SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

DIEDRICH COFFEE INC

CIK:**947661**| IRS No.: **330086628** | State of Incorp.:**CA** | Fiscal Year End: **0627**
Type: **10-Q** | Act: **34** | File No.: **000-21203** | Film No.: **09545793**
SIC: **5400** Food stores

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Table of Contents

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

FORM 10-Q

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

For the quarterly period ended December 10, 2008

OR

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

For the transition period from ______ to ______

Commission File Number 0-21203

DIEDRICH COFFEE, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0086628**
(State or Other Jurisdiction of Incorporation or Organization)	**(IRS Employer Identification No.)**

28 Executive Park
Irvine, California 92614
(Address of Principal Executive Offices, Zip Code)

(949) 260-1600
(Registrant' s Telephone Number, including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large Accelerated Filer ☐

Accelerated Filer ☐

Non-Accelerated Filer ☐

Smaller Reporting Company ☒

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of January 12, 2009, there were 5,468,316 shares of common stock of the registrant outstanding.

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TABLE OF CONTENTS

	Page Number
PART I–FINANCIAL INFORMATION	1
Item 1. Financial Statements	1
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)	1
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)	2
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)	3
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)	4
Item 2. Management' s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative And Qualitative Disclosures About Market Risk	24
Item 4. Controls and Procedures	24
PART II–OTHER INFORMATION	25
Item 1. Legal Proceedings	25
Item 1A. Risk Factors	25
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	25

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Please Consider the Environment Before Printing This Document

Item 3. Defaults upon Senior Securities 25

Item 4. Submission of Matters to a Vote of Security Holders 25

Item 5. Other Information 25

Item 6. Exhibits 25

SIGNATURES 27

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Please Consider the Environment Before Printing This Document

[Table of Contents](#)

PART I–FINANCIAL INFORMATION

Item 1. Financial Statements

DIEDRICH COFFEE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 10, 2008 (Unaudited)	June 25, 2008
Assets		
Current assets:		
Cash	$ 1,610,000	$670,000
Restricted cash and short term investments	623,000	623,000
Accounts receivable, less allowance for doubtful accounts of $459,000 at December 10, 2008 and $508,000 at June 25, 2008	4,449,000	5,015,000
Inventories	5,603,000	4,652,000
Current portion of notes receivable, less allowance of $143,000 at December 10, 2008 and $247,000 at June 25, 2008	1,037,000	1,074,000
Advertising fund assets, restricted	4,000	6,000
Prepaid expenses	575,000	412,000
Total current assets	13,901,000	12,452,000
Property and equipment, net	7,033,000	7,327,000
Notes receivable, less allowance of $0 at December 10, 2008 and June 25, 2008, respectively	2,196,000	2,663,000
Cash surrender value of life insurance policy	113,000	162,000

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Other assets	720,000	132,000
Total assets	$23,963,000	$22,736,000

Liabilities and Stockholders' Equity

Current liabilities:		
Liabilities of discontinued operations	$41,000	$89,000
Current portion of note payable, net of discount	2,619,000	1,741,000
Accounts payable	6,382,000	5,169,000
Accrued compensation	1,357,000	1,412,000
Accrued expenses	1,944,000	2,232,000
Franchisee deposits	506,000	587,000
Deferred franchise fee income	48,000	34,000
Advertising fund liabilities	78,000	204,000
Accrued provision for store closure	787,000	849,000
Deferred compensation	136,000	–
Total current liabilities	13,898,000	12,317,000
Note payable, net of discount and net of current portion	1,437,000	–
Income tax liabilities	270,000	261,000

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Deferred rent	182,000	190,000
Deferred compensation	–	226,000
Total liabilities	15,787,000	12,994,000
Commitments and contingencies (Notes 10, 11 and 12)		
Stockholders' equity:		
Common stock, $.01 par value; authorized 8,750,000 shares; issued and outstanding 5,468,000 shares at December 10, 2008 and June 25, 2008	55,000	55,000
Additional paid-in capital	61,493,000	60,281,000
Accumulated deficit	(53,372,000)	(50,594,000)
Total stockholders' equity	8,176,000	9,742,000
Total liabilities and stockholders' equity	$23,963,000	$22,736,000

See accompanying notes to condensed consolidated financial statements.

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Table of Contents

DIEDRICH COFFEE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Twelve Weeks Ended December 10, 2008	Twelve Weeks Ended December 12, 2007	Twenty-Four Weeks Ended December 10, 2008	Twenty-Four Weeks Ended December 12, 2007
Net revenue:				
Wholesale and other	$ 13,665,000	$ 10,370,000	$ 23,977,000	$ 16,834,000
Franchise revenue	564,000	803,000	1,069,000	1,432,000
Retail sales	1,373,000	1,275,000	2,288,000	2,342,000
Total net revenue	15,602,000	12,448,000	27,334,000	20,608,000
Costs and expenses:				
Cost of sales and related occupancy costs (exclusive of depreciation shown separately below)	12,430,000	9,362,000	21,635,000	15,334,000
Operating expenses	1,979,000	2,346,000	3,833,000	4,578,000
Depreciation and amortization	407,000	280,000	744,000	532,000
General and administrative expenses	1,590,000	1,694,000	3,472,000	3,149,000
Gain on asset disposals	(4,000)	(6,000)	(10,000)	(7,000)
Total costs and expenses	16,402,000	13,676,000	29,674,000	23,586,000
Operating loss from continuing operations	(800,000)	(1,228,000)	(2,340,000)	(2,978,000)

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Interest expense	(256,000)	(12,000)	(566,000)	(23,000)
Interest and other income, net	65,000	81,000	132,000	265,000
Loss from continuing operations before income tax benefit	(991,000)	(1,159,000)	(2,774,000)	(2,736,000)
Income tax provision (benefit)	4,000	–	4,000	(540,000)
Loss from continuing operations	(995,000)	(1,159,000)	(2,778,000)	(2,196,000)
Discontinued operations:				
Gain on sale of discontinued operations, net of tax expense of $507,000	–	–	–	767,000
Net loss	$ (995,000)	$ (1,159,000)	$ (2,778,000)	$ (1,429,000)
Basic and diluted net income (loss) per share:				
Loss from continuing operations	$ (0.18)	$ (0.21)	$ (0.51)	$ (0.40)
Income from discontinued operations, net	$ –	$ –	$ –	$ 0.14
Net loss	$ (0.18)	$ (0.21)	$ (0.51)	$ (0.26)
Weighted average and equivalent shares outstanding:				
Basic and diluted	5,468,000	5,448,000	5,468,000	5,448,000

See accompanying notes to condensed consolidated financial statements.

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[Table of Contents](#)

DIEDRICH COFFEE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Twenty-four Weeks Ended December 10, 2008	Twenty-four Weeks Ended December 12, 2007
Cash flows from operating activities:		
Net loss	$ (2,778,000)	$ (1,429,000)
Gain on sale of discontinued operations, net	–	(767,000)
Loss from continuing operations:	(2,778,000)	(2,196,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	744,000	532,000
Amortization and write off of loan fees	3,000	–
Amortization of note payable discount	369,000	–
Provision for bad debt	382,000	229,000
Income tax provision (benefit)	4,000	(540,000)
Provision for inventory obsolescence	25,000	2,000
Provision for store closure	94,000	352,000
Stock compensation expense	158,000	106,000
Notes receivable issued	(93,000)	(138,000)

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Gain on disposal of assets	(10,000)	(8,000)
Changes in operating assets and liabilities:		
Accounts receivable	184,000	(2,760,000)
Inventories	(976,000)	114,000
Prepaid expenses	(163,000)	(318,000)
Notes Receivable	(47,000)	(67,000)
Other assets	(665,000)	46,000
Accounts payable	1,213,000	1,238,000
Accrued and deferred compensation	(144,000)	(183,000)
Accrued expenses	(284,000)	(509,000)
Deferred franchise fee income and franchise deposits	(67,000)	(7,000)
Accrued provision for store closure	(156,000)	(133,000)
Deferred rent	(8,000)	(15,000)
Net cash used in continuing operations	(2,215,000)	(4,255,000)
Net cash used in discontinued operations	(48,000)	(36,000)
Net cash used in operating activities	(2,263,000)	(4,291,000)
Cash flows from investing activities:		

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Capital expenditures for property and equipment	(451,000)	(2,490,000)
Proceeds from disposal of property and equipment	10,000	7,000
Payments received on notes receivable	644,000	544,000
Change in restricted cash and short term investments	–	46,000
Net cash provided by (used in) investing activities of continuing operations	203,000	(1,893,000)
Proceeds from sale of discontinued operations, net	–	1,274,000
Net cash provided by (used in) investing activities	203,000	(619,000)
Cash flows from financing activities:		
Borrowings under credit agreement	3,000,000	–
Net cash provided by financing activities	3,000,000	–
Net increase (decrease) in cash	940,000	(4,910,000)
Cash at beginning of year	670,000	6,873,000
Cash at end of period	$ 1,610,000	$ 1,963,000
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 190,000	$ 25,000
Income taxes	$ 11,000	$ –

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Non-cash transactions:		
Issuance of notes receivable	$ 93,000	$ 138,000

See accompanying notes to condensed consolidated financial statements.

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DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 10, 2008
(UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements of Diedrich Coffee, Inc. and its subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America, as well as the instructions to Form 10-Q and as a "smaller reporting company," the Company can choose to comply with Article 8 of Regulation S-X. In particular, Rule 8-03 of Article 8 of Regulation S-X governs interim financial statements. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company' s annual report on Form 10-K for the year ended June 25, 2008.

In the opinion of management, all adjustments (consisting of normal, recurring adjustments and accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results expected for a full year.

Discontinued Operations

During the year ended June 27, 2007, the Company sold leaseholds and related assets of 32 stores to Starbucks Corporation and seven stores to other third parties.

In accordance with Statement of Financial Accounting Standards ("SFAS") 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), the financial results of the retail operations that were sold or closed are reported as discontinued operations for all periods presented.

During the first quarter of fiscal year 2008, the Company recorded a gain on sale of discontinued operations of $1,274,000 before income taxes of $507,000 in connection with the Starbucks transaction.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 *"Fair Value Measurements"* ("SFAS No. 157"). This standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. However, on February 12, 2008, the FASB issued FASB Staff Position ("FSP") SFAS No. 157-2 ("FSP No. 157-2") which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP No. 157-2 partially defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP No. 157-2. In addition, FASB issued a staff position, FSP SFAS No. 157-1, to clarify that SFAS No. 157 does not apply under SFAS No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classifications under SFAS No. 13. The Company adopted SFAS No. 157 on June 26, 2008. Adoption of SFAS No. 157 did not have an impact on the Company' s financial position or results of operations. The Company is evaluating the impact of SFAS No. 157 for non-financial assets and liabilities.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 *"The Fair Value Option for Financial Assets and Financial Liabilities"* ("SFAS No. 159"). SFAS No. 159 permits companies to make a one-time election to carry eligible types of financial assets and liabilities at fair value, even if fair value measurement is not required under U.S. GAAP. The Company adopted the provisions of SFAS No. 159 on June 26, 2008 and did not elect the fair value option to measure certain financial instruments. However, the Company will continue to evaluate for the possible future election for new financial instruments.

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In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "*Business Combinations*" ("SFAS No. 141R"). SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements that will enable users to evaluate the nature and financial effects of the business combination. SFAS No. 141R is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 and interim periods within those fiscal years. The Company will determine the impact of adopting SFAS No. 141R on its consolidated financial statements should applicable transactions occur in the future.

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 "*Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51"* ("SFAS No. 160"). SFAS No. 160 applies to all entities that prepare consolidated financial statements but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 establishes accounting and reporting standards that require noncontrolling interests to be reported as a component of equity, changes in a parent' s ownership interest while the parent retains its controlling interest be accounted for as equity transactions and any retained noncontrolling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value. SFAS No. 160 is to be applied prospectively to business combinations consummated on or after the beginning of the first annual reporting period on or after December 15, 2008. Acquisitions, if any, after the effective date will be accounted for in accordance with SFAS No. 160.

Income Taxes

The Company accounts for income taxes under SFAS No. 109, "*Accounting for Income Taxes*" ("SFAS No. 109"). SFAS No. 109 requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company' s financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of the Company' s assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Upon adoption of FIN 48, *"Accounting for Uncertainty in Income Taxes - An interpretation of FASB Statement No. 109"* ("FIN 48"), the Company analyzed its filing positions for all open tax years in all U.S. federal and state jurisdictions where the Company is required to file. At the adoption date of June 28, 2007, the Company had $200,000 of unrecognized tax benefits. The Company recorded a cumulative effect adjustment related to the adoption of FIN 48 of $245,000 including interest and penalties, which was accounted for as an increase to the June 28, 2007 balance of accumulated deficit on the consolidated balance sheet. The $200,000 of unrecognized tax benefits, if ultimately recognized, would reduce the Company' s annual effective tax rate. There were no material changes in unrecognized tax benefits as of the quarter ended December 10, 2008.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. In general, the Company is no longer subject to U.S. federal tax examinations for tax years ended prior to 2004 and for state tax examinations for tax years ended prior to 2000. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company' s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. There was $61,000 of interest and penalties associated with uncertain tax positions as of June 25, 2008. As of December 10, 2008, there was no significant change in accrued interest and penalties related to unrecognized tax benefits.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 materially differ from those estimates.

Stock-Based Compensation

On October 20, 2000, the Company' s board of directors authorized the adoption of the Diedrich Coffee, Inc. 2000 Equity Incentive Plan (the "2000 Equity Incentive Plan") and the concurrent discontinuation of option grants under the Diedrich Coffee, Inc. Amended and Restated 1996 Stock Incentive Plan and the Diedrich Coffee, Inc. 1996 Non-Employee Directors Stock Option Plan. The Company' s stockholders

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approved the 2000 Equity Incentive Plan on October 16, 2000. A total of 1,087,500 shares of the Company' s common stock may be issued under the 2000 Equity Incentive Plan, as amended. The board of directors determines the number of shares, terms and exercise periods for awards under the 2000 Equity Incentive Plan on a case by case basis, except for automatic annual grants of options to non-employee directors. Options generally vest ratably over three years and expire ten years from the date of grant. The exercise price of options is generally equivalent to the fair market value of the Company' s common stock on the date of grant.

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

On June 30, 2005, the Company adopted the provisions of SFAS No. 123R, "*Share-Based Payment*" ("SFAS No. 123R"). SFAS No. 123R sets accounting requirements for "share-based" compensation to employees and non-employee directors, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation.

The Company chose the modified-prospective transition alternative in adopting SFAS No. 123R. Under the modified-prospective transition method, compensation cost is recognized in financial statements issued subsequent to the date of adoption for all stock-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. Because the Company previously adopted only the pro forma disclosure provisions of SFAS No. 123, "*Accounting for Stock-Based Compensation*" ("SFAS No. 123"), it will recognize compensation cost relating to the unvested portion of awards granted prior to the date of adoption using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosures under SFAS No. 123, except that forfeitures rate will be estimated for all options, as required by SFAS No. 123R.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the price of the Company' s stock. The Company uses historical data to estimate option exercise and employee termination rates within the valuation model. The expected term of options is derived from the output of the option valuation model and represents the period of time that options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair values of the options were estimated using the Black-Scholes option-pricing model based on the following assumptions:

	TWELVE WEEKS ENDED				TWENTY-FOUR WEEKS ENDED			
	December 10, 2008		December 12, 2007		December 10, 2008		December 12, 2007	
Risk free interest rate	1.91	%	4.00	%	1.91% - 3.11	%	4.00% - 4.91	%
Expected life	3 years		2 years		3 years		2 years	
Expected volatility	64	%	59	%	56% - 64	%	59% - 63	%
Expected dividend yield	0	%	0	%	0	%	0	%
Forfeiture rate	6.82	%	9.38	%	5.58% - 6.82	%	5.45% - 9.38	%

A summary of option activity under our stock option plans for the twenty-four weeks ended December 10, 2008 is as follows:

	Number of options	Weighted average exercise price ($)	Weighted average remaining	Aggregate intrinsic Value ($)

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			contractual term (years)	
Options outstanding at June 25, 2008	618,000	$ 3.80		
Plus options granted	40,000	2.32		
Less:				
Options canceled or expired	(50,000)	4.23		
Options outstanding at December 10, 2008	608,000	3.67	8.2	$ –
Options exercisable at December 10, 2008	213,000	$ 4.50	6.5	$ –

Stock-based compensation expense included in the statement of operations for the twelve weeks ended December 10, 2008 was approximately $83,000 and for the twenty-four weeks ended December 10, 2008 was approximately $157,000. Stock-based compensation expense included in the statement of operations for the twelve weeks ended December 12, 2007 was approximately $54,000 and for the twenty-four weeks ended December 12, 2007 was approximately $106,000. As of December 10, 2008, there was approximately $235,000 of total unrecognized stock-based compensation cost related to options granted under the Company' s plans that will be recognized over a weighted average period of 1.2 years. Approximately 27,000 options vested during the twenty-four weeks ended December 10, 2008.

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

Cash Surrender Value of Life Insurance

The change in the cash surrender value (“CSV”) of company owned life insurance (“COLI”) contracts, net of insurance premiums paid and gains realized, is reported in compensation and benefits expense. See Note 14.

2. LIQUIDITY AND MANAGEMENT PLANS

For the twenty-four weeks ended December 10, 2008, the Company incurred a net loss of $2.8 million and reported net cash used in operating activities of $2.3 million. The Company had a cash balance of $1.6 million with $5 million of outstanding borrowings under its credit facilities as of December 10, 2008.

A $5,000,000 Contingent Convertible Note Purchase Agreement with Sequoia Enterprises, L.P. (“Sequoia”), a limited partnership whose sole general partner also serves as the Chairman of the Company’ s board of directors (the “Note Purchase Agreement”), expires on March 31, 2009 and the $2 million balance on the outstanding note is due in full on that date. On October 8, 2008, November 10, 2008 and January 23, 2009, the Company obtained commitments from the lenders Sequoia and Vessel Partners, L.P., which are limited partnerships whose general partner also serves as the Chairman of the Company’ s board of directors (collectively, the “Lenders”) for additional borrowings of up to $5 million and to extend the maturity date of the $2 million note due under the Note Purchase Agreement from March 31, 2009 to March 31, 2010. The Company and the Lenders are currently in the process of finalizing the contractual details of this commitment. In addition, the Company obtained a $3 million term loan on August 26, 2008. See Note 11.

The Company believes that cash flow from operations, funds available from the credit agreements and additional lending commitments obtained from the Lenders will be sufficient to satisfy working capital needs at the anticipated operating levels for at least the next twelve months.

The Company’ s future capital requirements will depend on many factors, including the extent and timing of the rate at which the business grows, if at all, with corresponding demands for working capital. The Company may be required to seek additional funding through debt financing, equity financing or a combination of funding methods to meet capital requirements and sustain operations. However, additional funds may not be available on terms acceptable or at all.

3. ACCOUNTS RECEIVABLE

During the twenty-four weeks ended December 10, 2008, the Company provided for $357,000 of additional allowance for doubtful accounts and charged off $406,000 of accounts receivable against the reserve.

The following table details the components of net accounts receivable:

	December 10, 2008	June 25, 2008
Wholesale receivables	$ 4,363,000	$4,814,000
Allowance for wholesale receivables	(293,000)	(285,000)
	4,070,000	4,529,000
Franchise and other receivables	545,000	709,000

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Allowance for franchise and other receivables	(166,000)	(223,000)
	379,000	486,000
Total accounts receivable, net	$ 4,449,000	$5,015,000

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

4. INVENTORIES

Inventories consist of the following:

	December 10, 2008	June 25, 2008
Unroasted coffee	$ 620,000	$1,608,000
Roasted coffee	2,072,000	1,163,000
Accessory and specialty items	180,000	104,000
Other food, beverage and supplies	2,731,000	1,777,000
Total inventory	$ 5,603,000	$4,652,000

5. NOTES RECEIVABLE

Notes receivable consists of the following:

	December 10, 2008	June 25, 2008
Notes receivable bearing interest at rates from 0% to 8.0%, payable in monthly installments varying between $115 and $3,869 and due on various dates through August 2016. Notes are secured by the assets sold under the asset purchase and sale agreements or general security agreement. Amounts are net of allowance of $143,000 and $247,000, respectively	$ 46,000	$177,000
Notes receivable from a corporation discounted at an annual rate of 8.0%, payable annually in installments varying between $1,000,000 and $2,000,000, due between January 31, 2009 and January 31, 2011	3,187,000	3,560,000
Less: current portion of notes receivable	(1,037,000)	(1,074,000)
Long-term portion of notes receivable	$ 2,196,000	$2,663,000

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6. ACCRUED PROVISION FOR STORE CLOSURE

As required by SFAS No. 146, *"Accounting for Costs Associated with Exit or Disposal Activities"* ("SFAS No. 146"), the Company records estimated costs for store closures when they are incurred rather than at the date of a commitment to an exit or disposal plan. These costs primarily consist of the estimated cost to terminate real estate leases.

The following table details the components of accrued provision for store closure:

	Beginning Balance	Amounts Charged to Expense	Cash Payments	Ending Balance
Fiscal Year ended June 25, 2008	$811,000	$806,000	$(679,000)	$938,000
Twenty-four Weeks ended December 10, 2008	$938,000	$94,000	$(204,000)	$828,000

Of the $828,000 reserve balance for store closures at December 10, 2008, $787,000 and $41,000 are reserved for continuing operations and discontinued operations, respectively. For the twenty-four weeks ended December 10, 2008, $94,000 was charged to costs of sales and related occupancy costs. Of the $938,000 reserve balance for store closures at June 25, 2008, $849,000 and $89,000 are reserved for continuing operations and discontinued operations, respectively.

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

7. NOTE PAYABLE

	December 10, 2008	June 25, 2008
Note payable amount bearing interest at a rate of three-month LIBOR plus 9.30% (13.45% as of December 10, 2008) is due and payable on March 31, 2009. Note is unsecured.	$ 2,000,000	$2,000,000
Note payable amount bearing interest at a rate of one-month LIBOR plus 9.30% (11.21% as of December 10, 2008). Note is unsecured.	3,000,000	–
Discount on note payable	(944,000)	(259,000)
	$ 4,056,000	$1,741,000
Less: current portion of notes payable, net of discount	(2,619,000)	(1,741,000)
Long-term portion of notes payable, net of discount	$ 1,437,000	$–

8. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted net loss per share from continuing operations:

	Twelve Weeks Ended December 10, 2008	Twelve Weeks Ended December 12, 2007	Twenty-Four Weeks Ended December 10, 2008	Twenty-Four Weeks Ended December 12, 2007
Numerator:				
Net loss from continuing operations	$ (995,000)	$ (1,159,000)	$ (2,778,000)	$ (2,196,000)
Denominator:				
Basic weighted average shares outstanding	5,468,000	5,448,000	5,468,000	5,448,000
Effect of dilutive securities	–	–	–	–

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Diluted adjusted weighted average shares	5,468,000	5,448,000	5,468,000	5,448,000
Basic and diluted net loss per share from continuing operations	$ (0.18)	$ (0.21)	$ (0.51)	$ (0.40)

For the quarters ended December 10, 2008 and December 12, 2007, employee stock options of approximately 608,000, and 537,000, respectively, and warrants of 500,000 for each year, were excluded from the computation of diluted earnings per share as their impact would have been anti-dilutive. In addition, for the twenty-four weeks ended December 10, 2008, approximately 1,667,000 stock purchase warrants outstanding pursuant to the terms of the 2008 Sequoia Warrant (as discussed in Note 11), and for the twenty-four weeks ended December 12, 2007, 1,275,000 stock purchase warrants outstanding pursuant to terms of the Note Purchase Agreement (as discussed in Note 11) were excluded from the computation of diluted earnings per share as their impact would have been anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share:

	Twelve Weeks Ended December 10, 2008	Twelve Weeks Ended December 12, 2007	Twenty-Four Weeks Ended December 10, 2008	Twenty-Four Weeks Ended December 12, 2007
Numerator:				
Net loss	$ (995,000)	$ (1,159,000)	$ (2,778,000)	$ (1,429,000)
Denominator:				
Basic weighted average shares outstanding	5,468,000	5,448,000	5,468,000	5,448,000
Effect of dilutive securities	–	–	–	–
Diluted adjusted weighted average shares	5,468,000	5,448,000	5,468,000	5,448,000
Basic and diluted net loss per share	$ (0.18)	$ (0.21)	$ (0.51)	$ (0.26)

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Table of Contents

DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

9. SEGMENT AND RELATED INFORMATION

The Company has three reportable segments: wholesale operations, franchise operations and retail operations. The Company evaluates performance of its operating segments based on income before provision for asset impairment and restructuring costs, income taxes, interest expense, depreciation and amortization, and general and administrative expenses.

Summarized financial information concerning the Company' s reportable segments is shown in the following tables. Corporate identifiable assets consist of corporate cash, corporate notes receivable, corporate prepaid expenses, and corporate property and equipment. The corporate component of segment loss before tax includes corporate general and administrative expenses, depreciation and amortization expense, interest income and interest expense.

	TWELVE WEEKS ENDED		TWENTY-FOUR WEEKS ENDED	
	December 10, 2008	December 12, 2007	December 10, 2008	December 12, 2007
Net revenue:				
Wholesale	$ 13,665,000	$ 10,370,000	$ 23,977,000	$ 16,834,000
Franchise	564,000	803,000	1,069,000	1,432,000
Retail	1,373,000	1,275,000	2,288,000	2,342,000
Total net revenue	$ 15,602,000	$ 12,448,000	$ 27,334,000	$ 20,608,000
Interest expense:				
Wholesale	$ −	$ −	$ −	$ −
Franchise	−	−	−	−
Corporate	256,000	12,000	566,000	23,000
Total interest expense	$ 256,000	$ 12,000	$ 566,000	$ 23,000

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Depreciation and amortization:				
Wholesale	$ 333,000	$ 176,000	$ 594,000	$ 320,000
Retail	9,000	30,000	17,000	59,000
Corporate	65,000	74,000	133,000	153,000
Total depreciation and amortization	$ 407,000	$ 280,000	$ 744,000	$ 532,000
Segment income (loss) from continuing operations before income tax benefit:				
Wholesale	$ 900,000	$ 827,000	$ 1,627,000	$ 993,000
Franchise	(63,000)	(510,000)	(313,000)	(900,000)
Retail	79,000	216,000	69,000	229,000
Corporate	(1,907,000)	(1,692,000)	(4,157,000)	(3,058,000)
Total segment loss from continuing operations before income tax provision (benefit)	$ (991,000)	$ (1,159,000)	$ (2,774,000)	$ (2,736,000)

	December 10, 2008	**June 25, 2008**
Identifiable assets:		
Wholesale	$ 15,124,000	$15,008,000
Franchise	820,000	1,084,000
Retail	601,000	170,000
Corporate	7,418,000	6,474,000

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Total assets	$ 23,963,000	$22,736,000

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DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

10. LEASE CONTINGENCIES

In addition to the corporate office, warehouse and store leases, the Company is liable on the master real property leases for 37 franchise locations. Under the Company' s historical franchising business model, the Company executed the master lease for these locations and entered into subleases on the same terms with its franchisees, which typically pay their rent directly to the landlords. Should any of these franchisees default on their subleases, the Company would be responsible for making payments under the master lease. The Company' s maximum theoretical future exposure at December 10, 2008, computed as the sum of all remaining lease payments through the expiration dates of the respective leases, was $9,567,000. This amount does not take into consideration any mitigating measures that the Company could take to reduce this exposure in the event of default, including re-leasing the location or terminating the master lease by negotiating a lump sum payment to the landlord in an amount that is less than the sum of all remaining future rents and related payables. In addition, the Company also leases equipment with various expiration dates.

11. OUTSTANDING DEBT, FINANCING ARRANGEMENTS AND RESTRICTED CASH

Note Purchase Agreement:

On May 10, 2004, the Company entered into the Note Purchase Agreement with Sequoia, which provided, at the Company' s election, the ability to issue notes with up to an aggregate principal amount of $5,000,000. The Company has amended the Note Purchase Agreement from time to time and has agreed to refrain from further borrowings under the Note Purchase Agreement in connection with the entry into the Loan Agreement (as defined below) entered into on August 26, 2008. As amended, the notes issued under the Note Purchase Agreement are due in full on March 31, 2009, and the Company is only required to make monthly payments of interest and the monthly commitment fee, but not principal, until such date. On the maturity date, all outstanding principal, interest and other amounts payable under the Note Purchase Agreement will be due unless due earlier pursuant to the terms of the Note Purchase Agreement upon a change in control of the Company or an event of default. Interest is payable at three-month LIBOR plus 9.3% for any period during which the ratio of Indebtedness (as defined in the Note Purchase Agreement) of the Company on a consolidated basis to Effective Tangible Net Worth (as defined in the Note Purchase Agreement) is greater than 1.75:1.00 or the three-month LIBOR plus 6.30% for any other period, in each case reset on a periodic basis as provided in the Loan Agreement. The Note Purchase Agreement contains covenants, among others, that limit the amount of indebtedness that the Company may have outstanding in relation to its tangible net worth. As of December 10, 2008, the Company was in compliance with all covenants under the Note Purchase Agreement. As of December 10, 2008, $2,000,000 is outstanding under the Note Purchase Agreement.

Loan Agreement:

On August 26, 2008, the Company entered into a loan agreement with Sequoia (the "Loan Agreement"). The Loan Agreement provides for a $3 million term loan (the "Term Loan") to the Company. The Term Loan accrues interest from the funding date at one-month LIBOR plus 5.30%, resetting on the first calendar day of each month. On November 10, 2008, the Company entered into a Waiver Agreement (as defined below). In consideration of such waiver, the interest rates under the Loan Agreement were increased to one-month LIBOR plus 9.30% for any period during which the ratio of Indebtedness (as defined in the Loan Agreement) of the Company on a consolidated basis to Effective Tangible Net Worth (as defined in the Loan Agreement) is greater than 1.75:1.00 or one-month LIBOR plus 6.30% for any other period, in each case reset on a periodic basis as provided in the Loan Agreement. The Company is required to make regular monthly payments of interest, and to cause the principal amount to be reduced to $2 million no later than August 26, 2009. All outstanding principal and interest will be due on the maturity date of August 26, 2011, unless due earlier pursuant to the terms of the Loan Agreement upon a change of control of the Company or an event of default. As of December 10, 2008, $3,000,000 is outstanding under the Loan Agreement.

The Loan Agreement requires the Company to refrain from further borrowings under the Note Purchase Agreement and contains restrictions on incurring indebtedness on par with, or senior to, the Term Loan. The Loan Agreement also contains a covenant that limits the

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amount of indebtedness that the Company may have outstanding in relation to tangible net worth, in addition to other standard covenants and events of default. As of December 10, 2008, the Company was in compliance with all covenants under the Loan Agreement.

The Term Loan is senior to all other indebtedness of the Company, except indebtedness pursuant to notes issued under the Note Purchase Agreement and certain permitted indebtedness identified in the Loan Agreement. Upon repayment of the notes under the Note Purchase Agreement, the Term Loan will be senior to all other indebtedness of the Company, except such permitted indebtedness.

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DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

Warrants:

In connection with the Loan Agreement and an amendment to the Note Purchase Agreement, on August 26, 2008, the Company issued to Sequoia a warrant (the "2008 Sequoia Warrant") to purchase 1,667,000 shares of common stock of the Company. On November 10, 2008 the exercise price of the 2008 Sequoia Warrant was decreased from $2.00 to $1.65 in connection with the Waiver Agreement (as defined below).

In addition, the exercise price of the 2001 Sequoia Warrants for 250,000 shares of common stock was reduced from $2.00 to $1.65 per share.

Waiver Agreement:

On November 10, 2008, the Company entered into a Waiver, Agreement, Amendment No. 1 to 2008 Warrant and Amendment No. 2 to 2001 Warrant (the "Waiver Agreement") with Sequoia. Pursuant to the Waiver Agreement, Sequoia waived the requirement set forth in the Note Purchase Agreement and the Loan Agreement with Sequoia (collectively, the "Loan Agreements") that the Company shall not permit, as of the end of any fiscal quarter, the ratio of Indebtedness of the Company on a consolidated basis to Effective Tangible Net Worth to be more than 1.75:1.00 (as such terms are defined in the Loan Agreements). Such waiver is effective until the earlier of (a) October 31, 2009 and (b) the end of any fiscal quarter at which the foregoing ratio is greater than 2.10:1.00.

In consideration of such waiver, (a) the exercise prices of the warrant to purchase 250,000 shares of the Company' s common stock issued to Sequoia on May 8, 2001 and the warrant to purchase 1,667,000 shares of the Company' s common stock issued to Sequoia on August 26, 2008 were decreased from $2.00 to $1.65, and (b) the *per annum* interest rates under the Loan Agreements were increased from the LIBOR Rate (as defined in the Loan Agreements) plus 5.30% to (i) the LIBOR Rate plus 9.30% for any period during which the ratio of Indebtedness of the Company on a consolidated basis to Effective Tangible Net Worth is greater than 1.75:1.00 or (ii) the LIBOR Rate plus 6.30% for any other period, in each case reset on a periodic basis as provided in the Loan Agreements.

Loan Commitment

On October 8, 2008, November 10, 2008 and January 23, 2009, the Company obtained commitments from the Lenders for additional borrowings of up to $5 million and to extend the maturity date of $2 million due under the Note Purchase Agreement from March 31, 2009 to March 31, 2010. The Company and the Lenders are currently in the process of finalizing the contractual details of this commitment.

Letter of Credit:

In addition, we entered into a Credit Agreement with Bank of the West on November 4, 2005. The agreement provides for a $750,000 letter of credit facility that expires on October 15, 2009. The letter of credit facility is secured by a deposit account at Bank of the West. As of December 10, 2008, this deposit account had a balance of $623,000, which is shown as restricted cash on the consolidated balance sheets. As of December 10, 2008, $472,000 of letters of credit were outstanding under the letter of credit facility. The agreement contains covenants that, among other matters, require us to submit financial statements to Bank of the West within specified time periods. As of December 10, 2008, the Company was in compliance with all Bank of the West agreement covenants.

12. LEGAL SETTLEMENT ACCRUAL

On September 21, 2006, a purported class action complaint entitled *Jason Reid; Kimberly Cornia, et al. v. Diedrich Coffee., et al.* was filed against the Company in United States District Court Central District of California by two former employees, who worked in the positions of team member and shift manager. A second similar purported class action complaint entitled *Deborah Willems, et al. v. Diedrich Coffee., et al.* was filed in Orange County, California Superior Court on February 2, 2007, on behalf of another former employee who worked in the

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position of general manager. These cases currently involve the issue of whether employees and former employees who worked in California stores during specified time periods were deprived of overtime pay, missed meal and rest breaks. In addition to unpaid overtime, these cases seek to recover waiting time penalties, interest, attorneys' fees and other types of relief on behalf of the current and former employees in the purported class.

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DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

The Company has entered into a settlement with the plaintiffs in the *Reid v. Diedrich* lawsuit. This settlement has been given preliminary approval by the court. A final approval hearing is set for April 27, 2009. As of December 10, 2008, the Company estimates the total amount to settle this claim to be $693,000 and has recorded an accrual for this amount.

Subject to court approval, the Company has entered into a tentative settlement with the plaintiffs in the *Willems v. Diedrich* lawsuit. As of December 10, 2008, the Company estimates the total amount to settle this claim to be $251,000 and has recorded an accrual for this amount.

Based on the Company' s examination of these matters and its experience to date, the Company has recorded its best estimate of liability with respect to these matters. However, the ultimate liability cannot be determined with certainty.

13. DISCONTINUED OPERATIONS

The Company' s strategic direction is to focus on growing the wholesale business segment and the related distribution channels, including franchise stores. During the fiscal year ended June 27, 2007, the Company sold leaseholds and related assets of 32 stores to Starbucks Corporation and seven stores to other third parties.

As part of the asset purchase agreement with Starbucks Corporation, the Company agreed to a non-compete provision that for three years after the closing of the transaction, restricts the Company' s ability to operate or have any interest in the ownership or operation of any entity operating any retail specialty coffee stores in any city where a Company Store was located at the time that the asset purchase agreement was executed. The non-compete provision applies only to stores opened after the date of the asset purchase agreement and does not apply to (1) any retail stores operated under the "Gloria Jean' s" brand name, (2) wholesale sales to retail businesses that are not operated by the Company, or other non-retail businesses, or (3) the conversion of company-operated stores existing on the date of the asset purchase agreement to franchise stores. The Company has also agreed that it will not solicit any Starbucks Corporation employee to enter the Company' s employment for three years after the closing of the transaction.

In accordance with SFAS No. 144, the financial results of the retail operations that were sold or closed are reported as discontinued operations for all periods presented. During the first quarter of fiscal year 2008, the Company received proceeds from escrow of $1,274,000 as part of the transaction with Starbucks in fiscal 2007. For the twenty-four weeks ended December 12, 2007, gain on sale of discontinued operations was $767,000, net of $507,000 in taxes.

The financial results included in discontinued operations were as follows:

	TWENTY-FOUR WEEKS ENDED December 12, 2007
Net revenue	$ −
Gain on sale of discontinued operations, net of tax expense of $507,000	767,000
Income from discontinued operations, net	$ 767,000

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14. EMPLOYEE BENEFITS

401(k) Plan

The Company maintains a 401(k) Salary Deferral Plan (the "401(k) Plan") for eligible employees. Employer matching contributions relating to the 401(k) Plan totaled $9,000 and $11,000 for the twelve weeks ended December 10, 2008 and December 12, 2007, respectively. Employer matching contributions totaled $17,000 and $21,000 for the twenty-four weeks ended December 10, 2008 and December 12, 2007, respectively.

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DIEDRICH COFFEE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS−(Continued)
DECEMBER 10, 2008
(UNAUDITED)

Deferred Compensation Plan

Effective December 15, 2005, the Company amended its non-qualified deferred compensation plan. Under the amended plan, plan participants may elect to defer, on a pre-tax basis, a portion (from 0% to 100%) of their base salary, service bonus, and performance-based compensation. Any amounts deferred by a plan participant will be credited to the plan participant' s deferred compensation account. The plan further provides that the Company may make discretionary contributions to a plan participant' s deferred compensation account. Each plan participant will be vested in the amounts held in the plan participant' s deferred compensation account as follows: (i) one hundred percent (100%) vested at all times with respect to all amounts of deferred compensation; and (ii) one hundred percent (100%) vested at all times with respect to all employer discretionary contributions. The Company made no discretionary contributions to plan participants' accounts for the twenty-four weeks ended December 10, 2008 and December 12, 2007.

The plan also provides that any amounts deferred under the plan may not be distributed to a plan participant until the earlier of: (i) the plan participant' s separation from service with the Company; (ii) the Plan participant' s retirement from the Company; (iii) the plan participant' s disability; (iv) the plan participant' s death; (v) the occurrence of a change in control of the Company; (vi) the occurrence of an unforeseeable emergency, as defined in the plan; or (vii) such other date as set forth in the plan participant' s deferral election, including a date that occurs prior to the plan participant' s separation from service with the Company. Any amounts distributed to a plan participant will be paid in a form specified by the plan participant, or in the form of either a lump sum payment in an amount equal to the plan participant' s deferred compensation account balance or equal annual installments of the plan participant' s deferred compensation account balance over a period not to exceed (i) 20 years in the case of a distribution due to separation from service, death or disability or (ii) five years in the case of a distribution for educational expenses.

The Company has purchased a COLI contract insuring two of the participants in the deferred compensation plan. The policy is held in a trust to provide additional benefit security for the deferred compensation plan. The assets in the trust are owned by the Company and are subject to claims of its creditors. The gross cash surrender value of these contracts as of December 10, 2008 was $113,000 as shown in the accompanying condensed consolidated balance sheets. Total life insurance policy death benefits payable was $14,558,000 at December 10, 2008. The Company has since terminated the deferred compensation plan effective December 31, 2008 and provided 60-day notice of the termination of the trust agreement effective February 28, 2009.

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Table of Contents

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

A WARNING ABOUT FORWARD LOOKING STATEMENTS

We make forward-looking statements in this quarterly report on Form 10-Q that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our financial condition, operations, plans, objectives and performance. Additionally, when we use the words "believe," "expect," "anticipate," "estimate" or similar expressions, we are making forward-looking statements. Many possible events or factors could affect our future financial results and performance. This could cause our results or performance to differ materially from those expressed in our forward-looking statements. You should consider these risks when you review this quarterly report on Form 10-Q, along with the following possible events or factors:

- the financial and operating performance of our wholesale operations;
- our ability to achieve and/or maintain profitability over time;
- the successful execution of our growth strategies;
- our franchisees' adherence to our practices, policies and procedures;
- the impact of competition; and
- the availability of working capital.

Additional risks and uncertainties are described elsewhere in this report and in detail under the caption "Risk Factors Relating to Diedrich Coffee and Its Business" in our annual report on Form 10-K for the fiscal year ended June 25, 2008 and in other reports that we file with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements, which reflect management' s analysis only as of the date of this quarterly report on Form 10-Q. Except where required by law, we do not undertake an obligation to revise or update any forward-looking statements, whether as a result of new information, future events or changed circumstances. Unless otherwise indicated, "we," "us," and "our," and similar terms refer to Diedrich Coffee, Inc., a Delaware corporation, and its predecessors and subsidiaries.

INTRODUCTION

Management' s discussion and analysis of financial condition and results of operations is provided as a supplement to the accompanying unaudited condensed consolidated financial statements and footnotes to help provide an understanding of our financial condition, the changes in our financial condition and our results of operations. Our discussion is organized as follows:

Overview. This section provides a general description of our business, as well as recent significant transactions or events that we believe are important in understanding the results of operations, as well as to anticipate future trends in those operations.

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Results of operations. This section provides an analysis of our results of operations presented in the accompanying unaudited condensed consolidated statements of operations by comparing the results for the twelve and twenty-four weeks ended December 10, 2008 to the results for the twelve and twenty-four weeks ended December 12, 2007, respectively.

Financial condition, liquidity and capital resources. This section provides an analysis of our cash flows and a discussion of our outstanding debt and commitments, both firm and contingent, that existed as of December 10, 2008. Included in the discussion of outstanding debt is a discussion of our financial capacity to fund our future commitments and a discussion of other financing arrangements.

Critical accounting estimates. This section contains a discussion of the accounting policies that we believe are important to our financial condition and results and that require significant judgment and estimates on the part of management in their application. In addition, all of our significant accounting policies are summarized in Note 1 to the accompanying unaudited condensed consolidated financial statements.

OVERVIEW

Business

We are a specialty coffee roaster, wholesaler and retailer. Our brands include Diedrich Coffee, Gloria Jean' s, and Coffee People. The majority of our revenue is generated from wholesale customers located across the United States. Our wholesale operation sells a

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wide variety of whole bean and ground coffee as well as in single-serve coffee products through a network of office coffee service ("OCS") distributors, chain and independent restaurants, coffeehouses, other hospitality operators and specialty retailers. We operate a large coffee roasting facility in Castroville, California that supplies freshly roasted coffee to all of our wholesale and retail customers.

We also sell brewed, espresso-based and various blended beverages primarily made from our own fresh roasted premium coffee beans, as well as light food items, whole bean coffee and accessories, through our company-operated and franchised retail locations. The critical components for each of our retail locations include high quality, fresh roasted coffee and superior customer service by knowledgeable employees. As of December 10, 2008, we owned and operated 10 retail locations and franchised 104 other retail locations under the brands described above, for a total of 114 retail coffee outlets. Although the retail specialty coffee industry is presently dominated by a single company, which operates over nine thousand domestic and international retail locations, we are one of the nation' s largest specialty coffee retailers with annual system-wide revenues in excess of $48 million. System-wide revenues include sales from company-operated and franchise locations. Our retail units are located in 25 states.

Recent Developments

On December 19, 2008, James W. Stryker was appointed to our board of directors. Mr. Stryker serves as chair of the audit committee of the board of directors, which is currently composed of Timothy J. Ryan, Gregory D. Palmer and James W. Stryker. As a result, the Company is in compliance with NASDAQ Marketplace Rule 4350(d)(2)(A), which requires a Nasdaq-listed registrant' s audit committee to consist of at least three independent directors.

NASDAQ Listing

In connection with our listing on the NASDAQ Global Market, on October 10, 2008, we received a staff deficiency letter from the NASDAQ Stock Market with respect to our non-compliance with the minimum stockholders' equity requirement of $10 million as set forth in NASDAQ Marketplace Rule 4450(a)(3). On October 20, 2008, we received a second staff deficiency letter from NASDAQ indicating that for the then last thirty consecutive trading days, our common stock had not maintained a minimum market value of publicly held shares ("MVPHS") of $5 million, and that as a result, we did not comply with the MVPHS requirement for continued listing on the NASDAQ Global Market as set forth in NASDAQ Marketplace Rule 4450(a)(2).

On October 30, 2008, we announced the submission of a transfer application to the NASDAQ Stock Market to transfer the listing of our common stock from the NASDAQ Global Market to the NASDAQ Capital Market. The transfer to the NASDAQ Capital Market, where the Company' s common stock continues to trade under the symbol "DDRX," was approved effective as of November 7, 2008.

Retail Outlets

A table summarizing the relative sizes of each of our brands, on a unit count basis, and changes in unit count for each brand for fiscal 2008 and fiscal 2009 through the twenty-four weeks ended December 10, 2008, is set forth below:

	Units at June 27, 2007	Opened	Closed/ Sold	Units at June 25, 2008	Opened	Closed	Net transfers between the Company and Franchise (A)	Units at December 10, 2008
Gloria Jean' s Brand								
Company-Operated	6	–	(2)	4	–	–	6	10
Franchise-Domestic	136	2	(27)	111	1	(9)	(6)	97

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Subtotal Gloria Jean' s	142	2	(29)	115	1	(9)	–	107
Diedrich Coffee Brand								
Company-Operated	3	–	(2)	1	–	(1)	–	–
Franchise – Domestic	4	–	(1)	3	–	–	–	3
Subtotal Diedrich	7	–	(3)	4	–	(1)	–	3
Coffee People Brand								
Company-Operated	–	–	–	–	–	–	–	–
Franchise – Domestic	4	–	–	4	–	–	–	4
Subtotal Coffee People	4	–	–	4	–	–	–	4
Total	153	2	(32)	123	1	(10)	–	114

(A) Six franchise Gloria Jean' s coffeehouses were transferred to company-operated coffeehouses during fiscal year 2009.

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Seasonality and Quarterly Results

Our business experiences some variations in sales from quarter to quarter due to the holiday season and other factors including, but not limited to, general economic trends, competition, marketing programs and the weather. The fall and winter months are generally the best sales months but our geographic and product line diversity provide for some sales stability in the warmer months when coffee consumption ordinarily decreases. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

RESULTS OF OPERATIONS

Twelve weeks ended December 10, 2008 compared with the twelve weeks ended December 12, 2007

Total Revenue. Total revenue for the twelve weeks ended December 10, 2008 increased by $3,154,000, or 25.3%, to $15,602,000 from $12,448,000 for the twelve weeks ended December 12, 2007. This result was the net effect of a 31.8% increase in wholesale revenue and an increase of 7.7% in retail sales offset by a decrease of 29.8% in domestic franchise revenue. Each component of total revenue is discussed below.

Wholesale Revenue. Our wholesale sales for the twelve weeks ended December 10, 2008 increased by $3,295,000, or 31.8%, to $13,665,000 from $10,370,000 for the twelve weeks ended December 12, 2007. Wholesale sales to OCS and food service customers for the twelve weeks ended December 10, 2008 increased by $3,622,000, or 41.4%, to $12,360,000 from $8,738,000 for the twelve weeks ended December 12, 2007 led by a 48.6%, or $3,793,000, net increase in Keurig “K-cup” sales. The Company generated 74.3% and 62.6% of its total revenues from the sale of K-cups for the quarter ended December 10, 2008 and December 12, 2007, respectively. Our manufacturing and distribution of K-cups is licensed from a single licensor. Sales to our licensor represented approximately 33.1% and 24.0% of wholesale sales for the quarter ended December 10, 2008 and December 12, 2007, respectively. Sales of roasted coffee to our franchisees decreased $327,000, or 20.1%, for the twelve weeks ended December 10, 2008 as compared to the twelve weeks ended December 12, 2007.

Franchise Revenue. Our franchise revenue consists of initial franchise fees, franchise renewal fees, area development fees, and royalties received on sales at franchised locations. Franchise revenue decreased by $239,000, or 29.8%, to $564,000 for the twelve weeks ended December 10, 2008 from $803,000 for the twelve weeks ended December 12, 2007. Of the decrease in domestic franchise revenue, $226,000 of the decrease resulted from a decrease in royalty income and was due to a net decrease in same stores sales of 4.3% for the Gloria Jean’ s brand in the current quarter compared to the prior year same quarter along with a decrease of 39 Gloria Jean’ s franchise units since the beginning of fiscal 2008. In addition, franchise store opening and renewal fees decreased $13,000 in the current quarter compared to the prior year same quarter.

Retail Sales. Retail sales for the twelve weeks ended December 10, 2008 increased by $98,000, or 7.7%, to $1,373,000 from $1,275,000 for the prior year period. This increase in retail sales was primarily due to a net increase of four Gloria Jean’ s company-operated stores since the beginning of fiscal 2008 and was partially offset by a decrease in same store sales of 11.0% compared to the same quarter of the prior year. Sales from our internet website decreased $21,000, or 4.7%, to $436,000 for the twelve weeks ended December 10, 2008 from $457,000 for the twelve weeks ended December 12, 2007.

Cost of Sales and Related Occupancy Costs. Cost of sales and related occupancy costs for the twelve weeks ended December 10, 2008 increased $3,068,000, or 32.8%, to $12,430,000 from $9,362,000 in the prior year quarter. As a percentage of total revenue, cost of sales and related occupancy increased from 75.2% for the twelve weeks ended December 12, 2007 to 79.7% in the current fiscal quarter. Because none of these costs relate to franchise revenue, the most relevant benchmark of these costs is their relationship to total retail and wholesale sales. Using that measure, cost of sales and related occupancy costs increased as a percentage of total retail and wholesale sales from 80.4% for the twelve weeks ended December 12, 2007 to 82.7% for the twelve weeks ended December 10, 2008. Retail cost of sales increased from 36.3% to 40.2% in the current fiscal quarter whereas wholesale cost of sales increased from 81.9% to 85.0% of wholesale sales in the current fiscal quarter due to a higher percentage of higher cost Keurig business over the prior year period. Wholesale sales, which carry a higher cost of goods sold than retail sales, also slightly increased as a percentage of the retail and wholesale sales mix from 89.1% to 90.9%. Occupancy

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costs for the twelve weeks ended December 10, 2008 decreased $150,000, to $257,000 from $407,000 in the prior year period primarily due to a decrease in franchise rent expense associated with closed stores.

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Operating Expenses. Total operating expenses for the twelve weeks ended December 10, 2008 decreased $367,000 and as a percentage of retail and wholesale sales, decreased from 20.1% of retail and wholesale sales to 13.2% for the twelve weeks ended December 10, 2008. The decrease in operating costs primarily resulted from decreases in franchise and wholesale of $349,000 and $63,000 respectively, and was offset by an increase in retail of $45,000. The decrease in wholesale costs of $63,000 resulted primarily from a decrease in equipment costs, compensation, travel and other of $57,000, $85,000 and $111,000 respectively. These decreases in wholesale operating costs were partially offset by an increase in marketing and allowances for doubtful accounts of $43,000, and $147,000, respectively. Franchise operating expense decreased by $349,000 and primarily resulted from a decrease in compensation of $324,000 along with decreases in marketing, travel and other costs of $25,000. The increase in retail operating costs of $45,000 resulted primarily from a $56,000 net increase in costs associated with new company-operated retail stores. This increase in retail operating costs was partially offset by a net decrease of $11,000 in marketing and labor costs associated with our internet business.

Depreciation and Amortization. Depreciation and amortization increased $127,000 to $407,000 for the twelve weeks ended December 10, 2008 as compared to $280,000 for the twelve weeks ended December 12, 2007. This increase resulted primarily from the completion of capital projects at our roasting facility during the fourth quarter of fiscal 2008 and the first quarter of fiscal 2009.

General and Administrative Expenses. Our general and administrative expenses decreased by $104,000, or 6.1%, to $1,590,000 for the twelve-weeks ended December 10, 2008 compared to $1,694,000 for the twelve weeks ended December 12, 2007. The decrease in general and administrative costs was due to decreases in compensation costs of $101,000 and legal, consulting and other costs of $82,000 and was partially offset by an increase in insurance and other costs of $79,000. As a percentage of total revenue, general and administrative expenses decreased from 13.6% for the twelve weeks ended December 12, 2007 to 10.2% for the twelve weeks ended December 10, 2008.

Interest Expense and Interest and Other Income, Net. Interest expense, interest income and other income, net was $191,000 of expense for the twelve weeks ended December 10, 2008 compared to $69,000 of income, net for the twelve weeks ended December 12, 2007. This change was primarily the result of interest payments on borrowings along with amortization of our warrants associated with the Loan Agreement (as described below under "Financial Condition, Liquidity and Capital Resources").

Income Tax Benefit. We had losses from continuing operations for the twelve weeks ended December 10, 2008 and December 12, 2007, respectively. In accordance with SFAS No. 109, "*Accounting for Income Taxes*" ("SFAS No.109"), the income tax provision from continuing operations was $4,000 and $0 for the twelve weeks ended December 10, 2008 and December 12, 2007, respectively.

Twenty-four weeks ended December 10, 2008 compared with the twenty-four weeks ended December 12, 2007

Total Revenue. Total revenue for the twenty-four weeks ended December 10, 2008 increased by $6,726,000, or 32.6%, to $27,334,000 from $20,608,000 for the twenty-four weeks ended December 12, 2007. This result was the net effect of a 42.4% increase in wholesale revenue, offset by a 2.3% decrease in retail sales and a 25.3% decrease in domestic franchise revenue. Each component of total revenue is discussed below.

Wholesale Revenue. Our wholesale sales for the twenty-four weeks ended December 10, 2008 increased by $7,143,000, or 42.4%, to $23,977,000 from $16,834,000 for the twenty-four weeks ended December 12, 2007. Wholesale sales to OCS and foodservice customers for the twenty-four weeks ended December 10, 2008 increased by $7,626,000, or 53.5%, to $21,880,000 from $14,254,000 for the twenty-four weeks ended December 12, 2007 led by a 66.3%, or $8,095,000 net increase in Keurig "K-cup" sales. The Company generated 74.3% and 59.3% of its total revenues from the sale of K-cups for the twenty-four weeks ended December 10, 2008 and December 12, 2007, respectively. Our manufacturing and distribution of K-cups is licensed from a single licensor. Sales to our licensor represented approximately 31.1% and 22.1% of wholesale sales for the quarters ended December 10, 2008 and December 12, 2007, respectively. Sales of roasted coffee to our franchisees decreased $483,000, or 18.7%, for the twenty-four weeks ended December 10, 2008 as compared to the twenty-four weeks ended December 12, 2007.

Franchise Revenue. Our franchise revenue consists of initial franchise fees, franchise renewal fees, area development fees, and royalties received on sales at franchised locations. Franchise revenue decreased by $363,000, or 25.3%, to $1,069,000 for the twenty-four weeks ended December 10, 2008 from $1,432,000 for the twenty-four weeks ended December 12, 2007. Of the decrease in domestic franchise revenue, $357,000 of the decrease resulted from a decrease in royalty income and was due to a net decrease in same stores sales of 4.3%

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for the Gloria Jean' s brand in the current quarter compared to the prior year same quarter along with a net decrease of 39 franchise units since the beginning of fiscal 2008. In addition, franchise store opening and renewal fees decreased $6,000 in the current quarter compared to the prior year same quarter.

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Retail Sales. Retail sales for the twenty-four weeks ended December 10, 2008 decreased by $54,000, or 2.3%, to $2,288,000 from $2,342,000 for the prior year period. This decrease was primarily the result of a decrease of 8.3% in same store sales for Gloria Jean' s company-operated stores compared to the prior year period. Sales from our internet website remained relatively flat for the twenty-four weeks ended December 10, 2008 compared to the prior year comparable period.

Cost of Sales and Related Occupancy Costs. Cost of sales and related occupancy costs for the twenty-four weeks ended December 10, 2008 increased $6,301,000, or 41.1%, to $21,635,000 from $15,334,000 in the prior year period. As a percentage of total revenue, cost of sales and related occupancy increased from 74.4% for the twenty-four weeks ended December 12, 2007 to 79.2% in the current fiscal quarter. Because none of these costs relate to franchise revenue, the most relevant benchmark of these costs is their relationship to total retail and wholesale sales. Using that measure, cost of sales and related occupancy costs increased as a percentage of total retail and wholesale sales from 80.0% for the twenty-four weeks ended December 12, 2007 to 82.4% for the twenty-four weeks ended December 10, 2008. Retail cost of sales increased from 36.8% to 41.1% of retail sales in the current year period whereas wholesale cost of sales increased from 81.4% to 84.1% of wholesale sales in the current year period due to a higher percentage of higher cost Keurig business over the prior year period. Wholesale sales, which carry a higher cost of goods sold than retail sales, also slightly increased as a percentage of the retail and wholesale sales mix from 87.8% to 91.3%. Occupancy costs for the twenty-four weeks ended December 10, 2008 decreased $231,000, to $537,000 from $768,000 in the prior year period primarily due to a decrease in franchise rent expense of $352,000 associated with closed stores and offset by an increase in rent for retail of $121,000 due to an increase in company-operated locations compared to the prior year period.

Operating Expenses. Total operating expenses for the twenty-four weeks ended December 10, 2008 decreased $745,000 and as a percentage of retail and wholesale sales, decreased from 23.9% of retail and wholesale sales to 14.6% for the twenty-four weeks ended December 10, 2008. The decrease in operating costs primarily resulted from a decrease in wholesale operating costs of $225,000, a decrease in franchise operating costs of $470,000 along with a decrease in retail operating costs of $50,000. The decrease in retail operating costs of $50,000 resulted primarily from a $96,000 net decrease in costs associated with company-operated stores and was partially offset by a net increase of $46,000 for labor, marketing and other costs associated with our internet business. The decrease in wholesale costs of $225,000 resulted primarily from decreases in compensation, equipment and other costs of $138,000, $152,000 and $132,000 and was offset by increases in allowance for doubtful accounts and marketing on $119,000 and $78,000, respectively. Franchise operating expense decreased by $470,000 and primarily resulted from a decrease in compensation $550,000 and other costs of $25,000 and was partially offset by increases in legal, consulting and outside services of $105,000.

Depreciation and Amortization. Depreciation and amortization increased $212,000 to $744,000 for the twenty-four weeks ended December 10, 2008 as compared to $532,000 for the twenty-four weeks ended December 12, 2007. This increase resulted primarily from the completion of capital projects at our roasting facility during the fourth quarter of fiscal 2008 and the first quarter of fiscal 2009.

General and Administrative Expenses. Our general and administrative expenses increased by $323,000, or 10.3%, to $3,472,000 for the twenty-four weeks ended December 10, 2008 compared to $3,149,000 for the twenty-four weeks ended December 12, 2007. As a percentage of total revenue, general and administrative expenses decreased from 15.3% for the twenty-four weeks ended December 12, 2007 to 12.7% for the twenty-four weeks ended December 10, 2008. The increase in general and administrative expenses of $323,000 was due primarily to increases in compensation of $152,000, legal and consulting of $134,000 and other costs of $37,000.

Interest Expense and Other, Net. Interest expense, interest income and other income, net was $434,000 of expense for the twenty-four weeks ended December 10, 2008 compared to $242,000 of income, net for the twenty-four weeks ended December 12, 2007. This change was primarily the result of interest payments on borrowings along with amortization of our warrants associated with the Loan Agreement.

Income Tax Benefit. We had losses from continuing operations for the twenty-four weeks ended December 10, 2008 and December 12, 2007. In accordance with SFAS No. 109, "*Accounting for Income Taxes*" ("SFAS No. 109"), the Company recorded an income tax provision and benefit of $4,000 and $540,000 generated by the loss from continuing operations for the twenty-four weeks ended December 10, 2008 and December 12, 2007, respectively. As of December 10, 2008 net operating loss carryforwards of approximately $17,337,000 and $15,735,000 for federal and state income tax purposes, respectively, are available to be utilized against future taxable income for years through fiscal 2030, subject to annual limitation pertaining to change in ownership rules under the Internal Revenue Code. Based upon the level of historical taxable income and projections of future taxable income over the periods which the deferred tax assets are deductible, management believes it

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is more likely than not that the Company will not realize the benefits of these deductible differences, and thus has recorded a valuation allowance against the entire deferred tax asset balance.

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Table of Contents

Results of Discontinued Operations−Retail. As a result of the sale and closure of certain retail stores during the previous fiscal year, the results from this component of our business are presented as discontinued operations for all periods presented in accordance with SFAS No. 144. During the first quarter of fiscal year 2008, the Company received proceeds from escrow of $1,274,000 as part of the transaction with Starbucks in fiscal 2007. For the twenty-four weeks ended December 12, 2007, gain on sale of discontinued operations was $767,000, net of $507,000 in taxes. The tax expense associated with the discontinued retail operations differed from the statutory federal effective tax rate primarily due to changes in the valuation allowance and permanently nondeductible goodwill associated with the discontinued operations.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Current Financial Condition. At December 10, 2008, we had working capital of $3,000, long term debt, tax liabilities, and deferred rent of $1,889,000 and $8,176,000 of stockholders' equity, compared to working capital of $135,000, long term tax liabilities, deferred rent and deferred compensation of $677,000 and $9,742,000 of stockholders' equity at June 25, 2008. As of December 10, 2008 and June 25, 2008, we had $5,000,000 and $2,000,000 outstanding, respectively, under our credit agreements.

The accounts receivable balance of $4,449,000 as of December 10, 2008 decreased $566,000 from the June 25, 2008 balance of $5,015,000. The accounts payable balance of $6,382,000 as of December 10, 2008 increased $1,213,000 from the June 25, 2008 balance of $5,169,000.

Cash Flows. Net cash used in operating activities for the twenty-four weeks ended December 10, 2008 totaled $2,263,000 as compared with $4,291,000 cash used in operating activities for the twenty-four weeks ended December 12, 2007. The Company has incurred losses from continuing operations of $2,778,000, and $2,196,000 for the twenty-four weeks ended December 10, 2008 and December 12, 2007, respectively. Net cash used in continuing operations of $2,215,000 for the twenty-four weeks ended December 10, 2008 resulted primarily from increases in inventories, prepaid expenses and other assets and was partially offset by increases in accounts payable all of which was attributable to working capital needs from a more than 42% increase in wholesale revenue for the twenty-four weeks ended December 10, 2008 compared to the prior year same period.

Net cash provided by investing activities for the twenty-four weeks ended December 10, 2008 totaled $203,000 as compared with net cash used in investing activities of $619,000 for the twenty-four weeks ended December 12, 2007. During the twenty-four weeks ended December 10, 2008, a total of $451,000 was used to invest in property and equipment primarily related to our Castroville roasting facility of $293,000, wholesale of $2,000, retail of $154,000 and our home office facility of $2,000. These expenditures were offset by $644,000 of payments received on notes receivable and $10,000 of other proceeds from the sale of assets. During the twenty-four weeks ended December 12, 2007, a total of $2,490,000 was used to invest in property and equipment primarily related to our Castroville roasting facility of $1,862,000, wholesale of $217,000, our retail stores of $198,000 and our home office facility of $213,000. These expenditures were primarily offset by $544,000 of payments received on notes receivable and $1,274,000, net of related expenses, received from the sale of retail stores to Starbucks.

Net cash provided by financing activities for the twenty-four weeks ended December 10, 2008 totaled $3,000,000 and related to borrowings on the Company' s credit facility during the first quarter of the current fiscal year.

Outstanding Debt and Financing Arrangements:

On May 10, 2004, we entered into a $5,000,000 Note Purchase Agreement with Sequoia Enterprises, L.P. ("Sequoia"), a limited partnership whose sole general partner also serves as the chairman of the board of directors of the Company (the "Note Purchase Agreement"), which provided, at our election, the ability to issue notes up to an aggregate principal amount of $5,000,000. We have amended the Note Purchase Agreement from time to time and have agreed to refrain from further borrowings under the Note Purchase Agreement in connection with the entry into the Loan Agreement (as defined below) entered into on August 26, 2008. As amended, the notes issued under the Note Purchase Agreement are due in full on March 31, 2009, and we are only required to make monthly payments of interest and the monthly commitment fee, but not principal, until such date. On the maturity date, all outstanding principal, interest and other amounts payable under the Note Purchase Agreement will be due unless due earlier pursuant to the terms of the Note Purchas Agreement upon a change in control of the Company or an event of default. Interest is payable at three-month LIBOR plus 9.30% for any period during which the ratio of

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our Indebtedness (as defined in the Note Purchase Agreement) on a consolidated basis to Effective Tangible Net Worth (as defined in the Note Purchase Agreement) is greater than 1.75:1.00 or the three-month LIBOR plus 6.30% for any other period, in each case reset on a periodic basis as provided in the Loan Agreement. The Note Purchase Agreement contains covenants, among others, that limit the amount of indebtedness that we may have outstanding in relation to our tangible net worth. As of December 10, 2008, we were in compliance with all covenants under the Note Purchase Agreement. As of December 10, 2008, $2,000,000 is outstanding under the Note Purchase Agreement.

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Loan Agreement:

On August 26, 2008, we entered into a loan agreement with Sequoia (the "Loan Agreement"). The Loan Agreement provides for a $3 million term loan (the "Term Loan"). The Term Loan accrues interest from the funding date at one-month LIBOR plus 5.30%, resetting on the first calendar day of each month. On November 10, 2008, we entered into a Waiver Agreement (as defined below). In consideration of such waiver, the interest rates under the Loan Agreement were increased to one-month LIBOR plus 9.30% for any period during which the ratio of our Indebtedness (as defined in the Loan Agreement) on a consolidated basis to Effective Tangible Net Worth (as defined in the Loan Agreement) is greater than 1.75:1.00 or one-month LIBOR plus 6.30% for any other period, in each case reset on a periodic basis as provided in the Loan Agreement. We are required to make regular monthly payments of interest, and to cause the principal amount to be reduced to $2 million no later than August 26, 2009. All outstanding principal and interest will be due on the maturity date of August 26, 2011, unless due earlier pursuant to the terms of the Loan Agreement upon a change of control of the Company or an event of default. As of December 10, 2008, $3,000,000 is outstanding under the Loan Agreement.

The Loan Agreement requires us to refrain from further borrowings under the Note Purchase Agreement and contains restrictions on incurring indebtedness on par with, or senior to, the Term Loan. The Loan Agreement also contains a covenant that limits the amount of indebtedness that we may have outstanding in relation to tangible net worth, in addition to other standard covenants and events of default. As of December 10, 2008, we were in compliance with all covenants under the Loan Agreement.

The Term Loan is senior to all other indebtedness of the Company, except indebtedness pursuant to notes issued under the Note Purchase Agreement and certain permitted indebtedness identified in the Loan Agreement. Upon repayment of the notes under the Note Purchase Agreement, the Term Loan will be senior to all other indebtedness of the Company, except such permitted indebtedness.

Warrants:

In connection with the Loan Agreement and an amendment to the Note Purchase Agreement, on August 26, 2008, we issued to Sequoia a warrant (the "2008 Sequoia Warrant") to purchase 1,667,000 shares of common stock of the Company. On November 10, 2008 the exercise price of the 2008 Sequoia Warrant was decreased from $2.00 to $1.65 in connection with the Waiver Agreement (as defined below).

In addition, the exercise price of the 2001 Sequoia Warrants for 250,000 shares of common stock was reduced from $2.00 to $1.65 per share.

Waiver Agreement:

On November 10, 2008, we entered into a Waiver, Agreement, Amendment No. 1 to 2008 Warrant and Amendment No. 2 to 2001 Warrant (the "Waiver Agreement") with Sequoia. Pursuant to the Waiver Agreement, Sequoia waived the requirement set forth in the Note Purchase Agreement and the Loan Agreement with Sequoia (collectively, the "Loan Agreements") that we shall not permit, as of the end of any fiscal quarter, the ratio of our Indebtedness on a consolidated basis to Effective Tangible Net Worth to be more than 1.75:1.00 (as such terms are defined in the Loan Agreements). Such waiver is effective until the earlier of (a) October 31, 2009 and (b) the end of any fiscal quarter at which the foregoing ratio is greater than 2.10:1.00.

Letter of Credit:

In addition, we entered into a Credit Agreement with Bank of the West on November 4, 2005. The agreement provides for a $750,000 letter of credit facility that expires on October 15, 2009. The letter of credit facility is secured by a deposit account at Bank of the West. As of December 10, 2008, this deposit account had a balance of $623,000, which is shown as restricted cash on the consolidated balance sheets. As of December 10, 2008, $472,000 of letters of credit was outstanding under the letter of credit facility. The agreement contains covenants that, among other matters, require us to submit financial statements to the bank within specified time periods. As of December 10, 2008, the Company was in compliance with all Bank of the West agreement covenants.

Liquidity and Management Plans

For the current quarter ended December 10, 2008, we incurred a net loss of approximately $1.0 million and reported net cash used in operating activities of approximately $2.3 million. We had a cash balance of $1.6 million with $5 million of outstanding borrowings under our credit facilities as of December 10, 2008.

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Table of Contents

A $5,000,000 Contingent Convertible Note Purchase Agreement with Sequoia Enterprises, L.P. (“Sequoia”), a limited partnership whose sole general partner also serves as the Chairman of the Company’ s board of directors, (the “Note Purchase Agreement”), expires on March 31, 2009 and the $2 million balance on the note is due in full on that date. On October 8, 2008, November 10, 2008 and January 23, 2009, we obtained commitments from the Lenders, for additional borrowings of up to $5 million and to extend the maturity date of the $2 million note due under the Note Purchase Agreement from March 31, 2009 to March 31, 2010. We and the Lenders are currently in the process of finalizing the contractual details of this commitment. In addition, we obtained a $3 million term loan on August 26, 2008.

Our management believes that cash flow from operations, funds available to us from our credit agreements and additional lending commitments obtained from the Lenders, will be sufficient to satisfy working capital needs at the anticipated operating levels for at least the next twelve months.

Our future capital requirements will depend on many factors, including the extent and timing of the rate at which our business grows, if at all, with corresponding demands for working capital. We may be required to seek additional funding through debt financing, equity financing or a combination of funding methods to meet our capital requirements and sustain our operations. However, additional funds may not be available on terms acceptable to us or at all.

Other Commitments. The following represents a comprehensive list of our contractual obligations and commitments as of December 10, 2008:

	Payments Due By Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(In thousands)				
Company-operated retail locations and other operating leases	$11,265	$3,409	$4,144	$2,037	$1,675
Franchise operated retail locations operating leases	9,567	2,108	3,395	2,328	1,736
Green coffee commitments	951	951	–	–	–
Note Payable	5,000	3,000	2,000	–	–
	$26,783	$9,468	$9,539	$4,365	$3,411

As of December 10, 2008, we have entered into an employment agreement with one executive that provides for a severance payment of nine months salary in the event that this individual is terminated without cause. Our maximum liability for severance under this contract is currently $169,000. Because such amount is contingent, it has not been included in the above table.

We have obligations under non-cancelable operating leases for our coffeehouses, roasting facility and administrative offices. Lease terms are generally for periods of 10 to 20 years with renewal options and generally require us to pay a proportionate share of real estate taxes, insurance, common area, and other operating costs. Some retail leases provide for contingent rental payments based on sales thresholds. In addition, we are liable on the master real property leases for 37 franchise locations. Under our historical franchising business model, we executed the master lease for these locations and entered into subleases on the same terms with our franchisees, which typically pay their rent directly to the landlords. Should any of these franchisees default on their subleases, we would be responsible for making payments thereunder. Our maximum theoretical future exposure at December 10, 2008, computed as the sum of all remaining lease payments through the expiration dates of the respective leases, was $9,567,000. This amount does not take into consideration any mitigating measures that we could take to

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reduce this exposure in the event of default, including re-leasing the locations or terminating the master lease by negotiating a lump sum payment to the landlord that is less than the sum payment of all remaining future rents and other amounts payable.

CRITICAL ACCOUNTING ESTIMATES

The preparation of our unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts. The estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and on various other factors that we believe to be reasonable. Accounts significantly impacted by estimates and assumptions include, but are not limited to, franchise receivables, allowance for bad debt reserves, fixed asset lives, income taxes, self-insurance and workers' compensation reserves, store closure reserves, stock-based compensation, the valuation allowance for net deferred tax assets and contingencies. We believe that the following represent the critical accounting policies and estimates that we use in the preparation of our unaudited condensed consolidated financial statements. The following discussion, however, does not list all of our accounting policies and estimates.

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Table of Contents

Impairment of Property and Equipment and Other Amortizable Long-Lived Assets Held and Used

Each quarter, or upon the occurrence of a triggering event as defined in SFAS No. 144, we evaluate the carrying value of individual stores when the operating results have reasonably progressed to a point to adequately evaluate the probability of continuing operating losses or a current expectation that a store will be sold or otherwise disposed of before the end of its previously estimated useful life. In making these judgments, we consider the period of time since the store was opened or remodeled, and the trend of operations and expectations for future sales growth. For stores selected for review, we estimate the future estimated cash flows from operating the store over its estimated useful life. We make judgments about future same-store sales and the operating expenses and estimated useful life that we would expect with such level of same-store sales.

The most significant assumptions in our analysis are those used when we estimate a unit' s future cash flows. We generally use the assumptions in our strategic plan and modify them as necessary based on unit specific information. If our assumptions are incorrect, the carrying value of our operating unit assets may be overstated or understated.

Estimated Liability for Closing Stores

We make decisions to close stores based on prospects for estimated future profitability and sometimes we are forced to close stores due to circumstances beyond our control (e.g., a landlord' s refusal to negotiate a new lease). Our management team evaluates each store' s performance every period. When stores continue to perform poorly, we consider the demographics of the location, as well as the likelihood of being able to improve the performance of an unprofitable store. Based on the management team' s judgment, we estimate the future net cash flows. If we determine that the store will not, within a reasonable period of time, operate at break-even cash flow or be profitable, and we are not contractually obligated to continue operating the store, we may close the store. Additionally, franchisees may close stores for which we are the primary lessee. If the franchisee cannot make payments on the lease, we continue making the lease payments and establish an estimated liability for the closed store if we decide not to operate it as a company-operated store. We established the estimated liability on the actual store closure date which is generally the date on which we cease to receive economic benefit from the unit. We also review the net cash flows to determine the need to provide for asset impairment.

The estimated liability for closing stores on properties vacated is generally based on the term of the lease and the lease termination fee that we expect to pay, as well as the estimated maintenance costs that we expect to pay until the lease has been abated. A significant assumption used in determining the amount of the estimated liability for closing stores is the amount of the estimated liability for future lease payments on vacant stores, which we determine based on our assessment of our ability to successfully negotiate early terminations of our lease agreements with the lessors or to sublease the property. Additionally, we estimate the cost to maintain leased and owned vacant properties until the lease has been abated. If the costs to maintain properties increase or it takes longer than anticipated to sell properties or sublease or terminate leases, we may need to record additional estimated liabilities. If the leases on the vacant stores are not terminated or subleased on the terms we used to estimate the liabilities, we may be required to record losses in future periods. Conversely, if the leases on the vacant stores are terminated or subleased on more favorable terms than we used to estimate the liabilities, we reverse previously established estimated liabilities through the line item in which it was originally recorded, resulting in an increase in operating income.

Estimated Liability for Self-Insurance

We are self-insured for a portion of our losses related to workers' compensation insurance for policy years ended prior to October 2006. We obtained stop loss insurance for individual workers' compensation claims with a $250,000 deductible per occurrence and a program maximum for all claims of $750,000. Insurance liabilities and reserves are accounted for based on actuarial estimates of the amount of incurred and unpaid losses. These estimates rely on actuarial observations of historical claim loss development. Management, in determining the estimated liability, bases the assumptions on the average historical losses on claims we have incurred. The actual loss development may be better or worse than the development we estimated in conjunction with the actuary. In that event, we will modify the reserve. As a result, if we experience a higher than expected number of claims or the costs of claims are greater than expected, then we may adjust the expected losses upward and our future self-insurance expenses will rise. As of October 2006, we are no longer self-insured.

Franchised Operations

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We monitor the financial condition of our franchisees and record provisions for estimated losses on receivables when we believe that our franchisees are unable to make their required payments to us. Each period we perform an analysis to develop estimated bad debts for each franchisee. We then compare the aggregate result of that analysis to the amount recorded in our unaudited condensed consolidated financial statements as the allowance for doubtful accounts and adjust the allowance as appropriate. Over time, our assessment of individual franchisees may change. For instance, we have had some franchisees for whom we had estimated a loss equal to the total amount of the receivable, but which have paid us in full or established a consistent record of payments (generally one year) such that we determined that an allowance was no longer required.

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Table of Contents

Depending on the facts and circumstances, there are a number of different actions we and/or our franchisees may take to resolve franchise collections issues. These actions may include the purchase of franchise stores by us or by other franchisees, a modification to the franchise agreement, which may include a provision to defer certain royalty payments or reduce royalty rates in the future, a restructuring of the franchisee' s business and/or finances (including the restructuring of leases for which we are the primary or secondary obligee), or, if necessary, the termination of the franchise agreement. The allowance is based on our assessment of the most probable course of action that will occur.

In accordance with SFAS No. 146, an estimated liability for future lease obligations on stores operated by franchisees for which we are the primary or secondary obligee is established on the date the franchisee closes the store. Also, we record an estimated liability for subsidized lease payments when we sign a sublease agreement committing us to the subsidy.

The amount of the estimated liability is established using the methodology described above under the heading "Estimated Liability for Closing Stores." Consistent with SFAS No. 146, we have not established an additional estimated liability for potential losses not yet incurred. If sales trends or economic conditions worsen for our franchisees, their financial health may worsen, our collection rates may decline and we may be required to assume the responsibility for additional lease payments on franchised stores. In addition, entering into restructured franchise agreements may result in reduced franchise royalty rates in the future.

Stock-Based Compensation

As discussed in the notes to the condensed consolidated financial statements, we have various stock-based compensation plans that provide options for certain employees and outside directors to purchase common shares of stock. Starting June 30, 2005, we adopted the provisions of SFAS No. 123R, which sets accounting requirements for "share-based" compensation to employees and non-employee directors, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation.

We determine the estimated fair value of stock-based compensation on the date of the grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model requires us to apply highly subjective assumptions, including our historical stock price volatility, expected life of the option and the risk-free interest rate. A change in one or more of the assumptions used in the Black-Scholes option-pricing model may result in a material change to the estimated fair value of the stock-based compensation.

Valuation Allowance for Net Deferred Tax Assets

As discussed above, we have recorded a 100% valuation allowance against our net deferred tax assets. If we have been profitable for a number of years and our prospects for the realization of our deferred tax assets are more likely than not, we would then reverse our valuation allowance and credit income tax expense. When circumstances warrant, we assess the likelihood that our net deferred tax assets will more likely than not be realized from future taxable income. As of December 10, 2008, our net deferred tax assets and related valuation allowance totaled approximately $8,296,000.

Item 3. Quantitative And Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures.

(a) As of the end of the period covered by this quarterly report, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 10, 2008.

(b) There was no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Table of Contents

PART II–OTHER INFORMATION

Item 1. Legal Proceedings.

In the ordinary course of our business, we may become involved in legal proceedings from time to time.

As of December 10, 2008, there are no material changes from the legal proceedings disclosure set forth in Part I, Item 3 of our annual report on Form 10-K for the fiscal year ended June 25, 2008. Please refer to the annual report on Form 10-K for the fiscal year ended June 25, 2008 for disclosure regarding legal proceedings.

Item 1A. Risk Factors.

The Annual Report on Form 10-K for the year ended June 25, 2008, as supplemented by the Quarterly Report on Form 10-Q for the quarter ended September 17, 2008, includes a detailed discussion of our risk factors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None

Item 3. Defaults upon Senior Securities.

None

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

None

Item 5. Other Information.

None

Item 6. Exhibits.

Set forth below is a list of the exhibits included as part of this quarterly report.

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated March 16, 1999, among Diedrich Coffee, Inc., CP Acquisition Corp., a wholly owned subsidiary of Diedrich Coffee, Inc., and Coffee People, Inc. (1)
3.1	Restated Certificate of Incorporation of Diedrich Coffee, Inc., dated May 11, 2001 (2)
3.2	Amended and Restated Bylaws of Diedrich Coffee, Inc. (8)
4.1	Specimen Stock Certificate (4)
4.2	Purchase Agreement for Series A Preferred Stock dated as of December 11, 1992 by and among Diedrich Coffee, Inc., Martin R. Diedrich, Donald M. Holly, SNV Enterprises, and D.C.H., LP (5)
4.3	Purchase Agreement for Series B Preferred Stock dated as of June 29, 1995 by and among Diedrich Coffee, Inc., Martin R. Diedrich, Steven A. Lupinacci, Redwood Enterprises VII, LP, and Diedrich Partners I, LP (5)
4.4	Form of Conversion Agreement in connection with the conversion of Series A and Series B Preferred Stock into Common Stock (3)
4.5	Common Stock and Warrant Purchase Agreement, dated March 14, 2001 (6)
4.6	Form of Warrant, dated May 8, 2001 (2)

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4.7	Registration Rights Agreement, dated May 8, 2001 (2)
4.8	Form of Common Stock and Option Purchase Agreement with Franchise Mortgage Acceptance Company, dated as of April 3, 1998 (7)
4.9	Amendment No. 1 to 2001 Warrant, dated August 26, 2008 (9)
10.1	Amended and Restated Commitment Letter with Sequoia Enterprises, L.P. and Vessel Partners, L.P., dated November 10, 2008 (10)

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Exhibit No.	Description
10.2	Waiver, Agreement, Amendment No. 1 to 2008 Warrant and Amendment No. 2 to 2001 Warrant with Sequoia Enterprises, L.P., dated November 10, 2008 (10)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement

(1) Previously filed as Appendix A to Diedrich Coffee' s Registration Statement on Form S-4, filed with the Securities and Exchange Commission on April 23, 1999.

(2) Previously filed as an exhibit to Diedrich Coffee' s Current Report on Form 8-K, filed with the Securities and Exchange Commission on May 16, 2001.

(3) Previously filed as an exhibit to Diedrich Coffee' s Registration Statement on Form S-1/A (Registration No. 333-08633), filed with the Securities and Exchange Commission on August 28, 1996 and declared effective on September 11, 1996.

(4) Previously filed as an exhibit to Diedrich Coffee' s Registration Statement on Form S-3 (Registration No. 333-66744), filed with the Securities and Exchange Commission on August 3, 2001.

(5) Previously filed as an exhibit to Diedrich Coffee' s Registration Statement on Form S-1 (Registration No. 333-08633), filed with the Securities and Exchange Commission on July 24, 1996 and declared effective on September 11, 1996.

(6) Previously filed as Annex B to Diedrich Coffee' s Definitive proxy Statement, filed with the Securities and Exchange Commission on April 12, 2001.

(7) Previously filed as an exhibit to Diedrich Coffee' s Annual Report on Form 10-K for the fiscal year ended January 28, 1998, filed with the Securities and Exchange Commission on April 28, 1998.

(8) Previously filed as an exhibit to Diedrich Coffee' s Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 3, 2008.

(9) Previously filed as an exhibit to Diedrich Coffee' s Current Report on Form 8-K filed with the Securities and Exchange Commission on August 28, 2008.

(10) Previously filed as an exhibit to Diedrich Coffee' s Current Report on Form 8-K filed with the Securities and Exchange Commission on November 17, 2008.

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Table of Contents

SIGNATURES

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

Dated: January 26, 2009

DIEDRICH COFFEE, INC.

/s/ J. Russell Phillips
J. Russell Phillips
Chief Executive Officer
(On behalf of the registrant)

/s/ Sean M. McCarthy
Sean M. McCarthy
Vice President and Chief Financial Officer
(Principal financial officer)

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Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Exhibit 31.1

Section 302 Certification

I, J. Russell Phillips, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Diedrich Coffee, Inc.;

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

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

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

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Dated: January 26, 2009

/s/ J. Russell Phillips

J. Russell Phillips
Chief Executive Officer

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Exhibit 31.2

Section 302 Certification

I, Sean M. McCarthy, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Diedrich Coffee, Inc.;

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

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

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

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Dated: January 26, 2009

/s/ Sean M. McCarthy

Sean M. McCarthy
Chief Financial Officer

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Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certifies, in his capacity as an officer of Diedrich Coffee, Inc. (the "Company"), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

the Quarterly Report on Form 10-Q for the period ended December 10, 2008 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

the information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Dated: January 26, 2009

/s/ J. Russell Phillips
J. Russell Phillips
Chief Executive Officer

Note: A signed original of this written statement required by Section 906 has been provided to Diedrich Coffee, Inc. and will be retained by Diedrich Coffee, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certifies, in his capacity as an officer of Diedrich Coffee, Inc. (the "Company"), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

the Quarterly Report on Form 10-Q for the period ended December 10, 2008 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

the information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Dated: January 26, 2009

/s/ Sean M. McCarthy

Sean M. McCarthy
Vice President and Chief Financial Officer

Note: A signed original of this written statement required by Section 906 has been provided to Diedrich Coffee, Inc. and will be retained by Diedrich Coffee, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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