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CHEFS INTERNATIONAL INC  
Form 10QSB  
December 11, 2002

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended OCTOBER 27, 2002

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-8513

CHEFS INTERNATIONAL, INC.

-----  
(Exact name of registrant as specified in its charter)

DELAWARE

22-2058515

-----  
(State or other jurisdiction of incorporation or organization)

-----  
(IRS Employer Identification No.)

62 BROADWAY, POINT PLEASANT BEACH, NJ 08742

-----  
(Address of principal executive offices)

(Registrant's telephone number, including area code) (732) 295-0350

-----  
(Former name, former address and former fiscal year, if changed since last report.)

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\_\_\_.

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

CLASS	OUTSTANDING SHARES AT NOVEMBER 8, 2002
-----	-----
Common Stock, \$.01 par value	3,969,579

CHEFS INTERNATIONAL, INC.

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### CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

#### PART I - FINANCIAL INFORMATION

#### ITEM 1 - CONSOLIDATED FINANCIAL STATEMENTS

##### CONSOLIDATED BALANCE SHEETS

##### ASSETS

	OCTOBER 27, 2002	JANUARY 27, 2002
	-----	-----
	(Unaudited)	
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 1,264,954	\$ 1,408,062
Investments	151,000	355,825
Available for sale securities	1,587,600	1,720,802
Miscellaneous receivables	65,073	62,468
Due from landlord- related party	40,000	---
Inventories	1,100,434	1,144,189
Prepaid expenses	87,371	181,459
	-----	-----

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TOTAL CURRENT ASSETS	4,296,432	4,872,805
	-----	-----
PROPERTY, PLANT AND EQUIPMENT, at cost	21,923,699	21,229,149
Less: Accumulated depreciation	9,445,158	8,559,539
	-----	-----
PROPERTY, PLANT AND EQUIPMENT, net	12,478,541	12,669,610
	-----	-----
OTHER ASSETS:		
Investments	---	151,000
Due from landlord - related party	86,588	---
Goodwill - net	583,922	430,403
Liquor licenses - net	889,913	821,788
Non-competition agreement - net	55,761	---
Equity in life insurance policies	589,862	589,862
Deferred income taxes	1,002,000	1,166,000
Other	40,710	61,492
	-----	-----
TOTAL OTHER ASSETS	3,248,756	3,220,545
	-----	-----
TOTAL ASSETS	\$20,023,729	\$20,762,960
	=====	=====

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

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

LIABILITIES AND STOCKHOLDERS' EQUITY

	OCTOBER 27, 2002	JANUARY 27, 2002
	-----	-----
	(Unaudited)	
CURRENT LIABILITIES:		
Notes and mortgages payable	\$ 276,831	\$ 277,745
Accounts payable	584,658	1,172,442
Accrued payroll	156,978	196,675
Accrued expenses	718,303	462,806
Income taxes payable	28,296	---
Gift certificates	270,726	461,610
	-----	-----
TOTAL CURRENT LIABILITIES	2,035,792	2,571,278
	-----	-----
NOTES AND MORTGAGE PAYABLE	1,986,298	1,816,930
	-----	-----
OTHER LIABILITIES	714,456	618,307

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STOCKHOLDERS' EQUITY:		
Capital stock - common \$.01 par value, Authorized 15,000,000 shares, Issued 3,969,579 and 3,969,508 respectively	39,696	39,695
Additional paid-in capital	31,549,491	31,549,492
Accumulated (deficit)	(15,790,360)	(15,739,658)
Accumulated other comprehensive (loss)	(507,759)	(89,199)
Treasury stock	(3,885)	(3,885)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	15,287,183	15,756,445
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$20,023,729	\$20,762,960
	=====	=====

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

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	NINE MONTHS ENDED		
	OCTOBER 27, 2002	OCTOBER 28, 2001	OCTOBER 2
	-----	-----	-----
SALES	\$ 18,550,308	\$ 16,899,502	\$ 5,96
COST OF GOODS SOLD	5,740,775	5,352,406	1,85
	-----	-----	-----
GROSS PROFIT	12,809,533	11,547,096	4,10
	-----	-----	-----
OPERATING EXPENSES:			
Payroll and related expenses	5,795,477	4,915,787	1,87
Other operating expenses	4,007,213	3,372,589	1,33
Depreciation and amortization	892,983	827,143	30
General and administrative expenses	1,492,464	1,525,027	50
	-----	-----	-----
TOTAL OPERATING EXPENSES	12,188,137	10,640,546	4,01
	-----	-----	-----
INCOME FROM OPERATIONS	621,396	906,550	9
	-----	-----	-----
OTHER INCOME (EXPENSE):			
Interest expense	(135,288)	(74,184)	(4
Investment income	120,593	150,747	4
	-----	-----	-----
OTHER INCOME, (EXPENSE) NET	(14,695)	76,563	(
	-----	-----	-----

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INCOME BEFORE INCOME TAXES	606,701	983,113	8
PROVISION FOR INCOME TAXES	227,000	(1,117,000)	4
	-----	-----	-----
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	379,701	2,100,113	4
CUMULATIVE EFFECT OF AN ACCOUNTING CHANGE (Note 2) - GOODWILL ACCOUNTING METHOD	(430,403)	---	-----
	-----	-----	-----
NET INCOME (LOSS)	\$ (50,702)	\$2,100,113	\$ 4
	=====	=====	=====
INCOME PER COMMON SHARE BEFORE CUMULATIVE EFFECT OF AN ACCOUNTING CHANGE	\$ .10	\$ .50	\$
CUMULATIVE EFFECT OF AN ACCOUNTING CHANGE - GOODWILL ACCOUNTING METHOD	(.11)	---	-----
	-----	-----	-----
NET INCOME (LOSS) PER COMMON SHARE	\$ (.01)	\$ .50	\$
	=====	=====	=====
Number of shares outstanding	3,969,579	4,211,947	3,96

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

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED OCTOBER 27, 2002 AND OCTOBER 28, 2001 (Unaudited)

	2002
	-----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income (loss)	\$ (50,702)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization	892,983
Cumulative effect of an accounting change	430,403
Deferred income taxes	164,000
Gain on sale of assets and investments	(5,154)
Changes in assets and liabilities:	
Miscellaneous receivables	(129,193)
Inventories	68,230
Prepaid expenses	94,088
Accounts payable	(170,684)
Accrued expenses and other liabilities	13,511
Income taxes payable	28,296
	-----

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NET CASH PROVIDED BY OPERATING ACTIVITIES	1,335,778 -----
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(960,107)
Acquisition of restaurant assets	(891,190)
Sale or redemption of investments	409,820
Purchase of investments	(226,645)
Other	20,782
	-----
NET CASH (USED IN) INVESTING ACTIVITIES	(1,647,340) -----
CASH FLOWS FROM FINANCING ACTIVITIES:	
Repayment of debt	(331,546)
Proceeds from debt	500,000
Purchase of treasury stock	---
Purchase of common stock	---
	-----
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	168,454 -----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(143,108)
CASH AND CASH EQUIVALENTS:	
Beginning	1,408,062 -----
Ending	\$ 1,264,954 =====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash payment for:	
Interest paid	\$ 135,207 =====
Income taxes paid	\$ 21,506 =====
Noncash Transactions:	
Other comprehensive (loss):	
Decrease in fair value of securities available for sale	\$ (311,006) =====
Change in fair value of derivatives accounted for as hedges	\$ (107,554) =====

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

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### NOTE 1: BASIS OF PRESENTATION

The accompanying financial statements have been prepared by Chefs International,

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Inc. (the "Company") and are unaudited. In the opinion of the Company's management, all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the Company's consolidated financial position, results of operations and cash flows for the periods presented have been made. Certain information and footnote disclosures required under generally accepted accounting principles have been condensed or omitted from the consolidated financial statements pursuant to the rules and regulations of the SEC. The consolidated financial statements and notes thereto should be read in conjunction with the Company's audited consolidated financial statements for the year ended January 27, 2002 and notes thereto included in the Company's Annual Report on Form 10-KSB filed with the SEC. The results of operations and the cash flows for the nine month period ended October 27, 2002 presented in the consolidated financial statements are not necessarily indicative of the results to be expected for any other interim period or the entire fiscal year.

### NOTE 2: ACCOUNTING FOR BUSINESS COMBINATIONS

In July 2001, the FASB issued Statements of Financial Accounting Standards ("Statement") No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"). These standards change the accounting for business combinations by, among other things, prohibiting the prospective use of pooling-of-interests accounting and requiring companies to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Instead, goodwill and intangible assets deemed to have an indefinite useful life will be subject to an annual review for impairment. The new standards were effective for the Company in the first quarter of Fiscal 2003 and for purchase business combinations consummated after June 30, 2001. The Company completed its initial goodwill impairment testing during the first quarter of Fiscal 2003, and initially determined that there was no impairment of goodwill. However, the Company subsequently revised its conclusion solely because the aggregate market capitalization of the Company is less than its book value (market capitalization at January 28, 2002 was \$8,923,406 versus a book value of \$15,756,445). Therefore, the Company has restated its results for the first quarter of Fiscal 2003 and recorded a one-time, noncash charge of \$430,403 to reduce the carrying value of its goodwill. Such charge is reflected as a cumulative effect of an accounting change in the accompanying consolidated statement of operations. The Company is currently in the process of completing its annual impairment testing and any further reduction in the value of its goodwill will be reflected in its year-end results.

Had SFAS No. 142 been effective at the beginning of Fiscal 2002, the non-amortization provisions would have had the following effect on the results of the quarter and 9-months ended October 28, 2001:

	Quarter Ended	
	OCTOBER 27, 2002	OCTOBER 28, 2001
Reported net income	\$ 45,498	\$ 1,346,781
Add back: Amortization of intangibles	0	13,435
	-----	-----
Adjusted net income	\$ 45,498	\$ 1,360,216
	=====	=====
Basic and Diluted earnings per share		
Reported net income per share	\$ .01	\$ .33
Amortization of intangibles	---	---
	-----	-----
Adjusted net income per share - basic	\$ .01	\$ .33

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	9-months Ended	
	OCTOBER 27, 2002	OCTOBER 28, 2001
	-----	-----
Reported net (loss) income	\$ (50,702)	\$ 2,100,113
Add back: Amortization of intangibles	0	40,307
	-----	-----
Adjusted net (loss) income	\$ (50,702)	\$ 2,140,420
Add back: Cumulative effect of change in accounting principle	430,403	---
	-----	-----
Adjusted earnings before cumulative effect of change in accounting principle	\$ 379,701	\$ 2,140,420
	=====	=====
Basic and Diluted earnings per share		
Reported net (loss) income per share	\$ (.01)	\$ .50
Amortization of intangibles	---	.02
	-----	-----
Adjusted net (loss) income per share - basic	\$ (.01)	\$ .52
Add back: Cumulative effect of change in accounting principle	.11	---
	-----	-----
Adjusted earnings per share before cumulative effect of change in accounting principle - basic	\$ .10	\$ .52
	=====	=====

NOTE 3: ACQUISITION

On April 1, 2002, the Company acquired for \$891,190 the inventory, furniture, fixtures, equipment, liquor license and franchising rights of a restaurant business located in Florida known as Mr. Manatee's Casual Grille. In connection with the acquisition, the Company entered into a five-year lease, effective April 1, 2002, which requires minimum annual rentals of \$96,000. The lease contains three five-year renewal options and includes a Company option to purchase the property during the first term of the lease for \$1,075,000.

NOTE 4: EARNINGS PER SHARE

Basic earnings per share is computed using the weighted average number of shares of common stock outstanding during the period.

NOTE 5: INVENTORIES

Inventories consist of the following:	OCTOBER 27, 2002	JANUARY 27, 2002
	-----	-----
Food	\$ 479,678	\$ 564,547
Beverages	163,230	149,735



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Supplies	457,526	429,907
	-----	-----
	\$ 1,100,434	\$ 1,144,189
	=====	=====

### NOTE 6: INCOME TAXES

At October 27, 2002, the Company had net deferred tax assets of approximately \$2,232,000 arising principally from net operating loss carryforwards. However, due to the uncertainty that the Company will generate sufficient income in the future to fully or partially utilize these carryforwards, an allowance of \$1,230,000 has been established to offset these assets. Management has determined that it is more likely than not that future taxable income will be sufficient to partially utilize the net operating loss carryforwards.

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### NOTE 7: DEPRECIATION AND AMORTIZATION

The Company depreciates its property and equipment using the straight-line method over the estimated useful lives of the assets, ranging from three to forty years.

### NOTE 8: HEDGING INSTRUMENTS

As of January 29, 2001, the Company adopted the provisions of the new accounting standard, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, which requires that the fair value of all derivative financial instruments be recorded on the Company's consolidated balance sheet as assets or liabilities. The Company has interest rate swap agreements relating to substantially all of its variable rate debt. The interest rate swap agreements are designated as cash flow hedges and are reflected at fair value in the consolidated balance sheet and the related losses on these contracts are deferred in stockholders' equity as a component of accumulated other comprehensive (loss).

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

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

#### SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements regarding future performance in this Quarterly Report on Form 10-QSB constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995. No assurance can be given that the future results covered by the forward-looking statements will be achieved. The Company cautions readers that important factors may affect the Company's actual results and could cause those results to differ materially from the forward-looking statements. Such factors include, but are not limited to, changing market conditions, weather, the state of the economy, substantial increases in insurance costs (in addition to those substantial increases which commenced in April 2002), the impact of competition to the Company's restaurants, pricing and acceptance of the Company's food products.

#### SIGNIFICANT TRANSACTIONS AND NONRECURRING ITEMS

As more fully described herein and in the related footnotes to the accompanying consolidated financial statements, the comparability of Chefs International, Inc.'s operating results has been affected by certain significant transactions and nonrecurring items in each period. During 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting standards No. 142 "Goodwill and Other Intangible Assets" ("FAS 142"), which requires that, effective for years beginning on or after January 1, 2002, goodwill, and certain other intangible assets deemed to have an indefinite useful life, cease amortizing. Under the new rules goodwill and certain intangible assets must be assessed for impairment using fair value measurement techniques. The Company completed its initial goodwill impairment testing during the first quarter of Fiscal 2003, and initially determined that there was no impairment of goodwill. However, the Company has subsequently revised its conclusion solely because the aggregate market capitalization of the Company was exceeded by its book value. Therefore, the Company has restated its results for the first quarter of Fiscal 2003, and recorded a \$430,403 impairment of goodwill. The charge is reflected as a cumulative effect of an accounting change in the accompanying consolidated financial statements. In order to enhance comparability, the Company compares current year results to the prior year exclusive of this charge.

#### OVERVIEW

The Company's principal source of revenue is from the operations of its restaurants. The Company's cost of sales includes food and liquor costs. Operating expenses include labor costs, supplies and occupancy costs (rent, insurance and utilities), marketing and maintenance costs. General and administrative expenses include costs incurred for corporate support and administration, including the salaries and related expenses of personnel and the costs of operating the corporate office at the Company's headquarters in Point Pleasant Beach, New Jersey.

The Company currently operates eleven restaurants on a year-round basis. At the year ended January 27, 2002, the Company was operating nine restaurants on a year-round basis. Seven of the restaurants are free-standing seafood restaurants in New Jersey and Florida and are operated under the names "Jack Baker's Lobster Shanty" or "Baker's Wharfside." At said date, the Company was also operating a Mexican theme restaurant in New Jersey under

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the name "Garcia's." The Company opened its first seafood restaurant in November 1978 and opened its Garcia's restaurant in April 1996. In February 2000, the Company commenced the operation of the ninth restaurant, Moore's Tavern and Restaurant, ("Moore's"), a free-standing restaurant in Freehold, New Jersey serving an eclectic American food type menu. On January 29, 2002, the Company commenced operation of its tenth restaurant, Escondido's Mexican Restaurant ("Freehold"), a Mexican theme restaurant located in Freehold, New Jersey, adjacent to Moore's. On February 1, 2002, Garcia's began to operate under the trade name Escondido's ("Monmouth"). On April 1, 2002, the Company commenced operations of its eleventh restaurant, Mr. Manatee's Casual Grille ("Manatee's"), a casual theme restaurant primarily featuring seafood items, located in Vero Beach, Florida near the Company's Vero Beach, Florida Lobster Shanty.

Generally, the Company's New Jersey seafood restaurants derive a significant portion of their sales from May through September. The Company's Florida seafood restaurants derive a significant portion of their sales from January through April. The Company's Monmouth Escondido's restaurant derives a significant portion of its sales during the holiday season from Thanksgiving through Christmas. Moore's experiences a seasonality factor similar to but not as dramatic as the seasonality factor of the New Jersey seafood restaurants. The Company anticipates that Freehold Escondido's will experience a seasonality factor similar to Moore's and that Manatee's will follow the seasonality pattern of the other Florida restaurants.

The Company operated nine restaurants during the nine months ended October 28, 2001.

### RESULTS OF OPERATIONS

#### SALES.

Sales for the nine months ended October 27, 2002 ("fiscal 2003") were \$18,550,300, an increase of \$1,650,800 or 9.8%, as compared to \$16,899,500 for the nine months ended October 28, 2001 ("fiscal 2002"). For the third quarter ended October 27, 2002, sales were \$5,966,200, an increase of \$577,100 or 10.7%, as compared to last year's third quarter. The increases include sales of \$1,218,100 and \$348,100 for the nine and three month periods at the Freehold Escondido's which opened on January 29, 2002 and sales of \$962,800 and \$352,700 at Manatee's, which opened on April 1, 2002. The other nine restaurants combined had decreased sales of approximately \$530,100 or 3.1% and \$123,700 or 2.3% for the nine and three month periods versus last year. The primary reasons for the decline in sales were the weak tourist and summer seasons in Florida, where sales were off by \$290,800 or 5.8% and \$7,100 or .6% for the nine and three month periods, due to public concerns about air travel safety after September 11, 2001 (see reduced customer traffic at Disney in Orlando), the slowing economy and fears that it may result in another recession, a dismal stock market performance during the second and third quarters which impacted discretionary spending and consumer confidence, concerns about Iraq, and, similar to the Florida tourist season, a slow summer and third quarter at the New Jersey restaurants, where sales were lower by \$239,300 or 2% and \$116,600 or 2.7% for the nine and three month periods ended October 27, 2002. Despite recording a slight increase in sales for the first quarter ended April 28, 2002, the New Jersey restaurants recorded lower sales during both the summer tourist season and the third quarter this year. The number of customers served in the nine restaurants which operated during the comparable nine and three month periods fell by 4.7% and 3.8% respectively, while the average check paid per customer increased by 1.6% for both periods versus last year. The average check paid per customer at both Freehold Escondido's and Manatee's is less than at the seven seafood restaurants and Moore's and higher than at Monmouth Escondido's.

## GROSS PROFIT; GROSS MARGIN.

Gross profit was \$12,809,500 or 69.1% of sales for the nine month period and \$4,107,800 or 68.9% of sales for the third quarter ended October 27, 2002, compared to \$11,547,100 or 68.3% and \$3,679,400 or 68.3% for the comparable periods of fiscal 2002. The primary reason for the improvement was the lower costs of high volume seafood items including shrimp, scallops, flounder and lobster, which are primary components of the Company's menus. Additionally, the Company's gross profit was improved by the addition of both Freehold Escondido's which offers a lower cost Mexican fare and Manatee's which offers a lower cost seafood menu.

## OPERATING EXPENSES.

Total operating expenses increased by 14.5% from \$10,640,500 during the first nine months of fiscal 2002 to \$12,188,100 during the first nine months of fiscal 2003, and by 12.4% from \$3,572,800 during the third quarter of fiscal 2002 to \$4,015,800 during the third quarter of fiscal 2003. Payroll and related expenses were 31.2% of sales for the nine months and 31.4% for the third quarter this year compared to 29.1% and 29.5% respectively for the comparable periods last year. The increase in payroll expenses as a percent of sales is attributable to several reasons: the substantial decrease in sales in the nine restaurants that operated during the comparable periods, health insurance premiums which increased by more than 30% on April 1, 2002, and the overall higher payroll costs at the two new restaurants. Historically, new restaurants have higher operating expenses during the first few months of operation. Other operating expenses increased to 21.6% of sales versus 20% of sales for the nine month comparison and to 22.3% versus 20.4% for the three month comparison primarily due to the addition of the two new restaurants and higher occupancy costs resulting from higher property insurance premiums and higher real estate taxes. The Company's property and casualty insurance coverages renewed in April 2002 at an overall increase of 26%. However, the property component of the insurance package, which is included in the Company's occupancy costs, was renewed with a 56% rate increase.

Depreciation and amortization expenses increased by approximately \$65,800 and \$27,200 over last year for the nine and three month periods ended October 27, 2002 due to the depreciation expenses associated with the \$1,334,200 renovation of the Freehold Escondido's and the \$866,700 purchase of the furniture, fixtures, equipment, liquor license and franchising rights of Manatee's offset by the reduction in amortization costs due to the Company's adoption of SFAS No. 142. Effective January 28, 2002 the Company no longer amortizes indefinite life goodwill and intangible assets (liquor licenses) as a charge to earnings.

General and administrative expenses were lower by approximately \$32,600 and \$103,100 versus last year for the nine and three month periods. Despite an increase of approximately \$59,000 in insurance costs this year, total general and administrative expenses were lower because the total for fiscal 2002 included higher salaries of approximately \$35,000 and \$80,000 to terminate an agreement with Garcimex of New Jersey to operate the Company's Garcia's Mexican Restaurant which now operates as Escondido's (Monmouth).

## OTHER INCOME AND EXPENSE.

Interest expense increased by \$61,100 and \$12,800 for the nine and three month periods ended October 27, 2002 as compared to the comparable periods last year due to the interest expense associated with a \$1,200,000 bank loan the Company borrowed from its primary bank to finance the renovation of Freehold Escondido's

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and the \$500,000 bank line of credit which the Company used to partially finance the acquisition of Manatee's. The \$1,200,000

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loan is repayable in monthly installments of principal with interest at an annual rate of 7.57% through September 2011. In June 2002 the Company borrowed \$500,000 from the bank to paydown its \$500,000 bank line of credit. The new loan is repayable in monthly installments of principal with interest at a variable rate of LIBOR plus 2% through May 2007. The entire \$500,000 bank line of credit is currently available for use through June 2003. Investment income was \$30,200 and \$22,800 less for the nine and three month periods ended October 27, 2002 due to the substantially lower rates of interest available for investments.

### NET INCOME.

Net income, before the \$430,403 charge for goodwill impairment, for the nine months ended October 27, 2002, was \$379,700 or \$.10 per share compared to net income of \$2,100,100 or \$.50 per share for the nine months ended October 28, 2001. For the quarter ended October 27, 2002, net income was \$45,500 or \$.01 per share as compared to net income of \$1,346,800 or \$.33 per share for last year's third quarter. The primary reasons for the decline in net income this year are the reduced sales and profits resulting from weak tourist seasons in both Florida and New Jersey, the higher operating expenses of the two new restaurants, the substantial increase in all insurance costs and the increase in interest expense associated with the two new bank loans.

Additionally, last year's net income included the recognition of a deferred tax asset of \$1,223,000 or .30 per share related to the Company's net operating loss carryforwards (see note 6). Prior to the third quarter of fiscal 2002, the Company had fully reserved against the future benefits of its net operating loss carryforwards as utilization of these losses was not assured. In the third quarter of fiscal 2002, the Company recognized a deferred tax asset associated with the benefit of utilizing the operating loss carryforwards as management determined, at that time, that future taxable income would be sufficient to partially utilize the loss carryforwards. Accordingly, the results of operations for the nine and three months ended October 27, 2002 include a deferred tax provision associated with the utilization of the Company's net operating loss carryforwards.

### LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations primarily from revenues derived from its restaurants.

The Company's ratio of current assets to current liabilities was 2.11:1 at October 27, 2002 compared to 1.90:1 at the year ended January 27, 2002. Working capital was \$2,260,000 at October 27, 2002 versus \$2,301,500 at the year-end, a decrease of \$41,500. During the nine months ended October 27, 2002, net cash decreased by \$143,100. Net cash provided by operating activities was \$1,335,800. The primary components were net income, after adjustment for depreciation, deferred income taxes and a cumulative effect of an accounting change, of \$1,436,700, a decrease in prepaid expenses of \$94,100 primarily due to the financing of the Company's property insurance renewal over a twelve month period, an increase of \$129,200 in miscellaneous receivables primarily due to costs associated with the construction of a paved parking area for the two Freehold, New Jersey restaurants, and a decrease in accounts payable of \$170,700. On September 1, 2002, the Company entered into a five year agreement with Moore's Realty (a partnership owned by the principal shareholders of the Company), the landlord of the Company's Moore's Tavern Restaurant ("Moore's"),

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and Escondido's Mexican Restaurant ("Escondido's"), to lease land for use as an enlargement of the two restaurants' common parking area. The Company will pay a minimum of \$40,000 per year, payable in monthly installments of \$3,333, during the first five years of

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the agreement which also includes three (3) five (5) year extensions. The landlord agreed to reimburse the Company up to a maximum of \$150,000 for costs associated with the construction of the parking area by providing credit against the monthly rent. During the third quarter, the Company spent approximately \$133,200 to construct the parking area which has been classified as a receivable on the balance sheet. At October 27, 2002, the landlord owed the Company approximately \$126,500 in future rent credits.

Investing activities during the first nine months of fiscal 2003 resulted in a net cash outflow of \$1,647,300. Capital expenditures were \$1,826,800 with the major components including \$866,700 for the April 1, 2002 acquisition of the furniture, fixtures, equipment, liquor license and franchising rights of Manatee's, approximately \$543,000 for restaurant improvements and company vehicles, and the payment of \$417,100 of accounts payable from January 27, 2002 associated with the renovation of Escondido's in Freehold. Other investing activities included investment purchases of available-for-sale securities totaling \$226,600 offset by \$409,800 from the sale of investments and proceeds of maturing certificates of deposit. At October 27, 2002, the fair value of the Company's holdings of available-for-sale securities resulted in net unrealized losses of \$344,800 compared to the investment cost of those securities, primarily due to the dismal performances of the US stock markets. The resulting losses are reported in stockholders' equity as a component of accumulated other comprehensive (loss).

Financing activities for the first nine months of fiscal 2003 generated a net cash flow of \$168,500 and included debt repayment of \$331,500 and bank loan proceeds of \$500,000 which were used to partially finance the purchase of assets of Manatee's.

During the corresponding nine month period ended October 28, 2001, working capital increased by \$1,448,600 and net cash increased by \$1,047,000. The primary components of last year's cash flow were net income, after adjustment for depreciation and deferred income taxes of \$1,704,300, capital expenditures of \$598,700 for restaurant improvements, company vehicles and design and construction costs at the Freehold Escondido's, investment purchases totaling \$832,200 for available-for-sale securities, debt repayment of \$150,300, bank loan proceeds of \$1,200,000 which were used to finance the renovation of Escondido's, and approximately \$17,200 to repurchase 17,916 shares of the Company's outstanding stock pursuant to a Stock Repurchase Plan authorized by the Company's Board of Directors in May, 2000. The Stock Repurchase Plan expired in May 2002. Additionally, during the third quarter of fiscal 2002, the Company paid \$569,900 to purchase a block of an aggregate 262,603 shares of the Company's outstanding common stock from three stockholders and their affiliates at \$2.10 per share, for cash.

Management believes that funds from operations and the Company's \$500,000 bank line of credit will be sufficient to meet obligations for the restaurants for the balance of fiscal 2003, including planned capital expenses of approximately \$75,000 in addition to those incurred during the first nine months.

### INFLATION.

It is not possible for the Company to predict with any accuracy the effect of

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inflation upon the results of its operations in future years. In general, the Company is able to increase menu prices to counteract the majority of the inflationary effects of increasing costs with the exception of the substantial increase in insurance costs that the Company will have to absorb in fiscal 2003.

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### CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

#### ITEM 3 - CONTROLS AND PROCEDURES

(a) EXPLANATION OF DISCLOSURE CONTROLS AND PROCEDURES. The Company's principal executive and principal financial officer after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c) as of a date within 90 days of the filing date of this quarterly report (the "Evaluation Date")) has concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to him by others within those entities, particularly during the period in which this quarterly report was being prepared.

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

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### CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

#### PART II - OTHER INFORMATION

#### ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

99.1 Certification of Principal Executive and Principal Financial Officer of the Company pursuant to 18 United States Code Section 1530.

(b) REPORTS OF FORM 8-K

No reports on Form 8-K were filed during the quarter ended October 27, 2002.

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

SIGNATURE

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

CHEFS INTERNATIONAL, INC.

/s/ Anthony C. Papalia

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ANTHONY C. PAPALIA  
Principal Executive and Financial Officer

DATED: December 11, 2002

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CHEFS INTERNATIONAL, INC. AND SUBSIDIARIES

PRINCIPAL EXECUTIVE

AND PRINCIPAL FINANCIAL OFFICER

CERTIFICATION

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I, Anthony C. Papalia, Principal Executive and Principal Financial Officer of Chefs International, Inc. (the "Company") do hereby certify that:

(1) I have reviewed this quarterly report on Form 10-QSB of the Company for the quarterly period ended October 27, 2002;

(2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by



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this quarterly report;

(3) Based on my knowledge, the financial statements and other financial information included in this quarterly report, fairly present in all material respects, the financial condition, results of operations and cash flows of the Company as of, and for, the period presented in this quarterly report;

(4) I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Company and I have:

- (a) designed such disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this quarterly report was being prepared;
- (b) evaluated the effectiveness of the Company's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
- (c) presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on my evaluation as of the Evaluation Date;

(5) I have disclosed, based on my most recent evaluation, to the Company's auditors and the audit committee of the Company's board of directors:

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- (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Company's ability to record, process, summarize and report financial data and have identified for the Company's auditors any material weaknesses in internal controls; and
- (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls; and

(6) I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of my most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: December 11, 2002

/s/ ANTHONY C. PAPALIA

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Anthony C. Papalia  
Principal Executive and  
Principal Financial Officer  
Chefs International, Inc.

