

MORTONS RESTAURANT GROUP INC
Form 10-Q
August 17, 2004

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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

For the quarterly period ended July 4, 2004

OR

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

For the transition period from to

Commission file number 1-12692

MORTON S RESTAURANT GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

13-3490149
(I.R.S. employer identification no.)

**3333 New Hyde Park Road, Suite 210, New Hyde Park,
New York**
(Address of principal executive offices)

11042
(Zip code)

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

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

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

As of August 17, 2004, the registrant had 1,000 shares of its Common Stock, \$0.01 par value, outstanding.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

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Part I - Financial Information

Item 1. Financial Statements

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(amounts in thousands)

| | July 4, 2004 (unaudited) | January 4, 2004 |
|--|--------------------------------|--------------------|
| <u>Assets</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,278 | \$ 17,997 |
| Restricted cash | 1,021 | 1,100 |
| Marketable securities | 1,741 | |
| Accounts receivable | 3,042 | 3,829 |
| Inventories | 9,483 | 9,094 |
| Prepaid expenses and other current assets | 5,887 | 5,069 |
| Deferred income taxes | 6,523 | 7,076 |
| Total current assets | 29,975 | 44,165 |
| Property and equipment, at cost: | | |
| Furniture, fixtures and equipment | 15,133 | 14,131 |
| Buildings and leasehold improvements | 39,088 | 38,667 |
| Land | 8,474 | 8,474 |
| Construction in progress | 2,294 | 338 |
| | 64,989 | 61,610 |
| Less accumulated depreciation and amortization | 10,352 | 7,500 |
| Net property and equipment | 54,637 | 54,110 |
| Intangible asset | 92,000 | 92,000 |
| Goodwill | 61,552 | 61,552 |
| Other assets and deferred expenses, net | 9,791 | 10,360 |
| | \$ 247,955 | \$ 262,187 |

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets, Continued

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

| | July 4, 2004 (unaudited) | January 4, 2004 |
|---|--------------------------------|--------------------|
| <u>Liabilities and Stockholder s Equity</u> | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,980 | \$ 6,111 |
| Accrued expenses | 23,393 | 27,955 |
| Current portion of obligations to financial institutions | 497 | 658 |
| Accrued income taxes | 47 | 296 |
| Total current liabilities | 29,917 | 35,020 |
| 7.5% senior secured notes, net of unamortized discount of \$14,157 and \$14,987 at July 4, 2004 and January 4, 2004 | 90,843 | 90,013 |
| Obligations to financial institutions, less current maturities | 6,903 | 12,274 |
| Deferred income taxes | 20,471 | 20,471 |
| Other liabilities | 2,957 | 2,087 |
| Total liabilities | 151,091 | 159,865 |
| Commitments and contingencies | | |
| Stockholder s equity: | | |
| Common stock, \$0.01 par value per share. Authorized, issued and outstanding 1,000 shares at July 4, 2004 and January 4, 2004 | | |
| Additional paid-in capital | 97,076 | 97,075 |
| Accumulated other comprehensive income | 70 | 128 |
| (Accumulated deficit) retained earnings | (282) | 5,119 |
| Total stockholder s equity | 96,864 | 102,322 |
| | \$ 247,955 | \$ 262,187 |

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(amounts in thousands)

| | Three month periods ended | | Six month periods ended | |
|---|---------------------------|------------------|-------------------------|--|
| | July 4, 2004 | June 29, 2003 | July 4, 2004 | June 29, 2003 Restated (see Note 2) |
| | (unaudited) | | | |
| Revenues | \$ 64,911 | \$ 59,746 | \$ 137,892 | \$ 124,862 |
| Food and beverage costs | 21,988 | 19,865 | 46,462 | 41,860 |
| Restaurant operating expenses | 31,042 | 29,226 | 63,242 | 59,351 |
| Pre-opening costs, depreciation, amortization and non-cash charges | 2,157 | 1,858 | 4,187 | 4,296 |
| General and administrative expenses | 4,662 | 3,781 | 9,548 | 7,817 |
| Marketing and promotional expenses | 2,240 | 1,108 | 4,869 | 2,575 |
| Costs associated with the repayment of certain debt | | | 264 | |
| Interest expense, net | 2,866 | 1,435 | 5,937 | 3,076 |
| Management fee paid to related party | 700 | 700 | 1,400 | 1,400 |
| (Loss) income before income taxes | (744) | 1,773 | 1,983 | 4,487 |
| Income tax (benefit) expense | (223) | 532 | 595 | 1,334 |
| Net (loss) income | \$ (521) | \$ 1,241 | \$ 1,388 | \$ 3,153 |

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(amounts in thousands)

| | Six month periods ended | |
|---|--------------------------|---------------|
| | July 4, 2004 | June 29, 2003 |
| | Restated (see Note 2) | |
| | (unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 1,388 | \$ 3,153 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization and other non-cash charges | 5,338 | 3,426 |
| Deferred income taxes | 553 | 1,108 |
| Change in assets and liabilities: | | |
| Accounts receivable | 784 | 2,679 |
| Income taxes receivable | | 251 |
| Inventories | (399) | 216 |
| Prepaid expenses and other assets | (792) | 1,548 |
| Accounts payable, accrued expenses and other liabilities | (4,158) | (7,718) |
| Accrued income taxes | (254) | (103) |
| Net cash provided by operating activities | 2,460 | 4,560 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (3,638) | (2,360) |
| Increase in marketable securities | (1,741) | |
| Net cash used in investing activities | (5,379) | (2,360) |
| Cash flows from financing activities: | | |
| Principal reduction on obligations to financial institutions and capital leases | (5,532) | (7,853) |
| Proceeds from obligations to financial institutions | | 5,900 |
| Payment of deferred financing costs | (550) | |
| Dividends paid | (6,789) | |
| Decrease in restricted cash | 79 | |
| Net cash used in financing activities | (12,792) | (1,953) |
| Effect of exchange rate changes on cash | (8) | 42 |
| Net (decrease) increase in cash and cash equivalents | (15,719) | 289 |
| Cash and cash equivalents at beginning of period | 17,997 | 1,703 |
| Cash and cash equivalents at end of period | \$ 2,278 | \$ 1,992 |

See accompanying notes to unaudited consolidated financial statements.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

July 4, 2004 and June 29, 2003

1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Morton s Restaurant Group, Inc. and its subsidiaries (the Company, we, us and our) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the Annual Report on Form 10-K for the fiscal year ended January 4, 2004.

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

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

The Company uses a 52/53 week fiscal year which ends on the Sunday closest to January 1. Approximately every six or seven years, a 53rd week will be added. Fiscal 2003 was a 53 week year.

2) Restatement of Consolidated Financial Statements

The effect of the restatement discussed herein on the Company s results as of and for the fiscal year ended January 4, 2004 was reflected in the Company s Annual Report on Form 10-K. The Company has restated its consolidated financial statements for the three month period ended March 30, 2003 and six month period ended June 29, 2003 as a result of having incorrectly provided estimates for expirations and non-redemption of gift certificates that it had sold. The effect of the restatement was to reduce revenues for the three month period ended March 30, 2003 in the amount of \$137,000 and accordingly reduce revenues for the six month period ended June 29, 2003 in the amount of \$137,000. The restatement had no effect on the Company s net operating cash position. The impact of the above-mentioned restatement on the consolidated statement of operations for the six month period ended June 29, 2003 is as follows (amounts in thousands):

**Six month period ended
June 29, 2003**

| | Reported | Restated |
|----------------------------|-----------------|-----------------|
| Revenues | \$ 124,999 | \$ 124,862 |
| Income before income taxes | 4,624 | 4,487 |
| Income tax expense | 1,387 | 1,334 |
| Net income | 3,237 | 3,153 |

3) **Recent Events**

On June 3, 2004, the Company paid a dividend of \$6,789,000 to its parent, Morton s Holdings, LLC (MHLLC).

On June 4, 2004, Morton's Holding Company, Inc. (MHCI), a newly formed wholly-owned subsidiary of MHLLC, became an intermediate holding company and the direct parent of the Company. Subsequently, MHCI completed a \$40,000,000 14% senior secured notes offering. The notes are secured by the assets of MHCI, which include the stock of the Company. The notes are not secured by the assets of, nor are they guaranteed by, the Company or any of its subsidiaries. MHCI used the proceeds of the offering to make a distribution to MHLLC's equity holders and to pay fees and expenses related to the issuance.

4) Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, the Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. The Company paid cash interest, net of amounts capitalized, of approximately \$4,811,000 and \$3,455,000, and income taxes of approximately \$318,000 and \$202,000, for the six month periods ended July 4, 2004 and June 29, 2003, respectively.

5) Restricted Cash

Restricted cash of \$1,021,000 and \$1,100,000 as of July 4, 2004 and January 4, 2004, respectively, represents cash collateral relating to two interest rate swap agreements with Bank of America, formerly Fleet National Bank (B of A). See Note 8.

6) Marketable Securities

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standard (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. In accordance with SFAS No. 115, marketable securities of approximately \$1,741,000 as of July 4, 2004 are accounted for as trading securities. Securities held by the Company are bought and held principally for the purpose of selling them in the near term and are recorded at fair value. Unrealized gains and losses on such securities have been recognized in interest expense, net in the consolidated statements of operations.

7) Intangible Asset and Goodwill

The identifiable intangible asset acquired represents the Company's trade name Morton's, which has an indefinite life and accordingly is not subject to amortization, but is subject to impairment testing. The trade name is used in the advertising and marketing of the restaurants and is widely recognized and accepted by consumers in its respective market as an indication of and recognition of service, value and quality. Goodwill represents the excess of costs over fair value of assets of the business acquired.

8) Derivative Financial Instruments

The Company accounts for its derivative financial instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. As of July 4, 2004, the Company's derivative financial instruments consist of two interest rate swap agreements with notional amounts of \$20,000,000 each. Prior to the July 7, 2003 repayment of our prior credit facility with a portion of the proceeds from our 7.5% senior secured notes offering, the interest rate swap agreements were originally designated as cash flow hedges for purposes of SFAS No. 133. As a result of such repayment, these two interest rate swap agreements, which are due to expire on October 24, 2004 and October 24, 2005, are accounted for as speculative

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instruments and resulting changes in their fair market value have been charged or credited to the consolidated statement of operations. As of July 4, 2004 and January 4, 2004, in accordance with SFAS No. 133, liabilities were approximately \$385,000 and \$723,000, respectively. The change in the fair market value has been

recognized in interest expense, net in the consolidated statement of operations for the three and six month periods ended July 4, 2004.

9) Comprehensive Income

The components of comprehensive income for the six month periods ended July 4, 2004 and June 29, 2003 are as follows (amounts in thousands):

| | Six month periods ended | |
|---|-------------------------|---------------------------|
| | July 4, 2004 | June 29, 2003 Restated |
| Net income | \$ 1,388 | \$ 3,153 |
| Other comprehensive income (loss): | | |
| Foreign currency translation | (58) | (1) |
| Change in fair value of interest rate swap agreements | | (200) |
| Total comprehensive income | \$ 1,330 | \$ 2,952 |

10) Morton s 90 West Street, NY

As a result of the impact of the World Trade Center terrorist attacks on September 11, 2001, the Morton s steakhouse restaurant located at 90 West Street, New York, New York, two blocks from the World Trade Center was closed permanently due to structural damage. During the six month period ended June 29, 2003, the Company recorded a benefit in Restaurant operating expenses in the accompanying consolidated statement of operations of approximately \$862,000 representing business interruption insurance recovery related to costs incurred from the closing of that restaurant. There were no comparable benefits recorded during the six month period ended July 4, 2004. During March 2004, the Company received approximately \$1,007,000 for such insurance. As of July 4, 2004, cumulative benefits recorded were approximately \$3,619,000 and cumulative amounts received were approximately \$3,619,000 for this insurance. Based on the insurance policy coverage, the Company believes that additional benefits will be recorded in fiscal 2004 and possibly in future periods relating to future insurance recoveries, although there is no assurance that any future recoveries will be received.

11) Employee Subscription Agreements

Certain of our executives and other employees have been granted common units of MHLLC, which represent an ownership interest in MHLLC, pursuant to employee subscription agreements. MHLLC s Board approved 1,711,344 units available for grant of which 1,497,585 and 26,200 were granted on August 26, 2003 and June 21, 2004, respectively. On August 26, 2003 and June 21, 2004, the fair value of each common unit granted was \$0.01. Common units granted to an employee pursuant to employee subscription agreements are granted at no cost to the employee. These common units are subject to vesting. Fifty percent of the granted common units vest upon certain dates if the employee is employed as of such date. In addition, fifty percent of the common units will vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30% and the employee is employed as of such date. Upon termination of employment, unvested common units will be forfeited and vested common units will be subject to repurchase pursuant to the terms of MHLLC s operating agreement. Stock-based employee compensation expense related to this plan will be charged to the Company based on the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, the Company recognized compensation expense relating to the vesting of common units granted in our consolidated statement of operations for the three and six month periods ended July 4, 2004. The compensation expense recorded during the three and six month periods ended July 4, 2004, represents the straight-line amortization of the difference between the fair value at the date of grant of \$0.01 per common unit and the exercise price (which is zero) of the common units of the outstanding time-vesting common units for the respective period. The remaining compensation expense that was measured at the

date of grant will be amortized on a straight-line basis over the remaining vesting period. Compensation expense relating to the other 50% of common units granted, which vest upon certain change of control or liquidation events if, upon the occurrence of such an event, Castle Harlan Partners III, L.P. achieves an internal rate of return of at least 30%, will be measured and recognized if and when these events occur.

Activity relating to the common units granted pursuant to employee subscription agreements during the six month period ended July 4, 2004 is as follows:

| | |
|---|-----------|
| Unvested common units outstanding as of January 4, 2004 | 1,482,385 |
| Granted units | 26,200 |
| Vested units | |
| Forfeited units | (16,600) |
| Unvested common units outstanding as of July 4, 2004 | 1,491,985 |

As of July 4, 2004, there were 219,359 common units available for grant.

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by SFAS No. 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transitional requirements of SFAS No. 148 are effective for all financial statements for fiscal years ending after December 15, 2002. The application of the disclosure portion of this standard did not have any impact on our consolidated financial statements. The financial and accounting standards board recently indicated that it will require stock-based employee compensation to be recorded as a charge to earnings pursuant to a standard it is currently deliberating, which it believes will become effective during 2004. We will continue to monitor its progress on the issuance of this standard as well as evaluate our position with respect to current guidance.

12) Financial Information about Geographic Areas

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

| | Three month periods ended | | Six month periods ended | |
|----------|---------------------------|------------------|-------------------------|------------------------------|
| | July 4, 2004 | June 29, 2003 | July 4, 2004 | June 29, 2003 Restated |
| Domestic | \$ (1,020) | \$ 2,096 | \$ 1,324 | \$ 4,697 |
| Foreign | 276 | (323) | 659 | (210) |
| Total | \$ (744) | \$ 1,773 | \$ 1,983 | \$ 4,487 |

13) Restaurant Activity

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In January 2003, the Company closed the Morton's steakhouse in Hong Kong Central. In August 2003, the Company closed the Morton's steakhouse in Addison, Texas. No restaurants were opened or closed during the six month period ended July 4, 2004. During July 2004, a new Morton's steakhouse opened in White Plains, New York.

14) Legal Matters and Contingencies

Since August 2002, a number of the Company's current and former employees in New York and Florida have initiated arbitrations with the American Arbitration Association in their respective states alleging that the Company has violated state and federal (New York arbitrations) and federal (Florida arbitrations) wage and hour laws regarding the sharing of tips with other employees and failure to pay for all hours worked. In general, the complainants are seeking restitution of tips, the difference between the tip credit wage and the minimum wage, payment for hours worked off the clock, liquidated damages and attorneys' fees and costs. The arbitrator in the New York arbitrations has permitted the complainants to consolidate their arbitrations into one action and proceed as a collective action. The Florida complainants are also seeking to consolidate their arbitrations, but there has been no determination to date. The Company believes that the allegations are without merit and intends to contest them vigorously.

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

15) Supplemental Condensed Consolidating Financial Information

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

Supplemental Consolidating Balance Sheet

July 4, 2004

(unaudited)

(amounts in thousands)

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|---------------------------|-------------------------------|--------------|--------------|
| <u>Assets</u> | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 695 | \$ 1,074 | \$ 509 | \$ | 2,278 |
| Restricted cash | 1,021 | | | | 1,021 |
| Marketable securities | 1,741 | | | | 1,741 |
| Accounts receivable | 57 | 2,839 | 146 | | 3,042 |
| Inventories | | 8,949 | 534 | | 9,483 |
| Prepaid expenses and other current assets | 329 | 5,519 | 39 | | 5,887 |
| Deferred income taxes | 3,210 | 3,313 | | | 6,523 |
| Total current assets | 7,053 | 21,694 | 1,228 | | 29,975 |
| Property and equipment, net | 135 | 53,292 | 1,210 | | 54,637 |
| Intangible asset | | 92,000 | | | 92,000 |
| Goodwill | | 61,552 | | | 61,552 |
| Other assets and deferred expenses, net | 8,343 | 3,721 | 247 | (2,520) | 9,791 |
| Amounts due from affiliates | 140,174 | 505 | | (140,679) | |
| | \$ 155,705 | \$ 232,764 | \$ 2,685 | \$ (143,199) | \$ 247,955 |

Supplemental Consolidating Balance Sheet

July 4, 2004

(unaudited)

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

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|---------------------------|-------------------------------|------------------|----------------|
| Liabilities and Stockholder's Equity | | | | | |
| Current liabilities: | | | | | |
| Accounts payable and accrued expenses | \$ 5,131 | \$ 23,216 | \$ 1,026 | \$ | \$ 29,373 |
| Current portion of obligations to financial institutions | | 497 | | | 497 |
| Accrued income taxes | (2,307) | 2,813 | (459) | | 47 |
| Amounts due to affiliates | | 140,174 | 505 | (140,679) | |
| Total current liabilities | 2,824 | 166,700 | 1,072 | (140,679) | 29,917 |
| 7.5% senior secured notes, net of unamortized discount of \$14,157 | 90,843 | | | | 90,843 |
| Obligations to financial institutions, less current maturities | | 6,903 | | | 6,903 |
| Deferred income taxes | | 20,471 | | | 20,471 |
| Other liabilities | (32) | 2,911 | 78 | | 2,957 |
| Total liabilities | 93,635 | 196,985 | 1,150 | (140,679) | 151,091 |
| Commitments and contingencies | | | | | |
| Stockholder's equity: | | | | | |
| Common stock, \$0.01 par value per share. Authorized, issued and outstanding 1,000 shares | | | | | |
| Additional paid-in capital | 97,076 | 2,520 | | (2,520) | 97,076 |
| Accumulated other comprehensive income (loss) | | 225 | (155) | | 70 |
| (Accumulated deficit) retained earnings | (35,006) | 33,034 | 1,690 | | (282) |
| Total stockholder's equity | 62,070 | 35,779 | 1,535 | (2,520) | 96,864 |
| | \$ 155,705 | \$ 232,764 | \$ 2,685 | \$ (143,199) | \$ 247,955 |

Supplemental Consolidating Balance Sheet

January 4, 2004

(amounts in thousands)

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|--|------------|---------------------------|-------------------------------|--------------|--------------|
| <u>Assets</u> | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 17,911 | \$ (614) | \$ 700 | \$ | \$ 17,997 |
| Restricted cash | 1,100 | | | | 1,100 |
| Accounts receivable | 2 | 3,665 | 162 | | 3,829 |
| Inventories | | 8,511 | 583 | | 9,094 |
| Prepaid expenses and other current assets | 382 | 4,649 | 38 | | 5,069 |
| Deferred income taxes | 1,875 | 5,201 | | | 7,076 |
| Total current assets | 21,270 | 21,412 | 1,483 | | 44,165 |
| Property and equipment, net | 91 | 52,537 | 1,482 | | 54,110 |
| Intangible asset | | 92,000 | | | 92,000 |
| Goodwill | | 61,552 | | | 61,552 |
| Other assets and deferred expenses, net | 8,899 | 3,732 | 249 | (2,520) | 10,360 |
| Amounts due from affiliates | 150,482 | 14,325 | 4,710 | (169,517) | |
| | \$ 180,742 | \$ 245,558 | \$ 7,924 | \$ (172,037) | \$ 262,187 |

Supplemental Consolidating Balance Sheet

January 4, 2004

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

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|------------|---------------------------|-------------------------------|--------------|--------------|
| Liabilities and Stockholder's Equity | | | | | |
| Current liabilities: | | | | | |
| Accounts payable and accrued expenses | \$ 6,090 | \$ 26,704 | \$ 1,272 | \$ | \$ 34,066 |
| Current portion of obligations to financial institutions | | 658 | | | 658 |
| Accrued income taxes | 10,661 | (11,774) | 1,409 | | 296 |
| Amounts due to affiliates | | 165,206 | 4,311 | (169,517) | |
| Total current liabilities | 16,751 | 180,794 | 6,992 | (169,517) | 35,020 |
| 7.5% senior secured notes, net of unamortized discount of \$14,987 | 90,013 | | | | 90,013 |
| Obligations to financial institutions, less current maturities | | 12,274 | | | 12,274 |
| Deferred income taxes | (3,860) | 24,331 | | | 20,471 |
| Other liabilities | (56) | 2,074 | 69 | | 2,087 |
| Total liabilities | 102,848 | 219,473 | 7,061 | (169,517) | 159,865 |
| Commitments and contingencies | | | | | |
| Stockholder's equity: | | | | | |
| Common stock, \$0.01 par value per share. Authorized, issued and outstanding 1,000 shares | | | | | |
| Additional paid-in capital | 97,075 | 2,520 | | (2,520) | 97,075 |
| Accumulated other comprehensive income (loss) | | 296 | (168) | | 128 |
| (Accumulated deficit) retained earnings | (19,181) | 23,269 | 1,031 | | 5,119 |
| Total stockholder's equity | 77,894 | 26,085 | 863 | (2,520) | 102,322 |
| | \$ 180,742 | \$ 245,558 | \$ 7,924 | \$ (172,037) | \$ 262,187 |

Supplemental Consolidating Statement of Operations**Three month period ended July 4, 2004****(unaudited)****(amounts in thousands)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenues | \$ 3,887 | \$ 61,745 | \$ 3,166 | \$ (3,887) | \$ 64,911 |
| Food and beverage costs | | 20,929 | 1,059 | | 21,988 |
| Restaurant operating expenses | | 29,455 | 1,587 | | 31,042 |
| Pre-opening costs, depreciation, amortization and non-cash charges | 3 | 2,000 | 154 | | 2,157 |
| General and administrative expenses | 4,662 | 3,887 | | (3,887) | 4,662 |
| Marketing and promotional expenses | | 2,150 | 90 | | 2,240 |
| Interest expense, net | 2,693 | 173 | | | 2,866 |
| Management fee paid to related party | 700 | | | | 700 |
| (Loss) income before income taxes | (4,171) | 3,151 | 276 | | (744) |
| Income tax benefit | (223) | | | | (223) |
| Net (loss) income | \$ (3,948) | \$ 3,151 | \$ 276 | \$ | \$ (521) |

Supplemental Consolidating Statement of Operations**Three month period ended June 29, 2003****(unaudited)****(amounts in thousands)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenues | \$ 3,574 | \$ 57,934 | \$ 1,812 | \$ (3,574) | \$ 59,746 |
| Food and beverage costs | | 19,209 | 656 | | 19,865 |
| Restaurant operating expenses | | 27,942 | 1,284 | | 29,226 |
| Pre-opening costs, depreciation, amortization and non-cash charges | 5 | 1,732 | 121 | | 1,858 |
| General and administrative expenses | 3,781 | 3,574 | | (3,574) | 3,781 |

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| | | | | | | |
|--------------------------------------|------------|-------|-------|----|-------|----------|
| Marketing and promotional expenses | | 1,044 | | 64 | | 1,108 |
| Interest expense, net | 972 | | 453 | | 10 | 1,435 |
| Management fee paid to related party | 700 | | | | | 700 |
| (Loss) income before income taxes | (1,884) | | 3,980 | | (323) | 1,773 |
| Income tax expense | 532 | | | | | 532 |
| Net (loss) income | \$ (2,416) | \$ | 3,980 | \$ | (323) | \$ 1,241 |

Supplemental Consolidating Statement of Operations**Six month period ended July 4, 2004****(unaudited)****(amounts in thousands)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenues | \$ 8,258 | \$ 131,449 | \$ 6,443 | \$ (8,258) | \$ 137,892 |
| Food and beverage costs | | 44,334 | 2,128 | | 46,462 |
| Restaurant operating expenses | | 60,015 | 3,227 | | 63,242 |
| Pre-opening costs, depreciation, amortization and non-cash charges | 6 | 3,933 | 248 | | 4,187 |
| General and administrative expenses | 9,548 | 8,258 | | (8,258) | 9,548 |
| Marketing and promotional expenses | | 4,688 | 181 | | 4,869 |
| Costs associated with the repayment of certain debt | 264 | | | | 264 |
| Interest expense, net | 5,481 | 456 | | | 5,937 |
| Management fee paid to related party | 1,400 | | | | 1,400 |
| (Loss) income before income taxes | (8,441) | 9,765 | 659 | | 1,983 |
| Income tax expense | 595 | | | | 595 |
| Net (loss) income | \$ (9,036) | \$ 9,765 | \$ 659 | \$ | \$ 1,388 |

Supplemental Consolidating Statement of Operations**Six month period ended June 29, 2003****(unaudited)****Restated****(amounts in thousands)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|----------|---------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenues | \$ 7,473 | \$ 120,145 | \$ 4,717 | \$ (7,473) | \$ 124,862 |

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| | | | | | | |
|---|------------|----------|----------|---------|----|--------|
| Food and beverage costs | | 40,210 | | 1,650 | | 41,860 |
| Restaurant operating expenses | | 56,476 | | 2,875 | | 59,351 |
| Pre-opening costs, depreciation, amortization and non-cash charges | 58 | 3,988 | | 250 | | 4,296 |
| General and administrative expenses | 7,817 | 7,473 | | (7,473) | | 7,817 |
| Marketing and promotional expenses | | 2,444 | | 131 | | 2,575 |
| Interest expense, net | 2,124 | 931 | | 21 | | 3,076 |
| Management fee paid to related party | 1,400 | | | | | 1,400 |
| (Loss) income before income taxes | (3,926) | 8,623 | | (210) | | 4,487 |
| Income tax expense | 1,334 | | | | | 1,334 |
| Net (loss) income | \$ (5,260) | \$ 8,623 | \$ (210) | \$ | \$ | 3,153 |

Supplemental Consolidating Statement of Cash Flows

Six month period ended July 4, 2004

(unaudited)

(amounts in thousands)

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

Supplemental Consolidating Statement of Cash Flows

Six month period ended June 29, 2003

(unaudited)

Restated

(amounts in thousands)

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
|--|------------|---------------------------|-------------------------------|--------------|
| Cash flows from operating activities: | | | | |
| Net (loss) income | \$ (5,260) | \$ 8,623 | \$ (210) | \$ 3,153 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: | | | | |
| Depreciation, amortization and other non-cash charges | 58 | 3,124 | 244 | 3,426 |
| Deferred income taxes | 4,939 | (3,831) | | 1,108 |
| Change in assets and liabilities: | | | | |
| Accounts receivable | (22) | 2,667 | 34 | 2,679 |
| Income taxes receivable | 250 | 1 | | 251 |
| Inventories | | 125 | 91 | 216 |
| Prepaid expenses and other assets | 1,951 | (928) | 525 | 1,548 |
| Accounts payable, accrued expenses and other liabilities | (1,791) | (4,828) | (1,099) | (7,718) |
| Accrued income taxes | (2,010) | 1,957 | (50) | (103) |
| Net cash (used in) provided by operating activities | (1,885) | 6,910 | (465) | 4,560 |
| Cash flows from investing activities: | | | | |
| Purchases of property and equipment | (22) | (2,275) | (63) | (2,360) |
| Net cash used in investing activities | (22) | (2,275) | (63) | (2,360) |
| Cash flows from financing activities: | | | | |
| Principal reduction on obligations to financial institutions and capital leases | (3,550) | (4,169) | (134) | (7,853) |
| Proceeds from obligations to financial institutions | 5,900 | | | 5,900 |
| Net cash provided by (used in) financing activities | 2,350 | (4,169) | (134) | (1,953) |
| Effect of exchange rate changes on cash | | | 42 | 42 |
| Net increase (decrease) in cash and cash equivalents | 443 | 466 | (620) | 289 |
| Cash and cash equivalents at beginning of period | 243 | 601 | 859 | 1,703 |
| Cash and cash equivalents at end of period | \$ 686 | \$ 1,067 | \$ 239 | \$ 1,992 |

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

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

Restatement of Consolidated Financial Statements

The effect of the restatement discussed herein on our results as of and for the fiscal year ended January 4, 2004 was reflected in our Annual Report on Form 10-K. We have restated our consolidated financial statements for the three month period ended March 30, 2003 and the six month period ended June 29, 2003 as a result of having incorrectly provided estimates for expirations and non-redemption of gift certificates that we sold. The effect of the restatement was to reduce revenues for the three month period ended March 30, 2003 in the amount of \$0.1 million and accordingly reduce revenues for the six month period ended June 29, 2003 in the amount of \$0.1 million. The restatement had no effect on our net operating cash position. See Note 2 to our unaudited consolidated financial statements.

Results of Operations

Our net loss for the three month period ended July 4, 2004 was \$0.5 million compared to net income of \$1.2 million for the three month period ended June 29, 2003. Net income decreased \$1.8 million, or 56.0%, to \$1.4 million for the six month period ended July 4, 2004 from \$3.2 million for the six month period ended June 29, 2003. These decreases are primarily due to increases in interest expense, net and marketing and promotional expenses discussed below.

Revenues increased \$5.2 million, or 8.6%, to \$64.9 million for the three month period ended July 4, 2004 from \$59.7 million for the three month period ended June 29, 2003. Revenues increased \$5.9 million due to an increase in comparable revenues from restaurants open all of both fiscal years. Revenues declined \$0.4 million due to the closing of the Morton s steakhouse formerly located in Addison, Texas (closed since August 2003). This steakhouse was closed due to its comparatively low revenues and negative cash flows. Revenues decreased \$0.3 million due to a decline in revenues attributable to the one new restaurant opened in fiscal 2003. Average revenue per restaurant open all of either period increased 10.3%. Revenues for the three month period ended July 4, 2004 also reflect the impact of aggregate menu price increases of approximately 3% in November 2003 and approximately 3% in February 2004.

Revenues increased \$13.0 million, or 10.4%, to \$137.9 million for the six month period ended July 4, 2004 from \$124.9 million for the six month period ended June 29, 2003. Revenues increased \$14.2 million due to an increase in comparable revenues from restaurants open all of both fiscal years. Revenues declined \$1.1 million due to the closing of the Morton s steakhouses formerly located in Hong Kong Central (closed since January 2003) and Addison, Texas (closed since August 2003). These steakhouses were closed due to their comparatively low revenues and negative cash flows. Revenues decreased \$0.1 million due to a decline in revenues attributable to the one new restaurant opened in fiscal 2003. Average revenue per restaurant open all of either period increased 11.8%. Revenues for the six month period ended July 4, 2004 also reflect the impact of aggregate menu price increases of approximately 3% in November 2003 and approximately 3% in February 2004.

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Percentage changes in comparable restaurant revenues for the three and six month periods ended July 4, 2004 versus June 29, 2003 for restaurants open all of both periods are as follows:

| | Three Month Period Ended July 4, 2004 Percentage Change | Six Month Period Ended July 4, 2004 Percentage Change |
|-------------|--|--|
| Morton s | 10.6% | 11.9% |
| Bertolini s | 4.7% | 8.5% |
| Total | 10.1% | 11.7% |

During the first and second quarters of fiscal 2003, we believe that the war in Iraq and the weak economic environment, adversely affected many of the markets in which we operate which, in turn, contributed to weak revenue trends and negative comparable restaurant revenues. Additionally, during the first and second quarters of fiscal 2003, the outbreak of severe acute respiratory syndrome materially affected the results of our three restaurants located in Hong Kong, Singapore and Toronto. During the first and second quarters of fiscal 2004, an improved economy has contributed to stronger revenue trends.

Our business is somewhat seasonal in nature, with revenues generally being less in the second and third quarters primarily due to our reduced summer volume. We believe we may incur a net loss in the third quarter of fiscal 2004.

Food and beverage costs increased \$2.1 million, or 10.7%, to \$22.0 million for the three month period ended July 4, 2004 from \$19.9 million for the three month period ended June 29, 2003. These costs increased \$4.6 million, or 11.0%, to \$46.5 million for the six month period ended July 4, 2004 from \$41.9 million for the six month period ended June 29, 2003. These costs as a percentage of revenues increased by 0.7% to 33.9% for the three month period ended July 4, 2004 from 33.2% for the three month period ended June 29, 2003 and increased by 0.2% to 33.7% for the six month period ended July 4, 2004 from 33.5% for the six month period ended June 29, 2003. During the three and six month periods ended July 4, 2004 high demand for U.S. beef products has decreased the availability of USDA prime beef which resulted in increased food costs. We were generally able to offset such cost increases with the benefit of menu price increases, which resulted in an increase in food and beverage costs as a percentage of revenue for the three and six month periods ended July 4, 2004 compared to the three and six month periods ended June 29, 2003. We cannot assure you that we would be able or willing to increase menu prices or take other actions to offset increases in such costs in the future.

Restaurant operating expenses, which include labor, occupancy and other operating expenses, increased \$1.8 million, or 6.2%, to \$31.0 million for the three month period ended July 4, 2004 from \$29.2 million for the three month period ended June 29, 2003. These costs increased \$3.9 million, or 6.6%, to \$63.2 million for the six month period ended July 4, 2004 from \$59.4 million for the six month period ended June 29, 2003. These increases were primarily due to increases in labor and benefit costs and the opening of an additional restaurant. Restaurant operating expenses as a percentage of revenues decreased 1.1% to 47.8% for the three month period ended July 4, 2004 from 48.9% for the three month period ended June 29, 2003 and decreased 1.6% to 45.9% for the six month period ended July 4, 2004 from 47.5% for the six month period ended June 29, 2003. The decreases in restaurant operating expenses as a percentage of revenue are primarily due to the benefit of menu price increases. Included in the three and six month periods ended June 29, 2003 are recoveries of approximately \$0.4 million and \$0.9 million for business interruption insurance benefits related to the closing of the Morton s steakhouse formerly located at 90 West Street, New York, New York, two blocks from the World Trade Center, which was closed permanently due to structural damages. There were no comparable benefits recorded during the three and six month periods ended July 4, 2004. As of July 4, 2004, cumulative benefits recorded were \$3.6 million and cumulative amounts received were \$3.6 million for this insurance. Based on our insurance policy coverage, we believe that additional

benefits will be recorded in fiscal 2004 relating to future insurance recoveries, although we cannot assure you that we will receive any future recoveries. Additionally, at this time, the total amount of any future recoveries is unknown.

Pre-opening costs, depreciation, amortization and non-cash charges increased \$0.3 million, or 16.1%, to \$2.2 million for the three month period ended July 4, 2004 from \$1.9 million for the three month period ended June 29, 2003. These costs increased as a percentage of revenues by 0.2% to 3.3% for the three month period ended July 4, 2004 from 3.1% for the three month period ended June 29, 2003. These costs decreased \$0.1 million, or 2.5%, to \$4.2 million for the six month period ended July 4, 2004 from \$4.3 million for the six month period ended June 29, 2003. These costs decreased as a percentage of revenues by 0.4% to 3.0% for the six month period ended July 4, 2004 from 3.4% for the six month period ended June 29, 2003. We expense all costs incurred during start-up activities, including pre-opening costs, as incurred. Pre-opening costs incurred and recorded as expense remained consistent at \$0.2 million for the three month periods ended July 4, 2004 and June 29, 2003 and decreased \$0.7 million to \$0.2 million for the six month period ended July 4, 2004 from \$0.9 million for the six month period ended June 29, 2003. The number of restaurants opened, the timing of restaurant openings and the costs per restaurant opened affected the amount of these costs.

General and administrative expenses increased \$0.9 million, or 23.3%, to \$4.7 million for the three month period ended July 4, 2004 from \$3.8 million for the three month period ended June 29, 2003. These costs increased \$1.7 million, or 22.1%, to \$9.5 million for the six month period ended July 4, 2004 from \$7.8 million for the six month period ended June 29, 2003. These costs as a percentage of revenues increased 0.9% to 7.2% for the three month period ended July 4, 2004 from 6.3% for the three month period ended June 29, 2003 and increased 0.6% to 6.9% for the six month period ended July 4, 2004 from 6.3% for the six month period ended June 29, 2003. The increases were primarily due to increased salary, bonus and benefit costs and legal and professional costs.

Marketing and promotional expenses increased \$1.1 million, or 102.2%, to \$2.2 million for the three month period ended July 4, 2004 from \$1.1 million for the three month period ended June 29, 2003. These costs increased \$2.3 million, or 89.1%, to \$4.9 million for the six month period ended July 4, 2004 from \$2.6 million for the six month period ended June 29, 2003. These costs as a percentage of revenues increased 1.6% to 3.5% for the three month period ended July 4, 2004 from 1.9% for the three month period ended June 29, 2003 and increased 1.4% to 3.5% for the six month period ended July 4, 2004 from 2.1% for the six month period ended June 29, 2003. These increases were primarily due to increased spending for print media advertising in conjunction with the introduction of our Savor the Good Life theme in 2004.

Costs associated with the repayment of certain debt of \$0.3 million for the six month period ended July 4, 2004 represent prepayment penalties that we incurred with the early repayment of two of our mortgages. There were no comparable costs associated with the repayment of certain debt during the three month period ended July 4, 2004 and the three and six month periods ended June 29, 2003.

Interest expense, net, increased \$1.4 million, or 99.7%, to \$2.9 million for the three month period ended July 4, 2004 from \$1.4 million for the three month period ended June 29, 2003 and increased \$2.9 million, or 93.0%, to \$5.9 million for the six month period ended July 4, 2004 from \$3.1 million for the six month period ended June 29, 2003. These increases were primarily due to the issuance of the 7.5% senior secured notes in July 2003. Interest income was not significant in any of these periods.

Management fee paid to related party was \$0.7 million for the three month periods ended July 4, 2004 and June 29, 2003 and \$1.4 million for the six month periods ended July 4, 2004 and June 29, 2003. We paid this fee pursuant to MHLLC's management agreement with Castle Harlan, Inc.

Provision for income taxes consisted of income tax expense of \$0.6 million and \$1.3 million for the six month periods ended July 4, 2004 and June 29, 2003, respectively. Our effective tax rate differs from the statutory rate due to the establishment of additional deferred tax assets relating to FICA and other tax credits.

Liquidity and Capital Resources

Our principal liquidity requirements are to service our debt and meet our working capital and capital expenditure needs. Subject to our operating performance, which, if significantly adversely affected, would adversely affect the availability of funds, we expect to be able to meet our liquidity requirements for the foreseeable future through cash provided by operations and through borrowings available under our working capital facility. We cannot assure you, however, that this will be the case. As of July 4, 2004, we had cash and cash equivalents of \$2.3 million compared to \$18.0 million as of January 4, 2004. The decrease in cash and cash equivalents is primarily due to the payment of a dividend of \$6.8 million and the early repayment of two mortgages aggregating \$5.3 million.

Working Capital and Cash Flows

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

Operating Activities. Cash flows provided by operating activities for the six month period ended July 4, 2004 were \$2.5 million, consisting primarily of a net increase in cash of \$6.7 million resulting from net income before depreciation, amortization and other non-cash charges partially offset by a net decrease in cash of \$4.2 million resulting from a decrease in accounts payable, accrued expenses and other liabilities.

Investing Activities. Cash flows used in investing activities for the six month period ended July 4, 2004 were \$5.4 million due to purchases of property and equipment of \$3.6 million, which include capital expenditures related to the Morton's steakhouse scheduled to open in the third quarter of fiscal 2004, and an increase in marketable securities of \$1.7 million.

Financing Activities. Cash flows used in financing activities for the six month period ended July 4, 2004 were \$12.8 million primarily consisting of the payment of a dividend of \$6.8 million, net principal reduction on obligations to financial institutions of \$5.5 million, primarily due to the early repayment of two mortgages aggregating \$5.3 million, and the payment of deferred financing costs of \$0.6 million relating to our 7.5% senior secured notes offering and our working capital facility.

Debt and Other Obligations.

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

class with the original notes. The exchange offer was completed on January 28, 2004. We refer to these notes as our 7.5% senior secured notes.

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

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

We pay interest on the 7.5% senior secured notes semi-annually in cash, in arrears, on January 1 and July 1 at an annual rate of 7.5%. The indenture governing the 7.5% senior secured notes contains various affirmative and negative covenants, subject to a number of important limitations and exceptions, including but not limited to those limiting our ability to incur additional indebtedness or enter into sale and leaseback transactions; pay dividends, redeem stock or make other distributions; issue stock of our subsidiaries; make certain investments or acquisitions; grant liens on assets; enter into transactions with affiliates; merge, consolidate or transfer substantially all of our assets; and transfer and sell assets. Our indenture has a covenant that limits our incurrence of additional indebtedness other than Permitted Indebtedness (defined therein) unless on the date of the incurrence of additional indebtedness our Consolidated Fixed Charge Coverage Ratio (defined therein) will be, after giving effect to the incurrence thereof and the application of the proceeds thereof, greater than 2.25 to 1.0. The indenture defines Consolidated Fixed Charge Coverage Ratio as the ratio of Consolidated EBITDA to Consolidated Fixed Charges (defined therein).

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

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

Working Capital Facility. On July 7, 2003, we entered into a \$15.0 million senior secured working capital facility with Wells Fargo Foothill, Inc. Our working capital facility matures on July 7, 2007. Availability under our working capital facility is limited to the lesser of (i) \$15.0 million and (ii) the borrowing base

amount, in each case, less the sum of (a) the revolving loans then outstanding (including letters of credit) and (b) reserves required by the lender. The borrowing base amount is defined as the lesser of (A) 80% of our twelve-month trailing EBITDA, as determined in accordance with the most recently delivered financial statements, or (B) 25% of our enterprise value, determined to be \$168.0 million as of July 7, 2003, and thereafter to be the amount determined by a third party appraiser. We are permitted to repay and reborrow such advances until the maturity date. As of July 4, 2004, we had no borrowings outstanding under our working capital facility. At our option, up to \$7.5 million of the facility can consist of one or more letters of credit issued by the lender. As of July 4, 2004, \$1.0 million was restricted for letters of credit under our working capital facility. Our working capital facility is guaranteed by all of our domestic restricted subsidiaries and secured by a first priority perfected security interest in all of the collateral securing the 7.5% senior secured notes. Interest will accrue on borrowings under our working capital facility at a floating rate of interest per annum equal to the rate of interest announced from time to time within the lender's principal office in San Francisco as its prime rate plus 1.75%, or a LIBOR-based equivalent thereof. Interest is calculated on the basis of a 360-day year and will be payable monthly for base rate loans and at the end of each interest period for LIBOR loans (but not less frequently than quarterly). Our working capital facility contains certain customary fees, including a closing fee, anniversary fees, servicing fees and pre-payment fees.

Our working capital facility contains various affirmative and negative covenants customary for similar working capital facilities, including but not limited to covenants pertaining to mergers and sales of assets outside the ordinary course of business; use of proceeds; granting of liens; incurrence of indebtedness; restricted payments; voluntary prepayment of indebtedness, including the 7.5% senior secured notes; payment of dividends; business activities; investments and acquisitions; transactions with affiliates; certain restrictions affecting subsidiaries; fundamental changes; and amendments or modifications to instruments governing certain indebtedness. Our working capital facility also requires us to achieve and maintain a twelve-month trailing EBITDA (as defined therein) of not less than \$16.0 million. As of July 4, 2004, we were in compliance with all of our financial covenants.

Our working capital facility contains customary events of default, including but not limited to those related to non-payment of principal, interest or fees; violations of certain covenants; change of control; certain bankruptcy-related events; inaccuracy of representations and warranties in any material respect; and cross defaults with certain other indebtedness and agreements, including without limitation the indenture governing the 7.5% senior secured notes.

Prior Credit Facility. Our prior credit facility was pursuant to the Second Amended and Restated Revolving Credit and Term Loan Agreement, dated June 19, 1995, between us and Fleet National Bank (subsequently acquired by B of A (Fleet), as amended from time to time, a portion of which had been syndicated to other lenders. On July 7, 2003, we used a portion of the proceeds from the 7.5% senior secured notes offering to repay our prior credit facility in full. Following repayment, the credit facility was terminated. On April 7, 1998 and May 29, 1998, we entered into interest rate swap agreements with Fleet on notional amounts of \$10.0 million each. These agreements terminated on April 7, 2003 and May 29, 2003. Additionally, on October 24, 2002, we entered into two interest rate swap agreements with Fleet on notional amounts of \$20.0 million each. These agreements terminate on October 24, 2004 and October 24, 2005. These agreements were used to reduce the potential impact of interest rate fluctuations relating to \$40.0 million of variable rate debt under our prior credit facility. As a result of the July 7, 2003 repayment of our prior credit facility with a portion of the proceeds from the 7.5% senior secured notes offering, these interest rate swap agreements are now accounted for as speculative instruments and resulting changes in their fair market value are charged or credited to the statement of operations. As of July 4, 2004 and January 4, 2004, in accordance with SFAS No. 133, liabilities were approximately \$0.4 million and \$0.7 million, respectively, in the accompanying consolidated balance sheets. The

change in the fair market value has been

recognized in interest expense, net in the consolidated statement of operations for the three and six month periods ended July 4, 2004.

CNL Loan. In March 1997, one of our subsidiaries entered into a \$2.5 million loan agreement with CNL Financial I, Inc. (CNL). This loan is scheduled to mature on April 1, 2007 and bears interest at 10.002% per annum. This loan is secured by a security interest in the assets of the Morton s steakhouses located in Chicago and Denver (downtown). Principal and interest payments are due monthly over the term of the loan. On July 4, 2004 and January 4, 2004 the outstanding principal balance of the CNL loan was approximately \$1.0 million and \$1.1 million, respectively, of which approximately \$0.3 million of principal for each period is included in Current portion of obligations to financial institutions in the accompanying consolidated balance sheets.

Mortgages. During 1998 and 1999, certain of our subsidiaries entered into a total of six mortgage loans with GE Capital Franchise Finance aggregating \$18.9 million with interest rates range from 7.68% to 9.26% per annum, the proceeds of which were used to fund the purchases of land and construction of restaurants. The loans generally require monthly payments of principal and interest. On July 4, 2004 and January 4, 2004 the aggregate outstanding principal balance due on these loans was approximately \$6.5 million and \$11.8 million, respectively, of which approximately \$0.2 million and \$0.4 million, respectively, of principal is included in Current portion of obligations to financial institutions in the accompanying consolidated balance sheets. We repaid one mortgage in May 2003, one in September 2003 and two in April 2004. The remaining two mortgages outstanding as of July 4, 2004 are scheduled to mature in February 2020 and March 2021.

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

Contractual Commitments. The following table represents our contractual commitments associated with our debt and other obligations disclosed above as of July 4, 2004:

| | Remainder of 2004 | 2005 | 2006 | 2007 | 2008 | Thereafter | Total |
|---|------------------------|--------|--------|--------|--------|------------|------------|
| | (amounts in thousands) | | | | | | |
| 7.5% senior secured notes | \$ | \$ | \$ | \$ | \$ | \$ 105,000 | \$ 105,000 |
| Loan agreement with CNL | 153 | 329 | 364 | 104 | | | 950 |
| Mortgage loans with GE Capital Franchise Finance | 81 | 189 | 207 | 227 | 248 | 5,498 | 6,450 |
| Subtotal | 234 | 518 | 571 | 331 | 248 | 110,498 | 112,400 |
| Restaurant operating leases | 8,085 | 16,768 | 16,147 | 15,054 | 14,318 | 94,029 | 164,401 |
| Letters of credit | 1,000 | | | | | | 1,000 |

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| | | | | | | | | | | | | | | |
|-------|----|-------|----|--------|----|--------|----|--------|----|--------|----|---------|----|---------|
| Total | \$ | 9,319 | \$ | 17,286 | \$ | 16,718 | \$ | 15,385 | \$ | 14,566 | \$ | 204,527 | \$ | 277,801 |
|-------|----|-------|----|--------|----|--------|----|--------|----|--------|----|---------|----|---------|

During the first six months of fiscal 2004, our net investment in fixed assets and related investment costs, including pre-opening costs, approximated \$3.9 million. We estimate that we will spend up to approximately \$11.0 million in fiscal 2004, including the \$3.9 million recorded in the first six months of fiscal 2004, to finance ordinary refurbishment of existing restaurants and capital expenditures, net of landlord development and/or rent allowances and net of equipment lease financing, for new restaurants. We anticipate that funds generated through operations and through borrowings under our new working capital facility will be sufficient to fund planned expansion. We cannot assure you, however that this will be the case.

New Accounting Standards

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by SFAS No. 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transitional requirements of SFAS No. 148 are effective for all financial statements for fiscal years ending after December 15, 2002. The application of the disclosure portion of this standard had no impact on the Company's consolidated financial position or results of operations. The FASB recently indicated that it will require stock-based employee compensation to be recorded as a charge to earnings pursuant to a standard it is currently deliberating, which it believes will become effective during late 2004. The Company will continue to monitor its progress on the issuance of this standard as well as evaluate the Company's position with respect to current guidance.

In January 2003, the FASB issued Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51. FIN 46 was subject to significant interpretation by the FASB, and was revised and reissued in December 2003 (FIN 46R). FIN 46R states that if an entity has a controlling financial interest in a variable interest entity, the assets, the liabilities and results of activities of the variable interest entity should be included in the consolidated financial statements to the entity. The provisions of FIN 46 and FIN 46R are applicable for all entities that are considered special purpose entities (SPE) by the end of the first reporting period ending after December 15, 2003. The provisions of FIN 46R are applicable to all other types of entities for reporting periods ending after March 15, 2004. The adoption of FIN 46 and FIN 46R did not have any effect on the Company's consolidated financial statements, as the Company does not have any SPEs. The Company is in the process of assessing the applicability of all other types of entities but does not expect that the adoption of the other provision that are applicable in 2004 will have any effect on the Company's consolidated financial statements.

Forward-Looking Statements

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

looking statement contained herein will prove to be accurate. The Company assumes no obligation to update the forward-looking statements.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

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

As of July 4, 2004, we owned and operated four international restaurants, one in Hong Kong, one in Singapore, one in Toronto, Canada and one in Vancouver, Canada. As a result, we are subject to risk from changes in foreign exchange rates. These changes result in cumulative translation adjustments, which are included in accumulated other comprehensive income (loss). We do not consider the potential loss resulting from a hypothetical 10% adverse change in quoted foreign currency exchange rates, as of July 4, 2004, to be material.

We also are subject to market risk from exposure to changes in interest rates based on our financing activities. This exposure relates to borrowings under our working capital facility that will be payable at floating rates of interest and the 7.5% senior secured notes that are payable at a fixed rate of interest of 7.5%. As of July 4, 2004, there were no borrowings outstanding under our floating rate working capital facility. A hypothetical 10% fluctuation in interest rates, as of July 4, 2004, would have a net impact of approximately \$0.3 million on earnings for the six month period ended July 4, 2004.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined under the Securities and Exchange Commission rules) was carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer. The Company's disclosure controls and procedures are designed to ensure that information that the Company must disclose in its reports filed under the Securities Exchange Act of 1934 is communicated and processed in a timely manner. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. No significant changes were made in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

MORTON S RESTAURANT GROUP, INC. AND SUBSIDIARIES

Part II - Other Information

Item 1. Legal Proceedings

Since August 2002, a number of the Company's current and former employees in New York and Florida have initiated arbitrations with the American Arbitration Association in their respective states alleging that the Company has violated state and federal (New York arbitrations) and federal (Florida arbitrations) wage and hour laws regarding the sharing of tips with other employees and failure to pay all hours worked. In general, the complainants are seeking restitution of tips, the difference between the tip credit wage and the minimum wage, payment for hours worked off the clock, liquidated damages and attorneys' fees and costs. The arbitrator in the New York arbitrations has permitted the complainants to consolidate their arbitrations into one action and proceed as a collective action. The Florida complainants are also seeking to consolidate their arbitrations, but there has been no determination to date. The Company believes that the allegations are without merit and intends to contest them vigorously.

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

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| Exhibit No. | Description |
|--------------------|--|
| 31.1 | Certification of Allen J. Bernstein Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Thomas J. Baldwin Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Allen J. Bernstein Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Thomas J. Baldwin Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated June 4, 2004 with the Securities and Exchange Commission to report under Item 5 of Form 8-K that a press release was issued on June 4, 2004 announcing the completion of a \$40 million 14% senior secured notes offering by its

recently formed parent, Morton s Holding Company, Inc.

SIGNATURES

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

MORTON S RESTAURANT GROUP, INC.
(Registrant)

Date August 17, 2004

By: /s/ ALLEN J. BERNSTEIN
Allen J. Bernstein
Chairman of the Board, President
and Chief Executive Officer

Date August 17, 2004

By: /s/ THOMAS J. BALDWIN
Thomas J. Baldwin
Executive Vice President,
Chief Financial Officer and Director