SHELLS SEAFOOD RESTAURANTS INC
Form 10-Q
November 13, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

__xx__Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended September 29, 2002
__ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Transition Period from ________to _______

Commission File No. 0-28258

SHELLS SEAFOOD RESTAURANTS, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 65-0427966 |
| (State or other jurisdiction of incorporation or organization) | (IRS)Employer Identification Number |

16313 North Dale Mabry Highway, Suite 100, Tampa, FL 33618
(Address of principal executive offices) (zip code)

(813) 961-0944
(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_x_ No__

| Class | Outstanding at November 13, 2002 |
|---|---|
| Common stock, $0.01 par value | 4,454,015 |
| Preferred stock, $0.01 par value | 66,862 |

SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
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SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | (Unaudited) September 29, 2002 | December 30, 2001 |
|---|---|---|
| ASSETS | | |
| Cash | $ 2,528,296 | $ 969,680 |
| Inventories | 385,418 | 457,610 |
| Other current assets | 436,258 | 84,465 |
| Receivables from related parties | 50,432 | 78,137 |
| Income tax refund receivable | 9,311 | 898,338 |
| Total current assets | 3,409,715 | 2,488,230 |
| Property and equipment, net | 7,707,857 | 8,106,500 |
| Property held for sale, net | - | 1,022,060 |
| Other assets | 486,847 | 549,492 |
| Goodwill | 2,525,956 | 2,680,603 |
| TOTAL ASSETS | $ 14,130,375 | $ 14,846,885 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Accounts payable | $ 2,214,077 | $ 4,079,396 |
| Accrued expenses | 3,487,015 | 3,872,266 |
| Sales tax payable | 185,416 | 207,913 |
| Current portion of long-term debt | 1,011,747 | 1,908,379 |
| Total current liabilities | 6,898,255 | 10,067,954 |
| Deferred rent | 1,112,477 | 1,243,057 |
| Long-term debt, less current portion | 3,233,215 | 1,633,073 |
| Total liabilities | 11,243,947 | 12,944,084 |

| | | |
|---|---|---|
| Minority partner interest | 431,564 | 427,642 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, $0.01 par value; authorized 2,000,000 shares; 66,862 shares issued and outstanding | 669 | 669 |
| Common stock, $0.01 par value; authorized 20,000,000 shares; 4,454,015 shares issued and outstanding | 44,540 | 44,540 |
| Additional paid-in-capital | 14,240,576 | 14,240,576 |
| Retained earnings (deficit) | (11,830,921) | (12,810,626) |
| Total stockholders' equity | 2,454,864 | 1,475,159 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 14,130,375 | $ 14,846,885 |

See notes to consolidated financial statements.



SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

| | 13 Weeks Ended | | |
|---|---|---|---|
| | September 29, 2002 | September 30, 2001 | Septembe |
| REVENUES | $ 10,965,891 | $ 11,280,954 | $ 3 |
| COST AND EXPENSES: | | | |
| Cost of revenues | 3,751,622 | 4,075,255 | 1 |
| Labor and other related expenses | 3,581,715 | 3,500,093 | 1 |
| Other restaurant operating expenses | 2,732,188 | 2,321,061 | |
| General and administrative expenses | 966,464 | 926,683 | |
| Depreciation and amortization | 330,852 | 409,914 | |
| Provision for impairment of assets | - | - | |
| Provision for store closings | - | - | |
| | 11,362,841 | 11,233,006 | 3 |
| INCOME (LOSS) FROM OPERATIONS | (396,950) | 47,948 | |
| OTHER INCOME (EXPENSE): | | | |
| Interest expense | (130,187) | (96,153) | |
| Interest income | 12,866 | 136 | |
| Other expense, net | (52,363) | (332,138) | |
| | (169,684) | (428,155) | |
| INCOME (LOSS) BEFORE ELIMINATION OF | | | |

| | | | |
|---|---|---|---|
| MINORITY PARTNER INTEREST AND INCOME TAXES | (566,634) | (380,207) | |
| ELIMINATION OF MINORITY PARTNER INTEREST | (47,060) | (54,017) | |
| INCOME (LOSS) BEFORE BENEFIT FROM INCOME TAXES | (613,694) | (434,224) | |
| BENEFIT FROM INCOME TAXES | 8,338 | 151,415 | |
| NET INCOME (LOSS) | $ (605,356) | $ (282,809) | $ |
| BASIC NET INCOME (LOSS) PER SHARE OF COMMON STOCK | $ (0.14) | $ (0.06) | $ |
| BASIC WEIGHTED AVERAGE NUMBER OF SHARES OF COMMON STOCK OUTSTANDING | 4,454,015 | 4,454,015 | |
| DILUTED NET INCOME (LOSS) PER SHARE OF COMMON STOCK | $ (0.14) | $ (0.06) | $ |
| DILUTED WEIGHTED AVERAGE NUMBER OF SHARES OF COMMON STOCK OUTSTANDING | 4,454,015 | 4,454,015 | 1 |

See notes to consolidated financial statements.



SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | 39 Weeks Ended | |
|---|---|---|
| | September 29, 2002 | September 30, 2001 |
| OPERATING ACTIVITIES: | | |
| Net income (loss) | $ 979,705 | $ (3,194,094) |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: | | |
| Provision for impairment of assets | - | 1,582,137 |
| Depreciation and amortization | 988,355 | 1,364,374 |
| Loss on sale of assets | 2,616 | 284,128 |
| Minority partner interest | 3,922 | (18,874) |
| Changes in assets and liabilities: | | |
| Decrease in inventories | 72,192 | 549,907 |
| (Increase) decrease in other assets | (200,520) | 300,800 |
| Decrease in prepaid rent | 12,036 | 37,800 |
| Decrease in income tax refunds receivable | 889,027 | - |
| Decrease in deferred tax asset | - | 94,527 |
| (Decrease) increase in accounts payable | (1,865,319) | 971,129 |
| Decrease in accrued expenses | (510,812) | (843,863) |
| Decrease in sales tax payable | (22,497) | (149,048) |
| Decrease in deferred rent | (130,580) | (534,728) |
| Total adjustments | (761,580) | 3,638,289 |

| | | |
|---|---|---|
| Net cash provided by operating activities | 218,125 | 444,195 |
| INVESTING ACTIVITIES: | | |
| Proceeds from the sale of assets,net | 1,091,324 | 1,496,646 |
| Purchase of property and equipment | (433,383) | (534,585) |
| Net cash provided by investing activities | 657,941 | 962,061 |
| FINANCING ACTIVITIES: | | |
| Proceeds from debt financing | 2,304,317 | 227,636 |
| Repayment of debt | (1,621,767) | (2,299,692) |
| Net cash provided by (used in) financing activities | 682,550 | (2,072,056) |
| Net increase (decrease) in cash | 1,558,616 | (665,800) |
| CASH AT BEGINNING OF PERIOD | 969,680 | 1,261,937 |
| CASH AT END OF PERIOD | $ 2,528,296 | $ 596,137 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $ 391,832 | $ 352,138 |
| Cash refunds received for income taxes | $ 1,216,438 | $ 234,164 |
| Note receivable on sale of assets | $ 100,000 | $ - |

See notes to consolidated financial statements.



SHELLS SEAFOOD RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

## 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, these statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all material adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The consolidated financial statements of Shells Seafood Restaurants, Inc. (the "Company") should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Form 10-K for the year ended December 30, 2001 filed with the Securities and Exchange Commission. Company management believes that the disclosures are sufficient for interim financial reporting purposes. Certain prior year amounts have been reclassified in the accompanying condensed consolidated financial statements to conform with the current year presentation.

## 2. EARNINGS PER SHARE

The following table represents the computation of basic and diluted earnings per share of common stock as required by Financial Accounting Standards Board ("FASB") Statement No. 128, "Earnings Per Share":

| | 13 Weeks Ended | | |
|---|---|---|---|
| | September 29, 2002 | September 30, 2001 | Septem |
| Net income(loss) applicable to common stock | $ (605,356) | $ (282,809) | $ |
| Weighted common shares outstanding | 4,454,015 | 4,454,015 | |
| Basic net income (loss) per share of common stock | $ (0.14) | $ (0.06) | $ |
| Effect of dilutive securities: | | | |
| Warrants | - | - | |
| Stock options | - | - | |
| Total dilutive securities | - | - | |
| Diluted weighted common shares outstanding | 4,454,015 | 4,454,015 | |
| Diluted net income (loss) per share of common stock | $ (0.14) | $ (0.06) | $ |

The earnings per share calculations excluded warrants and options to purchase an aggregate of 11,075,039 shares of common stock during the 13 week period ended September 29, 2002, and warrants and options and to purchase an aggregate of 1,612,758 shares of common stock during the 13 and 39 week periods ended September 30, 2001, as they were anti-dilutive.

The earnings per share calculations excluded warrants and options to purchase an aggregate of 2,308,726 shares of common stock during the 39 weeks ended September 29, 2002, as the exercise prices of these warrants and options were greater than the average market price of the common shares.

## 3. NEW ACCOUNTING PRONOUNCEMENT

In July 2001, the FASB issued Statement No. 141, "Accounting for Business Combinations," and Statement No. 142, "Goodwill and Other Intangible Assets." These Statements modify accounting for business combinations after June 30, 2001. The Statements require that goodwill existing at the date of adoption be reviewed for possible impairment and that impairment tests be periodically repeated, with impaired assets written-down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified consistent with the Statements' criteria. Intangible assets with estimated useful lives will continue to be amortized over those periods. Amortization of goodwill and intangible assets with indeterminate lives will cease. The adoption of Statement No. 142 is not expected to materially affect our consolidated financial statements.

In July 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations." This Statement requires capitalizing any retirement costs as part of the total cost of the related long-lived asset and subsequently allocating the total expense to future periods using a systematic and rational method. Adoption of this Statement is required for fiscal years beginning after June 15, 2002. The adoption of Statement No. 143 is not expected to materially affect our consolidated financial statements.

In October 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement supersedes Statement No. 121 but retains many of its fundamental provisions. Additionally, this Statement expands the scope of discontinued operations to include more disposal transactions. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. The adoption of Statement No. 144 did not and is not expected to materially affect our consolidated financial statements.

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." The Statement updates, clarifies and simplifies existing accounting pronouncements. Statement No. 145 rescinds Statement No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses. Statement No. 64 amended Statement No. 4, and is no longer necessary because Statement No. 4 has been rescinded. Statement No. 44 was issued to establish accounting requirements for the effects of transition to the provisions of the Motor Carrier Act of 1980. Because the transition has been completed, Statement No. 44 is no longer necessary. Statement No.145 also amends Statement No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. This amendment is consistent with the FASB's goal of requiring similar accounting treatment for transactions that have similar economic effects. Statement No. 145 also makes technical corrections to existing pronouncements. The adoption of Statement No. 145 is not expected to materially affect our consolidated financial statements.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The Statement addresses costs that are a result of exiting an activity, such as termination benefits, costs to terminate a contract that is not a capital lease, and costs to consolidate facilities or relocate employees. Under the Statement, a company may recognize costs related to a restructuring only when the liability is incurrred. Under previous US GAAP, a liability for such costs was recognized on the date when a company committed to an exit plan. The provisions of this Statement are effective for exits and disposal activities that are initiated after December 31, 2002. The adoption of Statement No. 146 is not expected to materially affect our consolidated financial statements.

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

The following table sets forth, for the periods indicated, the percentages which the items in the Company's Consolidated Statements of Income bear to total revenues.

| | 13 Weeks Ended | | |
|---|---|---|---|
| | September 29, 2002 | September 30, 2001 | Septembe |
| REVENUES | 100.0% | 100.0% | |
| COST AND EXPENSES: | | | |
| Cost of revenues | 34.2% | 36.1% | |
| Labor and other related expenses | 32.7% | 31.0% | |
| Other restaurant operating expenses | 24.9% | 20.6% | |
| Total restaurant costs and expenses | 91.8% | 87.7% | |
| General and administrative expenses | 8.8% | 8.2% | |
| Depreciation and amortization | 3.0% | 3.6% | |
| Provision for impairment of assets | 0.0% | 0.0% | |
| Provision for store closings | 0.0% | 0.0% | |
| Income (loss) from operations | -3.6% | 0.4% | |
| Interest expense, net | -1.1% | -0.9% | |
| Other expense, net | -0.5% | -2.9% | |
| Elimination of minority partner interest | -0.4% | -0.5% | |
| Income (loss) before benefit from taxes | -5.6% | -3.8% | |
| Benefit from income taxes | 0.1% | 1.3% | |
| Net income (loss) | -5.5% | -2.5% | |



13 weeks ended September 29, 2002 and September 30, 2001

Revenues. Total revenues for the third quarter of 2002 were $10,966,000 as compared to $11,281,000 for the third quarter of 2001, a $315,000, or 2.8% decrease. Same store sales for the third quarter of 2002 were 1.2% below the comparable period in 2001 due to a decline in check average partially offset by an increase in customer counts. The Company discontinued operations in one restaurant in each of the third quarters of 2002 and 2001. The Company operated 28 restaurants as of the third quarter ended September 29, 2002 versus 29 restaurants at the comparable period ended in 2001. Comparisons of same store sales include only stores, which were open during the entire periods being compared and, due to the time needed for a restaurant to become established and fully operational, at least six months prior to the beginning of that period.

Cost of revenues. The cost of revenues as a percentage of revenues decreased to 34.2% for the third quarter of 2002 from 36.1% for the third quarter of 2001. This decrease was due primarily to lowered protein costs, mostly in shrimp, greater focus on in-store cost control, and the continued favorable affect of the fourth quarter 2001 implementation of a new menu, which has better promoted more favorable margin items. The Company is continually attempting to anticipate and react to fluctuations in food costs by purchasing seafood directly from numerous suppliers, promoting certain alternative menu selections in response to price and availability of supply and adjusting its menu prices accordingly to help control the cost of revenues, both in absolute dollars and as a percentage of revenues.

Labor and other related expenses. Labor and other related expenses as a percentage of revenues increased to 32.7% during the third quarter of 2002 as compared to 31.0% for the third quarter of 2001. This increase was primarily attributable to an increase in hourly training and management staffing levels.

Other restaurant operating expenses. Other restaurant operating expenses as a percentage of revenues increased to 24.9% for the third quarter of 2002 as compared with 20.6% for the third quarter of 2001. The increase primarily was due to increased media advertising and local store marketing costs. In addition, the Company increased its expenditures in restaurant maintenance.

General and administrative expenses. General and administrative expenses were $966,000 or 8.8% of revenues for the third quarter of 2002 as compared with $927,000 or 8.2% of revenues for the third quarter of 2001. The increase was primarily due to a third quarter of 2002 increase in restaurant manager recruiting and training along with increased expenditures relating to the Company's strategic initiatives and marketing plan development.

Depreciation and amortization. Depreciation and amortization expense as a percentage of revenues were 3.0% and 3.6% for the third quarter of 2002 and 2001, respectively.
Other expense, net. The other expense was $52,000 for the 13 weeks ended September 29, 2002 compared to $332,000 for the same period in 2001 which included a book loss of $283,000 realized upon the disposition of a restaurant site in Delray Beach, Florida.

Other income (expense). The other expense was $170,000 for the 13 weeks ended September 29, 2002 compared to $428,000 for the same period in 2001, which included a book loss of $283,000 realized upon the disposition of a restaurant site in Delray Beach, Florida.

Benefit from income taxes. A benefit from income taxes was recognized for the third quarter of 2002 of $8,000 compared to $151,000 for the same quarter in 2001 relating to tax refunds.

Income (loss) from operations and net income (loss). As a result of the factors discussed above, loss from operations was $397,000 for the third quarter of 2002 compared to income from operations of $48,000 for the third quarter of 2001. Net loss was $605,000 for the third quarter of 2002 compared to $283,000 for the third quarter of 2001. Exclusive of non-recurring items, the net loss was $151,000 for the third quarter of 2001. Non-recurring items for the third quarter 2001 included a book loss of $283,000 from the sale of the Delray Beach, Florida unit and an increase to the deferred tax asset of $151,000.



39 weeks ended September 29, 2002 and September 30, 2001

Revenues. Total revenues for the 39 weeks ended September 29, 2002 were $37,603,000 as compared to $47,933,000 for the 39 weeks ended September 30, 2001. The $10,330,000 or 21.6% decrease primarily was due to the discontinuation of operations in 16 restaurants, 14 of which were Midwest units, during the 39 weeks ended September 30, 2001. Same store sales decreased 9.5% compared to the same period in 2001 due to declines in both check average and customer counts.

Cost of revenues. The cost of revenues as a percentage of revenues decreased to 33.7% for the 39 weeks ended September 29, 2002 from 37.4% for the same period in 2001. This decrease primarily was due to lower protein costs and the effect of the new menu, which generated improvements in margins.

Labor and other related expenses. Labor and other related expenses decreased to 30.4% as a percentage of revenues for the 39 weeks ended September 29, 2002 as compared to 30.3% for the same period in 2001. Also included in 2001, was a one-time nonrecurring charge of $102,000 for severance pay relating to the discontinuation of the Midwest operations.

Other restaurant operating expenses. Other restaurant operating expenses increased to 22.5% as a percentage of revenues for the 39 weeks ended September 29, 2002 as compared with 20.6% for the same period in 2001. The increase was primarily related to an increase in media advertising and local store marketing costs.

General and administrative expenses. General and administrative expenses were $2,754,000 or 7.3% of revenues for the 39 weeks ended September 29, 2002 compared with $3,699,000 or 7.7% of revenues for the same period in 2001. The decrease was primarily attributable to the reorganization and downsizing of administrative and supervisory staff in the first quarter of 2001 which included a one-time nonrecurring charge of $150,000 for severance pay.

Depreciation and amortization. Depreciation and amortization expenses as a percentage of revenues were 2.6% for the 39 weeks ended September 29, 2002 and 2.8% for the same period in 2001.

Provision for impairment of assets. The Company recorded a

$1,582,000 charge in the 39 weeks ended September 30, 2001 relating to the write-down of impaired assets to their estimated fair value in accordance with FASB Statement No. 121. The asset impairment charge related to the discontinuation of Midwest operations as well as reserving for certain under-performing Florida units.

Provision for store closings. The Company recorded a one-time charge of $1,333,000 relating to store closing costs primarily from the Midwest restaurant closures during the 39 weeks ended September 30, 2001. Store closing costs consisted primarily of real estate lease obligations incurred or anticipated to complete lease terminations or continuing costs while new tenants were located.

Interest expenses, net. The Company recorded a non-recurring charge of $106,000 in the first quarter of 2002 relating to the issuance of warrants on January 31, 2002 as part of the previously reported $2,000,000 financing transaction. Exclusive of the non-recurring charge, net interest expense was $319,000 for the 39 weeks ending September 29, 2002 compared to $412,000 in the comparable period in 2001. The reduction was primarily related to debt repayments associated with store closures in 2001 and related property dispositions through 2002.

Other income (expense). The other expense was $505,000 for the 39 weeks ended September 29, 2002 compared to $825,000 for the same period in 2001, which included a book loss of $283,000 realized upon the disposition of a restaurant site in Delray Beach, Florida.

Benefit from income taxes. A benefit from income taxes of $327,000 was recognized in the 39 weeks ended September 29, 2002 compared to a benefit of $151,000 for the same period in 2001. The increase related to a refund application to recover tax payments of $1,176,000 from prior years, resulting from the Economic Stimulus Package signed into law in March 2002. The refund was received in July 2002.

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Income (loss) from operations and net income (loss). As a result of the factors discussed above, the Company's income from operations was $1,327,000 for the 39 weeks ended September 29, 2002 compared to a loss from operations of $2,351,000 for the 39 weeks ended September 30, 2001. Exclusive of the provisions for impairment of assets and store closings, the Company's income from operations was $564,000 for the 39 weeks ended September 30, 2001. The Company's net income for the 39 weeks ended September 29, 2002 was $980,000 compared to a net loss of $3,194,000 in the same period in 2001. Exclusive of non-recurring items, the Company's net income was $768,000 for the 39 weeks ended September 29, 2002 and $105,000 for the 39 weeks ended September 30, 2001. Non-recurring items for the 39 weeks ended September 29, 2002 included $106,000 related to imputed interest expense and a tax benefit of $318,000. Non-recurring items for the 39 weeks ended September 30, 2001 included $1,582,000 related to the write-down of impaired assets, $1,333,000 related to expenses on restaurant closures, severance pay of $252,000, a book loss of $283,000 from the sale of the Delray Beach, Florida unit and an increase to the deferred tax asset of $151,000.

LIQUIDITY AND CAPITAL RESOURCES

As of September 29, 2002, the Company's current liabilities of $6,898,000 exceeded its current assets of $3,410,000, resulting in a working capital deficiency of $3,488,000. In comparison, the December 30, 2001 working capital deficiency was $7,580,000. The improvement in the working capital deficiency was primarily related to the cash received from the previously reported $2,000,000 financing transaction, completed in the first quarter of 2002, and favorable operating results in the first and second quarters of 2002. In addition, as a result of the Economic Stimulus Package signed into law in March 2002, the Company recognized an income tax benefit in the second quarter of 2002.
A federal income tax refund of $1,176,000 for taxes paid in fiscal years 1996 and 1997 was received in July 2002.

The Company continues to be negatively impacted by the ongoing costs of divestiture of its Midwest locations.
Such divestiture costs had and, in the near term, will continue to have an adverse affect on the Company's cash position.
Historically, the Company has generally operated with minimal or negative working capital as a result of the investment of current assets into non-current property and equipment as well as the turnover of restaurant inventory relative to more favorable vendor terms in accounts payable.

Cash provided by operating activities for the 39 weeks ended September 29, 2002 was $218,000 compared to $444,000 for the comparable period in 2001. The net decrease of $226,000 was primarily due to the settlement and payment of outstanding 2001 accounts payable and accrued expenses during 2002, offset in part by a net decrease of $889,000 in income tax refunds receivable.

The cash provided by investing activities was $658,000 for the 39 weeks ended September 29, 2002 compared to $962,000 for the same period in 2001; or a net decrease of $304,000 due to a reduction in proceeds on the sale of assets, which was partially offset by a decrease in expenditures for capital improvements.

The cash provided by financing activities was $683,000 for the 39 weeks ending September 29, 2002 compared to cash used in financing activities of $2,072,000 for the comparable period in 2001. The net increase of $2,755,000 was primarily due to the $2,000,000 financing transaction completed in January 2002 along with a reduction in repayments of debt related to the disposition of the Midwest restaurants in 2001.

The Company has existing indebtedness with Colonial Bank (previously known as Manufacturers Bank of Florida) consisting of two notes with a total principal balance, as of September 29, 2002, of $651,000. The loans, which were used to finance the purchase of a restaurant location and certain equipment, are subject to compliance by the Company with specified financial covenants. The Company was not in compliance with certain of these covenants, but received the appropriate covenant waivers as of September 29,2002.
Effective October 1, 2002, the Company renegotiated the loans and associated financial covenants. Subsequently, the Company is in compliance with the related financial covenants.

The Company had existing indebtedness with SunTrust Bank consisting of one note with a total principal balance, as of September 29, 2002, of $284,000. The loan, which was used to finance the purchase of a restaurant location, matured on August 4, 2002. The loan was repaid subsequent to September 29, 2002 and refinanced by Colonial Bank.

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SEASONALITY

The restaurant industry in general is seasonal, depending on restaurant location and the type of food served. The Company has experienced fluctuations in its quarter-to-quarter operating results due primarily to its high concentration of restaurants in Florida. Business in Florida is influenced by seasonality due to various factors which include but are not limited to weather conditions in Florida relative to other areas of the U.S., the health of Florida's economy and the effect of world events in general and on the tourism industry in particular. The Company's restaurant sales are generally highest from January through April and June through August, the peaks of the Florida tourism season, and generally lower from September through mid-December. In many cases, locations are in coastal cities, where sales are significantly dependent on tourism and its seasonality patterns.

In addition, quarterly results have been, and in the future could be, affected by the timing and conditions under which restaurants are closed both in and outside of Florida. Because of the seasonality of the Company's business and the impact of restaurant closures and openings, if applicable, results for any quarter are not generally indicative of the results that may be achieved for a full fiscal year on an annualized basis and cannot be used to indicate financial performance for the entire year.

Item 3. - Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to market risk from changes in interest rates on debt and changes in commodity prices. The Company's exposure to interest rate risk relates to its $949,000 in outstanding debt with banks that is based on variable rates. Borrowings under the loan agreements bear interest at rates ranging from 50 basis points under the prime-lending rate to 100 basis points over the prime-lending rate.

Item 4. - Controls and Procedures

During the 90-day period prior to the filing date of this report, management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon, and as of the date of that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required.

There have been no significant changes in the Corporation's internal controls or in other factors known to us that could significantly affect internal controls subsequent to the date of such evaluation, including any corrective sections with regard to significant deficiencies and material weaknesses.

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Part II - OTHER INFORMATION

Item 1 - Legal Proceedings
None

Item 2 - Changes in Securities and Use of Proceeds

None

Item 3 - Defaults Upon Senior Securities

The Company has existing indebtedness with Colonial Bank (previously known as Manufacturers Bank of Florida), consisting of two notes with a total principal balance, as of September 29, 2002, of $651,000. The loans, which were used to finance the purchase of a restaurant location and certain equipment, are subject to compliance by the Company with specified financial covenants. The Company was not in compliance with certain of these covenants as of September 29, 2002, but received the appropriate covenant waivers. The Company renegotiated these loans effective October 1, 2002 with modifications to the debt covenants. The Company is in compliance with the modified debt covenants.

Item 4 - Submission of Matters to a Vote of Security Holders

None

Item 5 - Other Information

None

Item 6 - Exhibits and Reports on Form 8-K

None

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SIGNATURES

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.

SHELLS SEAFOOD RESTAURANTS, INC.
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(Registrant)

/s/ David W. Head November 13, 2002
President and Chief Executive Officer

/s/ Warren R. Nelson November 13, 2002
Executive Vice President and Chief Financial Officer

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CERTIFICATIONS

I, David W. Head, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Shells Seafood Restaurants, Inc.;

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 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 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 registrant as of, and for, the periods presented in this quarterly report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant'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 our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant'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 registrant's internal controls; and
6. The registrant's other certifying officer and 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 our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002
/s/ David W. Head
David W. Head
President, and Chief Executive Officer



CERTIFICATIONS

I, Warren R. Nelson, certify that:
1. I have reviewed this quarterly report on Form 10-Q of Shells Seafood Restaurants, Inc.;
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 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 this annual 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 registrant as of, and for, the periods presented in this quarterly report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
(b) evaluated the effectiveness of the registrant'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 our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant'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 registrant's internal controls; and

6. The registrant's other certifying officer and 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 our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002
/s/ Warren R. Nelson
Warren R. Nelson
Chief Financial Officer