

Edgar Filing: Franchise Capital Corp. - Form 10QSB

Franchise Capital Corp.  
Form 10QSB  
February 22, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-QSB

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2004

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act

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

Commission File Number 000-26887

FRANCHISE CAPITAL CORPORATION  
(Exact name of small business issuer as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

98-0353403  
(IRS Employer Identification No.)

5080 N. 40th Street, Suite 103  
Phoenix, AZ 85018  
(Address of principal executive offices)

(602) 443-2308  
(Issuer's telephone number)

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

APPLICABLE ONLY TO CORPORATE ISSUERS

The number of shares of the issuer's common equity outstanding as of February 11, 2005 was 5,341,701 shares of common stock, par value \$.0001.

Transitional Small Business Disclosure Format (check one): Yes  No

INDEX TO FORM 10-QSB FILING  
FOR THE QUARTER ENDED DECEMBER 31, 2004

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### FRANCHISE CAPITAL CORPORATION BALANCE SHEET AS OF DECEMBER 31, 2004 (UNAUDITED)

#### ASSETS

Portfolio investments (equity in controlled companies)	\$ 315,709
Advances to controlled companies	303,390
Cash	2,213
Deferred financing costs, net	2,666

#### FIXED ASSETS

Computer Equipment, net	1,538
-------------------------	-------

#### TOTAL ASSETS

\$ 625,516
=====

#### LIABILITIES AND STOCKHOLDERS' EQUITY:

Accounts payable and accrued expenses	\$ 153,646
Advances from shareholders	2,350
Debentures payable, net of discount	207,741
Notes payable, current portion	300,000

#### TOTAL LIABILITIES

663,737
-----

#### STOCKHOLDERS' DEFICIT:

Preferred Series C stock, \$0.0001 par value, 30,000,000 authorized, 13,500,000 issued and outstanding	1,350
Common stock, \$0.0001 par value, 100,000,000 shares authorized, 4,845,863 shares issued and outstanding	485
Additional paid-in capital	5,821,969

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Deferred compensation	(192,000)
Accumulated deficit	(5,670,025)
	-----
Total stockholders' deficit	(38,221)
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 625,516
	=====

See accompanying notes to the financial statements.

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FRANCHISE CAPITAL CORPORATION  
SCHEDULE OF INVESTMENTS  
AS OF DECEMBER 31, 2004  
(UNAUDITED)

Portfolio Company -----	Industry -----	Title of Security Held by Company -----		December 31 Fair Value -----
Investments in Equity Securities:				
Fathom Business Systems, Inc.	Retail	Common Stock	100.00%	225,709
Iceberg Food Systems, Inc.	Food Industry	Common Stock	100.00%	--
				-----
				225,709
				-----
Investments in and advances to controlled companies:				
Comstock Jake's Franchise Co., LLC	Food Industry	Partnership	45.00%	7,500
Cousin Vinnie's Franchise Co., LLC	Food Industry	Partnership	50.00%	--
Kirby Foo's Franchise Co., LLC	Food Industry	Partnership	100.00%	7,500
Kokopelli Mexican Grill Franchise Co	Food Industry	Partnership	50.00%	75,000
				-----
				90,000
				-----
Total Investments				315,709
				=====

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FRANCHISE CAPITAL CORPORATION  
STATEMENT OF OPERATIONS  
(UNAUDITED)

FOR THE THREE MONTHS ENDED DECEMBER 31, 2004 -----	FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 -----	FOR THE THREE MONTHS ENDED DECEMBER 31, 2003 -----
--	--	--

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INCOME	\$	31,025	\$	62,334	\$	8,407
COST OF GOODS SOLD		8,304		13,808		4,975
Gross profit		22,721		48,526		3,432
COSTS AND EXPENSES:						
General and administrative expense		255,378		694,497		268,199
Total		255,378		694,497		268,199
INCOME (LOSS) FROM OPERATIONS		(232,657)		(645,971)		(264,767)
OTHER INCOME (EXPENSE)						
Goodwill impairment		--		(44,836)		--
Minority interest		--		2,510		--
Interest income		--		3,024		--
Financial and interest expense		(48,120)		(52,472)		--
INCOME (LOSS) BEFORE INCOME TAXES		(280,777)		(737,745)		(264,767)
INCOME TAXES		--		--		--
INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGES		(280,777)		(737,745)		(264,767)
CUMULATIVE EFFECT OF ACCOUNTING CHANGE NO INCOME TAX EFFECT		549,727		549,727		--
NET INCREASE (DECREASE) IN STOCKHOLDERS' EQUITY RESULTING FROM NET INCOME (LOSS)	\$	268,950	\$	(188,018)	\$	(264,767)
NET INCOME (LOSS) PER COMMON SHARE						
Basic and diluted:						
Before cumulative effect of accounting change	\$	(0.06)	\$	(0.18)	\$	(0.01)
Cumulative effect of accounting change	\$	0.13	\$	0.14	\$	\$-
Total	\$	0.07	\$	(0.04)	\$	(0.01)
WEIGHTED AVERAGE COMMON SHARES		4,060,278		3,868,572		21,557,527

See accompanying notes to the financial statements.

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FRANCHISE CAPITAL CORPORATION  
STATEMENTS OF CASH FLOWS  
(UNAUDITED)

		FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 -----	FOR THE SIX MONTHS ENDED DECEMBER 31, 2003 -----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss)		\$ (188,018)	\$ (397,572)
Adjustments to reconcile net loss to net cash used in operating activities:			
Common stock issued as consideration for services		296,000	347,460
Depreciation		3,909	--

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Amortization of deferred financing cost	1,334	-
Amortization of deferred compensation	16,000	-
Amortization of beneficial conversion feature	30,303	-
Impairment of goodwill	44,836	-
Minority interest	(2,510)	-
Cumulative effect of accounting change	(549,727)	-
Changes in assets and liabilities:		
Prepaid expenses	(85,086)	(24,96)
Accounts receivable	(219,703)	2,30
Inventories	--	13,56
Accounts payable and accrued liabilities	75,335	(18,31)
Deferred revenue	325,000	-
	-----	-----
Net cash used in operating activities	(252,327)	(77,51)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash invested in portfolio companies	(29,166)	-
Equipment	(3,586)	-
Cash acquired in business combination	--	3,61
	-----	-----
Net cash provided by/(used in) investing activities	(32,752)	3,61
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances from shareholders, officers and affiliates	(8,647)	19,05
Proceeds from notes payable and convertible debentures	249,938	-
Common stock issued for cash	--	55,00
	-----	-----
Net cash provided by financing activities	241,291	74,05
	-----	-----
INCREASE/(DECREASE) IN CASH	(43,788)	15
CASH BEGINNING OF PERIOD	46,001	-
	-----	-----
CASH END OF PERIOD	\$ 2,213	\$ 15
	=====	=====
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ --	\$ -
	=====	=====
Income taxes paid	\$ --	\$ -
	=====	=====
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Preferred stock converted to common stock	\$ 3,800,000	\$ -
	=====	=====
Note payable issued to acquire business	\$ --	\$ 349,80
	=====	=====
Common stock issued to acquire businesses	\$ --	\$ 525,00
	=====	=====
Common stock issued to acquire treasury stock	\$ --	\$ 1,130,00
	=====	=====

See accompanying notes to the financial statements.

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### 1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions for Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. All adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the interim periods have been made and are of a recurring nature unless otherwise disclosed herein. The results of operations for the three months ended December 31, 2004 are not necessarily indicative of the results that will be realized for the entire fiscal year. These financial statements should be read in conjunction with the Company's Annual Report on Form 10-KSB for the year ended June 30, 2004.

#### a. General

FRANCHISE Capital Corporation (the "Company") a Nevada corporation, was incorporated on July 6, 2001 as Cortex Systems, Inc. In December of 2004 the Company changed its name to Franchise Capital Corporation, to more accurately reflect its true business nature. The Company invests in developing and franchising casual dining restaurants. The Company is seeking to acquire additional investments within this industry and has acquired the rights to at least one concept. To date, the Company has had no revenues associated with these activities. Effective December 17, 2004, the Company as an internally managed, closed end investment company elected to be treated as a business development company under the Investment Company Act of 1940, as amended.

As a business development company, we provide long-term debt and equity investment capital to support the expansion of companies in the casual, fast food restaurant industry. We generally invest in private, small to middle market companies that lack access to public capital or whose securities may not be marginable. Today, our investment and lending activity is generally focused in private finance.

Our investment portfolio consists primarily of equity investments in companies, which may or may not constitute a controlling equity interest. At December 31, 2004 our investment portfolio totaled \$315,709 at cost. Our investment objective is to achieve current income.

The Company did not elect to be treated for federal income tax purposes as a regulated investment company under the Internal Revenue Code .

#### b. Going Concern

The Company faces many operating and industry challenges. There is no meaningful operating history to evaluate the Company's prospects for successful operations. Future losses for the Company are anticipated. The proposed plan of operations would include seeking an operating entity with which to merge. Even if successful, a merger may not result in cash flow sufficient to finance the continued expansion of a business.

The accompanying financial statements reflect the accounts of Franchise Capital Corporation, and the related results of operations. In accordance with Article 6 of Regulation S-X under the Securities Act of 1933 and Securities Exchange Act of 1934, the Company does not consolidate portfolio company investments in which the Company has a controlling interest. These

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financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred material operating losses, has continued operating cash flow deficiencies and has working capital deficit at December 31, 2004. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company believes that it will be successful in the management of its investment portfolio. However, the Company will likely require additional debt or equity capital in order to implement its business plan. The accompanying financial statements do not include any adjustments that might result from this uncertainty.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Franchise Capital Corporation changed to a Business Development Company, effective December 17, 2004. Therefore, the prior periods are no longer directly comparable. The balance sheet as of December 31, 2004, is presented to reflect the change to a BDC. The statements of operations for the periods ended December 31, 2004, are presented as if the all of the Company's portfolio companies are consolidated through the last day of the period. The Company determined that the effect of segregating operations for December 18, through December 31, would not be material. The Company's Board of Directors determined that absent any other operating information, all investments are valued at cost.

Cash and Cash Equivalents - Cash and cash equivalents include all short-term liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less.

Income taxes - The Company provides for income taxes based on the provisions of Statement of Financial Accounting Standards No. 109, ACCOUNTING FOR INCOME TAXES, which among other things, requires that recognition of deferred income taxes be measured by the provisions of enacted tax laws in effect at the date of financial statements.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income (Loss) Per Common Share - Basic income per share is computed using the weighted average number of shares of common stock outstanding for the period. The Company has a simple capital structure and therefore there is no presentation for diluted loss per share.

#### Recently Issued Accounting Pronouncements -

In October 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires companies to record the fair value of a liability for asset retirement obligations in the period in which they are incurred. The statement applies to a company's legal obligations associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, and development or through the normal operation of a long-lived asset. When a liability is initially recorded, the company would capitalize the cost, thereby increasing the carrying amount of the related asset. The capitalized asset retirement cost is depreciated over the life of the respective asset while the liability is

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accreted to its present value. Upon settlement of the liability, the obligation is settled at its recorded amount or the company incurs a gain or loss. The statement is effective for fiscal years beginning after June 30, 2002. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Statement 144 addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a single accounting model for long-lived assets to be disposed of. New criteria must be met to classify the asset as an asset held-for-sale. This statement also focuses on reporting the effects of a disposal of a segment of a business. This statement is effective for fiscal years beginning after December 15, 2001. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated With Exit or Disposal Activities". This Standard requires costs associated with exit or disposal activities to be recognized when they are incurred. The requirements of SFAS No. 146 apply prospectively after December 31, 2002, and as such, the Company cannot reasonably estimate the impact of adopting these new rules.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transaction and Disclosure, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation as prescribed in SFAS 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 requires more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of this statement are effective for fiscal years ending after December 15, 2002, with early application permitted in certain circumstances.

In November 2002, the FASB issued Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. FIN 45 requires a company, at the time it issues a guarantee, to recognize an initial liability for the fair value of obligations assumed under the guarantees and elaborates on existing disclosure requirements related to guarantees and warranties. The initial recognition requirements are effective for the Company during the third quarter ending March 31, 2003. The adoption of FIN 45 did not have an impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of FIN 46 did not have an impact on the Company's financial position or results of operations.

### 3. ACCOUNTING CHANGE

As a result of the Company converting to a Business Development Company,



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the Company changed its accounting principles. The primary difference relates to the accounting for investments. The investments that were previously consolidated, are now reflected at the estimated fair value of

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those investments. The Company estimated that the investments at cost approximate fair value. The effect of recoding those investments at the original cost and adjusting for the previously recorded consolidated net losses of those investments was \$549,727.

#### 4. CONVERTIBLE DEBENTURE

During the year ended June 30, 2004 the Company issued a 2-year 7.5% convertible debenture amounting to \$85,000 with interest payable monthly and due June 9, 2006. The debenture also included non-detachable warrants for 2,500,000 shares of common stock. During the three months ended December 31, 2004, this debenture was increased to \$177,438.

On October 14, 2004 the Company issued a six month convertible debenture amounting to \$25,000, with interest payable at the end of the term. The debenture may be converted, at the option of the holder, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion. The debenture may be converted, at the option of the Company, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion.

On October 4, 2004, the Company issued a six month convertible debenture amounting to \$25,000, with interest payable at the end of the term. The debenture may be converted, at the option of the holder, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion. The debenture may be converted, at the option of the Company, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion

On December 1, 2004, the Company issued a twelve month convertible debenture amounting to \$50,000, with interest of \$1,250 payable quarterly beginning March 1, 2005. The debenture may be converted, at the option of the holder, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion. The debenture may be converted, at the option of the Company, into common shares of the Company. The conversion price is 50% of the closing bid on the day the Company receives notice of conversion.

For the debentures issued in the period ended December 31, 2004, the Company computed the beneficial conversion feature to be equal to the face amount of the debentures. The \$100,000 discount is being amortized over the terms of the debt. During the three month period ended December 31, 2004, \$30,303 of the discount was amortized leaving a remaining discount of \$69,697.

#### 5. CAPITAL STOCK

The Company declared a 6 for 1 stock split during the year ended June 30, 2003. The number of shares presented in these financial statements has been retroactively restated for all periods to reflect this stock split.

During the three months ended December 31, 2003, the Company sold 125,000 shares of its common stock for \$55,000. In connection with this sale of common stock, the Company also granted 137,500 warrants to acquire the

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Company's common stock at \$0.50 per share.

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Also during the three months ended December 31, 2003, the Company granted 275,000 shares of its common stock to consultants as consideration for services rendered. The shares were valued at the trading price of the common shares aggregating to \$99,966.

Additionally, during the three months ended December 31, 2003, the Company granted 675,000 shares of its common stock to consultants as consideration for services rendered. The shares were valued at the trading price of the common shares aggregating to \$247,500.

The Company reacquired 15,535,000 shares of its common stock in the three month period ended December 31, 2003. The Company entered into an agreement to acquire all of the outstanding shares of "ICEBERG FOOD SYSTEMS, CORP." ("IFSC"). IFSC was owned by a former officer and director of the Company. The only holdings of IFSC were 30,000,000 shares of the Company's common stock. As part of the agreement, IFSC distributed 14,465,000 shares of the Company's common stock to its shareholder. IFSC then became a wholly owned subsidiary of the Company with its only holdings being the remaining 15,535,000 shares of the Company's common stock. Effectively, the transaction was an acquisition of treasury stock by the Company. In exchange, the Company would assume a commitment to raise capital and develop the Iceberg Drive-In concept. The rights to develop that concept were previously held by IFSC. The Company is to assist IFSC in providing up to \$1,130,000. The Company has accounted for this transaction as an acquisition of treasury stock through the issuance of a note payable of \$1,130,000.

During the three months ended September 30, 2004, the Company sold 140,000 shares of its common stock for \$35,000.

Also during the three months ended September 30, 2004, the Company granted 3,050,000 shares of its common stock to consultants as consideration for services rendered. The shares were valued at the trading price of the common shares aggregating to \$602,275.

On October 13, 2004, the Company negotiated a consulting agreement with Javelin Holdings, Inc. The agreement with Javelin provides for \$15,000 upon execution of the agreement, \$15,000 cash and a \$30,000 60 day Convertible Note upon successful filing of requisite SEC documents. In addition, Javelin receives 5% of any Preferred Class of stock created for the benefit of the Company, 10% of any bridge financing and 5% of any subsequent funding. During October, 2004, Javelin earned finders fee of \$5,000 from the Company for two short-term convertible debentures in the amount of \$25,000 each.

In November 2004, the Company converted its Preferred Series B stock into common stock. This conversion resulted in the retiring of all Preferred Series B stock, and issuance of 10,000,000 shares of common stock.

In December, 2004, the Company approved a reverse 1 for 10 common stock split.

In conjunction with the transactions discussed in Note 4, the Company issued an aggregate of 5,015,000 shares of its common stock.

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The information contained in this section should be read in conjunction with the Selected Financial Data and our Financial Statements and notes thereto appearing elsewhere in this 10Q. The 10Q, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs, and our assumptions. Words such as "anticipates", "expects", "intends", "plans", "believes", "seeks", and "estimates" and variations of these words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements including without limitation (1) any future economic downturn could impair our customers' ability to repay our loans and increase our non-performing assets, (2) a contraction of available credit and/or an inability to access the equity markets could impair our lending and investment activities, (3) interest rate volatility could adversely affect our results, (4) the risks associated with the possible disruption in the Company's operations due to terrorism and (5) the risks, uncertainties and other factors we identify from time to time in our filings with the Securities and Exchange Commission, including our Form 10-Ks, Form 10-Qs and Form 8-Ks. Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be incorrect. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Quarterly Report should not be regarded as a representation by us that our plans and objectives will be achieved. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report.

### EXECUTIVE OVERVIEW

The Company was formed as a Nevada corporation on July 6, 2001 under the name Cortex Systems, Inc. We were originally a development stage company that intended to establish memory clinics in several different locations in North America. We were unable to successfully execute this business plan. As a result, in July of 2003, we changed the Company's name to BGR Corporation, replaced or reconstituted the management and board of directors and changed our business focus. The Company's focus was on acquiring new innovative fast-casual restaurant concepts, develop them into a profitable working design, and franchise them across the United States. On January 20, 2003, we entered into an agreement with American Restaurant Development Corporation, or ARDC, to grow restaurant concepts into a fully viable franchise system and to expand each restaurant concepts nationwide. The controlling shareholder of ARDC is our largest shareholder. To date, we have formed four joint ventures with different restaurant concepts under this model.

On November 4, 2003, we acquired Fathom Business Systems, or Fathom. Fathom is a company specializing in restaurant point of sales equipment. Fathom generates additional revenue by providing its customers with the supplies and service needed for the equipment.

On February 2, 2004, we executed an agreement with AZTECA Wrap Foods, LLC, or AZTECA. AZTECA is the owner and operator of KoKopelli's Mexican Grill. KoKopelli's is a fast casual Mexican restaurant specializing in made-to-order Mexican-style food. Per the agreement, we own 50% of the joint venture entity, while the other 50% is owned by AZTECA. Additionally, we are required to provide

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the funding to initiate the franchising of KoKopelli's through ARDC. AZTECA will provide exclusive rights to the "KoKopelli" name, trade marks, trade dress, operating system and recipes.

In April 2004, we entered into a shareholders agreement with Alexis Group, LLC, or ALEXIS. ALEXIS is the owner and operator of Pauli's Home of the SteakBurger. Per the agreement, we own 50% of the joint venture entity, while the other 50% is owned by ALEXIS. Additionally, we are required to provide the funding to initiate the franchising of Pauli's through ARDC. ALEXIS will provide exclusive rights to the "Pauli's" name, trade marks, trade dress, operating system and recipes.

In April 2004, we executed a shareholders agreement with Brian Ruggiero, the owner and operator of Cousin Vinnie's Italian Diner. The Cousin Vinnie's concept was brought to FRANCHISE CAPITAL Corporation by American Restaurant Development Corporation ("ARDC"). Per the agreement, we own 50% of the joint venture entity, while the other 50% is owned by Ruggiero. Additionally, we are required to provide the funding to initiate the franchising of Cousin Vinnie's through ARDC. Ruggiero will provide exclusive rights to the "Cousin Vinnie's" name, trade marks, trade dress, operating system and recipes.

In April 2004, the purchase agreement for us to acquire Deville, Inc. was mutually cancelled. The agreement called for us to pay \$700,000 in stock and cash for the exclusive rights to the Lucky Lou's fast casual restaurant concept. Stock that had been issued per the agreement has been returned to the Company's treasury.

On April 15, 2004, our Board of Directors approved a stock dividend for all shareholders of record as of May 15, 2004. Under the terms of the dividend distribution, for every three shares held by a shareholder they will receive one additional share. No fractional shares are to be issued.

On December 17, 2004 the Company changed its name to Franchise Capital Corporation. The Board of Directors felt this name more closely defined its true operations, of investing in small, start up companies.

Effective December 23rd, 2004, the Company converted to a Business Development Company under the Investment Company Act of 1940. Upon completion of this conversion, they became an internally managed, diversified, closed-end investment company. Prior to the conversion they were a diversified holding company. Since the conversion to a Business Development Company occurred at the end of the quarter, the financials in this quarterly report reflect the Company operating as a diversified holding company for the 3 months ended December 31, 2004.

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### RESULTS OF OPERATIONS

The Company generated revenues of \$31,025 during the three months ending December 31, 2004. Revenues in future periods will be generated from dividends received from investments, gains on the sale of investments, management fees charged to portfolio companies, and unrealized gains resulting from the appreciation of investments.

Total general and administrative operating expenses for the three months ending December 31, 2004 were \$255,378. As a result, the Company recorded a net loss from operations for the three months ending December 31, 2004 of \$232,657. This loss was primarily due to the expense related to legal and accounting fees.

### LIQUIDITY AND CAPITAL RESOURCES

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The Company experienced a cash outflow of \$252,327 from operations during the six months ending December 31, 2004, as compared to a net of \$77,519 during the six months ending December 31, 2003. This increase was due to legal and accounting fees, as well as salaries for the officers.

### CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies are detailed in the notes to the financial statements which are an integral component of this filing.

The following summarizes critical estimates made by management in the preparation of the financial statements:

Management evaluates the probability of the utilization of the deferred income tax asset related to the net operating loss carry forwards. The Company has estimated a \$2,225,000 deferred income tax asset related to net operating loss carry forwards and other book tax differences at December 31, 2004. Management determined that because the Company has yet to generate taxable income and that the generation of taxable income in the short term is uncertain, it was appropriate to provide a valuation allowance for the total deferred income tax asset.

The Company has reviewed ASR 118 that deals with the valuation of assets held by investment companies. As a result of this review, the following guidelines were adopted:

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Where there is not a readily available source for determining the market value of any investment, either because the investment is not publicly traded, or is thinly traded, and in absence of a recent appraisal, the value of the investment shall be based on the following criteria:

- \* Total amount of the Company's actual investment. This amount shall include all loans, purchase price of securities and fair value of securities given at the time of exchange
- \* Total revenues for the preceding twelve months
- \* Earnings before interest, taxes and depreciation
- \* Estimate of likely sales price of investment
- \* Net assets of investment
- \* Likelihood of investment generating positive returns

The estimated value of each investment shall be determined as follows:

- \* Where no or limited revenues or earnings are present, then the value shall be the greater of the investments a) net assets, b) estimated sales price, or c) total amount of actual investment.
- \* Where revenues and/or earnings are present, then the value shall be the greater of one times (1x) revenues or three times (3x) earnings, plus the greater of the net assets of the investment or the total amount of the actual investment.
- \* Under both scenarios, the value of the investment shall be adjusted down if there is a reasonable expectation that the Company will not be

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able to recoup the investment or if there is a reasonable doubt about the investment's ability to continue as a going concern.

### CERTAIN RISK FACTORS AFFECTING OUR BUSINESS

Our business involves a high degree of risk. Potential investors should carefully consider the risks and uncertainties described below and the other information in this report before deciding whether to invest in shares of our common stock. If any of the following risks actually occur, our business, financial condition, and results of operations could be materially and adversely affected. This could cause the trading price of our common stock to decline, with the loss of part or all of an investment in the common stock.

WE HAVE A LIMITED OPERATING HISTORY AND THERE IS NO ASSURANCE THAT OUR COMPANY WILL ACHIEVE PROFITABILITY. Until recently, we have had no significant operations with which to generate profits or greater liquidity. Although we have recently established joint ventures with various fast-casual dining restaurants in keeping with our proposed business model, we have not generated a meaningful amount of operating revenue and we have a very limited current operating history on which investors can evaluate our potential for future success. Our ability to generate revenue is uncertain and we may never achieve profitability. Potential investors should evaluate our company in light of the expenses, delays, uncertainties, and complications typically encountered by early-stage businesses, many of which will be beyond our control. These risks include the following:

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- \* lack of sufficient capital,
- \* unanticipated problems, delays, and expenses relating to acquisitions of other businesses, concepts, or product development and implementation,
- \* licensing and marketing difficulties,
- \* competition, and
- \* uncertain market acceptance of our products and services.

As a result of our limited operating history, our plan for growth, and the competitive nature of the markets in which we may compete, our company's historical financial data are of limited value in anticipating future revenue, capital requirements, and operating expenses. Our planned capital requirements and expense levels will be based in part on our expectations concerning potential acquisitions, capital investments, and future revenue, which are difficult to forecast accurately due to our company's current stage of development. We may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenue. Once we acquire new restaurant concepts, product development and marketing expenses may increase significantly as we expand operations. To the extent that these expenses precede or are not rapidly followed by a corresponding increase in revenue or additional sources of financing, our business, operating results, and financial condition may be materially and adversely affected.

WE MAY NEED SIGNIFICANT INFUSIONS OF ADDITIONAL CAPITAL. Based upon our current cash reserves and forecasted operations, we believe that we will need to obtain outside funding. We may require significant additional financing in the future in order to further satisfy our cash requirements. Our need for additional capital to finance our business strategy, operations, and growth will be greater should, among other things, revenue or expense estimates prove to be incorrect. If we fail to arrange for sufficient capital in the future, we may be required to reduce the scope of our business activities until we can obtain adequate financing. We cannot predict the timing or amount of our capital requirements at this time. We may not be able to obtain additional financing in sufficient amounts or on acceptable terms when needed, which could adversely affect our

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operating results and prospects. Debt financing must be repaid regardless of whether or not we generate profits or cash flows from our business activities. Equity financing may result in dilution to existing shareholders and may involve securities that have rights, preferences, or privileges that are senior to our common stock.

WE WILL FACE A VARIETY OF RISKS ASSOCIATED WITH ESTABLISHING AND INTEGRATING NEW JOINT VENTURES. The growth and success of our company's business will depend to a great extent on our ability to find and attract appropriate restaurant concepts with which to form joint ventures in the future. We cannot provide assurance that we will be able to

- \* identify suitable restaurant concepts,
- \* form joint ventures on commercially acceptable terms,
- \* effectively integrate the operations of any joint ventures with our existing operations,
- \* manage effectively the combined operations of the businesses,
- \* achieve our operating and growth strategies with respect to the new joint ventures, or
- \* reduce our overall selling, general, and administrative expenses associated with the new joint ventures.

The integration of the management, personnel, operations, products, services, technologies, and facilities of any businesses that we associate ourselves with in the future could involve unforeseen difficulties. These difficulties could

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disrupt our ongoing businesses, distract our management and employees, and increase our expenses, which could have a material adverse affect on our company's business, financial condition, and operating results.

WE DEPEND ON OUR CURRENT MANAGEMENT TEAM. Our company's success will depend to a large degree upon the skills of our current management team and advisors and upon our ability to identify, hire, and retain additional senior management, sales, marketing, technical, and financial personnel. We may not be able to retain our existing key personnel or to attract and retain additional key personnel. The loss of any of our current executives, employees, or advisors or the failure to attract, integrate, motivate, and retain additional key employees could have a material adverse effect on our company's business. We do not have "key person" insurance on the lives of any of our management team.

OUR COMPANY MAY NOT BE ABLE TO MANAGE ITS GROWTH. We anticipate a period of significant growth. This growth could cause significant strain on our company's managerial, operational, financial, and other resources. Success in managing this expansion and growth will depend, in part, upon the ability of our senior management to manage effectively the growth of our company. Any failure to manage the proposed growth and expansion of our company could have a material adverse effect on our company's business.

THERE IS NO ASSURANCE THAT OUR FUTURE PRODUCTS AND SERVICES WILL BE ACCEPTED IN THE MARKETPLACE. Our products and services may not experience broad market acceptance. Any market acceptance for our company's products and services may not develop in a timely manner or may not be sustainable. New or increased competition may result in market saturation, more competitive pricing, or lower margins. Further, overall performance and user satisfaction may be affected by a variety of factors, many of which will be beyond our company's control. Our company's business, operating results, and financial condition would be materially and adversely affected if the market for our products and services fails to develop or grow, develops or grows more slowly than anticipated, or becomes more competitive or if our products and services are not accepted by targeted customers even if a substantial market develops.

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WE MAY FACE STIFF COMPETITION. There are existing companies that offer or have the ability to develop products and services that will compete with those that our company may offer in the future. These include large, well-recognized companies with substantial resources and established relationships in their respective industries. Their greater financial, technical, marketing, and sales resources may permit them to react more quickly to emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion, and sale of competing products and services. Emerging companies also may develop and offer products and services that compete with those offered by our company.

WE OPERATE IN A HIGHLY REGULATED ENVIRONMENT. A business development company is defined and regulated by the 1940 Act. A business development company must be organized in the United States for the purpose of investing in or lending to primarily private companies and making managerial assistance available to them. A business development company may use capital provided by public shareholders and from other sources to invest in long-term, private investments in businesses. A business development company provides shareholders the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits, if any, of investing in primarily privately owned companies.

As a business development company, we may not acquire any asset other than "qualifying assets" unless, at the time we make the acquisition, the value of our qualifying assets represent at least 70% of the value of our total assets. An eligible portfolio company is generally a domestic company that is not an investment company (other than a small business investment company wholly owned by a business development company) and that:

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- \* does not have a class of securities registered on an exchange or a class of securities with respect to which a broker may extend margin credit;
- \* is actively controlled by the business development company and has an affiliate of a business development company on its board of directors; or
- \* meets such other criteria as may be established by the SEC.

Control under the 1940 act is presumed to exist where a business development company beneficially owns more than 25% of the outstanding voting securities of the portfolio company.

To include certain securities described above as qualifying assets for the purpose of the 70% test, a business development company must make available to the issuer of those securities significant managerial assistance such as providing significant guidance and counsel concerning management, operations, or business objectives and policies of a portfolio company or making loans to a portfolio company. We offer to provide managerial assistance to each of our portfolio companies.

### ITEM 3. CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed with an objective of ensuring that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission, such as this Quarterly Report on Form 10-QSB, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls are also designed with an objective of ensuring that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, in order to allow timely consideration regarding required disclosures.



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The evaluation of our disclosure controls by our principal executive officer and principal financial officer included a review of the controls' objectives and design, the operation of the controls, and the effect of the controls on the information presented in this Quarterly Report. Our management, including our chief executive officer and chief financial officer, does not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, projections of any evaluation of the disclosure controls and procedures to future periods are subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on their review and evaluation as of the end of the period covered by this Form 10-QSB, and subject to the inherent limitations all as described above, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective as of the end of the period covered by this report. They are not aware of any significant changes in our disclosure controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. During the period covered by this Form 10-QSB, there have not been any changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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### PART II -- OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

The Company is not presently a party to any legal action.

#### ITEM 2. CHANGES IN SECURITIES

In September 2004, the Company issued 4,220,000 shares of its common stock to consultants as compensation for services. These shares were valued at \$.05 per share.

The foregoing-described issuances of securities were exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 4(2) of that act as a transaction not involving a public offering. This exemption was available in connection with the issuances because (i) the shares were issued only to persons or parties who the Company believed were "accredited investors" within the meaning of Regulation D under that act; (ii) no form of general solicitation or general advertising was used in connection with the transactions; and (iii) the persons or parties receiving the securities had access to complete information concerning our company, acquired the securities for investment and not with a view to the distribution thereof, and otherwise were not underwriters within the meaning of Section 2(11) of the Securities Act. There were no underwriters involved in these transactions.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

#### ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

