 28, 2003, one hundred and twenty-five and ninety-one domestic franchise stores and three and four Company stores, respectively, were in operation. In addition, at January 2, 2005 and December 28, 2003, fifty-five and fifty foreign franchise stores, respectively, were in operation. At January 2, 2005, a total of approximately two hundred and eighty outlets sold fresh and frozen product.

The Company maintains its accounting records using the accrual method of accounting for both book and tax purposes.

Fiscal Year

The reporting period for the Company is the 52 or 53 week period ending on the Sunday closest to December 31. The years ended January 2, 2005 and December 28, 2003 comprise 53 and 52 week years, respectively.

Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Inventories

Inventories, consisting of food, beverages, sundries, menu boards and kitchen supplies are carried at lower of cost or market with cost determined using the first-in, first-out (FIFO) basis.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment

Leasehold improvements, furniture and equipment are depreciated on the straight-line and accelerated methods over the estimated useful lives of the related assets, which range from five to ten years. Costs of additions, renewals, and betterments are capitalized; maintenance and repairs are charged to expense when incurred.

Income Taxes

No provision has been made in the accompanying financial statements for federal or state income taxes. Under current law, no federal or state income taxes are paid directly by the LLC, as each member is held responsible for his respective share of LLC income or loss. California assesses a limited liability company tax of \$800 and a fee up to \$11,790 based on gross revenues. Certain foreign governments withhold taxes on franchise royalties at various rates.

Estimates

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

Revenues

Sales relate to the retail sales of the Company operated stores and the wholesale sales of mix, frozen food and sundries to franchisees and licensees. Franchise fees are assessed at the commencement of a franchise agreement to operate a franchise store. Under SFAS No. 45, such fees are recognized as income when the company has substantially performed all material services required by the franchise agreement, primarily training and assisting the franchisee in obtaining a store lease. Franchise royalties are charged on the retail sales of the franchise stores.

Stores Held for Sale

In some instances, the Company will locate, plan, build and operate a store as a company store before a suitable franchisee is found. In these instances, store construction costs are recorded on the balance sheet as Stores held for sale. These costs are not amortized, but are written down to market if necessary. No stores were sold in the year ended January 2, 2005. At January 2, 2005 and December 28, 2003, the Company operated one store held for sale.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 2 - CASH

Cash and cash equivalents consist of the following:

	<u>2004</u>	<u>2003</u>
Cash in banks	\$1,568,359	\$ 439,108
Cash on hand	8,516	6,557
Money market funds	<u> -</u>	<u>1,370,247</u>
	<u>\$1,576,875</u>	<u>\$1,815,912</u>

The cash and cash equivalents, maintained in high quality financial institutions, exceeded federally insured limits by \$1,300,302 and \$1,531,923 at January 2, 2005 and December 28, 2003, respectively.

NOTE 3 – ADVERTISING FUND

As a franchisor, the Company receives weekly advertising fund contributions of one percent of sales from each franchisee, as well as its Company stores. The purpose of the advertising fund is to pool advertising monies to achieve greater benefits for all contributors. The advertising fund is used for market research, advertising materials, media space, point-of-purchase materials, and public relations projects. The fund may also be used for advertising grants to franchisees, collectively on a regional basis or individually on a local basis. Up to 20 percent of fund monies may be used to compensate the Company for overhead and other expenses incurred in connection with advertising administration. The activity in the advertising fund is summarized as follows:

	<u>2004</u>	<u>2003</u>
Balance, beginning of year	(\$ 7,986)	(\$ 3,449)
Contributions from franchisees	337,405	273,491
Contributions from Company stores	32,864	32,260
Vendor marketing incentives	<u>83,483</u>	<u>85,748</u>
	445,766	388,050
Advertising cost incurred	(380,557)	(317,736)
Company overhead reimbursement	<u>(90,750)</u>	<u>(78,300)</u>
Balance, end of year	<u>(\$ 25,541)</u>	<u>(\$ 7,986)</u>

Total 2004 and 2003 advertising expense unrelated to the advertising funds was \$28,311 and, \$30,285 respectively. Such amounts were included in selling, general and administrative expenses, franchise origination costs, and company operating costs.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2004</u>	<u>2003</u>
Equipment	\$ 442,197	\$ 301,599
Furniture and fixtures	41,325	41,422
Leasehold improvements	1,168,158	1,379,163
Construction in process	<u>14,444</u>	<u>-</u>
	1,666,124	1,722,184
Less accumulated depreciation	<u>587,607</u>	<u>470,773</u>
	<u>\$1,078,517</u>	<u>\$1,251,411</u>

NOTE 5 – COMMITMENTS AND CONTINGENCIES

The Company conducts its corporate administration from one office and its retail sales from four Company stores, including one held for sale, under various leases. The following is a schedule of future minimum rental payments required under these leases as of January 2, 2005:

<u>Fiscal Year</u>	
2005	\$ 361,112
2006	323,612
2007	311,112
2008	160,630
2009	111,000
Thereafter	<u>360,750</u>
	<u>\$1,628,216</u>

During 2004 and 2003, total rent expense was \$1,030,415 and \$859,988 of which \$901,244 and \$762,025 was included in cost of revenues and \$129,171 and \$97,963 was included in selling, general and administrative expenses, respectively.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 5 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

In some instances, it is necessary for the Company to execute leases for domestic franchise locations and then sub-lease the stores to franchisees. Accordingly, the Company is contingently liable for rental payments at forty-one franchise locations in the event of franchisee default. The future minimum lease payments of such franchisees at January 2, 2005 are as follows:

2005	\$2,145,022
2006	1,848,569
2007	1,266,449
2008	833,413
2009	507,098
Thereafter	<u>264,134</u>
	<u>\$6,864,685</u>

Included in accrued liabilities at January 2, 2005 and December 28, 2003 is a \$13,455 reserve to provide for estimated costs expected to be incurred relating to early lease termination on several domestic franchise locations where the Company executed leases and sub-leased the store to franchisees.

NOTE 6 – CAPITAL STRUCTURE

The Company was capitalized in 1995 with \$200,000 in net assets from a predecessor business. Certain shareholders of the predecessor corporation became Common Members and others became nonvoting/nonmanaging Economic Interest Holders. The Common Members received a percentage interest in profits, losses and capital of 90 percent and the Economic Interest Holders received a percentage interest of 10 percent. In 1995 and 1996, additional net capital contributions of \$625,560 were made by one Common Member. Such Common Member had borrowed \$595,978 from a financial institution, payable with interest at the institution's prime rate plus .5 percent, in order to fund these capital contributions. The Company agreed to pay him the same interest on his capital that he paid to the financial institution. Such monthly payment has been classified as interest expense. In April 1997, the Company distributed \$140,000 to such Common Member to allow him to pay down the loan from the financial institution. At January 2, 2005 and December 28, 2003, the underlying loan balance was \$455,978.

Effective as of July 21, 1997, the Company entered into an Equity Purchase Agreement with certain purchasers of preferred interests of the Company. Concurrent with such transaction, the Company amended and restated its Operating Agreement.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 6 – CAPITAL STRUCTURE (CONTINUED)

Under the Equity Purchase Agreement and the amended and restated Operating Agreement, the Preferred Members contributed \$1,000,000 to the Company in exchange for equity interests in the Company which have a liquidation preference and a priority return. The liquidation preference permits the capital contributed by the Preferred Members and \$455,978 of capital contributed by one founding Common Member to be distributed on an equal preference basis from the first dollars distributed as a return of capital to equity interest holders in any future liquidation of the Company. The priority return is computed at 8 percent per annum on the unrecovered capital invested.

The unpaid priority return is to be distributed to Preferred Members prior to any other distributions of income or return of capital. In recent years, the Preferred Members have agreed to waive such requirement in order for distributions to be made to all members to cover income taxes on members' allocations of income. During the year ended January 2, 2005, the Company paid the full amount of the accrued priority return, such that it was able to distribute approximately \$1,530,000, in addition to approximately \$624,000 of tax distributions, as a general return of capital. The Preferred Members' unrecovered capital at January 2, 2005 and December 28, 2003 was \$486,938 and \$1,000,000, respectively. The Preferred Members' unpaid priority return at January 2, 2005 and December 28, 2003 was \$12,985 and \$433,534, respectively.

Preferred interests are convertible into common interests at any time at the election of each Preferred Member. The conversion price is based on prices of additional interests sold after July 21, 1997, as provided for in the amended and restated Operating Agreement.

NOTE 7 – EMPLOYEE AND OTHER BENEFIT PLANS

Retirement Plan

On June 1, 2000, the Company established a SIMPLE IRA plan for the benefit of employees who receive at least \$5,000 in compensation for the calendar year and have received at least \$5,000 in compensation during any one prior calendar year. Employees may elect to contribute a portion of their compensation up to \$7,000 per year. The Company matches such contributions on a dollar-for-dollar basis, not to exceed three percent of the employee's compensation. Contributions by the Company for the years ended January 2, 2005 and December 28, 2003, amounted to \$29,406 and \$26,981, respectively.

WETZEL'S PRETZELS, LLC
NOTES TO FINANCIAL STATEMENTS

NOTE 7 – EMPLOYEE AND OTHER BENEFIT PLANS (CONTINUED)

Deferred Compensation Plan

On July 27, 2000, the Company established a deferred compensation plan for the benefit of certain key employees as determined by the Company's Board of Managers. The terms of the plan provide for the granting of up to 366,300 "phantom units" with a defined value ("strike price") at the date of the grant. The employees' rights in the units vest over four years. Upon exercise of their vested portion of units at the time of the employees' termination or a triggering event, as defined in the plan, the employees will be paid the difference between the current fair market value, as defined in the plan, and the strike price. The period for making grants will end on June 1, 2005 and all grants must be exercised by June 1, 2010. As of January 2, 2005, the Company had granted 219,400 phantom units. The phantom units granted have a strike price of \$.30 - \$.60 per unit and the current fair market value, as defined in the plan, is approximately \$.68 per unit.

Equity Purchase Plan

The amended and restated Operating Agreement provides for the creation of an employee equity purchase plan pursuant to which common interests of up to 8 percent of the Company may be issued to employees, consultants, and non-employee managers. To date, the Company has issued two non-employee managers options to purchase approximately a 4 percent interest in the Company for \$122,500. The options were fully vested as of December 31, 2000 and had no stated expiration date. On January 1, 2004, one of the non-employee managers exercised his right to purchase .417 percent of the Company for \$12,500.