SHELLS SEAFOOD RESTAURANTS INC
Form S-1
July 08, 2005

As filed with the Securities and Exchange Commission on July 8, 2005

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

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

Delaware	**5812**	**65-0427966**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

16313 North Dale Mabry Highway, Tampa, Florida 33618 (813) 961-0944
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Leslie J. Christon, President and Chief Executive Officer
Shells Seafood Restaurants, Inc.
16313 North Dale Mabry Highway
Tampa, Florida 33618
(813) 961-0944
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Sheldon G. Nussbaum, Esq.
Fulbright & Jaworski L.L.P.
666 Fifth Avenue
New York, New York 10103
Telephone (212) 318-3000
Fax (212) 318-3400

Approximate date of commencement of proposed sale to public:
From time to time after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), check the following box. [x]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered**	**Proposed Maximum Aggregate Offering Price**	**Amount of Registration Fee**
Common Stock	10,813,011	$9,191,059 (1)	$1,082
Common Stock issuable upon exercise of warrants	4,996,050	6,494,865 (2)	765
Common Stock issuable upon exercise of warrants	1,946,250	1,167,750 (3)	138
Common Stock issuable upon conversion of Series B Convertible Preferred Stock	9,992,100 (4)	8,493,285 (1)	1,000
Total	27,747,411 (5)	25,346,959	2,984

(1) The price is estimated in accordance with Rule 457(c) under the Securities Act, based on the average of the bid and asked price as of July 1, 2005 on the OTC bulletin board.

(2) The price is estimated in accordance of Rule 457(g) under the Securities Act of 1933, as amended (the "Securities Act"), solely for the purpose of calculating the registration fee and is $1.30, the exercise price of the warrants.

(3) The price is estimated in accordance of Rule 457(g) under the Securities Act solely for the purpose of calculating the registration fee and is $.60, the exercise price of the warrants.

(4) The amount to be registered includes an indeterminate number of shares of common stock issuable upon conversion of the Series B Convertible Preferred Stock, as this amount may be adjusted as a result of, among others, antidilution provisions.

(5) Pursuant to Rule 416 under the Securities Act, this Registration Statement also relates to an indeterminate number of additional shares of our common stock which may become issuable by reason of any stock split, stock dividend, recapitalization, or similar transaction that is effective without the receipt of consideration and results in an increase in the number of shares of our common stock that are outstanding.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED JULY 8, 2005

27,747,411 Shares

Common Stock

The holders of common stock, Series B Convertible Preferred Stock, and warrants to purchase shares of common stock of Shells Seafood Restaurants, Inc. listed in this prospectus may offer and sell from time to time up to an aggregate of 27,747,411 shares of our common stock under this prospectus for their own accounts. We will not receive any proceeds from the sale of the shares other than the exercise price, if any, payable to us upon the exercise of the warrants.

The number of shares being registered for resale under this prospectus consists of 10,813,011 outstanding shares of our common stock, 6,942,300 shares of our common stock issuable upon the exercise of warrants and 9,992,100 shares of our common stock issuable upon the conversion of our Series B Convertible Preferred Stock. The outstanding shares of common stock being registered for resale under this prospectus consist of 8,813,011 shares of common stock we issued upon exercise of warrants originally issued with our promissory notes sold in January 2002, and 2,000,000 shares of common stock upon exercise of warrants issued to the note holders for their granting us a two-year extension of the maturity date of these notes until January 2007. We issued warrants to purchase an aggregate of 1,971,250 shares of common stock to the investors and the placement agent in our December 2004 private placement of debentures to accredited investors. 1,946,250 shares of the 1,971,250 shares issuable upon exercise of these warrants are being registered for resale under this prospectus. We sold units consisting of 461,954 shares of our Series B Convertible Preferred Stock and warrants to purchase 4,619,540 shares of our common stock in a private transaction in May 2005. In addition, we issued a warrant to purchase 37,651 units (consisting of 37,651 shares of our Series B Convertible Preferred Stock and warrants to purchase 376,510 shares of our common stock) at a purchase price of $15.00 per unit to the placement agent in our May 2005 private financing to accredited investors. Each share of our Series B Convertible Preferred Stock is initially convertible into 20 shares of our common stock, subject to certain adjustments under specified circumstances. All of the underlying shares of common stock of the units we sold in May 2005 are being registered for resale under this prospectus.

The selling stockholders (and their donees and pledgees) may offer their common stock of Shells Seafood Restaurants, Inc. through public or private transactions, on or off the United States exchanges, at prevailing market prices, or at privately negotiated prices.

Our common stock is listed on the OTC bulletin board under the symbol “SHLL.OB.” The last reported sale price of our common stock on the OTC bulletin board on July 7, 2005 was $0.80.

Investing in our common stock involves risks. See “Risk Factors” beginning on page 4.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is   , 2005.

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You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different from that contained in this prospectus. This document may only be used where it is legal to sell these securities. The information in this prospectus may only be accurate on the date of this prospectus regardless of the time of delivery of this prospectus.

Market and industry data and other statistical information used throughout this prospectus are based on independent industry publications, government publications and other published independent sources. Some data are also based on our good faith estimates, which are derived from management’s knowledge of the industry and independent sources. Although we believe that these sources are reliable, we have not independently verified the information and cannot guarantee its accuracy and/or completeness. Similarly, we believe our internal research is reliable, but it has not been verified by any independent sources.

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus but might not contain all of the information that is important to you. Before investing in our common stock, you should read the entire prospectus carefully, including the "Risk Factors" section and our historical and pro forma consolidated financial statements and the notes thereto included elsewhere in this prospectus.

For purposes of this prospectus, unless the context otherwise requires, all references herein to "our company," "Shells," "we," "us" and "our" refer to Shells Seafood Restaurants, Inc.

Our Company

Shells Seafood Restaurants, Inc. manages and operates full service, mid-priced, casual dining seafood restaurants, designed to appeal to a broad range of customers by providing generous portions of high-quality seafood, warm, friendly service, and a relaxed atmosphere at reasonable prices. Our restaurants feature a wide selection of seafood items, including shrimp, oysters, clams, scallops, mussels, lobster, crab and daily fresh fish specials, cooked to order in a variety of ways: steamed, sautéed, grilled, blackened and fried. In addition, our restaurants offer a wide selection of signature pasta dishes, appetizers, salads, and desserts and full bar service. All of our 26 restaurants are open for dinner and 24 of our restaurants are also open for lunch.

As of January 2, 2005, our fiscal year end, we owned 20 Shells restaurants, owned a 51% ownership interest in one Shells restaurant and managed four additional Shells restaurants pursuant to contractual arrangements. In March 2005, we opened a new 11,000 square-foot restaurant in Clearwater Beach, Florida. All of our restaurants are located in Florida.

Over the past several months, we have dramatically improved many aspects of the guest dining experience at our restaurants. Beginning with our new menu, we have strengthened our guest appeal and bolstered our commitment to serving the highest-quality fresh seafood. We have added bold new flavors and better variety, from new fish and shellfish items to exciting new salad and dessert selections. We have increased the size of our shrimp and crab legs, added new grill and pasta dishes and refined our plate presentations.

We continue to work diligently to elevate our service levels and operating standards. We have revamped our training procedures and rolled out a new service system known as "Ship Shape Service," providing all team members with the opportunity to graciously serve our guests.

Providing a more attractive, comfortable and energetic atmosphere for enjoying our delicious seafood is a key part of our repositioning strategy. Consumer expectations have risen significantly since Shells opened its first, non-frills restaurant 20 years ago. We believe that updating and enhancing the appearance of all Shells restaurants, while strategically opening great-looking new restaurants, will enhance our business. During 2004, we took a major step forward to reenergize the appearance and atmosphere of our restaurants. Shells' contemporary and spirited new look features brighter and warmer colors and textures, enhanced lighting and décor accents reflecting the spirit of the sea. The new look initially was tested at three restaurants in 2004, resulting in robust sales increases and exceptional guest approval. In the first quarter of 2005, we renovated six additional restaurants, giving nine remodeled restaurants, to-date.

Corporate Information

We were incorporated under the laws of the State of Florida in April 1993 and were reincorporated under the laws of the State of Delaware in April 1996. Our principal executive offices are located at 16313 North Dale Mabry Highway, Tampa, Florida 33618, and our telephone number is (813) 961-0944. Shells, Inc., a company incorporated under the laws of State of Florida, was merged with and into our company and became our wholly owned subsidiary effective December 1994. Our website is located at www.shellsseafood.com. Information contained on our website does not constitute a part of this prospectus.

The Offering

Common stock offered	27,747,411 shares by selling stockholders
Offering Price	Market price or privately negotiated price
Common stock outstanding	15,641,417 shares as of July 3, 2005 (1)
Use of proceeds	We will not receive any proceeds from the sale of the shares offered by the selling stockholders. Any proceeds we receive from the selling stockholders upon their exercise of warrants to purchase the shares included in the shares that are being offered by them hereunder will be used for general working capital and capital expenditures.
OTC bulletin board symbol	“SHLL.OB”
Risk Factors	An investment in our common stock involves a high degree of risk. You should carefully consider the risk factors set forth under “Risk Factors” beginning on page 4 and the other information contained in this prospectus prior to making an investment decision regarding our common stock.

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(1) The number of shares outstanding excludes:

· 3,216,500 shares of common stock issuable upon the exercise of options outstanding under our equity compensation plans, having a weighted average exercise price of $0.94 per share;

· 2,842,508 shares of common stock reserved for future grant under our equity compensation plans;

· 1,971,250 shares of common stock issuable upon the exercise of outstanding warrants, at an exercise price of $0.60 per share;

· 4,619,540 shares of common stock issuable upon the exercise of outstanding warrants, at an exercise price of $1.30 per share;

· 9,239,080 shares of common stock issuable upon the conversion of outstanding Series B Convertible Preferred Stock;

· warrants to purchase 37,651 units issued to the placement agent in our May 2005 private financing at an exercise price of $15.00 per unit (each unit consisting of one share of Series B Convertible Preferred Stock (initially convertible into 20 shares of common stock) and warrants to purchase 10 shares of common stock at an exercise price of $1.30 per share); and

· 35,275 shares of our Series A 5% Convertible Preferred Stock.

Summary Financial Information and Other Data

The following table sets forth our summary financial information and other data. The historical statement of operations data for our fiscal years ended December 29, 2002, December 28, 2003 and January 2, 2005 are derived from, and should be read in conjunction with, our audited financial statements and related notes appearing elsewhere in this prospectus. The historical statement of operations data for the thirteen weeks ended March 28, 2004 and April 3, 2005 and the historical and pro forma balance sheet data as of April 3, 2005 are derived from our unaudited financial statements. The pro forma balance sheet data assumes the May 2005 private placement financing was consummated on April 3, 2005. In management's opinion, these unaudited financial statements and pro forma data have been prepared on substantially the same basis as the audited financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial data for the periods presented. The results of operations for the interim period are not necessarily indicative of the operating results for the entire year or any future period.

The information contained in this table should also be read in conjunction with "Use of Proceeds,""Capitalization,""Selected Historical Financial Information,""Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and accompanying notes thereto, all included elsewhere in this prospectus.

(Dollars and Shares in Thousands)	Year (53 Weeks) Ended	Year (52 Weeks) Ended				Thirteen Weeks Ended	
	January 2, 2005	December 28, 2003	December 29, 2002	December 30, 2001	December 31, 2000	March 28, 2004	April 3, 2005
Statement of Operations Data:							
Total revenues	$ 41,564	$ 44,046	$ 47,228	$ 57,529	$ 90,442	$ 12,591	$ 12,526
Income (loss) from operations	43	(207)	1,108	(3,430)	(6,125)	832	528
Interest expense, net	(1,154)	(463)	(534)	(481)	(789)	(101)	(168)
(Loss) income before elimination of minority partner interest and income taxes	(1,078)	(770)	571	(3,799)	(6,769)	714	495
Net (loss) income	$ (1,344)	$ (1,034)	$ 677	(3,019)	$ (9,332)	$ 645	$ 410
Operating Data:							
Number of managed restaurants at end of period (1)	25	28	28	29	45	27	26
Average annual sales per Company-owned and joint venture restaurant open for full period (2)	$ 1,896	$ 1,828	$ 1,924	$ 2,047	$ 2,071	---	---
Decrease in Company-owned and joint venture restaurant same store sales (2)	-1.6%	-5.1%	-7.2%	-13.1%	-0.4%	-1.4%	+6.8%

Balance Sheet Data:	As of April 3, 2005	Pro Forma as of April 3, 2005 (3)
Working capital (deficiency)	$ (5,207)	$ (516)
Total assets	15,272	17,520
Short-term debt	2,787	320
Long-term debt	3,207	1,436
Minority partner interest	463	463
Stockholders' equity	2,451	8,834

(1) Includes restaurants owned by us, one joint venture restaurant in which we own a 51% equity interest and four licensed restaurants.

(2) Includes only restaurants open during the full fiscal year shown and open for the full prior fiscal year and at least the full six months prior thereto. Same store sales are calculated on a comparable calendar period basis.

(3) Assumes the May 2005 private placement financing was consummated on April 3, 2005. See Note 1 in the notes to consolidated financial statements included in this prospectus for additional information.

RISK FACTORS

You should carefully consider the risks described below before investing in our common stock. Although the risks described below are all of the risks that we believe are material, they are not the only risks relating to our business and our common stock. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business operations. Any of the following risks could materially adversely affect our business, financial condition or results of operations. The trading price of our common stock could decline due to any of these risks and, therefore, you may lose all or part of your investment.

Risks Relating to Our Business

We have significant capital requirements and may need additional financing in the near future.

Historically, our cash requirements have exceeded our cash flow from operations. This has been due to costs associated with developing and opening restaurants as well as the operating performance of many of our restaurants. As of January 2, 2005, our company had a working capital deficiency of $4,639,000 and a cash balance of $2,350,000. In 2004, we incurred a net loss of $1,344,000 and we invested in property and equipment of $1,292,000. In 2003, we incurred a net loss of $1,034,000 and we invested $755,000 in property and equipment. In addition, we have only recently experienced some success in reversing the long-term trends in declining sales and customer traffic. There are no assurances that these recent reversals will continue and that the implementation of our strategies will result in sales and customer traffic gains which are required to meet our contemplated cash flow requirements.

In May 2005, we sold an aggregate of $6.9 million of our securities in a private placement, resulting in net proceed to Shells of approximately $5.8 million. After retiring $2.2 million in loans from debenture holders to the extent not converted in the offering, we have used and plan to use the remaining proceeds to remodel additional Shells restaurants, to open new restaurants and for working capital purposes. We estimate that approximately $3.6 million will be required to complete the remodeling of our existing restaurants. Additional funding may be necessary to support our plans for growth.

In March 2005, our investors provided us with a $1.6 million revolving line of credit, which originally was scheduled to mature on the earlier of March 31, 2006 or the closing of a financing providing us not less than $1.6 million of net proceeds. The maturity date of this credit line has been extended to May 23, 2007.

We have, from time-to-time utilized, and to the extent applicable may utilize sale-leaseback transactions, real estate mortgage and restaurant equipment financing with various banks or financing institutions as necessary. In the event that our plans change, assumptions prove to be inaccurate, or due to unanticipated expenses, and in the event projected cash flow or third party financing otherwise prove to be insufficient to fund operations, we could be required to seek additional financing from sources not currently anticipated.

We cannot be assured that third party financing will be available to us when we need it or available on acceptable terms, if at all, in the future. If we cannot obtain third party financing when we need it, it could materially adversely affect our results of operations. Conversely, if we raise additional capital, our existing stockholders could be substantially diluted.

Our business plan is contingent on additional future financing.

Integral to our business plan, we plan to continue our renovation and remodeling of existing restaurants. In addition, we will continue to explore restaurant locations for new growth and relocations. We estimate that $3,600,000 will be required to complete the renovation and remodeling of our existing restaurants. Additional funding may be necessary to support our plans for growth. If we cannot secure the financing we need and achieve our operating cash flow requirements, our plans for growth may be adversely affected.

***We may be unable to repay certain of our debts when they mature*.**

We have two promissory notes outstanding to Colonial Bank, for the financing of two restaurant locations, Melbourne and Winter Haven. As of April 3, 2005, we owed collectively $1,076,000 on the principal balances of these notes. We are required to meet a financial covenant relating to debt coverage. We were in compliance in meeting this loan covenant as of the most recent measurement period, the fiscal quarter ended April 3, 2005. However, in the past, we were not in compliance with meeting the loan covenant for which a covenant waiver was provided by the bank. The two bank notes are secured by various of our assets. Our failure to pay these notes as they mature will allow the holders of these notes to seize and sell various of our assets to satisfy amounts owed.

Additionally, at various times in the past, we were not able to repay our debts when due. Convertible debentures totaling $2,375,000 matured in April 2005 and we required an extension of the maturity date for repayment until we were able to obtain funds from the financing in May 2005. In addition, in August 2004, we extended the maturity dates on notes totaling $2.0 million from January 31, 2005 to January 31, 2007. Although these debt obligations were ultimately retired, our inability to repay our debts on their originally scheduled maturity dates may negatively impact our ability to secure additional financing, if necessary. Also, we could be materially adversely affected, to the extent we undertake additional indebtedness and are unable to repay our debts on a timely basis.

***History of losses*.**

We have experienced operating and net losses during the majority of our recent prior years. In 2004, we had losses of $1,344,000. In 2003, we had losses of $1,034,000. Excluding non-recurring items, our losses were $734,000 and $765,000 in 2004 and 2003, respectively.

Our ability to use net operating loss carryforwards and general business credits to reduce future tax payments may be further limited if there are additional changes in ownership of Shells.

As of January 2, 2005, for federal income tax purposes, we had approximately $8,500,000 of net operating loss carryforwards, or NOLs, available to reduce taxable income in future years and approximately $2,800,000 of general business credits to carry forward. We believe that a substantial amount of these NOLs and credits are currently subject to an annual limitation under sections 382 and 383 of the Internal Revenue Code of 1986, as amended as a result of an "ownership change" in 2002, as defined by the Internal Revenue Code. Our ability to utilize our NOLs and credits were further limited by sections 382 and 383 as a result of our issuance of units consisting of shares of our Series B Convertible Preferred Stock and warrants to purchase shares of our common stock in May 2005. We estimate that the limit in the amount of net operating loss and credit carryforwards that may be used against taxable income is approximately $665,000 per year. Any portion of the $665,000 amount not utilized in any year will carry forward to the following year subject to a 15 to 20 year limitation on carryforward of net operating losses and credits.

***Substantial dilution to our stockholders is possible*.**

As of July 3, 2005, there were 15,641,417 shares of common stock outstanding, and warrants, options or other convertible securities outstanding to purchase an additional 16,959,400 shares of common stock at an average exercise price of $0.89 per share.

During January 2002, we completed a $2.0 million financing transaction pursuant to which, among other things, we issued warrants to purchase 8,908,030 shares of our common stock, at an exercise price of $0.16 per share. These warrants have been exercised in full, some in accordance with a cashless exercise provision; whereby 8,813,011 shares of common stock were issued to the respective warrant holders.

In August 2004, we agreed with the holders of the $2.0 million of promissory notes to an extension of the term of the notes from their original expiration date of January 31, 2005 to January 31, 2007. In connection with this extension, we issued warrants to purchase 2,000,000 shares of common stock, at an exercise price of $0.50 per share. These warrants have been exercised in full, whereby we issued 2,000,000 shares of common stock.

In December 2004, we completed a $2,375,000 private placement of convertible debentures. The debentures matured on April 5, 2005 and were fully repaid in May 2005. In conjunction with this private placement, we issued warrants to purchase 1,971,250 shares of common stock at $0.60 per share to the debenture holders and the placement agent. 1,946,250 shares of these underlying shares of common stock are part of the shares being registered for resale under this prospectus.

In March 2005, we amended our certificate of incorporation to increase the total number of authorized shares of our common stock from 20,000,000 shares to 40,000,000 shares. Subsequently, in June 2005, our stockholders approved a further increase of the total number of authorized shares of our commons stock from 40,000,000 shares to 58,000,000 shares. There are no restrictions on our ability to issue additional shares of stock.

In May 2005, we sold 461,954 units of securities at the selling price of $15.00 per unit for an aggregate sale price of $6.9 million in a private placement to some of the selling stockholders. Each unit consists of (i) one share of our Series B Convertible Preferred Stock, initially convertible into 20 shares of the our common stock, subject to adjustment under certain circumstances and (ii) a warrant to purchase 10 shares of our common stock at an exercise price of $1.30 per share. If these warrants and the Series B Convertible Preferred Stock are fully exercised or converted, we would issue 13,858,620 additional shares of common stock. In addition, we granted JMP Securities LLC, the placement agent in our May 2005 private financing, warrants to purchase 37,651 units at a purchase price of $15.00 per unit as a portion of their fees. The holders of the Series B Convertible Preferred Stock have antidilution protection for issuances of common stock by us at prices less than the "conversion price" in effect immediately prior to any such issuance. The initial conversion price is $0.75 per share, and will be subsequently reduced for future issuances if we sell shares at a price below the conversion price. All of the underlying shares of common stock of the units we sold in May 2005 are being registered for resale under this prospectus.

There can be no assurance that we will not be required to issue additional shares, warrants or other convertible securities in the future in conjunction with any capital raising efforts, including at price (or exercise prices) below the price at which shares of our common stock are being traded on the OTC bulletin board.

Provisions with Potential Anti-Takeover Effect.

Our certificate of incorporation provides that we may issue up to 2,000,000 shares of preferred stock from time-to-time in one or more series. The board of directors is authorized to determine the rights, preferences, privileges and restrictions granted to and imposed upon any wholly unissued series of preferred stock. The board is authorized to fix the number of shares of any series of preferred stock and the designation of any such series, without any vote or action by our stockholders. The board may authorize and issue preferred stock with voting, dividend, liquidation, conversion or other rights that could adversely affect the voting power or other rights of the holders of our common stock. In addition, the potential issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control, may discourage bids for our common stock at a premium over the market price of the common stock and may adversely affect the market price of the common stock.

We have no present intention to issue any additional shares of our preferred stock. However, we cannot assure you that we will not do so in the future.

Control by Management and Certain Individuals.
Frederick R. Adler, James Adler and Bruce Galloway, significant stockholders, together with members of our board of directors and executive management team, are beneficial owners of record, in the aggregate, of approximately 56.0% of our outstanding common stock as of July 3, 2005 and are able to control the business and affairs of our company, including the election of our directors and decisions regarding any proposed dissolution, merger or sale of our assets.

We depend on key personnel.

Our success is largely dependent upon our executive management and other key personnel. The loss of the services of one of our executives or other key personnel could materially adversely affect us. Due to our limited number of executive personnel, we may be particularly susceptible to an adverse impact from the loss of the services of one of our executives. Our success may also depend on our ability to attract and retain qualified management restaurant industry personnel.

Operating results may require the closure of additional restaurants.

If we experience prolonged periods of unfavorable operating results at any existing restaurants, view the prospects for a restaurant to be less than satisfactory or elect not to renew a restaurant lease due to its operating results, we may elect to close or relocate restaurants. The lack of success or closing of any of our restaurants could have an adverse effect upon our financial condition and results of operations. We closed 16 restaurants during 2001, of which 14 were located in the Midwest and two were located in Florida. We closed one restaurant in 2002 and three restaurants in 2004. We are continuing to monitor the operations and financial performance of our other existing restaurants.

Our operating results fluctuate seasonally because of our geographic concentration.

We experience significant fluctuations in our quarter-to-quarter operating results because of factors including:

- the seasonal nature of our business; and

- weather conditions in Florida, which may be severe from time-to-time.

Our restaurants are all located in Florida and can be affected by the health of Florida's economy in general, and of the tourism industry in particular, which can further be affected by anticipated world events, as well as economic trends. In addition, while the majority of our restaurants are located primarily in residential areas in Florida, many of our restaurants are located in seasonal tourist areas.

Our restaurant sales generally increase from January through April and June through August, the peaks of the Florida tourism season, and generally decrease from September through mid-December. In addition, because of our present geographic concentration, adverse publicity relating to our restaurants or adverse weather conditions could have a more pronounced adverse effect on our operating results than if our restaurants were more geographically dispersed. Adverse weather conditions or a decline in tourism in Florida, or in general economic conditions, which would likely affect the Florida economy or tourism industry, particularly during the time of peak sales, could materially adversely affect our operations and prospects. During the third and fourth quarters of 2004, we incurred substantial business and property losses as a result of four hurricanes that struck Florida. Because of the seasonality of our business, our results for any quarter are not necessarily indicative of the results that may be achieved for a full year.

The supply and quality of our seafood may fluctuate.

In recent years, the availability of certain types of seafood has fluctuated. This has resulted in a corresponding fluctuation in prices. We maintain short-term contracts with several of our suppliers. In addition, we purchase products through Performance Food Group in the ordinary course of business. Performance Food Group distributes and warehouses the majority of our seafood supply and procures, distributes and stores other supplies for us. We believe that our relationships with our suppliers and Performance Food Group are satisfactory and that alternative sources are readily available. However, the loss of some suppliers or of our relationship with Performance Food Group could materially adversely affect us.

Some species of seafood have become subject to adverse publicity because of claims of contamination by lead, mercury or other chemicals that may exist in the ocean or in an aquaculture environment. This can adversely affect both market demand and supply for these food products. Customer demand may also be negatively impacted by reports of medical or other risks resulting from eating seafood. We maintain a continuous inspection program for our seafood purchases. However, we cannot assure you that seafood contamination or consumer perception of inadequate seafood quality, in the industry in general or as to us specifically, will not have a material adverse effect on us. Our failure to obtain adequate supplies of seafood or problems or difficulties resulting from the contamination of seafood, in general, or at any of our restaurants in particular, will have a material adverse effect on our operations and profitability.

Our expenses for food and other costs fluctuate.

Our profitability depends on our ability to anticipate and to react to increases in food, labor, employee benefits, and similar costs. We have limited control over these costs. Specifically, our dependence on frequent deliveries of seafood, produce, dairy and other products means we are at greater risk of shortages or interruptions in supply because of adverse weather or other conditions. This could adversely affect the availability and cost of these items. Also, substantial price increases imposed by our suppliers in the absence of alternative sources of supply in a timely manner, could have a material adverse effect on us. We have been able to anticipate and react to fluctuations in food costs by:

- adjusting selected menu prices;
- purchasing seafood directly from numerous suppliers; and
- promoting alternative menu selections in response to price and availability of supply.

However, we cannot assure you that we will be able to continue to anticipate and respond to supply and price fluctuations or that we will not be subject to significantly increased costs. A shortage of available seafood could cause our cost of sales to increase. Because of our value oriented pricing structure, this could materially adversely affect our operations and profitability. In addition, seafood suppliers and processors are subject to a program of inspection by the Food and Drug Administration. This program may increase our seafood costs because seafood suppliers' and processors' costs in complying with this program may increase.

Recent wage hike.

In May 2005, the minimum wage rate in Florida increased by $1.00 per hour. Tipped employees also receive the $1.00 per hour wage increase under this new law. Each year thereafter, the minimum wage will increase according to the U.S. Department of Labor, Bureau of Labor Statistics cost of living index. Such payroll cost increases could have a significant adverse affect to our company. Menu price increases and other actions are required to negate the effect of these wage increases. There can be no assurances that such measures being taken and expected to be taken by our company will be successful to adequately offset these additional payroll costs, or will be accepted without adverse reaction by our customers.

We face risks associated with government regulation.

We are subject to extensive state and local government regulation by various agencies, including:

- state and local licensing, zoning, land use, construction and environmental regulations;
- various regulations relating to the sale of food and alcoholic beverages;
- regulations relating to sanitation, disposal of refuse and waste products;

- regulations relating to public health; and

- safety and fire standards.

Our restaurants are inspected periodically by governmental agencies to ensure conformity with these regulations. The suspension of, or inability to renew a license at an existing restaurant would adversely affect our operations. A significant percentage of our revenue comes from sales of alcoholic beverages. State and local regulation of the sale of alcoholic beverages require us to obtain a license or permit for each of our restaurants. The failure of a restaurant to obtain or retain a license to serve liquor would adversely affect our operations. In addition, our failure or difficulty in obtaining required licensing or other regulatory approvals could delay or prevent new restaurant openings.

Restaurant operating costs are also affected by other government actions, which are beyond our control, including increases in:

- the minimum hourly wage requirements;
- workers compensation insurance rates;
- health care insurance costs;
- other insurance costs, including general liability and property; and
- unemployment and other taxes.

Furthermore, the Americans with Disabilities Act may require us to make certain modifications to certain of our restaurants to meet specified access and use requirements. These and other initiatives could adversely affect our results of operations.

We may have liability for sales of alcoholic beverages.

We are also subject to “dram-shop” statutes. These statutes generally provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. In certain states, statutes also provide that a vendor of alcoholic beverages may be held liable in a civil cause of action for injury or damage caused by or resulting from the intoxication of a minor under certain conditions. In addition, significant national attention is currently focused on the problem of drunk driving, which could result in the adoption of additional legislation. This could increase our potential liability for damage or injury caused by our customers.

Our industry is highly competitive.

The restaurant industry, particularly the full-service casual dining segment, is highly competitive. We compete in the areas of:

- price;
- service;
- food quality, including taste, freshness, healthfulness and nutritional value; and
- location.

We have numerous well-established competitors, some of which dominate the industry. These competitors possess substantially greater financial, marketing, personnel and other resources than we do. Many of our competitors have achieved significant brand name and product recognition. They also engage in extensive advertising and promotional programs, both generally and in response to efforts by additional competitors to enter new markets, or introduce new products to respond to changes in consumer preferences, tastes and eating habits. Our competitors include national, regional and local full-service casual dining chains, many of which specialize in or offer seafood products.

We believe that the full-service casual dining segment is likely to attract a significant number of new entrants, some offering seafood products. We also expect to face competition from a broad range of other restaurants and food service establishments. These include full-service, quick-service and fast food restaurants, which specialize in a variety of menu offerings. In addition, the full-service restaurant industry is characterized by the frequent introduction of new food products, which are accompanied by substantial promotional campaigns. In recent years, numerous companies in the full-service restaurant industry have introduced products, including seafood, intended to capitalize on growing consumer prefer-ence for food products that are, or are perceived to be, healthful, nutritious, and low in calories, carbohydrates or fat content. You can expect that we will be subject to increasing competition from companies whose products or marketing strategies address these consumer preferences. While we believe that we offer a broad variety of quality seafood products, we cannot assure you that:

- consumers will be able to distinguish our products from competitive products;
- substantially equivalent food products will not be introduced by our competitors; or
- we will be able to compete successfully.

We may not be able to protect our service marks and proprietary information.

We own two United States registrations for the service marks that we use, including the name *"Shells."* We believe that our service marks have significant value and are essential to our ability to create demand for and awareness of our restaurants. We cannot assure you, however, that our service marks:

- do not or will not violate the proprietary rights of others; or
- would be upheld if challenged;

or that we would not be prevented from using our service marks. Any of these occurrences could materially adversely affect us. In addition, we cannot assure you that we will have the financial resources necessary to enforce or defend our service marks.

We believe that we own all of our intellectual property and that the management and license agreements to which we are a party are enforceable. In the past, the enforceability of these management and license agreements has been questioned by certain of the licensees. Although we believe the agreements are enforceable, there can be no assurance that the agreements will not be challenged in the future, and, if challenged, that the agreements will be determined to be enforceable and the managed restaurants will be restricted from using the Shells service marks independent of us.

We also rely on trade secrets and proprietary knowledge. We employ various methods to protect our concepts and recipes. However, these methods may not completely protect us. We cannot assure you that others will not independently develop similar knowledge or obtain access to our knowledge, concepts and recipes. Although we generally enter into confidentiality agreements with our executives and managers, we cannot assure you that these agreements will adequately protect our trade secrets.

Our insurance coverage may not be adequate.

We maintain insurance, including insurance relating to personal injury, in amounts, which we currently consider adequate. Nevertheless, a partially or completely uninsured claim against us, if successful, could materially adversely affect us.

Liquidation preference of preferred stock.

On October 24, 2001, we issued 66,862 shares of Series A 5% Convertible Preferred Stock, par value $0.01 per share, pursuant to an exemption from registration under Section 4(6) of the Securities Act of 1933, as amended, in consideration for the cancellation of $669,000 of trade indebtedness by trade creditors of our company. As of July 3, 2005, we had 35,275 shares of Series A Preferred Stock outstanding.

On May 24, 2005, we sold an aggregate of $6.9 million of 461,954 units in a private placement to the selling stockholders. Each unit consisted of (i) one share of our Series B Convertible Preferred Stock, initially convertible into 20 shares of our common stock, subject to adjustment under certain circumstances, and (ii) a warrant to purchase 10 shares of our common stock at an exercise price of $1.30 per share. In addition, we issued a warrant to purchase 37,651 units (consisting of 37,651 shares of our Series B Convertible Preferred Stock and warrants to purchase 376,510 shares of our common stock) at a purchase price of $15.00 per unit to the placement agent in our May 2005 financing.

Upon the occurrence of a liquidation event, each holder of our preferred stock is entitled to be paid, prior to any payment being made to holders of our common stock, an amount in cash equal to (i) in the case of the holders of Series A 5% Convertible Preferred Stock, the liquidation value of its shares of Series A 5% Convertible Preferred Stock, plus all declared but unpaid dividends on such shares or (ii) in the case of the holders of Series B Convertible Preferred Stock, the sum of the liquidation value of its shares of Series B Convertible Preferred Stock and all declared but unpaid dividends on such shares and the amount the holder of the Series B Convertible Preferred Stock would receive if all holders of the Series B Convertible Preferred Stock had converted their shares of Series B Convertible Preferred Stock prior to the liquidation event. If we are forced to liquidate, we cannot assure you that any assets will remain available for distribution to the holders of common stock after distribution to the holders of our preferred stock.

Absence of Dividends.

We have never paid cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. In addition, any future financing agreements may prohibit the payment of cash dividends.

REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains “forward-looking statements” that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and statements of management’s goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as “may,”“will,”“should,”“could,”“would,”“predicts,”“potential,”“continue,”“expects,”“anticipates,”“future,”“intends,”“plans,”“ and similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Important factors that could cause such differences include, but are not limited to:

- general economic and business conditions;
- industry trends;
- changes in our business strategy, development plans or cost savings plans;
- competition;
- our expansion into new markets; and
- other factors discussed under the headings "Risk Factors,""Management's Discussion and Analysis of Financial Conditions and Results of Operations" and "Business."

In light of these risks, uncertainties and assumptions, our actual results of operations and execution of our business strategy could differ materially from those expressed in, or implied by, the forward-looking statements, and you should not place undue reliance upon them. In addition, past financial and/or operating performance is not necessarily a reliable indicator of future performance and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition.

Forward-looking statements speak only as of the date the statements are made. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect thereto or with respect to other forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements included in this prospectus.

SELLING STOCKHOLDERS

The following table presents information regarding the selling stockholders. The selling stockholders are the investors that provided financing to us or are those that acted as placement agents in two of our financings. Percentage of outstanding shares beneficially owned after the offering is based on 32,575,817 shares of common stock outstanding after giving effect to the 9,992,100 shares of our common stock to be issued upon conversion of the Series B Convertible Preferred Stock and 6,942,300 shares of common stock to be issued upon exercise of the warrants by the selling stockholders.

Selling Stockholder	Shares Beneficially Owned Before Offering	Number of Shares Registered Herein	Shares Beneficially Owned After Offering	Percentage of Outstanding Shares Beneficially Owned After Offering
Gary A. Gelbfish (1) (2)	668,120	668,120	0	0%
Richard Molinsky (1) (3)	133,630	133,630	0	0%
James W. Robertson GST Trust (1) (4)	63,440	63,440	0	0%
Frederick R. Adler (5) (6) *	3,669,416	2,464,990	1,204,426	3.70%
Trinad Capital, LP (5) (7) *	3,539,648	3,539,648	0	0%
Bruce Galloway, IRA R/O (5) (8) *	2,180,224	1,899,224	281,000	0.86%
Lagunitas Partners, LP (9)	2,600,010	2,600,010	0	0%
Pequot Scout Fund, LP (9)	2,467,020	2,467,020	0	0%
Drawbridge Global Macro Master Fund Ltd. (9)	1,680,000	1,680,000	0	0%
Pequot Mariner Onshore Fund, LP (9)	1,532,970	1,532,970	0	0%
Gruber & McBaine International (9)	800,010	800,010	0	0%
Drawbridge Investment Partners LLC (9)	320,010	320,010	0	0%
Jon and Linda Gruber (9)	3,700,020	300,000	0	0%
J. Patterson McBaine (9)	3,700,020	300,000	0	0%
Craig Johnson (9)	200,010	200,010	0	0%
Alan L. and Ruth S. Stein Revocable Trust (9)	200,010	200,010	0	0%
Harvey Bibikoff (9)	100,020	100,020	0	0%
Christopher Condy (9)	50,010	50,010	0	0%
Evan Azriliant (9)	50,010	50,010	0	0%
JMP Securities LLC (10)	1,129,530	1,129,530	0	0%
Adam Weis (1) (11)	250,000	250,000	0	0%
Sandor Capital Master Fund, LP (1) (11)	150,000	150,000	0	0%
Broadlawn Partners (1) (11)	100,000	100,000	0	0%
Leonard S. Goodman/Helen E. (1) (11)	50,000	50,000	0	0%

Selling Stockholder	Shares Beneficially Owned Before Offering	Number of Shares Registered Herein	Shares Beneficially Owned After Offering	Percentage of Outstanding Shares Beneficially Owned After Offering
John S. Lemak (1) (11)	50,000	50,000	0	0%
Gerald Heller (1) (11)	50,000	50,000	0	0%
Source One Corp (1) (11)	50,000	50,000	0	0%
Brunella Jacs LLC (1) (11)	50,000	50,000	0	0%
Commonwealth Investors LLC (1) (11)	37,500	37,500	0	0%
Daniel E. Larson (1) (11)	25,000	25,000	0	0%
Michael Lusk (1) (11)	25,000	25,000	0	0%
Joseph G. Kump/Jean Kump (1) (11)	25,000	25,000	0	0%
Garry Higdem (1) (11)	25,000	25,000	0	0%
Thomas J. Banholzer (1) (11)	25,000	25,000	0	0%
Simon Kearney (1) (11)	20,000	20,000	0	0%
Anasazi Partners III Offshore, LTD (1) (11)	20,000	20,000	0	0%
Christopher P. Baker (1) (11)	20,000	20,000	0	0%
Anasazi Partners III, LLC (1) (11)	20,000	20,000	0	0%
Casimir Capital LP (1) (12)	783,750	783,750	0	0%
George Heaton (5) (13)	116,794	116,794	0	0%
Thomas Newkirk (5) (13)	116,794	116,794	0	0%
Stephen Gardner (5) (13)	58,397	58,397	0	0%
John Giordano (5) (13)	58,396	58,396	0	0%
Galloway Capital Management, LLC * (5) (14)	387,502	387,502	0	0%
Bruce Galloway C/F Alana M Galloway UGMA/NY (5) (15)	31,250	31,250	0	0%
Bruce Galloway C/F Justine P Galloway UGMA/NY (5) (15)	31,250	31,250	0	0%
Steven Herman (5) (15)	15,625	15,625	0	0%
Gary L. Herman (5) (15) *	93,750	93,750	0	0%
Gary L. Herman C/F Edward H Herman UGTMA NY (5) (15)	4,688	4,688	0	0%
Jacombs Trading Inc. (5) (15) *	93,100	93,100	0	0%
Lorraine Herman (5) (15)	10,938	10,938	0	0%
Banyon Investment, LLC * (5) (16)	4,454,015	4,454,015	0	0%

* Insider or an entity owned or associated with our insider(s). See description of relationships below. See “Management,”“Principal Stockholders” and “Certain Relationships and Related Transactions” for additional information.

The following information contains a description of each selling stockholder's relationship to us and how each selling stockholder acquired the shares of common stock (or securities convertible into the shares of common stock) to be sold from time to time pursuant to this prospectus.

(1) On December 7, 2004, we sold $2,375,000 principal amount of debentures and warrants to purchase an aggregate of 1,187,500 shares of our common stock at an exercise price of $0.60 per share. We received net proceeds of $2,010,000 from the sale. The debentures matured on April 5, 2005, and, to the extent not converted, were fully repaid in May 2005.

(2) Consists of warrants to purchase 125,000 shares of common stock originally issued by us in connection with the issuance of debentures in December 2004 described in (1) above and 18,104 units purchased in the May 2005 private placement using the full principal amount of, and interest accrued on, the debenture purchased in December 2004. The 18,104 units consist of 18,104 shares of Series B Convertible Preferred Stock (initially convertible into 362,080 shares of our common stock) and warrants to purchase 181,040 shares of our common stock at $1.30 per share.

(3) Consists of warrants to purchase 25,000 shares of common stock originally issued by us in connection with the issuance of debentures in December 2004 described in (1) above and 3,621 units purchased in the May 2005 private placement using the full principal amount of, and interest accrued on, the debenture purchased in December 2004. The 3,621 units consist of 3,621 shares of Series B Convertible Preferred Stock (initially convertible into 72,420 shares of our common stock) and warrants to purchase 36,210 shares of common stock at $1.30 per share.

(4) Consists of warrants to purchase 20,000 shares of common stock originally issued by us in connection with the issuance of debentures in December 2004 described in (1) above and 1,448 units purchased in the May 2005 private placement using a portion of the principal amount of, and interest accrued on, the debenture purchased in December 2004. The 1,448 units consist of 1,448 shares of Series B Convertible Preferred Stock (initially convertible into 28,960 shares of our common stock) and warrants to purchase 14,480 shares of common stock at $1.30 per share.

(5) In January 2002, we raised $2.0 million in a private financing transaction, consisting of secured promissory notes and warrants to purchase Common Stock. The two original investors in this financing were Shells Investment Partners, L.L.C. ("SIP") and Banyon Investment, LLC ("Banyon"). In the financing, we issued to each of SIP and Banyon a $1.0 million secured promissory note initially due January 31, 2005 (subsequently extended to January 31, 2007), and warrants to purchase 4,454,015 shares of common stock at $0.16 per share.

The $1.0 million promissory note issued to Banyon was sold to Frederick R. Adler in April 2004 and Banyon's right to nominate three individuals to serve on our board of directors was transferred to Mr. Adler in connection with the sale of the promissory note.

On June 23, 2004, SIP sold $400,000 of the $1.0 million note to GCM Shells Seafood Partners, LLC, a Delaware limited liability company ("GCM"), and $600,0000 of the $1.0 million note to Trinad Capital, L.P., a Delaware limited partnership ("Trinad"); and GCM and Trinad acquired the rights of SIP to nominate three individuals to serve as board members under an Investor Rights Agreement (now expired). SIP also transferred warrants to purchase 1,603,445 shares of common stock to Trinad, warrants to purchase 1,068,964 shares of common stock to GCM, warrants to purchase 668,103 shares of common stock to Galloway Capital Management, LLC and warrants to purchase 668,103 shares of common stock to Atlantis Equities, Inc. SIP retained the warrants to purchase 445,400 shares of common stock. Subsequently, Atlantis Equities, Inc. transferred the warrants to purchase 668,103 shares of common stock to Trinad.

In accordance with the Investor Rights Agreement (now expired), each of GCM, Trinad and Banyon nominated individuals (Robert S. Ellin, Jay A. Wolf and Gary L. Herman in the case of GCM and Trinad, and Philip R. Chapman, Christopher D. Illick and Dr. Michael R. Golding in the case of Banyon) to serve as members of our board of directors during fiscal 2004.

In August 2004, the maturity date of the notes was extended for an additional two years until January 2007, in consideration for which the note holders were issued warrants to purchase an aggregate of 2,000,000 shares of common stock at $0.50 per share, in proportion to the value of the respective notes held by these note holders.

In October 2004, GCM sold the note it acquired from SIP, the warrants to purchase 1,068,964 shares of common stock at $0.16 per share, and the warrants to purchase 400,000 shares of common stock at $0.50 per share to the Bruce Galloway, IRA R/O.

As part of the May 24, 2005 private placement, Frederick R. Adler, Trinad and the Bruce Galloway, IRA R/O converted all of the remaining dollar amount of secured promissory notes then held by them into units of Series B Preferred Stock.

(6) The number of shares registered herein consists of 1,000,000 shares of common stock acquired upon exercise of warrants at $0.50 per share issued in connection with the extension of maturity date of the notes issued in 2002 described in (5) above and 48,833 units purchased in the May 2005 private placement. The 48,833 units consist of 48,833 shares of Series B Convertible Preferred Stock (initially convertible into 976,660 shares of our common stock) and warrants to purchase 488,330 shares of common stock at $1.30 per share. Mr. Adler used the remaining principal amount and the interest accrued on the note he acquired from Banyon issued by us in January 2002 to purchase the units. Shares beneficially owned prior to the offering also includes an additional 1,194,326 shares of common stock owned by Mr. Adler and 10,100 shares of common stock held by 1520 Partners, Ltd., a limited partnership of which Mr. Adler is the general partner.

(7) Consists of (i) 2,271,548 shares of common stock acquired upon exercise of warrants at $0.16 per share transferred from SIP, (ii) 600,000 shares of common stock acquired at $0.50 per share upon exercise of the warrants issued in connection with the extension of maturity date of the notes issued in 2002 described in (5) above and (iii) 22,270 units purchased in the May 2005 private placement. The 22,270 units consist of 22,270 shares of Series B Convertible Preferred Stock (initially convertible into 445,400 shares of our common stock) and warrants to purchase 222,700 shares of common stock at $1.30 per share. Trinad Capital, LP used the remaining principal amount and the interest accrued on the note it acquired from SIP issued by us in January 2002 to purchase the units. Robert S. Ellin and Jay A. Wolf who are members of our board are managing members of Trinad Advisors. Trinad Advisors is the general partner of Trinad Capital.

(8) Number of shares registered herein consists of (i) 1,068,964 shares of common stock purchased upon exercise of warrants at $0.16 per share issued in January 2002, (ii) 400,000 shares of common stock purchased upon exercise of warrants at $0.50 per share issued in connection with the extension of maturity date of the notes issued in 2002 described in (5) above and (iii) 14,342 units purchased in the May 2005 private placement. The 14,342 units consist of 14,342 shares of Series B Convertible Preferred Stock (initially convertible into 286,840 of our common stock) and warrants to purchase 143,420 shares of common stock at $1.30 per share. Bruce Galloway, IRA R/O used the remaining principal amount and the interest accrued on the note it acquired from SIP issued by us in January 2002 to purchase the units. Shares beneficially owned includes 281,000 shares acquired in the open market.

(9) Consists of shares of common stock issuable upon conversion/exercise of the units purchased from us in the May 2005 private placement. Each unit consists of one share of Series B Convertible Preferred Stock (initially convertible into 20 shares of our common stock) and warrants to purchase 10 shares of our common stock at the exercise price of $1.30 per share. Jon Gruber and J. Patterson McBaine are managers of Gruber McBaine Capital Management which is the general partner of Lagunitas Partners and Gruber & McBaine International, both of which are also selling stockholders. Consequently, shares beneficially owned by Jon and Linda Gruber and J. Patterson McBaine include shares owned by Lagunitas Partners and Gruber & McBaine International.

(10) JMP Securities LLC acted as the placement agent in the May 2005 private placement and received warrants to purchase 37,651 units at a purchase price of $15.00 per unit as a portion of their fees. Each unit consists of one share

of Series B Convertible Preferred Stock (convertible into 20 shares of our common stock) and warrants to purchase 10 shares of our common stock at the exercise price of $1.30 per share.

(11) Consists of warrants to purchase common stock at $0.60 per share, issued in the December 2004 financing described in (1) above.

(12) Casimir Capital LP acted as the placement agent in our December 2004 private financing and received warrants to purchase 783,750 shares of common stock at $0.60 per share, as a portion of their fees.

(13) SIP acquired 350,381 shares of common stock upon "cashless exercise" of the warrants retained by SIP to purchase 445,400 shares of common stock. Simultaneously with the exercise of the warrants, SIP transferred 116,794 shares of common stock to George Heaton, 116,794 shares of common stock to Thomas Newkirk, 58,397 shares of common stock to Stephen Gardner and 58,396 shares of common stock to John Giordano.

(14) Galloway Capital Management acquired warrants to purchase 668,103 shares of common stock at $0.16 per share from SIP, and subsequently, transferred warrants to purchase an aggregate of 280,601 shares of common stock as described in (15) below. Consists of 387,502 shares of common stock acquired upon exercise of the remaining warrants.

(15) Galloway Capital Management transferred warrants to purchase an aggregate of 280,601 shares of common stock as follows: (i) 31,250 shares to Bruce Galloway C/F Alana M Galloway UGMA/NY, (ii) 31,250 shares to Bruce Galloway C/F Justine P Galloway UGMA/NY, (iii) 15,625 shares to Steven Herman, (iv) 93,750 shares to Gary Herman, (v) 4,688 shares to Gary Herman C/F Edward H Herman UGTMA NY, (vi) 93,100 shares to Jacombs Trading Inc. and (vii) 10,938 shares to Lorraine Herman. Gary L. Herman is a member of our board of directors and Bruce Galloway and Gary L. Herman are managing members of Galloway Capital Management. Bruce Galloway who is a significant stockholder of Shells is also the principal owner of Jacombs Trading Inc.

(16) Consists of 4,454,015 shares of common stock acquired upon exercise of warrants at $0.16 per share, issued in connection with the $2.0 million private financing in January 2002.

USE OF PROCEEDS

We will not receive any proceeds from the sale by the selling stockholders of our common stock. We will receive proceeds of approximately $7.7 million if the selling stockholders exercise their warrants in full. These proceeds will be used for general corporate purposes.

DIVIDEND POLICY

We have not paid any dividends on our common stock and do not intend to pay any dividends on our common stock in the foreseeable future. We currently intend to retain our future earnings, if any, to repay debt or to finance the further expansion and continued growth of our business. Future dividends, if any, will be determined by our board of directors. Dividends on the Series A Preferred Shares are not cumulative. However, in any given fiscal year, dividends equal to 5% of the liquidation value of the Series A Preferred Shares must be paid in full prior to the payment of any dividends on any shares of our capital stock ranking junior to the Series A Preferred Shares.

Subject to the rights of the holders of any shares of any series of preferred stock ranking prior and superior to the shares of Series B Preferred Stock with respect to dividends, if our board of directors declares a dividend payable upon the outstanding shares of our common stock, our board must declare at the same time a dividend upon each outstanding share of the Series B Preferred Stock, payable at the same time as the dividend paid on our common stock, in an amount per share of the Series B Preferred Stock equal to the amount payable on the largest number of whole shares of common stock into which each share of the Series B Preferred Stock is then convertible. If our assets are insufficient to pay each of the holders of common stock and Series B Preferred Stock, the full amount of dividends to which they are entitled, then the holders of Series B Preferred Stock and the holders of common stock will share in such payment of dividends on a pro rata basis according to the respective amounts each such holder would have received had there been sufficient assets for the full dividend amount.

PRICE RANGE OF COMMON STOCK

Our shares are traded on the OTC bulletin board under the symbol “SHLL.OB.”

The following table sets forth, for the periods indicated, the high and low sales prices of our shares as reported by the OTC bulletin board.

	PRICE PER SHARE	
	HIGH	LOW
During each fiscal quarter of 2003, 2004 and 2005:		
First Quarter 2003	$0.75	$0.35
Second Quarter 2003	$0.70	$0.40
Third Quarter 2003	$0.70	$0.51
Fourth Quarter 2003	$0.95	$0.42
First Quarter 2004	$0.75	$0.34
Second Quarter 2004	$0.65	$0.27
Third Quarter 2004	$0.80	$0.47
Fourth Quarter 2004	$0.88	$0.47
First Quarter 2005	$1.45	$0.63

Second Quarter 2005	$1.30	$0.75
Third Quarter 2005 (through July 7, 2005)	$0.85	$0.80

On July 7, 2005, the last reported sale price of our shares on the OTC bulletin board was $0.80 per share.

As of May 10, 2005, we had 244 known common stockholders of record. The number of record holders is not representative of the number of beneficial holders of our shares since many of the shares are held of record by brokers or other nominees.

EQUITY COMPENSATION PLANS

Securities authorized for issuance under equity compensation plans as of January 2, 2005 (our last completed fiscal year end) were as follows:

Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants, and rights [a]**	**Weighted-average exercise price of outstanding options, warrants and rights [b]**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column [a]) [c]**
Equity compensation plans approved by security holders	1,143,500	$1.00	1,583,043 (1)
Equity compensation plans not approved by security holders	9,129,280	$0.30	—
Total	10,272,780		1,583,043 (1)

(1) At our annual meeting of stockholders held on June 22, 2005, our stockholders approved an amendment to our 2002 Equity Incentive Plan, which, among other things, increased the number of shares of common stock available for issuance under the plan by 3,150,000 from 1,850,000 to 5,000,000. Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column [a]) is now 4,733,043 shares.

Equity compensation plans not approved by security holders consist of (i) warrants to purchase 5,158,030 shares of common stock, issued on January 31, 2002, in connection with a $2.0 million private financing transaction; warrants were exercised at $0.16 per share on January 31, 2005, the expiration date, resulting in the issuance of 4,712,630 shares of common stock, which provided proceeds of $754,000 to us; and warrants to purchase 445,400 shares of common stock were also exercised by a “cashless exercise” on January 31, 2005 resulting in the issuance of 350,381 shares of common stock; (ii) warrants to purchase 2,000,000 shares of common stock, issued on August 4, 2004, in connection with the extension of the maturity date of the $2.0 million private financing transaction to January 31, 2007; all of these warrants were exercised in March and May 2005 at the exercise price of $0.50 per share by certain of our investors, the proceeds of which were used to pay down the principal amount of the notes to these investors; and (iii) warrants to purchase 1,971,250 shares of common stock, exercisable through December 7, 2010, at $0.60 per share, issued on December 7, 2004 in connection with the $2,375,000 debenture offering; in accordance with their terms, the exercise price was subsequently determined based on the pricing of the May 2005 financing.

The number of securities and type of plans available for future issuance of stock options as of January 2, 2005 was:

	Options and Warrants for Common Shares			
Plan Name	**Authorized**	**Exercised**	**Outstanding**	**Available**
Stock Option Plan for Non-Employee Directors	150,000	0	32,000	118,000
1995 Employee Stock Option Plan	840,000	0	173,750	666,250
1996 Employee Stock Option Plan	101,000	11,001	31,992	58,007
2002 Equity Incentive Plan	1,850,000(2)	203,456	905,758	740,786(2)
Total stock options	2,941,000	214,457	1,143,500	1,583,043(3)

(2) See footnote (1) above. Number of securities remaining available for future issuance under our 2002 Equity Incentive Plan as of January 2, 2005 was 3,890,786 shares.

(3) See footnote (1) above.

Stock options exercised consist of (i) 42,666 shares of common stock issued from options exercised in 2004 by employees, (ii) 160,790 shares of common stock issued in 2003 to key employees pursuant to our fiscal year 2002 management bonus plan, and (iii) 11,001 shares of common stock issued from options exercised by employees in prior years.

DILUTION

The net tangible book value of our common stock on April 3, 2005 (our last completed fiscal quarter end) was a deficit of approximately $(0.4) million, or approximately $(0.03) per share. Net tangible book value per share represents the amount of our total tangible assets, less our total liabilities and the aggregate liquidation preference of our preferred stock outstanding, divided by the total number of shares of our common stock outstanding. The number of shares of our common stock outstanding may be increased by shares issued upon conversion of the preferred stock, payment of dividends, or exercise of the warrants, and, to the extent the warrants are exercised for cash, the net tangible book value of our common stock may increase. If all the warrants (or in the case of JMP Securities, underlying preferred stock) for which the shares of our common stock that are issuable upon exercise of the warrants (or preferred stock) being offered pursuant to this prospectus were exercised for cash, the net tangible book value of our common stock would be $8.6 million, or approximately $0.37 per share, excluding the effect of any other transactions occurring after May 24, 2005. Since we will not receive any of the proceeds from the sale of common stock sold under this prospectus, the net tangible book value of our common stock will not be increased as a result of such sales, nor will the number of shares outstanding be affected by such sales. Consequently, subsequent to the exercise of all the warrants (and preferred stock) previously referred to, there will be no change in net tangible book value per share of our common stock as a result of any sales under this prospectus.

SELECTED HISTORICAL FINANCIAL INFORMATION

The following table presents, as of the dates and for the periods indicated, our selected historical financial information as discussed below. The historical statement of operations data for our fiscal years ended December 29, 2002, December 28, 2003 and January 2, 2005 and the historical balance sheet data as of December 28, 2003 and January 2, 2005 are derived from our audited financial statements included elsewhere in this prospectus. The historical statement of operations data for the years ended December 31, 2000 and December 30, 2001 and the historical balance sheet data as of December 31, 2000, December 30, 2001 and December 29, 2002 are derived from our audited financial statements that are not included herein. The historical statement of operations data for the thirteen weeks ended March 28, 2004 and April 3, 2005 and the historical balance sheet data as of April 3, 2005 are derived from our unaudited financial statements. In management's opinion, these unaudited financial statements have been prepared on substantially the same basis as the audited financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial data for the periods presented. The results of operations for the interim period are not necessarily indicative of the operating results for the entire year or any future period.

The information contained in this table should also be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the consolidated financial statements and accompanying notes thereto included elsewhere in this prospectus.

(In thousands)	Year (53 Weeks) Ended	Year (52 Weeks) Ended				Thirteen Weeks Ended	
	January 2, 2005	December 28, 2003	December 29, 2002	December 30, 2001	December 31, 2000	March 28, 2004	April 3, 2005
Statement of Operations Data:							
Revenues							
Restaurant sales	$ 41,393	$ 43,881	$ 47,065	$ 57,258	$ 90,023	$ 12,546	$ 12,485
Management fees (1)	171	165	163	271	419	45	41
Total revenues	41,564	44,046	47,228	57,529	90,442	12,591	12,526
Costs and expenses							
Cost of sales	14,051	14,467	15,778	21,239	33,984	4,111	4,097
Labor and other related expenses	12,935	13,845	14,585	17,628	28,028	3,748	3,667
Other restaurant operating expenses	10,123	11,117	10,774	12,047	19,635	2,811	2,675
General and administrative expenses	3,249	3,387	3,565	4,751	7,212	793	911
Depreciation and amortization	1,058	1,077	1,102	1,702	2,703	296	348
Pre-opening expenses	—	—	—	—	—	—	300
Provision for impairment of assets	105	360	110	2,259	3,978	—	—
Provision for impairment of goodwill	—	—	206	—	—	—	—
Provision for store closings	—	—	—	1,333	1,027	—	—
	43	(207)	1,108	(3,430)	(6,125)	832	528

Income (loss) from operations							
Interest expense, net	(1,154)	(463)	(534)	(481)	(789)	(101)	(168)
Other income (expense)							
Lease buy-out option	—	—	—	—	—	—	600
Provision for impairment of assets	—	—	—	—	—	—	(211)
Other income (expense), net	33	(100)	(3)	(476)	145	(17)	(254)
Gain on preferred stock conversion	—	—	—	588	—	—	—
(Loss) income before elimination of minority partner interest and income taxes	(1,078)	(770)	571	(3,799)	(6,769)	714	495
Elimination of minority partner interest	(266)	(264)	(221)	(221)	(259)	(69)	(85)
(Loss) income before benefit (provision) for income taxes	(1,344)	(1,034)	350	(4,020)	(7,028)	645	410
Income tax benefit (provision) (2)	—	—	327	1,001	(2,304)	—	—
Net (loss) income	$ (1,344)	$ (1,034)	$ 677	$ (3,019)	$ (9,332)	$ 645	$ 410

(Dollars and Shares in Thousands)	Fiscal Years Ended January 2, 2005	December 28, 2003	December 29, 2002	December 30, 2001	December 31, 2000	Thirteen Weeks Ended March 28, 2004	April 3, 2005
Earnings per Share Data:							
Basic net (loss) income per share	$ (0.26)	$ (0.23)	$ 0.15	$ (0.68)	$ (2.10)	$ 0.14	$ 0.03
Diluted net (loss) income per share	$ (0.26)	$ (0.23)	$ 0.07	$ (0.68)	$ (2.10)	$ 0.06	$ 0.03
Shares Outstanding Data:							
Basic weighted average	5,262	4,577	4,454	4,454	4,454	4,634	12,357
Diluted weighted average	5,262	4,577	10,259	4,454	4,454	10,790	15,441
Operating Data:							
Number of restaurants (at end of period):							
Company-owned restaurants (3)	21	24	24	25	41	23	22
Licensed restaurants	4	4	4	4	4	4	4
Total managed restaurants	25	28	28	29	45	27	26
Average annual sales per Company-owned and joint venture restaurant open for full period (4)	$ 1,896	$ 1,828	$ 1,924	$ 2,047	$ 2,071	---	---
Decrease in Company-owned and joint venture restaurant same store sales (4)	-1.6%	-5.1%	-7.2%	-13.1%	-0.4%	-1.4%	+6.8%

	January 2, 2005	December 28, 2003	December 29, 2002	December 30, 2001	December 31, 2000	March 28, 2004	April 3, 2005	Pro Forma as of April 3, 2005 (5)
Balance Sheet Data:								
Working capital (deficiency)	$ (4,639)	$ (3,606)	$ (3,116)	$ (7,580)	$ (7,500)	$ (5,072)	$ (5,207)	$ (516)
Total assets	13,519	11,616	13,858	14,847	21,461	12,383	15,272	17,520
Long-term debt	3,734	3,826	3,883	1,633	5,700	1,532	3,207	1.436
Minority partner interest	442	466	428	428	449	478	463	463
Preferred stock	—	1	1	1	—	1	—	5
	502	1,183	2,152	1,475	4,414	1,836	2,451	8,834

Stockholders' equity

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(1) Management fees are derived from the licensed restaurants consisting of 2% of sales plus a fixed fee for placement of fully trained managers, if needed. Sales for the licensed restaurants for the fiscal years ended January 2, 2005, December 28, 2003, December 29, 2002, December 30, 2001, December 31, 2000 were $7,883,000, $7,167,000, $8,147,000, $8,935,000 and $10,009,000, respectively; sales for the thirteen weeks ended March 28, 2004 and April 3, 2005 were $2,262,000 and $2,395,000, respectively.

(2) The effective tax rates for fiscal years 2004, 2003, 2002, 2001 and 2000 include the effect of recognizing valuation allowance adjustments relating to tax benefits. There was no benefit or provision for income taxes in 2004 or 2003. Income tax benefit (provision) of 93.3%, 24.9% and (32.8)% for the fiscal years ended 2002, 2001 and 2000, respectively, differ from the amounts computed by applying the effective federal income tax rate of 34% as a result of adjusting the valuation allowance, primarily related to net operating loss carryforwards from prior years. The valuation allowance in 2004 was increased by $210,000, reserving for all tax assets that were deemed non-realizable. The valuation allowance in 2003 was increased by $596,000, reserving for all tax assets that were deemed non-realizable. The valuation allowance in 2002 was increased by $1,403,000, reserving for all tax assets that were deemed non-realizable The valuation allowance in 2001 was decreased by $706,000, reserving for all tax assets except those subject to recovery through carrybacks resulting from the March 9, 2002 Economic Stimulus Package.

(3) Includes one joint venture restaurant in which we own a 51% equity interest.

(4) Includes only restaurants open during the full fiscal year shown and open for the full prior fiscal year and at least the full six months prior thereto. Same store sales are calculated on a comparable calendar period basis.

(5) Assumes the May 2005 private placement financing was consummated on April 3, 2005. See Note 1 in the notes to consolidated financial statements included in this prospectus for additional information.

SUPPLEMENTARY FINANCIAL INFORMATION

	THREE MONTHS ENDED (IN THOUSANDS)							
	APR 3, 2005	JAN 2, 2005	SEP 26, 2004	JUN 27, 2004	MAR 28, 2004	DEC 28, 2003	SEP 28, 2003	JUN 29, 2003
Revenues	$ 12,526	$ 9,293	$ 8,683	$ 10,997	$ 12,591	$ 9,008	$ 10,125	$ 11,901
Net income (loss)	410	(1,448)	(799)	258	644	(1,229)	(833)	244
Net income (loss) per share:								
Basic	$ 0.03	$ (0.21)	$ (0.17)	$ 0.05	$ 0.14	$ (0.27)	$ (0.18)	$ 0.05
Diluted	0.03	(0.21)	(0.17)	0.02	0.06	(0.27)	(0.18)	0.02
Shares used in computing per share amounts:								
Basic	12,357	6,765	4,813	4,721	4,634	4,631	4,631	4,562
Diluted	15,441	6,765	4,813	10,445	10,790	4,631	4,631	11,466

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition and results of operations for the fiscal years ended December 29, 2002, December 28, 2003 and January 2, 2005 and for the thirteen weeks ended March 28, 2004 and April 3, 2005. You should read this discussion and analysis together with our consolidated financial statements and notes to those consolidated financial statements included elsewhere in this prospectus. This discussion contains forward-looking statements that are based on management's current expectations, estimates and projections about our business and operations. Our actual results may differ from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those described under the caption "Risk Factors" and elsewhere in this prospectus.

Overview

The changes we have been implementing over the past several months to improve Shells' food, service and atmosphere have been well-received by our guests, and reflected in part by positive sales trends. Over the last two quarters, restaurant sales increased 5.8% and 6.8%, respectively, in year-to-year comparisons. This is the first time in a few years that Shells has posted consecutive quarters of positive comparable restaurant sales gains. Our guest count trend also improved, with first quarter guest counts on a same store basis down 1.2% in year-to-year comparisons, a marked improvement from declines of 4.0% in the fourth quarter of 2004 and 10.5% for fiscal 2004. We believe that both sales and customer count trends reflect a growing momentum in positive customer reaction to the many steps taken to strengthen the Shells brand.

Enhancing the atmosphere and appeal in our remodeled restaurants, coupled with our service and menu improvements has resulted in an incremental 10% aggregate sales increase at remodeled restaurants above the sales increases reported by non-remodeled restaurants. The remodeled restaurants incorporate a new, brighter, more contemporary look. We completed renovations on an additional six restaurants during the first quarter of 2005, bringing the total to nine of our 25 pre-existing restaurants that have received the new interior and exterior décor and lighting package. In addition, we opened our 26th restaurant at a large, waterfront location on Clearwater Beach during late March, the first new opening for our company since 1999. This flagship restaurant immediately began posting very robust sales.

In May 2005, we sold an aggregate of $6.9 million of securities in a private placement to accredited investors, including $1.3 million and $348,000 from conversions of then outstanding related party debt and debentures, respectively. We realized approximately $5.8 million in net proceeds from this financing. After retiring $2.2 million in loans from debenture holders to the extent not converted in the offering, we plan to use the remaining proceeds of the financing to remodel additional Shells restaurants and to open new restaurants. Additionally, our existing $1.6 million revolving line of credit previously scheduled to expire with the financing has been extended to May 23, 2007. We are also seeking to raise additional capital through the financing of new restaurant equipment and through sale leaseback transactions for two of our company-owned restaurant properties. There are no assurances we will be able to secure such financing at terms acceptable to us, or at all.

We continue to focus on elevating our service and restaurant execution levels to improve the dining experience for guests, and have bolstered our training and recruiting efforts with additional resources. We recognize a direct correlation between strong hiring and training practices and restaurant performance, and expect to continue to increase our investment in these areas to ensure we are attracting and developing effective restaurant managers and employees. We have also transitioned to a new guest satisfaction feedback system to better measure all aspects of the Shells dining experience and provide more actionable information.

We launched new advertising in the first quarter of 2005, focusing on Shells' image and brand attributes of freshness, quality, variety and value. This marketing approach has been well received and marks a significant departure from traditional Shells advertising focusing on price and limited-time promotional offerings. We also recently changed advertising agencies, which has allowed us to improve both creative efforts and media buying efficiencies.

We believe our restaurants are better positioned to capitalize on continuing increases in seafood consumption and favorable publicity about the health benefits associated with eating seafood. As our guests become more knowledgeable about quality differences and positive nutritional aspects of seafood, they are appreciating the improvements we have made. Understanding that consumer expectations are constantly rising, we continue to work on enhancing many aspect of the Shells experience.

Results of Operations

The following table sets forth, for the periods indicated, the percentages that the items in our Consolidated Statements of Operations bear to total revenues, or where indicated, restaurant sales.

	Fiscal Years Ended			Thirteen Weeks Ended	
	January 2, 2005	December 28, 2003	December 29, 2002	March 28, 2004	April 3, 2005
Revenues					
Restaurant sales	99.6%	99.6%	99.7%	99.7%	99.6%
Management fees	0.4%	0.4%	0.3%	0.3%	0.4%
	100%	100%	100%	100%	100%
Cost and expenses					
Cost of sales (1)	33.9%	33.0%	33.5%	32.6%	32.7%
Labor and other related expenses (1)	31.2%	31.6%	31.0%	29.8%	29.3%
Other restaurant operating expenses (1)	24.5%	25.3%	22.9%	22.3%	21.4%
Total restaurant costs and expenses (1)	89.6%	89.9%	87.4%	84.7%	83.4%
General and administrative expenses	7.8%	7.7%	7.5%	6.3%	7.3%
Depreciation and amortization	2.5%	2.4%	2.3%	2.4%	2.8%
Pre-opening expenses	0.0%	0.0%	0.0%	0.0%	2.4%
Provision for impairment of assets	0.3%	0.8%	0.2%	0.0%	-1.7%
Provision for impairment of goodwill	0.0%	0.0%	0.4%	0.0%	0.0%
Income (loss) from operations	0.1%	-0.5%	2.3%	6.6%	4.2%
Interest expense, net	-2.8%	-1.1%	-1.1%	-0.8%	-1.3%
Lease buy-out option	0.0%	0.0%	0.0%	0.0%	4.8%
Provision for impairment of assets	0.0%	0.0%	0.0%	0.0%	-1.7%
Other income (expense), net	0.1%	-0.2%	0.0%	-0.1%	-2.0%
Elimination of minority partner interest	-0.6%	-0.6%	-0.5%	-0.5%	-0.7%
(Loss) income before benefit for income taxes	-3.2%	-2.4%	0.7%	5.2%	3.3%
Income tax benefit	0.0%	0.0%	0.7%	0.0%	0.0%
Net (loss) income	-3.2%	-2.4%	1.4%	5.2%	3.3%

(1) As a percentage of restaurant sales.

13 weeks ended April 3, 2005 and March 28, 2004

Revenues. Total revenues for the first quarter of 2005 were $12,526,000 as compared to $12,591,000 for the first quarter of 2004. The $65,000, or 0.5%, decrease in revenues primarily was due to the closing of three restaurants during 2004, partially offset by a 6.8% increase in comparable store sales and the opening of a new restaurant on March 22, 2005. In total, there were 28 fewer restaurant operating weeks in the first quarter of 2005 than in the first quarter of 2004. 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 increased to 32.7% for the first quarter of 2005 from 32.6% for the first quarter of 2004. This increase primarily was due to commodity price increases (0.5%), partially offset by menu mix shifts (0.4%). We are 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 our menu prices accordingly to help control the cost of revenues.

Labor and other related expenses. Labor and other related expenses as a percentage of revenues decreased to 29.3% during the first quarter of 2005 as compared to 29.8% for the first quarter of 2004. This decrease was primarily due to decreases in kitchen labor expenses (0.4%) and workers' compensation insurance (0.3%), partially offset by increases in restaurant management labor (0.2%).

Other restaurant operating expenses. Other restaurant operating expenses of $2,675,000 for the first quarter of 2005 decreased by $137,000, or 0.9% of revenues, compared to the first quarter of 2004 primarily due to decreases in occupancy expenses (0.6%) and non-food supplies (0.5%), partially offset by an increase in advertising (0.2%).

General and administrative expenses. General and administrative expenses of $911,000 or 7.3% of revenues for the first quarter of 2005 increased from $793,000 or 6.3% of revenues for the first quarter of 2004, primarily due to increases in restaurant manager training wages (0.5%), administrative salaries (0.3%) and recruiting costs (0.2%). Such increases in expenses are expected to continue in the immediate future.

Depreciation and amortization. Depreciation and amortization expense increased to $348,000 or 2.8% of revenues for the first quarter of 2005 from $296,000 or 2.4% of revenues in the first quarter of 2004. The increase as a percentage of revenues primarily related to an increase in depreciation expense for those restaurants that have been remodeled and the acceleration of depreciation expense for a restaurant lease due to expire in March 2007.

Pre-opening expenses. Pre-opening expenses of $300,000 in the first quarter of 2005 related to the new restaurant which opened on March 22, 2005 at Clearwater Beach, Florida. There were no restaurant openings in 2004. Pre-opening expenses represent start-up costs incurred prior to opening for business and include occupancy expenses, training labor, advertising and classified ads, utilities and supplies.

Lease buy-out option. In January 2005, we entered into an agreement with our landlord in St. Pete Beach, Florida, whereby on February 22, 2005, the landlord paid $600,000 to Shells for an option to buy-out the lease. Commencing February 22, 2006, the landlord can provide notice of lease termination to Shells. Thereafter, we have 60 days to wind down business and vacate the premises.

Provision for impairment of assets. The provision for impairment of assets of $211,000 for the first quarter of 2005 was due to a valuation adjustment for the St. Pete Beach location due to an expected shortened lease period relating to the lease buy-out option. There was no provision in the first quarter of 2004.

Interest expense, net. Interest expense, net was $168,000 in the first quarter of 2005 compared to $101,000 in the first quarter of 2004. The increase was primarily related to the 12% annual interest on the $2,375,000 aggregate principal amount of debentures, which we issued in December 2004.

Other expense, net. Other expense was $254,000 for the first quarter of 2005 compared to $17,000 for the comparable period in 2004. The increase over the prior year primarily was due to a loss on disposal of assets of $162,000 relating to the write-down of fixed assets replaced during remodeling and financing costs of $80,000 paid by us for a line-of-credit. Exclusive of these non-recurring items, other expense was $12,000 for the first quarter of 2005.

Provision for income taxes. No provision for income taxes was recognized for the first quarter of 2005 or 2004.

Income from operations and net income. As a result of the factors discussed above, we had income from operations of $528,000 for the first quarter of 2005 compared to $832,000 for the first quarter of 2004. Shells had net income of $410,000 for the first quarter of 2005 compared to $645,000 for the first quarter of 2004. Exclusive of $300,000 in pre-opening expenses partially offset by net non-recurring income of $147,000, we had net income of $563,000 for the first quarter of 2005. Non-recurring items included income of $600,000 for the lease option buy-out; partially offset by a $211,000 provision for impairment of assets, $162,000 for the disposition of assets, and an $80,000 fee paid by us for a line-of-credit.

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Fiscal Year 2004 versus Fiscal Year 2003

Revenues. Total revenues for the 53-week fiscal year 2004 were $41,564,000 as compared to $44,046,000 for the 52-week fiscal year 2003. The $2,482,000 or 5.6% decrease in revenues was primarily due to a reduction in the number of restaurants open for operation in 2004. We operated 25 restaurants as of the end of 2004 compared to 28 restaurants at the end of 2003. However, revenues in 2004 contained an additional operating week compared to 2003, as our fiscal year is the 52 or 53 weeks ending the Sunday nearest to December 31st. Our revenues consisted of restaurant sales of our company-owned restaurants and management and licensing fees on sales at the managed restaurants. Our food sales and liquor sales accounted for 88% and 12% of revenues, respectively, for 2004 compared to 89% and 11%, respectively, for 2003. Liquor sales, relative to food sales, increased year-to-year as a result of a new beverage program initiated in the first quarter of 2004. Same store sales in 2004 decreased 1.6% when compared to 2003. The decline in same store sales was the result of a 10.5% decline in customer traffic, offset in part by a 10.0% increase in average customer check. In 2004, we incurred estimated sales losses of $930,000 due to hurricane-related business interruption. Adjusting for estimated hurricane-related sales losses, same store sales would have increased by 0.2% above the prior year. Comparisons of same store sales include only stores, which were operating during the equivalent calendar 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 restaurant sales as a percentage of restaurant sales increased to 33.9% for 2004 from 33.0% for 2003. This increase primarily was due to a 0.6% of sales increase in commodity costs and 0.4% increase relating to menu mix changes including promotional items which affected customer preferences. Fiscal year 2004 and 2003 cost of sales included a non-recurring inventory write down of $22,000 and $36,000, respectively. Exclusive of these non-recurring items, cost of restaurant sales was 33.9% and 32.9% of restaurant sales for 2004 and 2003, respectively. The cost of restaurant sales generally consists of the cost of food, beverages, freight, and paper and plastic goods used in food preparation and carry-out orders.

Labor and other related expenses. Labor and other related expenses as a percentage of restaurant sales decreased to 31.2% in 2004 as compared to 31.6% for 2003. This decrease was mostly due to a reduction in workers' compensation insurance costs of 0.2% of sales and a reduction in key hourly labor of 0.2% of sales. Fiscal year 2004 and 2003 included a non-recurring reduction in expenses of $161,000 and $196,000, respectively, relating to a refund and corresponding reserve adjustment for prior years workers' compensation experience. Exclusive of these non-recurring items, labor and other related expenses was 31.6% and 32.0% of restaurant sales for 2004 and 2003, respectively. Labor and other related expenses generally consist of restaurant hourly and management payroll, benefits, taxes and workers' compensation insurance.

Other restaurant operating expenses. Other restaurant operating expenses as a percentage of restaurant sales decreased to 24.5% for 2004 as compared with 25.3% for 2003. This decrease was primarily due to a 0.9% decrease in restaurant repairs and maintenance costs, partially offset by a loss of sales leverage caused by lower unit sales volumes. Other restaurant operating expenses generally consist of advertising, costs associated with area directors, supplies, repairs and maintenance, rent and other occupancy costs and utilities.

General and administrative expenses. General and administrative expenses were $3,249,000 or 7.8% of revenues and $3,387,000 or 7.7% of revenues in 2004 and 2003, respectively. The $138,000 expense reduction was mostly due to a general downsizing in corporate office staff, which occurred in June 2004. Non-recurring expense in 2004 and 2003 each included a one-time charge for severance expense of $39,000 and $70,000, respectively. Exclusive of these non-recurring charges, general and administrative expense was 7.7% and 7.5% of revenues in 2004 and 2003, respectively. General and administrative expenses relate to the operations of all Shells restaurants owned by us and management services that we provide to the managed restaurants.

Depreciation and amortization. Depreciation and amortization expenses as a percentage of revenues were 2.5% for 2004 and 2.4% for 2003. The 0.1% of revenues increase was mostly due to increasing the fixed asset basis as a result of restaurant remodeling and hurricane-related reconstruction.

Provision for impairment of assets. The provision for impaired assets was $105,000 or 0.3% of revenues for 2004 as compared to $360,000 or 0.8% of revenues for 2003. In 2004 and 2003, we recorded a pre-tax charge relating to the write-down of impaired assets to their estimated fair value in accordance with Financial Accounting Standards Board Statement No. 144. The asset impairment charge in 2004 related to one restaurant compared to three restaurants in 2003. The respective write-downs were necessitated by the then current period operating losses and the projected cash flows of the restaurants, many of which were negative.

Provision for impairment of goodwill. Goodwill was evaluated for impairment in each of 2004 and 2003 in accordance with FASB Statement No. 142. As a result of the evaluation, we did not recognize goodwill impairment in either year.

Interest expense. Net interest expense was $1,154,000 in 2004 compared to $463,000 in 2003. In 2004, we recorded one-time charges of $446,000 in the third quarter, relating to warrants to purchase 2,000,000 shares of common stock issued in connection with the extension of the maturity dates on the $2.0 million promissory notes; and $265,000 in the fourth quarter, relating to warrants to purchase 1,187,500 shares of common stock issued to debenture holders in conjunction with the $2,375,000 financing transaction. Exclusive of these non-recurring charges, net interest expense was $443,000 in 2004. The $20,000 decrease in net interest expense in 2004 from 2003, excluding the non-recurring charges, was generally due to the pay down of outstanding debt, partially offset by a $9,000 reduction in interest income resulting from lower balances of cash in 2004 compared to 2003.

Other expense, net. Other income in 2004 was $33,000, compared to other expense of $100,000 in 2003. In 2004, we recognized non-recurring gains for hurricane-related insurance settlements of $597,000 and the disposition of assets of $89,000. In 2004, we also recognized non-recurring charges for financing costs of $539,000 relating to the $2,375,000 financing transaction and a loss on the disposal of assets of $41,000 relating to our restaurant renovations. Exclusive of these non-recurring items, other expense in 2004 was $139,000.

Provision for income taxes. No benefit or provision for income taxes was recognized in either 2004 or 2003.

Income (or loss) from operations and net income (or loss). As a result of the factors discussed above, the income from operations for 2004 was $43,000 compared to a loss from operations for 2003 of $207,000. Exclusive of non-recurring items, our loss from operations was $57,000 for 2004 compared to net income of $63,000 for 2003. Net loss for 2004 was $1,344,000 compared to $1,034,000 for 2003. Exclusive of non-recurring items, the net loss in 2004 was $733,000 compared to $764,000 for 2003.

Fiscal Year 2003 versus Fiscal Year 2002

Revenues. Total revenues for 2003 were $44,046,000 as compared to $47,228,000 for 2002. The $3,182,000 or 6.7% decrease in revenues was primarily due to a 5.1% decrease in same store sales and, to a lesser extent, due to operating one less restaurant during and after the third quarter of 2002. The decline in same store sales was the result of a decline in customer traffic, offset in part by an increase in average customer check. Our food sales and liquor sales accounted for 89% and 11% of revenues, respectively, for the fiscal year ended December 28, 2003.

Cost of revenues. The cost of restaurant sales as a percentage of restaurant sales decreased to 33.0% for 2003 from 33.5% for 2002. This decrease primarily was due to favorable food costs and lower distribution costs, partially offset by a non-recurring write-down of inventory of $36,000. Exclusive of the non-recurring item, cost of restaurant sales was 32.9% for 2003.

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Labor and other related expenses. Labor and other related expenses as a percentage of restaurant sales increased to 31.6% during 2003 as compared to 31.0% for 2002. This percentage increase was due to a loss of sales leverage caused by lower unit sales volumes, along with increases in health insurance and workers' compensation insurance; partially offset by a non-recurring reduction in expenses of $196,000 relating to a reserve adjustment for prior years workers' compensation experience. Exclusive of the non-recurring item, labor and other related expenses was 32.0% of restaurant sales for 2003.

Other restaurant operating expenses. Other restaurant operating expenses as a percentage of restaurant sales increased to 25.3% for 2003 as compared with 22.9% for 2002. This percentage increase was primarily due to a loss of sales leverage caused by lower unit sales volumes, along with increases in restaurant maintenance; utilities, particularly electricity and gas; insurance and real estate taxes.

General and administrative expenses. General and administrative expenses were $3,387,000 or 7.7% of revenues and $3,565,000 or 7.5% of revenues in 2003 and 2002, respectively. Non-recurring expense in 2003 included a one-time charge for severance expense of $70,000. Exclusive of the non-recurring charge, general and administrative expense was 7.5% in 2003.

Depreciation and amortization. Depreciation and amortization expenses as a percentage of revenues were 2.4% for 2003 and 2.3% for 2002.

Provision for impairment of assets. The provision for impaired assets was $360,000 or 0.8% of revenues for 2003 as compared to $110,000 or 0.2% of revenues for 2002. In 2003 and 2002, we recorded a pre-tax charge relating to the write-down of impaired assets to their estimated fair value in accordance with Financial Accounting Standards Board Statement No. 144. The asset impairment charge in 2003 related to three restaurants, two of which were previously not written down and a third that was partially written down in 2002. The asset impairment charge in 2002 related to three restaurants that were previously not written down.

Provision for impairment of goodwill. Goodwill was evaluated for impairment in 2003 and 2002 in accordance with FASB Statement No. 142 which we adopted in 2002. As a result of the evaluation we did not recognize goodwill impairment in 2003. The provision for impairment of goodwill was $206,000 or 0.4% of revenues in 2002.

Interest expense. Net interest expense was $463,000 in 2003 compared to $534,000 in 2002. We recorded a one-time charge of $106,000 in the first quarter of 2002 relating to the previously reported $2.0 million financing transaction. Exclusive of this non-recurring charge, net interest expense was $428,000 in 2002. The increase in net interest expense in 2003 over 2002, excluding the non-recurring charge was primarily due to a $23,000 reduction in interest income, resulting from lower balances of cash in 2003 compared to 2002.

Other expense, net. Other expense in 2003 was $100,000, compared to $3,000 in 2002. The increase primarily related to a net change in the reserve adjustment for gift certificates.

Provision for income taxes. A benefit from income taxes of $327,000 was recognized in 2002. No benefit or provision was recognized in 2003. The benefit in 2002 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.

Income (or loss) from operations and net income (or loss). As a result of the factors discussed above, loss from operations for 2003 was $207,000 compared to income from operations for 2002 of $1,108,000. Exclusive of non-recurring items, our income from operations was $63,000 for 2003 compared to $1,218,000 for 2002. Our net loss for 2003 was $1,034,000 compared to net income of $677,000 for 2002. Exclusive of non-recurring items, net loss in 2003 was $764,000 compared to net income in 2002 of $575,000.

Liquidity and Capital Resources

In the first quarter of 2005, we remodeled six restaurants, giving nine total restaurants remodeled to-date. We acquired a restaurant lease through a bankruptcy proceeding in early February and converted this beachfront location in Clearwater Beach into a new Shells flagship restaurant which opened late March 2005. Our investment spending also included significant enhancements to our marketing media message, a step up in the hiring and training of new restaurant managers and improvements made to our guest feedback system. These investments were generally funded by the proceeds from a $2,375,000 convertible debenture financing in December 2004, and the proceeds of $754,000 from the exercise of common stock warrants and $600,000 relating to a landlord option to buy out a restaurant lease, both occurring in the first quarter of 2005.

In May of 2005, we completed an aggregate financing of $6.9 million through a private placement of securities to accredited investors. Under the terms of the transaction, we issued 462,000 units with each unit consisting of (i) one share of Series B Convertible Preferred Stock, initially convertible into 20 shares of common stock, and (ii) a warrant to purchase 10 shares of common stock at an exercise price of $1.30 per share. The purchase price was $15.00 per unit. We realized net proceeds of approximately $5.8 million from the financing. Of the total proceeds from securities issued, $1,282,000 represented related party debt and $348,000 represented existing convertible debentures, both of which converted into the securities issued in the transaction. As a condition to the transaction, our existing $1.6 million revolving line of credit previously scheduled to expire on the closing of the transaction, was extended to May 23, 2007. To the extent not converted into this private placement, we used the net proceeds from the private placement to retire $2,232,000 of loans and accrued interest from debenture holders and $8,000 of related party accrued interest. Additionally, as part of this transaction, $500,000 principal amount of related party debt was used to exercise warrants to purchase 1,000,000 shares of common stock.

The following table presents a summary of our cash flows for the last three fiscal years and first quarters ended March 28, 2004 and April 3, 2005 (in thousands):

	Fiscal Years Ended			13 Weeks Ended	
	January 2, 2005	**December 28, 2003**	**December 29, 2002**	**March 28, 2004**	**April 3, 2005**
Net cash provided by (used in) operating activities	$ 161,833	$ (263,693)	$ 665,187	$ 910,932	$ 1,065,735
Net cash (used in) provided by investing activities	(1,291,804)	(754,778)	324,552	(121,205)	(1,768,788)
Net cash provided by (used in) financing activities	2,755,551	(726,399)	509,390	(35,214)	437,661
Net increase (decrease) in cash	$ 1,625,580	$ (1,744,870)	$ 1,499,129	$ 754,513	$ (265,392)

As of April 3, 2005, our current liabilities of $8,312,000 exceeded our current assets of $3,105,000, resulting in a working capital deficiency of $5,207,000. In comparison, the January 2, 2005 working capital deficiency was $4,639,000. The increase in the working capital deficiency primarily related to a $320,000 increase in current liabilities and a $265,000 decrease in cash. Our operating leverage has decreased mostly due to the deployment of capital toward restaurant remodeling and a new restaurant opening. We may still encounter operating pressures from declining sales, increasing food, labor or other operating costs or additional restaurant disposition or pre-opening costs. Historically, we have generally operated with minimal or marginally 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 13 weeks ended April 3, 2005 was $1,066,000 compared to $911,000 for the comparable period in 2004. The net increase of $155,000 compared to the same period in 2004 primarily related to favorable variances in accrued expenses for payroll and bonuses, and the timing of payments for accounts payable and prepaid advertising; partially offset by an unfavorable variance in prepaid rent associated with the acquisition of a new location, prepaid insurance, collection of insurance proceeds receivable, and a decrease in net income.

The cash used in investing activities was $1,769,000 for the 13 weeks ended April 3, 2005 compared to $121,000 for the same period in 2004. A net increase in cash used in investing activities of $1,648,000 was due to $2,369,000 in capital expenditures, partially offset by $600,000 in proceeds from the lease buy-out option.

The cash provided by financing activities was $438,000 for the 13 weeks ended April 3, 2005 compared to cash used in financing activities of $35,000 for the comparable period in 2004. The net increase of $473,000 primarily related to proceeds on the exercise of warrants ($754,000) partially offset by an increase in repayments of debt ($279,000).

As of January 2, 2005, our current liabilities of $7,992,000 exceeded our current assets of $3,353,000, resulting in a working capital deficiency of $4,639,000. In comparison, as of December 28, 2003, our working capital deficiency was $3,606,000. Our operating leverage decreased mostly due to the deployment of interim financing toward restaurant remodeling and reconstruction from hurricane-related property losses.

During 2004, our cash position increased by $1,626,000, from $724,000 as of December 28, 2003 to $2,350,000 as of January 2, 2005. The increase in cash was almost exclusively provided by financing activities of $2,756,000, representing proceeds from the issuance of debt of $2,832,000 and common stock of $618,000, partially offset by $404,000 in debt repayment and $290,000 in distribution to minority partner. The net cash used in investing activities was $1,292,000, generally reflecting capital expenditures related to restaurant remodeling and hurricane-related reconstruction. Net cash provided by operating activities totaled $162,000.

In connection with the $2.0 million financing dated January 31, 2002, we issued warrants to purchase an aggregate of 8,908,030 shares of our common stock, at an exercise price of $0.16 per share. These warrants were exercised from November 2004 through January 31, 2005, resulting in net proceeds to us of $600,000 in 2004 and $754,000 in 2005.

On August 4, 2004, the $2.0 million aggregate principal amount of secured promissory notes set to mature on January 31, 2005 were extended to be due on January 31, 2007, under the same terms as the original notes. As an inducement to extend the maturity date of the notes, warrants to purchase 2,000,000 shares of common stock at an exercise price of $0.50 per share were issued to the note holders in proportion to the value of their respective notes. Warrants to purchase 1,000,000 shares of common stock were exercised in March 2005 by certain of our investors, and the proceeds of $500,000 were used to pay down the principal amount of the notes to these investors. Additionally, in March 2005, the $1.0 million note then held by Frederick R. Adler was modified to allow Shells to defer entirely the monthly interest payment on $500,000 of principal amount of the note until the maturity date of January 31, 2007, resulting in the deferral of $72,000 of cash payments until the maturity date.

On December 7, 2004, we sold $2,375,000 principal amount of debentures and warrants to purchase 1,187,500 shares of our common stock. We received net proceeds of $2,010,000 from the sale. The debentures bore interest at 12%, and matured on the earlier of: (i) April 5, 2005, (ii) the closing of an additional round of financing of no less than $1.5 million, or (iii) upon the occurrence of an event of default. In the event that we, on or prior to the maturity date, consummated the sale of shares of capital stock (other than a sale of capital stock to our officers, directors, employees or consultants in connection with their provision of services to us) resulting in net proceeds to us of at least $250,000, then the outstanding principal amount of the debentures and all accrued and unpaid interest, at the sole option of the holder of the debenture, converted in whole or in part, into shares of the common stock sold in such future financing. The warrants are exercisable until December 7, 2007. The warrants provided for an exercise price equal to 80% of the price per share or unit in our next round of equity financing resulting in net proceeds to us of at least $250,000, provided that the exercise price could not exceed $0.80 per share or be less than $0.45 per share. In the event that such financing was not completed on or before September 4, 2005, the warrants would automatically be assigned an exercise price equal to 65% of the closing price of our common stock on September 4, 2005, but in no event greater than $0.80 or less than $0.45 per share. Based on the closing of our May 2005 financing, these warrants have an exercise price of $0.60 per share. The exercise price of the warrants and the number of underlying shares of common stock is subject to adjustment under certain circumstances. As compensation for their services as placement agent in the debenture offering and future consulting services to us, the placement agent received cash fees and warrants with terms substantially identical to those received by the investors.

During the first quarter of 2005, our principal shareholders and Board members provided us with a $1.6 million revolving line of credit. It was expected that this credit facility, coupled with then existing cash, to the extent available, would be used to pay back the debenture notes, interest and penalties if the financing were ultimately not completed.

In October 2002, we refinanced through Colonial Bank two of our restaurant locations, Melbourne and Winter Haven, with notes of $635,000 and $667,000, respectively. The loans, which bear interest at the bank's base rate, are for terms of five years with required monthly principal payments based on a 15 year amortization schedule, and a balloon payment at the end of the five years. The principal balances owed on these two notes as of April 3, 2005 were $520,000 and $556,000, respectively. Relative to these two promissory notes, we are required to meet a financial covenant relating to debt coverage. We were in compliance in meeting this loan covenant as of January 2, 2005 and April 3, 2005. However, in the past, we were not in compliance with meeting the loan covenant for which a covenant waiver was provided by the bank.

We are seeking to raise additional capital through financing of new restaurant equipment and through sale leaseback transactions for two of our company-owned restaurant properties. There are no assurances we will be able to secure such financing at all or at terms acceptable to us or at all.

The remaining proceeds available from the private placement financing, coupled with the revolving line of credit, cash flow from operations and, if available, equipment and sale leaseback financing will be used to continue restaurant remodels (estimated to cost approximately $3.6 million) and for acquisitions of new restaurants. In the event that our plans change, assumptions prove to be inaccurate, or due to unanticipated expenses, and in the event projected cash flow or third party financing otherwise prove to be insufficient to fund operations, we could be required to seek additional financing from sources not currently anticipated. There can be no assurance that third party financing will be available to us when needed, on acceptable terms, or at all.

Contractual Obligations

As of January 2, 2005, our contractual obligations were:

	Payments due by period				
	Total	**< 1 yr**	**1 - 3 yrs**	**3 - 5 yrs**	**> 5 yrs**
Long-term debt (1)	$ 2,010,609	$ 515,761	$ 1,254,504	$ 240,344	$ —
Capital lease obligations	—	—	—	—	—
Operating lease obligations (2)	15,086,000	1,968,000	3,475,000	3,112,000	6,531,000
Purchase obligations	—	—	—	—	—
Other debt obligations reflected on our balance sheet under GAAP (3)	4,634,242	2,395,301	2,238,941	—	—
Total	$ 21,730,851	$ 4,879,062	$ 6,968,445	$ 3,352,344	$ 6,531,000

Note 1 - consists of long-term debt as reported in footnote 6 of the financial statements.
Note 2 - consists of operating leases primarily for real estate.
Note 3 - consists of convertible debentures and interest payable of $2,395,301 due in May 2005 and related party debt and deferred interest payable of $2,238,941 due in January 2007.

Inflation

We have not operated in a highly inflationary period and management does not believe that inflation has had a material effect on sales or expenses. As expenses increase, we expect to recover increased costs by increasing prices, to the extent permitted by competition, or by modifying our menu and promoting other less cost sensitive products. Many food products purchased by us are affected by commodity pricing and are, therefore, subject to unpredictable price volatility. Extreme changes in commodity prices and/or long-term changes could affect us adversely. From time-to-time, competitive circumstances could limit menu price flexibility, and in those cases margins would be negatively impacted by increased commodity prices. Due to the fact that our business is somewhat dependent on tourism in Florida, any significant decrease in tourism due to inflation would likely have a material adverse effect on revenues and profitability.

In May 2005, the minimum wage rate in Florida increased by $1.00 per hour. Tipped employees also receive the $1.00 per hour wage increase under this new law. Each year thereafter, the minimum wage will increase according to the U.S. Department of Labor, Bureau of Labor Statistics cost of living index. Such payroll cost increases could have a significant adverse affect to our company. Menu price increases and other actions are required to negate the effect of these wage increases. There can be no assurances that such measures being taken and expected to be taken by our company will be successful to adequately offset these additional payroll costs, or will be accepted without adverse reaction by our customers.

Recent Accounting Pronouncements

In April 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. In addition, all provisions of this Statement should be applied prospectively. Adoption of FASB Statement 149 did not materially impact our consolidated financial statements.

In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Many of those instruments were previously classified as equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of FASB Statement No. 150 did not materially impact our consolidated financial statements.

In December 2003, the FASB issued a pronouncement, Financial Interpretation Number 46R ("FIN 46R"), "Consolidation of Variable Interest Entities." This FIN deals with Off-Balance Sheet Assets, Liabilities, and Obligations and gives guidance for determining which entities should consolidate the respective assets and liabilities associated with the obligations. We must fully consolidate assets and liabilities covered by FIN 46R in our financial statements in the first fiscal year or interim period beginning after March 15, 2004. Full disclosure, as well as consolidation, if applicable, of any newly created agreements after January 31, 2003 must begin immediately. Adoption of FIN 46R did not materially impact our consolidated financial statements.

In December 2003, the FASB revised Statement No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" which amended FASB Statements No. 87, 88, and 106. Statement No. 132 requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit post-retirement plans. The required information is to be provided separately for pension plans and for other post-retirement benefit plans. Adoption of revised FASB Statement No. 132 did not materially impact our consolidated financial statements.

In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs" which amended ARB No. 43, Chapter 4. The amendments made by FASB Statement No. 151 will improve financial reporting by clarifying that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and by requiring the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. The provisions of FASB Statement No. 151 are to be applied prospectively. Adoption of FASB Statement No. 151 is not expected to materially impact our consolidated financial statements.

In December 2004, the FASB issued Statement No. 153, “Exchanges of Non-monetary Assets” which amended APB Opinion No. 29, “Accounting for Non-monetary Transactions.” The amendments made by FASB Statement No. 153 are based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for non-monetary exchanges of similar productive assets and replace it with a broader exception for exchanges of non-monetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. The Statement is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for non-monetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement are to be applied prospectively. Adoption of FASB Statement No. 153 is not expected to materially impact our consolidated financial statements.

In December 2004, the FASB revised Statement No. 123, “Accounting for Stock-Based Compensation.” This Statement supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. Revised Statement No. 123 focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement does not change the accounting guidance for share-based payment transactions with parties other than employees provided in Statement 123 as originally issued and EITF Issue No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services,” nor address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, “Employers’ Accounting for Employee Stock Ownership Plans.” Revised Statement No. 123 will become effective for Shells as of the first quarter of fiscal 2006, being the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005.

On June 22, 2005, the Compensation Committee and the our board of directors approved the acceleration of vesting of certain unvested and “out-of-the-money” stock options with exercise prices equal to or greater than $0.85 per share previously awarded to its employees, including its executive officers, and its directors under the Plan that were originally scheduled to vest during 2006. The acceleration of vesting is effective for stock options outstanding as of June 22, 2005. Options to purchase approximately 295,000 shares of common stock or 18.5% of our outstanding unvested options (of which options to purchase approximately 233,000 shares or 14.6% of the Corporation’s outstanding unvested options are held by the Corporation’s executive officers and directors) were subject to the acceleration. The weighted average exercise price of the options subject to the acceleration is $1.10.

The purpose of the acceleration is to enable us to avoid recognizing compensation expense associated with these options in future periods in its consolidated statements of income, upon adoption of FASB Statement No. 123 R (Share-Based Payment) in December 2005. The pre-tax charge which we expect to avoid in 2006 amounts to approximately $87,000 based on the original vesting periods. We also believe that because many of the options to be accelerated have exercise prices in excess of the current market value of our common stock, these options have limited economic value and are not fully achieving their original objective of incentive compensation and employee retention.

On both June 13 and June 22, 2005, each of Philip R. Chapman, Robert S. Ellin, Gary L. Herman, Michael R. Golding, Christopher D. Illick and Jay A. Wolf, our non-employee directors, was awarded an option to purchase 20,000 shares of our common stock at exercise prices of $0.76 and $0.85 per share, respectively. The June 13, 2005 awards were made subject to stockholder approval of the Amendment. In general, these options will vest on a monthly basis with respect to 1/12th increments during each of the first six months following the date of grant and with respect to all remaining shares on December 31, 2005.

On June 13, 2005, each of Leslie Christon, Warren Nelson and Guy Kathman, our executive officers, was awarded, subject to stockholder approval of the Amendment, an option to purchase 450,000, 125,000 and 125,000 shares of our common stock, respectively, at an exercise price of $0.76 per share. In general, these options will vest on an annual basis with respect to 1/3 during each of the three years following the date of grant, except that those increments that would have otherwise vested on the first anniversary in 2006 based on the foregoing schedule will instead vest on December 31, 2005. In addition, options to purchase an aggregate of 173,000 shares of our common stock were awarded, subject to stockholder approval of the Amendment, to 37 of our non-executive officer employees on the same terms.

Based on the vesting schedules of those stock options outstanding as of July 3, 2005, net of the effect of the acceleration of vesting discussed previously, adoption of revised FASB Statement No. 123 is expected to result in the recognition of compensation expense of approximately $160,000 in fiscal 2006, $210,000 in fiscal 2007 and $85,000 in fiscal 2008.

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in interest rates on debt and changes in commodity prices. Our exposure to interest rate risk relates to the $1,099,000 and $1,076,000 in outstanding debt with banks that is based on variable rates as of January 2 and April 3, 2005, respectively. Borrowings under the loan agreements bear interest at the rate equal to the applicable bank’s base rate.

BUSINESS

General

We operate a chain of full-service, mid-priced, casual dining seafood restaurants under the name “Shells.” Our restaurant system currently includes 26 restaurants, of which 21 are owned by us, one is owned by a joint venture in which we hold a 51% ownership interest and the remaining four are owned by third parties and managed by us pursuant to contractual arrangements.

Concept and Strategy

We believe that the relatively small number of national and regional chain restaurants competing in the seafood segment of the restaurant industry, as compared to other restaurant segments, provides us with a significant opportunity to capitalize on our casual dining seafood restaurant concept. We believe that we have benefited and will continue to benefit from the continuing trend towards increased seafood consumption, which we believe is due to, among other things, the pleasing taste, high protein and low fat content and variety of preparation techniques of seafood.

We are a full-service, neighborhood concept, designed to appeal to a broad range of customers by providing generous portions of high-quality seafood, warm, friendly service, and a relaxed atmosphere at reasonable prices. Shells restaurants feature a wide selection of seafood items, including shrimp, oysters, clams, scallops, mussels, lobster, crab and daily fresh fish specials, cooked to order in a variety of ways: steamed, sautéed, grilled, blackened and fried. In addition, our restaurants offer a wide selection of signature pasta dishes, appetizers, salads, and desserts and full bar service. All our restaurants are open for dinner and 24 restaurant locations are also open for lunch.

Fiscal year 2004 marked a turning point in the evolution of the Shells concept. Beginning in late 2003, our senior executive team led by then new President & CEO Leslie J. Christon began to strategically reposition the concept by leveraging the freshness, quality and variety of Shells food as a competitive advantage. This challenging effort to successfully improve Shells’ concept appeal and reverse unfavorable long-term sales trends remained our focus throughout 2004.

We revamped the menu, improved the quality of ingredients purchased, broadened customer appeal by adding more variety, and adjusted pricing. The new menu still maintains a very strong emphasis on value through a two-tier pricing strategy, offering exceptionally high-quality, fresh seafood at reasonable prices alongside lower-priced favorites. To support the brand’s quality and freshness positioning, we worked hard to elevate levels of service and overall operational execution, recruiting new operations talent into our company and enforcing higher standards. We also addressed the critical need to improve Shells’ atmosphere and facilities, successfully developing a prototypical remodel package that dramatically improves Shells’ appearance, comfort and consumer appeal.

Our efforts to significantly update the Shells concept generally have been embraced by customers. As a result, our comparable restaurant sales turned consistently positive beginning in the latter portion of the third quarter of 2004. Comparable restaurant sales have remained at strong levels through the balance of 2004 and into the first half of 2005.

Restaurant Locations

Our managed and operated restaurants are located in the following Florida markets and cities/neighborhoods:

Tampa/Sarasota	**Orlando**	**South Florida**
Brandon	Daytona Beach	Coral Springs
Clearwater Beach	Kissimmee	Davie
Holmes Beach	New Smyrna Beach	Kendall
Redington Shores	Ocala	Pembroke Pines
St. Pete Beach	Orlando	Sunrise
Winter Haven	Winter Park	
Carrollwood *	Melbourne **	
North Tampa *		
Sarasota *		
South Tampa *		

West Palm Beach	**Fort Myers**
Stuart	Fort Myers
West Palm Beach	Port Charlotte

* We manage and operate the restaurant at these locations and do not own them.

** We own 51% equity interest in the restaurant at this location.

From 1997 to 1999, in an attempt to diversify and minimize the seasonal effect of the Florida market, we opened 18 restaurants in various Midwest markets. We sustained operating losses in these Midwest markets and discontinued operations at our remaining 12 Midwest restaurants in April 2001. We closed one under-performing Florida restaurant in 2002, and an additional three Florida restaurants in 2004. We, continuously review the performance, unit economics and location of each of our restaurants, and regularly evaluate new real estate sites in Florida for potential expansion or relocation.

Restaurant Operations

Management and Employees. We currently employ five area directors. Each area director is responsible for the management of several restaurants, including management development, recruiting, training, quality of operations and unit profitability. The staff of a typical dinner-only restaurant consists of one general manager, two or three assistant managers and approximately 45 other employees. The restaurants that are also open for lunch generally have 15 to 20 additional part-time employees. Restaurant management and area directors participate in a bonus program based upon the financial results of their particular restaurant or restaurants.

Restaurant Reporting. We maintain financial and accounting controls for each restaurant through a central accounting system. Our financial systems and controls allow us to access each restaurant's sales, inventory costs and other financial data on a daily basis, enabling both store-level management and senior management to quickly react to changing sales trends, to effectively manage food, beverage and labor costs, to minimize theft, and to improve the quality and efficiency of accounting and audit procedures. Store level management performs weekly inventories and manages weekly operating results versus budget.

Recruitment and Training. We believe that achieving customer satisfaction by providing knowledgeable, friendly, efficient service is critical to a restaurants' long-term success. We typically recruit restaurant managers with significant experience in the restaurant industry. During an 8 week training program, our restaurant managers are taught to promote our team-oriented atmosphere among restaurant employees with emphasis on preparing and serving food in accordance with strict standards and providing friendly, courteous and attentive service. The restaurant staff, through our Team Trainer program, is trained on site by restaurant managers and other staff members. During 2002 and 2003, we reduced restaurant management turnover. In 2004 and to a lesser extent to-date in 2005, restaurant management turnover increased as part of an effort to improve the level of quality in our managers. Other than our recent efforts to raise manager quality levels, we strive to reduce turnover levels.

Purchasing. Obtaining a reliable supply of quality seafood at competitive prices is critical to our success. We have formed long-term relationships with several seafood suppliers and purchase both fresh and frozen seafood and certain other supplies used in restaurant operations in bulk. In addition, Shells' menu has been designed to feature seafood varieties with stable sources of supply, as well as to provide flexibility to adjust to shortages and to take advantage of occasional purchasing opportunities. We believe our diverse menu selection minimizes the effect of the shortage of any seafood products. We generally have been able to anticipate and react to fluctuations in food costs through selected menu price adjustments, purchasing seafood directly from numerous suppliers and promoting certain alternative menu selections in response to availability and price of supply.

Performance Food Group of Florida, our primary distributor since October 2002, distributes our food products, comprising seafood and other commodities that make up our menu ingredients, to our restaurants. Performance Food Group purchases and takes delivery of the products that we recommend for purchase according to our specifications and subject to our inspections. Based on purchase orders initiated by our restaurants, Performance Food Group then sells the food products to us on a cost plus basis, and distributes the food products directly to the restaurants. From time-to-time, at our direction to facilitate a forward purchase opportunity, Performance Food Group acquires inventory in excess of normal recurring restaurant delivery and re-supply, which approximates 30 days supply. We pay interest on inventory holdings above 30-day supply levels, at an interest rate of 7.8% per annum. In addition, Performance Food Group procures, on our behalf, many operating supplies, other than food products, used by our restaurants and distributes and sells these products to the individual restaurants at agreed upon price mark-ups.

Quality Control. We maintain a continuous inspection program for all of our seafood purchases. Each shipment of frozen seafood is inspected through statistical sampling methods upon receipt at Performance Food Group's distribution center for quality and conformity to our written specifications, prior to delivery to the restaurants. Fresh fish are also inspected on a random basis by our quality control inspector. In addition, fresh fish purchased by our individual restaurants must be purchased from one of our approved suppliers and is inspected by a restaurant manager at the time of delivery. As part of our training program, restaurant employees are educated as to the correct handling and proper physical characteristics of each product.

Our area directors, general managers and assistant managers are all responsible for properly training hourly employees and ensuring that Shells restaurants are operated in accordance with strict health and quality standards. Compliance with our quality standards is monitored by on-site visits and formal inspections by the area directors. We believe that our inspection procedures and employee training practices help to maintain a high standard of quality for the food and service we provide.

Advertising and Marketing

Our marketing efforts leverage the use of billboard, newspaper, radio and television advertising to raise awareness of the Shells brand and to inform new and existing customers about food-focused promotions. The fact that our restaurants are generally clustered in particular media markets helps us obtain cost effective advertising. We also stage in-store promotions and various local marketing efforts to help our restaurants partner with their communities.

Across most major markets, our broad scale marketing initiatives included network television, radio, outdoor, newspaper, concentrated internet and direct mail campaigns. The advertising messages were designed to heighten brand awareness and drive trial through food-focused brand positioning, while spotlighting freshness, quality and variety. In 2005, we introduced a focused local store marketing program, providing all of our restaurants with the resources to take advantage of an array of sales building initiatives.

In December 2004, we entered into a consulting agreement with Lawrence Wolf, principal of the Wolf Group. Mr. Wolf, as a consultant, assists our company in providing marketing services; including guidance toward building our creative strategy around the “Shells” brand positioning and providing support in coordinating our media production.

Disclosure Controls

Consolidated subsidiaries are managed through a centralized executive office in Tampa, Florida. Material information is discussed at various weekly and monthly meetings with officers and directors. An open door policy is observed by corporate officers to facilitate communication.

Joint Venture and Third-Party Owned Restaurants

The Shells restaurant system currently consists of (i) 21 restaurants that are wholly owned by us; (ii) one restaurant, in Melbourne, Florida, in which we have an interest of 51%; and (iii) four restaurants that we manage and operate, but do not own. The remaining 49% interest in the Melbourne restaurant is indirectly owned by Wanda L. Hattaway, wife of William E. Hattaway, a former director and president of our company. In addition to the equity interest in this restaurant, we receive a management and licensing fee of 6% of the restaurant sales of the Melbourne restaurant.

Three of the managed restaurants are managed and operated by us pursuant to management and license agreements, originally entered into in July 1993. Pursuant to these agreements, we provide management services and license proprietary information required to operate these restaurants for a percentage of that restaurant’s sales. The agreements, as amended in October 2001, provide for a 4% management fee until such time as sales return near to 1999 levels, and then returning to a 6% fee. Of the total management fee received, 2% of sales is placed in escrow and disbursed to a third party to satisfy each managed restaurants’ requirement to make third party royalty payments. The management agreements grant us authority to determine the programs and policies affecting the day-to-day operations of each of these managed restaurants. Although the management agreements differ slightly, they generally have a remaining term of 18 years and provide that the third-party owners are responsible for funding all the restaurant expenses, including food and beverage costs, staffing, training, recruiting, inventory, and working capital.

We operate the fourth managed restaurant pursuant to an oral agreement requiring that the restaurant is operated in conformity with the policies and procedures established by us for Shells restaurants. In accordance with the amended management agreements for our managed restaurants, beginning in October 2001, we receive a management fee of 2% of the restaurant’s sales.

In the past, the enforceability of these management and license agreements has been questioned by certain of the licensees. Although we believe the agreements are enforceable, there can be no assurance that the agreements will not be challenged in the future, and, if challenged, that the agreements will be determined to be enforceable.

Competition

The restaurant industry is intensely competitive with respect to price, service, location, food quality and variety, and there are many well-established competitors with substantially greater financial and other resources than us. These competitors include national, regional and local full-service casual dining chains, many of which specialize in or offer seafood products. We also face competition from a broad range of other restaurants and foodservice establishments, including full-service, quick service and fast food restaurants, which specialize in a variety of cuisines. Some of our competitors have been in existence for substantially longer periods than we have, and may be better established in the markets where we have our restaurants. In addition, we believe that the full-service casual dining segment is likely to attract a significant number of new entrants, some offering seafood products.

Government Regulation

We are subject to extensive federal, state and local government regulation by various governmental agencies, including state and local licensing, zoning, land use, construction and environmental regulations and various regulations relating to the sale of food and alcoholic beverages, sanitation, disposal of refuse and waste products, public health, safety and fire standards. Our restaurants are subject to periodic inspections by governmental agencies to ensure conformity with these regulations. Difficulties or failure in obtaining required licensing or other regulatory approvals could delay or prevent the opening of a new restaurant, and the suspension of, or inability to renew, a license at an existing restaurant could adversely affect our operations. Restaurant operating costs are also affected by other government actions, beyond our control, including increases in the minimum hourly wage requirements, workers compensation insurance rates, health care insurance costs and unemployment and other taxes.

Approximately 12% of our revenue is attributable to the sale of alcoholic beverages. Alcoholic beverage control regulations require each of our restaurants to apply to a state authority and, in certain locations, county or municipal authorities for a license or a permit to sell alcoholic beverages on the premises. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time. Alcoholic beverage control regulations relate to numerous aspects of daily operations of our restaurants, including minimum age of patrons and employees, hours of operation, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages. The failure of a restaurant to obtain or retain liquor or food service licenses would adversely affect the restaurant’s operations.

We are also subject to “dram-shop” statutes, which generally provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated person. We carry liquor liability coverage as part of our existing comprehensive general liability insurance.

Our restaurants are subject to federal and state minimum wage laws governing such matters as working conditions, overtime and tip credits. A significant number of our restaurant personnel are paid at rates related to the federal minimum wage and, accordingly, further increases in the minimum wage rate could increase our labor costs.

In May 2005, the minimum wage rate in Florida increased by $1.00 per hour. Tipped employees also receive the $1.00 per hour wage increase under this new law. Each year thereafter, the minimum wage will increase according to the U.S. Department of Labor, Bureau of Labor Statistics cost of living index. Such payroll cost increases could have a significant adverse affect to our company. Menu price increases and other actions are required to negate the effect of these wage increases. There can be no assurances that such measures being taken and expected to be taken by our company will be successful to adequately offset these additional payroll costs, or will be accepted without adverse reaction by our customers.

The Americans with Disabilities Act prohibits discrimination in employment and public accommodations on the basis of disability. Under the Act, including in situations where we elect to remodel a restaurant, or acquire or purchase a restaurant, we could be required to expend funds to modify our restaurants to better provide service to, or make reasonable accommodations for the employment of, disabled persons.

Service Marks and Proprietary Information

We have registered the service mark “Shells” with the Secretary of the State of Florida and the “Shells” service mark and “jumping fish” logo with the United States Patent and Trademark Office. We believe that our service marks have significant value and are essential to our ability to create demand for, and awareness of, our restaurants. There can be no assurance, however, that our service marks do not or will not violate the proprietary rights of others, that they would be upheld if challenged or that we would not be prevented, in such an event, from using our service marks, any of which could have a material adverse effect on us. Although there can be no assurance that we will have the financial resources necessary to enforce or defend our service marks, we have vigorously opposed, and intend to continue to oppose vigorously, any infringement of our service marks.

We also rely on trade secrets and proprietary knowledge and employ various methods to protect our concepts and recipes. These methods may not afford complete protection and there can be no assurance that others will not independently develop similar knowledge or obtain access to our knowledge, concepts and recipes.

Employees

As of July 3, 2005, we employed approximately 1,170 persons, of whom approximately 130 were management or administrative personnel employed on a salaried basis and 1,040 were employed in non-management restaurant positions on an hourly basis. Approximately 600 employees are employed on a full-time basis. We consider our employee relations to be good. No employees are covered by a collective bargaining agreement.

Seasonality

The restaurant industry in general is seasonal, depending on restaurant location and the type of food served. We have experienced fluctuations in our quarter-to-quarter operating results due, in large measure, to our full 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. and the health of Florida’s economy and the effect of world events in general and the tourism industry in particular. Our 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. Many of our restaurant locations are in coastal cities, where sales are significantly dependent on tourism and its seasonality patterns.

Legal Proceedings

On April 20, 2005, we received a notice from the Equal Employment Opportunity Commission (EEOC) that an employee in a Tampa Shells restaurant had filed a charge of discrimination with the EEOC. Specifically, this employee claimed age discrimination in violation of the Age Discrimination in Employment Act of 1964. Based on our investigation to date, we believe the charge is without merit and intend to vigorously defend our position.

On April 28, 2005, we received notification from a law firm representing three holders of our debentures, each in the principal amount of $40,000. The notification demands payment of the debentures in full plus accrued interest and penalties owed thereon. The notification states that the holders have authorized the law firm to commence legal action against us unless the amounts owed under the debentures are repaid in full within 10 days of the date of the letter. Payment of the debentures, accrued interest, penalties and claimants’ legal costs were paid in full on May 24, 2005.

On June 22, 2005, we received notification from a law firm representing a former employee of an alleged violation of the Family Medical Leave Act. Based on our investigation to date, we believe the charge is without merit and intend to vigorously defend our position.

In the ordinary course of business, Shells is and may be a party to various legal proceedings, the outcome of which, singly or in the aggregate, is not expected to be material to our financial position, results of operations or cash flows.

Properties

We lease 4,500 square feet of space in Tampa, Florida for our executive offices. The annual rent payable under the lease, which expires October 31, 2007, is approximately $66,000.

All but three of our existing restaurants in operation are leased properties. In the future, we intend to lease most of our properties but may from time-to-time acquire restaurant locations based on individual site evaluation. Each of our leases provides for a minimum annual rent and certain of these leases require additional rental payments to the extent sales volumes exceed specified amounts. Generally, we are required to pay the cost of insurance, taxes and a portion of the landlord's operating costs to maintain common areas. Restaurant leases have initial terms averaging 13 years and renewal options averaging 16 years, and rents averaging $15.00 per square foot.

MANAGEMENT

The following table sets forth certain information with respect to our executive officers and the members of our board of directors:

Name	Age	Position
Leslie J. Christon	51	President and Chief Executive Officer, Director
Guy C. Kathman	48	Vice President of Operations
Warren R. Nelson	53	Executive Vice President of Finance, Chief Financial Officer, Treasurer and Secretary
Philip R. Chapman	45	Chairman of the Board
Robert S. Ellin	41	Director
Michael R. Golding	72	Director
Gary L. Herman	40	Director
Christopher D. Illick	67	Director
Jay A. Wolf	32	Director

Our directors hold office until the earlier of their death, resignation, removal or disqualification or until their successors have been elected and qualified. Officers serve at the discretion of the board of directors.

Leslie J. Christon has been our President and Chief Executive Officer since joining Shells in July 2003. From 2002 to 2003, Mrs. Christon was self-employed as a management consultant in the restaurant industry. From 2000 to 2002, Mrs. Christon was employed by Sutton Place Gourmet, Inc. as its President and Chief Operating Officer. From 1996 to 2000, Mrs. Christon was employed by Brinker International, On the Border Restaurants, as its President.

Guy C. Kathman has been our Vice-President of Operations since joining Shells in September 2003. From 2001 to 2003, Mr. Kathman was employed by Posados Café as a General Manager. From 1997 to 2001, Mr. Kathman was employed by Brinker International, On the Border Restaurants, as a Regional Director.

Warren R. Nelson currently serves as our Executive Vice-President of Finance, Chief Financial Officer, Treasurer, and Secretary, positions he has held since June 1993.

Philip R. Chapman has served on the Board of Directors beginning May 1997 and as Chairman since April 2002. Since 1993, Mr. Chapman has been President of Adler & Company, a corporation which provides administrative services for financial and venture capital investing, including certain entities controlled by Frederick R. Adler, a greater than 10% stockholder. Mr. Chapman is a director of Regeneration Technologies, Inc., a company which produces allografts for surgical use, and of various private companies. He is also a General Partner in Euro-America II, L.P., a private venture capital fund, and a managing partner of Zenith Asset Management, a private hedge fund. Mr. Chapman is the son-in-law of Frederick R. Adler.

Robert S. Ellin has served on the Board of Directors since June 2004. In 2003, Mr. Ellin founded Trinad Capital, LP and has served as a managing member of Trinad Advisors GP, LLC which is the general partner of Trinad Capital, LP, since its inception. In 1990, Mr. Ellin founded and served as President of Atlantis Equities Inc., a private investment company. From 1996 to 1998, he served as President of S&S Industries, Inc. Prior to founding Atlantis Equities, Mr. Ellin worked in Institutional Sales at LF Rothschild and was the Manager of Retail Operations at Lombard Securities.

Michael R. Golding has been a professor of surgery at the State University of New York Health Science Center in Brooklyn, New York since 1963, where he is currently an Emeritus Clinical Professor of Surgery. From 1977 to 1989, Dr. Golding served as Director of Surgery at Lutheran Medical Center in Brooklyn, New York. From 1984 to 1989, Dr. Golding was President of the Tri-Boro Association of Directors of Surgery. Dr. Golding is a Fellow of the American College of Surgeons, a Fellow of the American College of Chest Physicians, and a Fellow of the American College of Angiology. Dr. Golding is a Member of the Board of Directors of the United Hospital Fund. Dr. Golding also serves on the boards of numerous professional entities and private companies.

Gary L. Herman has been the Chairman and Secretary of Digital Creative Development Corporation, an investment holding company, since 2001. He has been the Secretary and a member of the Board of Directors of DataMetrics Corporation, a military defense company, since 2000. In addition, Mr. Herman has been a member of Galloway Capital Management, LLC, an affiliate of a greater than 10% stockholder of our company, since 2002. Mr. Herman also has been a member of the Board of Directors of NYC Industrial Development Agency since 1997. From 1997 to 2002, Mr. Herman served as an Associate Managing Director of Burnham Securities, Inc.

Christopher D. Illick has been the President of iQ Venture Partners, Inc., an investment bank, since 2001 and a General Partner of Illick Brothers, a real estate and management concern, since 1965. From 1997 to 2001, Mr. Illick was a senior officer of the investment bank of Brean Murray & Co., Inc. Mr. Illick is a member of the Board of Directors of Analytical Surveys, Inc., a public company which provides data and technical services for the geographic information systems market.

Jay A. Wolf has served on the Board of Directors since June 2004 and as Audit Committee Chairman since 2004. Since 2004, Mr. Wolf has served as a Managing Director of Trinad Capital, LP. From 1999 to 2003, Mr. Wolf served as Vice President of Corporate Development for Wolf Group Integrated Communications Ltd., where he was responsible for the company’s acquisition program. From 1996 to 1999, Mr. Wolf was employed by Canadian Corporate Funding, Ltd., a Toronto-based merchant bank in the senior debt department and, subsequently by Trillium Growth Capital, the firm’s venture capital fund. Mr. Wolf currently sits on the Board of Amalgamated Technologies Inc., a public company with limited operations.

Board of Directors and Committees of the Board

The Board of Directors has standing Executive, Audit, and Stock Option and Compensation Committees and a Nominating Committee.

The Executive Committee possesses all the powers and authority of the Board in the management of the business and affairs of our company, except for certain powers which are specifically reserved by Delaware law to the entire Board or the stockholders. Messrs. Chapman and Herman are the current members of the Executive Committee.

The Audit Committee’s responsibilities, which include reviewing our internal accounting procedures and consulting with and reviewing the services provided by the independent auditors, are described in the Audit Committee Charter. Messrs. Illick and Wolf and Dr. Golding are the current members of the Audit Committee. Mr. Illick and Dr. Golding are independent directors as that term is defined by Rule 4200(a)(15) of the Nasdaq Listing Standards. Mr. Wolf may not be an independent director pursuant to that definition. Messrs. Illick and Wolf are audit committee financial experts, as that term is defined in Item 401(h)(2) of Regulation S-K.

The Stock Option and Compensation Committee is charged with reviewing compensation policies and practices, recommending compensation for executives and key employees and administering our stock option plans. Messrs. Chapman and Ellin are the current members of the Stock Option and Compensation Committee.

The Nominating Committee assists the Board in its selection of individuals (i) as nominees for election to the Board of Directors and (ii) to fill any vacancies or newly created directorships on the Board. The members of the Nominating

Committee are Messrs. Herman and Illick and Dr. Golding. Mr. Illick and Dr. Golding are independent directors as that term is defined by Rule 4200(a)(15) of the Nasdaq Listing Standards. Mr. Herman may not be an independent director pursuant to that definition. In evaluating candidates, the Nominating Committee will consider the following criteria: personal integrity, sound business judgment, business and professional skills and experience, independence, potential conflicts of interest, the extent to which a candidate would fill a present need, and concern for the long term interests of stockholders. In any particular situation, the Nominating Committee may focus on persons possessing a particular background, experience or qualifications which the Committee believes would be important to enhance the effectiveness of the Board. The evaluation process for stockholder recommendations is the same as for candidates recommended from any other source. The Nominating Committee does not have a charter.

Executive Compensation

The following table shows all the cash compensation, as well as other compensation, we paid during the fiscal years indicated to (i) our Chief Executive Officer and (ii) each other executive officer whose total annual salary and bonus exceeded $100,000 for our fiscal year 2004.

SUMMARY COMPENSATION TABLE

		Annual Compensation			Long-Term Compensation	
Name and Principal Position	**Fiscal Year**	**Salary**	**Bonus**	**Other**	**Awards**	**Options**
Leslie J. Christon,	2004	$ 285,577	$ 1,164	8,120	—	—
Chief Executive Officer and						
President [1]	2003	121,635	—	31,403	—	297,374
Warren R. Nelson,	2004	162,000	1,164	530	—	—
Executive Vice President of Finance,	2003	155,769	36,334	605	—	—
Chief Financial Officer, Secretary						
and Treasurer	2002	142,225	—	—	—	157,984
Guy C. Kathman,	2004	124,615	1,164	12,768	—	—
Vice President of Operations	2003	27,692	—	—	—	50,000

(1) Mrs. Christon joined Shells in July 2003. Compensation for 2003 reflects payments made pursuant to her employment agreement for the portion of 2003 during which she was employed by us. The amount of other compensation for 2004 consisted of: (i) $7,500 paid by Shells for Mrs. Christon’s automobile allowance, and (ii) $620 paid by Shells for life insurance premiums. The amount of other compensation for 2003 consisted of: (i) $1,403 paid by Shells for Mrs. Christon’s automobile allowance, and (ii) $30,000 paid by Shells for relocation costs of Mrs. Christon.

(2) Mr. Nelson’s other compensation consists of $530 and $605 for 2004 and 2003, respectively, paid by Shells for life insurance premiums. The fiscal 2003 bonus consisted of $18,167 in cash and $18,167 in common stock grants, which after adjusting for payroll tax withholdings, comprised 28,318 shares of unrestricted common stock at $0.40 per share, issued and paid pursuant to the 2002 management incentive plan relating to 2002 results.

(3) Mr. Kathman joined Shells in September 2003. Compensation for 2003 reflects payments made for the portion of 2003 during which he was employed by us. The amount of other compensation for 2004 consisted of: (i) $12,451 paid by Shells for relocation costs of Mr. Kathman, and (ii) $317 paid by Shells for life insurance premiums.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

The following table sets forth information with respect to (i) options exercised during fiscal 2004 by the persons named in the Summary Compensation Table and (ii) unexercised options held by these individuals at January 2, 2005 (our fiscal year end).